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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

TAXATION LAWS AMENDMENT BILL (No. 3) 2003

Previous citation Taxation Laws Amendment Bill (No. 8) 2002

REVISED EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello, MP)

Table of contents

Glossary 1

General outline and financial impact 3

Chapter 1 Income tax deductions for gifts 11

Chapter 2 Employee share schemes 17

Chapter 3 Franking of distributions by co-operatives 27

Chapter 4 Reasonable benefit limits 33

Chapter 5 Petroleum resource rent tax 35

Chapter 6 Technical corrections 47

Chapter 7 No tax consequences result from AGL's corporate conversion49

Glossary

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

Abbreviation	***Definition***
AGL	Australian Gas Light Company
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
Conversion Act	*AGL Corporate Conversion Act 2002 of New South Wales*
ESS	employee share scheme
ETP	eligible termination payment
FBT	fringe benefits tax
FBTAA 1986	*Fringe Benefits Tax Assessment Act 1986*
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
IT(TP) Act 1997	*Income Tax (Transitional Provisions) Act 1997*
Minister	Minister for Revenue and Assistant Treasurer
PRRT	petroleum resource rent tax
PRRTAA 1987	*Petroleum Resource Rent Tax Assessment Act 1987*
RBL	reasonable benefit limit
UNHCR	United Nations High Commissioner for Refugees

Income tax deductions for gifts

Schedule 1 to this bill amends the ITAA 1997 and the ITAA 1936 to allow income tax deductions for certain gifts of $2 or more made to the organisations listed below. This bill also reflects the name changes of some organisations and extends the period of deductibility for two organisations.

Date of effect:

Gifts to new organisations:

- Aboriginal Education Council (N.S.W) Incorporated after 6 May 2002.
- General Sir John Monash Foundation after 16 June 2002.
- Mount Macedon Memorial Cross Trust after 14 August 2002 and before 15 August 2004.
- The Manly Warringah War Memorial Regional Park Remembrance Trust after 7 April 2002 and before 8 April 2004.
- Shrine of Remembrance Foundation after 2 July 2002 and before 3 July 2004.
- Australian Council for Children and Youth Organisations Inc. after 23 July 2002.
- St Paul's Cathedral Restoration Fund after 22 April 2002 and before 23 April 2004.

Gifts to organisations that have changed their names:

- The Royal Society for the Prevention of Cruelty to Animals (Victoria) to Royal Society for the Prevention of Cruelty to Animals (Victoria) Inc. after 8 January 1992.
- The Nursing Mothers' Association of Australia to Australian Breastfeeding Association after 31 July 2001.

Gifts to organisations whose period of deductibility has been extended:

- Australia for UNHCR for an additional five years until 27 June 2007.

- St Patrick's Cathedral Parramatta Rebuilding Fund for an additional two years until 24 February 2004.

Proposal announced: Gifts to new organisations and extensions to the period of deductibility for the specified organisations were announced by the Treasurer and Minister for Revenue and Assistant Treasurer in press releases during 2002.

Financial impact: Unquantifiable, but insubstantial, cost to revenue.

Compliance cost impact: Nil.

Employee share schemes

Schedule 2 to this bill amends the CGT provisions that deal with ESSs to ensure the law operates as intended. The amendments are required where the ESS is operated through a trust and the employee chooses to be taxed under the employee share provisions of the income tax law at the time those provisions treat the employee as acquiring the shares or rights.

The amendments will ensure that:

- capital gains or capital losses that arise while the shares or rights are held in trust are recognised;

- the 12-month minimum qualifying period for the CGT 50% discount begins from the time the trustee acquires the shares.

This bill also makes technical amendments to the CGT and FBT provisions as they relate to ESSs.

Date of effect: The primary amendments will apply to certain shares or rights acquired by a taxpayer after 5.00 pm eastern summer time on 27 February 2001. However, the taxpayer can choose that the amendments can apply to shares or rights acquired before, and disposed of after, this date.

The technical amendments to the ESS CGT provisions apply to assessments for the 1998-1999 and later income years.

The technical amendment to the FBTAA 1986 applies for the FBT year commencing 1 April 1995 and later FBT years.

Proposal announced: The primary amendments were announced in former Assistant Treasurer's Press Release No. 7 of 27 February 2001. The provision for the taxpayer to choose an earlier application date, and the other technical amendments, have not been previously announced.

Financial impact: The cost to revenue of the primary amendments is unquantifiable. The cost of allowing the taxpayer to choose an earlier application date is unquantifiable but is not expected to be significant. The technical amendments will not have any impact on revenue.

Compliance cost impact: Allowing taxpayers to choose an earlier application date for the primary amendments will reduce costs of compliance where it would have otherwise been difficult for taxpayers to determine the market value of shares or rights at the time the shares or rights are transferred to them from the trustee. The market value of the shares or rights at the time the trustee allocates the shares or rights to the beneficiary can be more easily ascertained by taxpayers.

Franking of distributions by co-operatives

Schedule 3 to this bill contains amendments relating to the franking of distributions by co-operative companies. This measure will enable a co-operative company to either frank distributions to shareholders or, alternatively, to claim the existing deduction for distributions of assessable income to shareholders.

Date of effect: These amendments will generally apply to distributions made on or after 1 July 2002.

Proposal announced: The former Assistant Treasurer announced in Press Release No. 41 of 27 August 2001 that co-operative companies would be given the option of franking distributions to shareholders. The Minister for Revenue and Assistant Treasurer announced the details of the proposal in Press Release No. C120/02 of 21 November 2002.

Financial impact: Cost to revenue of $5 million per annum for 2002-2003 and the next four years.

Compliance cost impact: Negligible.

Reasonable benefit limits

Schedule 4 to this bill rectifies an anomaly in the RBL provisions so that a reversionary pension benefit paid on the death of the original recipient will receive the same proportion of concessional taxation rebate as applied to the original pension. This ensures that benefits that have been assessed as above the relevant RBL of the deceased, and thus subject to reduced concessional taxation treatment, will continue to be treated in the same manner after death. This also ensures consistency with the RBL treatment of lump sum benefits paid on death.

Date of effect: The amendment applies in relation to the 1999-2000 and later years of income.

Proposal announced: The measure was announced by the Government in former Assistant Treasurer's Press Release No. 14 of 6 April 2000.

Financial impact: Negligible. The amendments correct an anomaly in the law so that the law operates as intended and that revenue that otherwise may be at risk is protected.

Compliance cost impact: Negligible. Taxpayers affected by the measure will have to ensure that they are claiming the correct amount of pension rebate.

Petroleum resource rent tax

Schedule 5 to this bill amends the PRRTAA 1987 to:

- allow expenditures associated with closing down a facility that has ceased to be used in relation to a PRRT project, but continues to be used under an infrastructure licence, to be deductible against the project's PRRT receipts at the time the production licence ceases. Infrastructure licences were introduced in March 2000 to allow for the construction and operation of infrastructure facilities in Commonwealth waters without a necessary connection to any specific PRRT project; and
- produce a more equitable and uniform treatment of partial use arrangements by extending the PRRT to:
  - include all receipts received; and
  - allow a deduction for all expenditures incurred,

that relate to a PRRT project's petroleum activities in the situation where, for example, one PRRT project buys unprocessed petroleum from another project and processes the petroleum (sales situation) or where one project charges another a 'toll' or fee for the use of facilities (tolling situation).

Date of effect: Royal Assent.

Proposal announced: The amendments have not been announced.

Financial impact:

Infrastructure licence proposal

Currently there are no specific petroleum projects that would be affected by these amendments and it is difficult to predict when any such changes will occur.

The amendment provides for an eligible deduction to be brought forward. It is not possible to identify the changed timing impact on PRRT receipts.

Partial use proposal

These amendments will not have any significant impact in the short term as there are currently no specific petroleum projects tolling external petroleum.

In the future the revenue impact is unquantifiable, but likely to be positive due to the broadening of activities falling within the scope of PRRT.

Any PRRT revenue impact will have a smaller but opposite income tax impact because PRRT is deductible for income tax purposes.

Compliance cost impact: Minimal.

Summary of regulation impact statement

Regulation impact on business

Impact:

Infrastructure licence proposal

Currently, there are no known petroleum projects affected by these amendments and as such these changes have no immediate revenue or administrative impact.

The amendments bring forward the time at which an eligible deduction may be claimed. Compliance costs may be reduced, as a taxpayer will be able to determine their final PRRT liability when the project is terminated.

Partial use proposal

Currently there are no petroleum production operators using their infrastructure to process petroleum from another field, therefore the immediate financial impact of the partial use proposal will be nil. Any future financial impact is unquantifiable. Compliance costs will be reduced, as it will no longer be necessary to apportion capital and operating costs and receipts in partial use situations.

Main points:

- The PRRTAA 1987 is amended to ensure that all appropriate closing down costs are deductible at the time the production licence ceases.

- There is equitable and uniform treatment of commercial tolling situations and other partial use arrangements, for example, sale situations, whether they be contemplated from start-up or instigated at a later date.

Technical corrections

Schedule 6 to this bill makes a number of technical corrections to the ITAA 1936, the ITAA 1997 and other tax-related legislation.

Date of effect: The amendments have various dates of effect.

Proposal announced: Not previously announced.

Financial impact: Nil.

Compliance cost impact: Nil.

No tax consequences result from AGL's corporate conversion

Clause 5 of this bill ensures that generally no taxation consequences will arise for any person under any Commonwealth taxation laws as a result of the corporate conversion of AGL or from its registration under the *Corporations Act 2001*.

Date of effect: The provisions apply from 11 October 2002, which is the date of AGL's corporate conversion.

Proposal announced: The proposal was announced in Minister for Revenue and Assistant Treasurer's Press Release No. C60/02 of 23 May 2002.

Financial impact: Nil.

Compliance cost impact: Nil.

Outline of chapter

1.1 Schedule 1 to this bill amends Division 30 of the ITAA 1997 and section 78 of ITAA 1936. These amendments will allow an income tax deduction to a donor for certain gifts to the value of $2 or more to the funds and organisations listed in Table 1.1.

1.2 The amendments also make minor changes to give effect to certain organisations' changes of name and to extend the period of deductibility for other organisations.

Summary of new law

1.3 The amendments will allow income tax deductions for certain gifts to the value of $2 or more made to the following funds and organisations from, and including, the day of announcement.

Table 1.1

Name of fund	*Treasurer's or Minister's Press Release No.*	*Date of announcement*
Aboriginal Education Council (N.S.W) Incorporated	C41/02	7 May 2002
General Sir John Monash Foundation	C69/02	17 June 2002
Mount Macedon Memorial Cross Trust	C87/02	15 August 2002
The Manly Warringah War Memorial Regional Park Remembrance Trust	C34/02	8 April 2002

Name of fund	***Treasurer's or Minister's Press Release No.***	***Date of announcement***
Shrine of Remembrance Foundation	C77/02	3 July 2002
Australian Council for Children and Youth Organisations Inc.	C79/02	24 July 2002
St Paul's Cathedral Restoration Fund	17 of 2002	23 April 2002

1.4 The amendments also reflect the change the name of the funds, authorities or institutions, as listed in Table 1.2. This will ensure that each organisation continues to qualify for gift deductibility status from, and including, the date of effect of the name change.

Table 1.2

Former name of organisation	***New name of organisation***	***Date of effect of name change***
Royal Society for the Prevention of Cruelty to Animals (Victoria)	Royal Society for the Prevention of Cruelty to Animals (Victoria) Inc.	9 January 1992
Nursing Mothers' Association of Australia	Australian Breastfeeding Association	1 August 2001

1.5 Further, the amendments extend the period of income tax deductibility for the two organisations as listed in Table 1.3. This will ensure that the organisations continue to qualify for gift deductibility status for the period shown.

Table 1.3

Name of fund	***Treasurer or Minister's Press Release No.***	***Date deductibility currently ends***	***Date deductibility will end after extension***
Australia for UNHCR	C89/02	27 June 2002	27 June 2007
St Patrick's Cathedral Parramatta Rebuilding Fund	C12/02	24 February 2002	24 February 2004

Detailed explanation of new law

1.6 The funds, authorities and institutions listed in paragraphs 1.7 to 1.13 have been included in the tables in the gift provisions of the ITAA 1997. Gifts of $2 or more to these organisations will allow a donor to claim the gift as an income tax deduction.

1.7 The Aboriginal Education Council (N.S.W) Incorporated has been established for the advancement of Aboriginal people in NSW through the provision of greater educational opportunities at all levels. This is achieved by providing educational scholarships and educational resources and the funding of educational projects for indigenous people. ***[Schedule 1, item 2, subsection 30-25(2)]***

1.8 The General Sir John Monash Foundation has been established to raise funds to administer the General Sir John Monash Awards, which will recognise the highest academic achievement and aim to attract potential national leaders in their chosen fields. ***[Schedule 1, item 2, subsection 30-25(2)]***

1.9 The Mount Macedon Memorial Cross Trust has been established to restore, develop, protect and maintain the Mount Macedon Memorial Cross to commemorate the service and sacrifice of Australia's servicemen and women. ***[Schedule 1, item 4, subsection 30-50(2)]***

1.10 The Manly Warringah War Memorial Regional Park Remembrance Trust has been established to raise funds to establish a unique War Memorial feature in Manly Warringah War Memorial Regional Park. This War Memorial feature will acknowledge all personnel who gave their lives, served or who are serving in Australia in the armed forces and civilian support services throughout the years and includes those who work and strive for world peace. ***[Schedule 1, item 4, subsection 30-50(2)]***

1.11 The Shrine of Remembrance Foundation has been established to raise funds for the establishment, management and maintenance of the Galleries of Remembrance and other educational, operational and management functions at the Shrine of Remembrance in Melbourne. ***[Schedule 1, item 4, subsection 30-50(2)]***

1.12 The Australian Council of Children and Youth Organisations Inc. has been established to assist and empower disadvantaged children and young people by establishing and operating a regulatory framework and accreditation system which is recognised by the wider community. ***[Schedule 1, item 9, section 30-105]***

1.13 St Paul's Cathedral Restoration Fund has been established to raise money for the restoration, refurbishment and improvement of St Paul's Anglican Cathedral, Melbourne and in particular for important repair and restoration work to the Cathedral spires. ***[Schedule 1, item 9, section 30-105]***

Changes of names

1.14 This Schedule updates the tables in Subdivision 30-B to reflect the change of name of two organisations.

1.15 The Royal Society for the Prevention of Cruelty to Animals (Victoria) has changed its name to Royal Society for the Prevention of Cruelty to Animals (Victoria) Inc. from 9 January 1992. ***[Schedule 1, item 1, subsection 78(4) of the ITAA 1936; Schedule 1, item 3, subsection 30-45(2)]***

1.16 The Nursing Mothers' Association of Australia has changed its name to Australian Breastfeeding Association from 1 August 2001. ***[Schedule 1, items 5 and 6, subsection 30-70(2)]***

Extension of period of deductibility

1.17 This Schedule extends the period of deductibility for two organisations.

1.18 Income tax deductions for gifts to Australia for UNHCR are currently allowable for gifts made before 28 June 2002. Deductibility of gifts has been extended for a further five years. Gifts made before 28 June 2007 will now be deductible. ***[Schedule 1, item 7, subsection 30-80(2)]***

1.19 Income tax deductions for gifts to the St Patrick's Cathedral Parramatta Rebuilding Fund are currently allowable for gifts made before 25 February 2002. Deductibility of gifts has been extended for a further two years. Gifts made before 25 February 2004 will now be deductible. ***[Schedule 1, item 8, section 30-105]***

Update to index

1.20 The index to the Division is also updated to include the new funds, authorities and institutions. ***[Schedule 1, items 10 to 19, subsection 30-315(2)]***

Application and transitional provisions

1.21 The amendments apply from the dates of the press releases shown in Table 1.1 and Table 1.3.

1.22 The amendments contained in Table 1.2 apply from the date of effect of the change of name.

Outline of chapter

2.1 Part 1 of Schedule 2 to this bill amends the income tax law to ensure that the CGT provisions that deal with ESSs operate as intended. The amendments are required where an ESS is operated through a trust and the employee elects under Division 13A of the ITAA 1936 to be assessed on the discount on the shares at the time the shares or rights are acquired by the trustee. The amendments ensure that:

- capital gains and losses while the shares or rights are held in an employee share trust are recognised ; and
- the time of acquisition of shares or rights for the purpose of the CGT 50% discount is the time the shares or rights are acquired by the trustee.

2.2 Part 2 of Schedule 2 inserts an integrity measure into Subdivision 130-DA of the IT(TP) Act 1997 to ensure that trustees currently holding ESS shares or rights in a trust cannot take advantage of the non-recognition of capital gains on shares or rights while held in trust.

2.3 Parts 1 and 2 of Schedule 2 also make technical amendments to the CGT provisions in the ITAA 1997 and IT(TP) Act 1997 that deal with ESSs.

2.4 Part 3 of Schedule 2 makes a technical amendment to the FBTAA 1986 to ensure consistency between the FBTAA 1986 and Division 13A of the ITAA 1936.

Context of amendments

Existing law – employee share schemes

2.5 Division 13A of the ITAA 1936 deals with the taxation of benefits provided to employees under an ESS. Generally, where an employer provides a share or a right to a share to an employee at less than market value under an ESS, the discount is included in the employee's assessable income in the year of income in which the shares or rights to shares are acquired.

2.6 Division 13A of the ITAA 1936 provides concessional treatment that applies to qualifying shares or rights. An employee who acquires a qualifying share or right may defer income tax on the discount for up to 10 years or elect to have the discount assessed in the year of income the share or right is acquired.

2.7 A taxpayer who makes an election is eligible for a reduction of up to $1,000 on the discount, subject to the ESS satisfying further conditions, including the requirement that the shares or rights be held at least 3 years before disposal. If the employee does not make an election, the employee will be assessed on the discount in the year of income the cessation time occurs.

Employee share trusts

2.8 Employers often establish a trust to hold the shares or rights to shares for their employees and thus restrict an employee's ability to dispose of them for the period they are held in trust.

2.9 A share or right to a share is acquired for the purpose of Division 13A when the employee receives a legal or beneficial interest in the share or right. If the share or right is acquired by a trust, the employee acquires the shares or rights held in trust at the time the trustee provides the employee with a legal or beneficial entitlement to those shares or rights.

2.10 The effect is that for Division 13A purposes, where an ESS is operated through a trust, the value of ESS benefits is taxed to the employee, not the trustee. This recognises the fact that the trustee holds the shares or rights for the sole purpose of providing them to the employee.

2.11 If the employee does not make an election to have the discount assessed in the year the shares or rights are acquired, the employee is assessed in the year of income in which the cessation time occurs. For an employee share trust, this is often the time the shares or rights are physically transferred from the trustee to the employee.

Existing law – CGT provisions as they relate to ESS shares and rights

Time of acquisition

2.12 In general terms, the date of acquisition of a CGT asset is the date on which a taxpayer becomes the asset's owner.

2.13 The time of acquisition for shares or rights to shares acquired under an ESS operated through a trust is the date when the employee becomes absolutely entitled to the shares or rights (table item relating to CGT event E5 (the beneficiary becoming absolutely entitled to a trust asset) in subsection 109-5(2) of the ITAA 1997)).

CGT discount

2.14 A CGT discount is available for capital gains made by certain entities listed in section 115-10 of the ITAA 1997. The CGT discount (50% for individuals and trusts other than complying superannuation entities) is generally available where the asset has been owned by the taxpayer for at least 12 months.

2.15 The 12-month ownership period for shares or rights acquired under an ESS operated through a trust begins on the happening of CGT event E5 (i.e. the date when the employee becomes absolutely entitled as against the trustee to the shares or rights).

Cost base/reduced cost base

2.16 Division 110 of the ITAA 1997 sets out general rules as to how to work out the cost base (for a capital gain) and reduced cost base (for a capital loss) of a CGT asset. Division 112 of the ITAA 1997 sets out situations that may modify the general rules about the cost base and reduced cost base of a CGT asset. Generally, if an element of the cost base is modified, the taxpayer uses the modified amount in CGT calculations and in relation to ESSs the modifications are listed in section 112-75.

2.17 Sections 130-80 and 130-85 of the ITAA 1997 establish the first element (the acquisition cost) of the cost base and reduced cost base for shares and rights acquired under an ESS where the discount on the shares or rights is assessed in the year of acquisition (i.e. it will be market value). Different rules are in section 130-83 for the circumstance where the taxpayer elects, in effect, to be assessed in the year of acquisition so there is a deferral of assessment on the discount.

Section 130-90

2.18 Section 130-90 provides a special rule in relation to a share or right to a share acquired under an employee share trust. It provides that a capital gain or loss a trustee makes when the beneficiary becomes absolutely entitled to the share or right is disregarded. This rule is intended to ensure that there is no double taxation, that is, that a discount on the shares or rights that is taxed to the employee is not then taxed as a capital gain.

Problems with the existing law

2.19 The existing law does not operate as intended in relation to:

- the recognition of capital gains and losses while the shares or rights are held in an employee trust; and

- the application of the CGT 50% discount .

2.20 As the law currently operates, any capital gain or loss which accrues during the period the shares or rights to shares are held in the trust is not recognised for CGT purposes. Any increase in the market value of the shares or rights during this period will not be subject to CGT. Conversely, if the market value of the shares or rights has fallen during this period, the employee will be denied a capital loss.

2.21 Also, an employee is denied access to the CGT discount if the employee disposes of the shares or rights within 12 months of becoming absolutely entitled to them.

2.22 In former Assistant Treasurer's Press Release No. 7 of 27 February 2001 the Government announced that it would introduce amendments to ensure the law operates as intended and also include an integrity measure rule to ensure that taxpayers's cannot take advantage of the non-recognition of capital gains on shares or rights held in an employee share trust.

Summary of new law

Section 1 – amendments to CGT provisions in the ITAA 1997

Amendment to Subdivision 115-A (discount capital gains)

2.23 This bill amends subsection 115-30(1) (special rules about acquisition times for the CGT discount) of the ITAA 1997 to ensure that, for shares or rights acquired under an ESS operating through a trust, the 12-month ownership period requirement for the 50% CGT discount commences from the date when the employee or associate acquires a beneficial interest in the shares or rights to shares held by the trust. The amendment will apply where:

- a CGT asset is a share or right to a share acquired under an ESS via an employee share trust; and
- if the shares or rights are qualifying shares or rights the taxpayer has made an election under section 139E of the ITAA 1936.

[Schedule 2, item 5]

2.24 The amendment ensures that for the purposes only of the 12-month minimum qualifying period for the CGT discount, taxpayers who acquire shares or rights under an ESS through a trust and elect to be assessed on the discount at the time the shares or rights are acquired will be treated under the CGT rules as having acquired the shares or rights at that time. This reflects the fact that, once the amendments take effect, these taxpayers will be subject to CGT from when the trustee acquires the shares or rights on their behalf.

2.25 A consequential amendment is made to the table in section 109-55 (which lists CGT acquisition rules) so that the above modification to the acquisition date for CGT discount purposes is listed. ***[Schedule 2, item 3]***

Amendments to Subdivision 130-D (CGT ESS provisions)

2.26 This bill provides that where:

- an employee acquires shares or rights to shares through an employee share trust; and

- if the shares or rights are qualifying shares or rights the taxpayer has made an election under section 139E of the ITAA 1936,

then the cost base or reduced cost base of the shares or rights for the taxpayer is the cost base or reduced cost base when the taxpayer acquires a beneficial interest in the shares or the rights. ***[Schedule 2. item 6, subsection 130-80(3)]***

2.27 The time the taxpayer acquires a beneficial interest in the shares or rights will be the time the trustee first holds the shares or rights for the taxpayer. The effect is that:

- an increase in the value of the shares or rights during the trust holding period is subject to CGT on the ultimate disposal of the shares or rights by the taxpayer; and

- a decrease in the value of the shares or rights during this period is available to the taxpayer as a capital loss or as a smaller capital gain.

2.28 This bill also deals with the equivalent situation where an associate of the employee acquires the shares or rights. ***[Schedule 2, item 9, subsection 130-85(3)]***

2.29 A definition for the term employee share trust is inserted as a dictionary term in subsection 995-1(1) of the ITAA 1997. ***[Schedule 2, item 11]***

Application date

2.30 The amendments apply to shares or rights acquired by a taxpayer under an ESS through a trust after the date of announcement, that is, 5.00 pm eastern summer time on 27 February 2001. ***[Schedule 2, subitems 12(2) and (3)]***

2.31 However, in the case of amendments made to sections 130-80 and 130-85 a taxpayer can choose that the amendments can apply to share or rights to shares acquired (within the meaning of Division 13A) by a taxpayer via an employee share trust before 5.00 pm eastern summer time on 27 February 2001 ***[Schedule 2, subitem 12(3)]***. For example, the taxpayer’s shares may decline in value over the trust holding period. In the absence of this provision, the taxpayer could not make a capital loss on disposal of the shares or rights or a smaller capital gain.

2.32 A taxpayer can make this choice by how he or she prepares their income tax return including supporting documentation that he or she

keeps**.** If the return has already been lodged, the taxpayer will need to seek an amendment to their assessment.

Section 2 – integrity measure – IT(TP) Act 1997

2.33 A trustee of a employee share trust that is already in existence at the date of the Government announcement could change the terms and conditions of the trust to take advantage of the non-recognition of capital gains on shares or rights held in an employee share trust**.** The trustee could achieve this by extending the trust holding period so that capital gains accruing during this period are not subject to CGT on disposal of the shares or rights.

2.34 This bill amends the IT(TP) Act 1997 to provide that where:

- the shares or rights to shares are held by an employee share trust at 5.00 pm eastern summer time on 27 February 2001;
- at the time the employee share trust acquired the shares or rights it was possible to determine how long the shares or rights would be held in trust (this period could be determined by a specified date or at the occurrence of a particular event); and
- the shares or rights held in trust are acquired at a later time from that time,

then the first element (acquisition cost) of the cost base and the reduced cost base is its market value as determined under sections 139FA to 139FF of the ITAA 1936 at the earlier time. ***[Schedule 2, item 13]***

Example 2.1

On 1 January 2001 Barbara acquires shares in an ESS via an employee share trust. Barbara makes an election under section 139E of the ITAA 1936 to be assessed on the discount on the shares at the time the trustee acquires the shares. The market value of the shares at the time Barbara acquires the shares is $1.00.

The trustee changes the trust deed to extend the trust holding period from 3 years to 5 years. At the end of the 3 year trust holding period the market value of the shares is $3.00 and at the end of the 5 year period is $5.00.

Under new section 130-80 of Subdivision 130-DA of the IT(TP) Act 1997 Barbara will be taken to have a cost base for the shares at the end of the extended trust holding period of $3.00.

Section 3 – minor technical corrections

2.35 Certain amendments contained in Schedule 2 to Part 1 of this bill will make corrections to the CGT provisions in the ITAA 1997 and the IT(TP) Act 1997 that relate to ESSs.

Table 2.1: Amendments to the *Income Tax Assessment Act 1997*

No.	***What the provision does***	***What the amendment will do***
1.	109-55 – lists rules for acquisition of a CGT asset. Item 12 in the table refers to an acquisition rule contained in 130-83(3).	Repeal item 12 in 109-55. *Taxation Laws Amendment Act (No 7) 2000* repealed section 130-83 and replaced it with a provision, which does not contain a rule for the time of acquisition. Item 12 should have been repealed at the same time ***[Schedule 2, item 2].*** (The reference in column 4 in table item 12 to section 130-80 rather than 130-83 was always incorrect).
2.	112-75 – lists where an element of the cost base/reduced cost base of a share or right acquired under an ESS is affected. The sections listed are 130-80 and 130-85.	List 130-83 in section 112-75. This provision also contains a rule, which affects the cost base/reduced cost base. ***[Schedule 2, item 4]***
3.	130-90 – provides that where an employee becomes absolutely entitled to a share as against a trustee of an employee share trust a capital gain or capital loss of the trustee is disregarded.	Ensure that any capital gain or loss that arises to an employee on becoming absolutely entitled to the shares or rights to shares is also disregarded. This correctly reflects the intention of the provision, which is to ensure that no capital gain or loss arises to a trustee or employee when an employee becomes absolutely entitled to the shares or rights to shares ***[Schedule 2, item 10]***. It also conforms to the ATO administrative practice. Make consequential amendment to 104-75(6) similar to the note to 104-75(4). ***[Schedule 2, item 1]***

No.	*What the provision does*	*What the amendment will do*
4.	130-83(2) – provides that where a taxpayer disposes of a share or right to a share at the cessation time or within 30 days after that time any capital gain or capital loss is disregarded.	List CGT event C2 (which includes forfeiture of rights) as one of the CGT events that result in the disposal of rights by a taxpayer. ***[Schedule 2, item 7]***
5.	130-83(2) – sets out the CGT consequences if a CGT event happens in relation to shares or rights at the cessation time or within 30 days of the cessation time.	Change the word "disposal" to "event" to ensure consistency with the CGT event terminology as used throughout the CGT provisions. ***[Schedule 2, item 8]***

Table 2.2: Amendment to the *Income Tax (Transitional Provisions) Act 1997*

No.	*What the provision does*	*What the amendment will do*
1.	130-95 – describes the application of Subdivision 130-D.	In subsection 130-95(1), substitutes "This Subdivision" for "Subdivision 130-D of the *Income Tax Assessment Act 1997*". ***[Schedule 2, item 14]*** In subsection 130-95(2), substitutes "this Subdivision" for "Subdivision 130-D of the *Income Tax Assessment Act 1997*". ***[Schedule 2, item 15]*** This reverses an inappropriate amendment made by Act No. 114 of 2000. This amendment should not have been made to subsections 130-95(1) and (2) as these provisions relate to section 26AAC Employee Share Acquisition Scheme CGT provisions.

Table 2.3: Amendment to the *Fringe Benefits Tax Assessment Act 1986*

No.	*What the provision does*	*What the amendment will do*
1.	Paragraph (hb) of the definition of fringe benefit in subsection 136(1) – ensures that an employer does not provide a fringe benefit to employees where ESS shares are provided to an employee through an employee share trust.	Includes the words "to employees of the employer" after employees of the employer. Provides that a fringe benefit (and therefore double taxation) will not arise where the shares or rights are provided to associates of employees. This ensures consistency between Division 13A and the FBTAA 1986. ***[Schedule 2, item 17]***

Application date

2.36 The amendments to the ITAA 1997 and the IT(TP) Act 1997 are to apply to assessments for the 1998-1999 income year and later income years. ***[Schedule 2, subitem 12(1), item 16]***

2.37 The amendment to the FBTAA 1986 is to apply from 1 April 1995 and later FBT years. ***[Schedule 2, item 18]***

Outline of chapter

3.1 Schedule 3 to this bill contains amendments that will make it easier for co-operative companies to frank distributions to shareholders. A co-operative company will be able to choose to frank distributions to shareholders. Alternatively, a co-operative company may prefer to make unfranked distributions and remain entitled to the existing deduction for distributions of assessable income to shareholders. This measure will apply to distributions made on or after 1 July 2002.

Context of reform

3.2 Co-operative companies may frank distributions from sources other than assessable income of the income year in which the distribution is made. However, a co-operative company is allowed a deduction under paragraphs 120(1)(a) and (b) of the ITAA 1936 for distributions of assessable income for the current year, which are not frankable. This deduction can make it difficult for a co-operative company to frank distributions and so pass on to its shareholders the benefit of franking credits arising from tax paid by the co-operative.

3.3 This measure will give co-operative companies the same access to imputation credits as other companies while maintaining the deduction for unfranked distributions.

Summary of new law

3.4 This measure will enable a co-operative company to choose to frank distributions to shareholders for which a deduction would otherwise be available under paragraphs 120(1)(a) or (b) of the ITAA 1936. A deduction will be allowable for assessable income distributed as unfranked distributions. This approach means that, in general terms, for any distribution made in any income year by a co-operative company sourced from assessable income for that income year, either the distribution will be franked or the co-operative will be entitled to a deduction.

3.5 Also, a co-operative company will be able to treat a distribution paid within three months after the end of an income year as if it was paid

during the income year for the purpose of determining whether a deduction is allowable under paragraphs 120(1)(a) or (b). This amendment recognises that generally a company cannot determine the final profit for the year until after the end of the year. It is consistent with the Commissioner's administrative practice.

Detailed explanation of new law

Amendments to the ITAA 1997

3.6 Part 3-6 of the ITAA 1997 will be amended so that the imputation rules will apply to co-operative companies in the same way as they do to other companies. Paragraph 202-45(a) will be removed, so that distributions made by a co-operative will no longer be unfrankable distributions. Further, all distributions made by a co-operative company that are covered by paragraphs 120(1)(a) or (b) of the ITAA 1936 will be treated as distributions for imputation purposes. ***[Schedule 3, items 2 and 3, subsection 218-5(2)]***

3.7 A co-operative company will be obliged to give a distribution statement to its shareholders under section 202-75 only for franked distributions, that is distributions that are fully or partly franked. This means that no additional compliance burden will be placed on a co-operative company that does not choose to frank distributions. ***[Schedule 3, item 3, subsection 218-5(3)]***

Amendments to the ITAA 1936

3.8 The deductions available under paragraphs 120(1)(a) and (b) will be confined to the amount of assessable income distributed to shareholders as unfranked distributions. ***[Schedule 3, item 1, subsection 120(4)]***

Example 3.1: A co-operative company makes franked distributions

A co-operative company fully franks all distributions of assessable income to shareholders in an income year. A deduction would not be allowable under paragraphs 120(1)(a) or (b) because no amount of assessable income was distributed as unfranked distributions.

Example 3.2: A co-operative company makes unfranked distributions

A co-operative company makes only unfranked distributions to its shareholders in an income year. A deduction would be allowable to the extent that the distributions were made from assessable income of the

income year. This is the deduction that would be allowable under the existing law.

Note that the benchmark rule under the Simplified Imputation System rules, which apply to distributions made on or after 1 July 2002, allows a company to make an unfranked distribution even though it has sufficient franking credits to frank the distribution.

Example 3.3: A co-operative company makes partly franked distributions

A co-operative company distributes $10 million to its shareholders in an income year. The distributions are 90% franked. The distributions are sourced from assessable income of the income year.

A deduction of $1 million would be allowable because this is the amount of assessable income distributed as unfranked distributions.

3.9 A deduction will be allowable under paragraphs 120(1)(a) and (b) only for distributions from assessable income that are unfranked. Where a partly franked distribution is paid partly from assessable income of the income year and partly from another source, for example retained earnings or a pre-CGT gain, it will be necessary to identify that part of the distribution that is both unfranked and sourced from assessable income for the purpose of calculating the allowable deduction.

3.10 In determining the extent to which the unfranked part of a distribution is paid from assessable income of the income year, it is to be assumed that the imputation credit is attached first to that part of the distribution that is attributable to a source other than assessable income of the income year. This approach maximises the amount of the deduction available to a co-operative company where the co-operative does not fully frank all distributions made to shareholders in an income year. ***[Schedule 3, item 1, subsection 120(5)]***

Example 3.4: A co-operative company makes a partly franked distribution not sourced wholly from assessable income

A co-operative company distributes $10 million to shareholders in an income year. The distributions are 50% franked. The distributions are sourced partly ($8 million) from the disposal of pre-CGT assets, that is non-assessable income, and partly ($2 million) from profits from trading that were assessable income for the income year. The co-operative company's assessable income for the income year is $21 million.

A deduction of $2 million would be allowable. This is the part of the distribution that is both unfranked and attributable to assessable

income of the income year, assuming that the imputation credit is attached first to that part of the dividend paid from pre-CGT assets.

3.11 The benchmark rule requires that all frankable distributions paid in a certain period, called a franking period, be franked to the same extent. If a co-operative company breaches the benchmark rule, the penalties under the benchmark rule will apply in the same way as they do to other companies, that is a penal franking debit or overfranking tax would be imposed. However, there would be no adjustment to the amount of the deduction allowed to the co-operative company under subsection 120(1*)*.

3.12 A deduction is allowable under paragraphs 120(1)(a) or (b) only in respect of assessable income for a year of income that is distributed in that year of income. New subsection 120(6) will permit a co-operative company to treat a distribution made within three months after the end of an income year as though it was paid during the income year for the purpose of the deduction. ***[Schedule 3, item 1, subsection 120(6))]***

3.13 This rule will apply only in determining whether a deduction is allowable under section 120. The actual distribution date is used for the purpose of the imputation rules in Part 3-6 of the ITAA 1997.

Example 3.5: A co-operative company makes a distribution after the end of the income year

A co-operative company with a standard income year (i.e. ending at 30 June) makes an unfranked distribution of $1 million to its shareholders on 15 August 2003. The distribution is sourced from assessable income for the income year ending at 30 June 2003.

As the distribution was paid within 3 months after the end of the 2002-2003 income year, the co-operative may treat the distribution as though it was paid during the 2002-2003 income year. If the co-operative makes such an election, and made no other unfranked distributions of assessable income during that income year, a deduction of $1 million would be allowable for the 2002-2003 income year.

Consequential amendment

3.14 An amendment needs to be made to paragraph 202-45(b) of the ITAA 1936 because of the removal of paragraph 202-45(a). The amendment will preserve an existing legislative reference that currently exists in paragraph 202-45(b). ***[Schedule 3, Item 3A, paragraph 202-45(b)]***

Application provisions

3.15 These amendments will apply to distributions made on or after 1 July 2002.

Outline of chapter

4.1 Schedule 4 to this bill will amend the ITAA 1936 to rectify an anomaly in the RBL provisions. This will ensure that a reversionary pension (or annuity) paid on the death of the original recipient will receive the same proportion of concessional taxation rebate as applied to the original pension (or annuity). Benefits that have been assessed as above the relevant RBL of the deceased, and thus subject to reduced concessional taxation treatment, will therefore continue to be treated in the same manner after death. The amendment also ensures that the RBL treatment of pension benefits paid on death is consistent with the RBL treatment of lump sum benefits paid on death.

Context of amendments

Background

4.2 Division 14 of Part III of the ITAA 1936 contains the legislation relating to RBLs.

4.3 The purpose of RBLs is to limit the amount of concessionally taxed superannuation and termination of employment benefits received by a person.

4.4 Lump sum benefits which do not exceed the relevant RBL are taxed at concessional rates. However, if a lump sum benefit exceeds a person's RBL then the amount by which the lump sum exceeds the RBL is taxed at the highest marginal rate.

4.5 Pension benefits which do not exceed the relevant RBL are normally entitled to a 15% rebate. However, if a pension benefit exceeds a person's RBL then the amount of the pension that attracts the 15% pension rebate is reduced. The part of a pension that attracts the pension rebate is called the 'rebatable proportion'.

4.6 Death benefits are generally measured against the RBL of the deceased. If the benefits are paid as a lump sum and found to be excessive then the excessive amount will be taxed at the highest marginal rate. If the benefits are paid as a reversionary pension, and the original pension was

in excess of the deceased's RBL, then the intention is that the reversionary pension will receive the same reduced rebatable proportion as the original pension. However, an anomaly in the law means that the reversionary pension may not receive the same rebatable proportion as the original pension.

Summary of new law

4.7 The amendment ensures that when a person receiving a superannuation pension or annuity dies, and the benefit is passed on to a reversionary beneficiary, the RBL treatment of those benefits does not change. That is, the same rebatable proportion applies to the reversionary pension or annuity as applied to the original pension or annuity.

Detailed explanation of new law

4.8 The amendment inserts new subsection 140ZQ(1A) in Division 14 of Part III of the Act. The Subdivision provides that where a rebatable superannuation pension or a rebatable ETP annuity is payable to a person as the result of the death of another person, and is a reversion of another pension or annuity that was already payable to the other person, then the rebatable proportion of the pension or annuity is the same as the rebatable proportion of the original pension or annuity.

Application and transitional provisions

4.9 The amendment made by this Schedule applies, and is taken to have applied in relation to the 1999-2000 income year and later income years. This gives effect to the former Assistant Treasurer's Press Release No. 14 of 6 April 2000 which announced that the anomaly in the legislation would be corrected effective from that date (and hence effective for the 1999-2000 and later income years). Commencement of the measure from this date is necessary to maintain the integrity of the RBL system and ensure the revenue is protected.

Outline of chapter

5.1 Schedule 5 to this bill amends the PRRTAA 1987 to:

- allow expenditures associated with closing down a particular petroleum processing project, where the facility continues to be used under an infrastructure licence for another processing project, to be deductible against the first project's PRRT receipts (infrastructure licence proposal); and
- produce a more equitable and uniform tax treatment of partial use arrangements in the petroleum processing industry by extending the PRRT to:
  - include all receipts received; and
  - allow a deduction for all expenditures incurred,

that relate to a particular project's petroleum activities (partial use proposal).

Context of amendments

5.2 The PRRT is a profits based tax which applies when there is an excess of petroleum production project revenue for a financial year over accumulated undeducted expenditures, including expenditure on plant.

Infrastructure licence proposal

5.3 Infrastructure licences were introduced in March 2000 to allow for the construction and operation of infrastructure facilities in Commonwealth waters without a necessary connection to any specific PRRT project. This means that facilities can be used for more than one project. A PRRT project can be converted into an infrastructure licence when the petroleum reserves of the PRRT project are exhausted – this allows the life of the facilities to be extended as they are then used for other projects.

5.4 Currently, where a taxpayer incurs costs in closing down a particular project, such as environmental restoration costs; subsequent to

the surrender of a production licence, these costs are not deductible against PRRT at the time the production licence ceases.

Partial use proposal

5.5 Partial use of a PRRT project's facilities can occur in a number of ways where the facilities are used to process, treat or store petroleum from another PRRT project; for example, where one project buys unprocessed petroleum from another project and then processes it for sale (sales situation) or where a petroleum project charges another a 'toll' or fee for the use of facilities (tolling situation).

5.6 Currently, where there is partial use of petroleum infrastructure, tolling receipts and expenditures may not be taken into account for PRRT purposes.

5.7 This may discourage partial use arrangements and impact adversely on productivity and the international competitiveness of Australian petroleum projects.

5.8 Currently, where the facilities are intended for use partly in processing petroleum from outside the production licence area, the capital cost of facilities used in carrying on a petroleum project is apportioned. The apportionment does not change if relative use changes throughout the life of the project.

Summary of new law

Infrastructure licence proposal

5.9 Sections 27 and 39 of the PRRTAA 1987 are amended to ensure that, where there is continuity of ownership between the production licence and a subsequent infrastructure licence, deemed assessable property receipts and closing down expenditure include estimated future closing down costs.

5.10 Where a taxpayer has to pay a new user to take over a project facility at the end of a production licence, or where the value of the facility at the cessation of the production licence is deemed (taking into account closing down costs) to be negative, this amount will be recognised as closing down expenditure.

Partial use proposal

5.11 The amendments broaden the scope of what constitutes a project under the PRRTAA 1987 to ensure that the PRRT remains economically efficient and neutral in application by including all partial use related revenues and expenses in determining a project's PRRT liability.

Comparison of key features of new law and current law

New law	*Current law*
Where a project licensee ceases production and applies for an infrastructure licence to toll process or carry out some other related process, much of the project's infrastructure would still be in place at the time the project closes down for the purposes of the PRRTAA 1987. In such situations the new law will provide for estimated closing down costs to be deductible, for PRRTAA 1987 purposes, when the project is terminated.	Closing down costs incurred in certain situations may not be deductible for the purposes of the PRRTAA 1987.
Where a project licensee has to pay an amount to a new user to take over a project facility located on an infrastructure licence, or where the value of the facility at the cessation of the production licence is deemed (taking into account closing down costs) to be negative, this amount is treated as a deductible closing down cost for PRRT purposes.	When a project ends and the facilities move into an infrastructure licence, the project licensee either sells the facility and receives a property receipt, or retains the facility and receives a deemed property receipt. If the costs of closing down the project exceed the value of the facility at this time, such that the property receipt would be negative, this amount is not deductible for PRRT purposes.
Capital expenditure incurred by petroleum production operators for plant that is used to process petroleum from one or more petroleum projects will be deductible expenditure for the purposes of calculating the PRRT liability, irrespective of whether the partial use was or was not anticipated.	Capital expenditure incurred by petroleum production operators for facilities intended to be used for processing petroleum from more than one petroleum project is apportioned for the purposes of calculating the petroleum resource rent taxable value for a project. The apportionment occurs at the commencement of the project and

New law	***Current law***
	does not change even if relative use does change.
Revenue received as a toll fee from another project will be assessable.	Revenue received as a toll fee from another project is not assessable.
Toll fees paid by a project will be deductible expenditure.	Toll fees paid by a project may not be deductible expenditure.
Entities engaged in tolling operations will be able to deduct the operating costs involved in such processes.	Entities engaged in tolling operations can not deduct the operating costs involved in such processes.
Operating costs incurred and revenue received in situations where one project purchases another project's hydrocarbons and processes them for sale are included in determining a project's petroleum resource rent taxable amount.	Operating costs incurred and revenue received in situations where one project purchases another project's hydrocarbons and processes them for sale are not included in determining a project's petroleum resource rent taxable amount.

Detailed explanation of new law

Infrastructure licence proposal

5.12 For PRRT purposes, closing down costs of a petroleum project will ordinarily be incurred where a project ends and a facility becomes redundant to the project and is partially or completely removed, made safe or reclaimed.

5.13 The amendments take into account the circumstance where a project facility ceases to be used in relation to a petroleum project, but continues to be used for other purposes under an infrastructure licence.

5.14 Under this circumstance the future closing down expenditure of the facility (which will not be incurred until the end of the infrastructure licence), is taken into account at the time when the facility ceases to be used in relation to a production licence. This expenditure is determined by calculating the present value of the estimated costs of closing down the project's property when the infrastructure licence ceases. In estimating the closing down costs, the property's condition when the project terminates and any estimated environmental restoration costs as a consequence of closing down the property when the infrastructure licence is expected to cease, are required to be taken into account. ***[Schedule 5, items 2, 3 and 6]***

5.15 Where a project terminates but the taxpayer retains the project facility rather than closing it down at that time, in general an assessable

property receipt is deemed, which will take into account the future closing down expenditure. ***[Schedule 5, item 13, subsection 27(3)]***

5.16 However, where the value of the facility at the project's termination is deemed (taking into account closing down costs) to be negative, the assessable property receipt is zero and the negative amount is to be recognised as deductible closing down expenditure. This treatment removes any economic impediment to the ongoing use of the facility for other purposes. ***[Schedule 5, item 13, subsection 27(4) and item 20, subsection 39(3)]***

5.17 Where a taxpayer has to pay and/or give consideration to a new user to take over a project facility located on an infrastructure licence, to the extent that the payment and/or consideration relates to the excess of future closing down costs over the current value of the facilities, it will now be recognised as closing down expenditure at the time the production licence ceases. Treating any such expenditure as closing down expenditure removes any economic impediment to the disposal of the facility for other purposes. ***[Schedule 5, item 20, subsection 39(2)]***

5.18 Where a taxpayer has already taken into account future closing down expenditure for a project, any costs actually incurred by that taxpayer under an infrastructure licence in disposing of the facility or closing down the facility cannot be included as closing down expenditure nor can those costs be used as an offset against PRRT paid. ***[Schedule 5, item 20, subsection 39(4)]***

Partial use proposal

5.19 These proposed amendments aim to provide an equitable and uniform treatment of partial use situations, whether they be contemplated from start-up or instigated at a later date. They do this by ensuring that all revenue earned from tolling and sale situations will be included as assessable receipts and that capital and operating costs involved in processing the tolled or purchased hydrocarbons will be available for deduction by the processing parties.

5.20 The scope of what constitutes a project under the PRRTAA 1987 will be broadened for the purposes of determining revenues and deductions, to encompass petroleum that originates from outside the production licence area (external petroleum), provided that the project's own operations and facilities are wholly or partly used to process that petroleum. ***[Schedule 5, items 1, 4, 5 and 7]***

Example 5.1

Petgas Ltd uses its project operations and facilities to process external petroleum and stores it in a tank dedicated for that petroleum. The costs of processing the external petroleum incurred by Petgas Ltd, including the storage tank, are deductible.

5.21 Assessable receipts will include receipts for the use of facilities which are part of the project. Any doubt about the PRRT treatment of receipts for activities such as recovery, stabilisation, transport, storage or processing of third-party petroleum (including petroleum sourced from another PRRT area or from a non-PRRT area) is removed by clarifying that they are included as assessable receipts. ***[Schedule 5, items 8, 11 and 12]***

5.22 The proceeds received from the sale of hydrocarbons from another project (including those sourced from outside PRRT waters), are included as assessable receipts. ***[Schedule 5, items 9 and 10, subsection 24(1)]***

5.23 The value of unprocessed hydrocarbons purchased from third parties is included as deductible expenditure. ***[Schedule 5, items 14, 15, 16 and 18, paragraph 38(c)]***

5.24 Any doubt about the PRRT treatment of tolling charges is removed by clarifying that they are included as deductible expenditure. ***[Schedule 5, items 17 and 18, paragraph 38(d)]***

5.25 Any doubt about the PRRT treatment of expenditures incurred in recovering, stabilising, transporting, storing or processing of third-party petroleum (including petroleum sourced from another PRRT area or from a non-PRRT area) is removed by clarifying that they are included as deductible expenditure. ***[Schedule 5, item 19]***

5.26 Where one project pays fees to another project to extract, stabilise, transport, store or process petroleum under a partial use arrangement, the person providing the service is taken to be carrying out those activities. ***[Schedule 5, item 21, subsection 41(2)]***

5.27 These amendments will result in all partial usage situations being treated consistently.

Application and transitional provisions

5.28 The amendments will apply from the date of Royal Assent.

REGULATION IMPACT STATEMENT

Policy objective

5.29 The policy objective for the infrastructure licence proposal is to remove a potential taxation impediment to infrastructure licence activities by taking into account the future closing down costs of a project facility when it ceases to be used in relation to a petroleum project, but continues to be used under an infrastructure licence.

5.30 The policy objective for the partial use proposal is to produce a more consistent and equitable treatment of partial use arrangements by extending the PRRT area to include all petroleum activities related to that project.

Implementation options

Infrastructure licence proposal

5.31 Currently, for the purposes of the PRRTAA 1987 a tax credit, calculated in accordance with section 46, is given for the costs involved in closing down a petroleum project following the surrender of its production licence. However, where a project licensee ceases production and the facility becomes part of an infrastructure licence to toll process or carry out some other related process, much of the project's infrastructure would still be in place at the time the project closes down for the purposes of the PRRTAA 1987. In such situations the current treatment results in legitimate closing down costs not being deductible for PRRTAA 1987 purposes at the time the production licence ceases.

5.32 The PRRTAA 1987 is amended to allow such expenditure to be deductible for the calculation of a project's PRRT liability at the time the production licence ceases.

5.33 Two options were considered for implementation of this proposal.

5.34 The selected option, described below, is to calculate a property receipt at the end of the production licence that includes an estimate of future closing down costs.

5.35 An alternative approach is to include actual closing down costs at the end of the infrastructure licence for PRRT purposes. However, this would involve significantly higher compliance costs where taxpayers have a continuing interest, due to the need to retain PRRT records for the duration of the infrastructure licence, during which period the nature of the infrastructure may change.

5.36 Under the selected approach, where a taxpayer disposes of their interest in the facility at the cessation of the production licence, the property receipt they receive at that point in time will, for PRRT purposes, take into account the future closing down costs of the facility. If, instead of receiving a positive property receipt, the taxpayer is required to pay an amount to the acquirer of that interest to compensate them for future closing down costs, such an amount will be recognised as closing down expenditure.

5.37 For taxpayers with a continuing interest in the infrastructure licence, the property receipt they are deemed to have received at that point in time for PRRT purposes, will take into account the future closing down costs of the facility. If the deemed property receipt, taking into account future closing down costs, is a negative amount, such an amount will be recognised as closing down expenditure.

Partial use proposal

5.38 Currently, the treatment of capital expenditure is dependent on whether the partial use of petroleum facilities was intended at the time the capital was commissioned. (Section 42 of the PRRTAA 1987.)

5.39 Where such use is intended the capital amount included in the calculation of PRRT liability is that portion relating to project use. Where such use is not intended at the time of commissioning of the capital or is different from the initial expectation there is no subsequent apportionment, or re-apportionment, of the amount of capital expenditure included in the calculation of PRRT liability.

5.40 In partial use cases, receipts and non-capital expenditure associated with the use of the facility for non-project petroleum are excluded from the PRRT.

5.41 The PRRTAA 1987 is amended to allow deductibility of all capital against PRRT in all partial use situations, and ensure all revenue earned from tolling or purchase arrangements are included as assessable receipts and that all operating costs involved in processing the tolled or purchased hydrocarbons will be available for deduction by the parties.

Assessment of impacts

Infrastructure licence proposal

5.42 Currently there is not any specific petroleum projects that would be affected by these amendments. It is possible that some projects could change from a production licence to an infrastructure licence, but it is difficult to predict when these changes will occur.

5.43 Estimates of the revenue impacts of potential closing down costs of infrastructure from such licences has been costed as ranging between $0.28 million and $56 million depending on the size of the field. These are estimates of deductions available under the current law and do not represent the revenue implication associated with the proposed amendment.

5.44 The amendment only brings forward an already eligible deduction. That is, the only cost to revenue relating to this amendment is the potential timing cost from allowing the deduction at the time the production licence ceases rather than when the infrastructure licence ceases. It is not possible to identify the changed timing impact on PRRT receipts or refunds.

Partial use proposal

5.45 These amendments will not have any significant impact in the short term as there are currently no specific petroleum projects tolling external petroleum.

5.46 The revenue impact from the partial use proposal is unquantifiable, but likely to be positive due to the broadening of activities falling within the scope of PRRT.

5.47 Any PRRT revenue impact will have a smaller but opposite income tax impact because PRRT is deductible for income tax purposes.

Impact group identification

Infrastructure licence proposal

5.48 Petroleum project licensees of a project facility that ceases to be used in relation to a PRRT project, but will continue to be used under an infrastructure licence, will be affected by this proposal. It is anticipated that only a few such arrangements will arise in the next decade.

Partial use proposal

5.49 This proposal will affect petroleum production operators that use the same plant, such as a storage or processing facility, for petroleum sourced from two or more petroleum projects. It is anticipated that only a few such arrangements will arise in the next decade.

Analysis of costs / benefits

Infrastructure licence proposal

5.50 This proposal will benefit petroleum production operators by ensuring that future closing down expenditures will be deductible expenditure for PRRT at the time the production licence ceases. This prevents a potential distortion to commercial production decisions and will increase economic efficiency by enhancing the optimal development of petroleum deposits.

5.51 In the case where a taxpayer has a continuing interest, it will be necessary to consider the value of future closing down costs in the calculation of the deemed property receipt. It is considered that the information required for such a calculation would be readily available. Hence, any additional compliance costs would be minimal.

5.52 Amending the law in this way will mean that taxpayers bear some risk that actual closing down costs incurred at the end of the infrastructure licence will differ from those estimated in calculating the deemed property receipt. However, this risk could equally result in over-compensation or under-compensation of the taxpayer, and a similar risk already exists with the calculation of deemed property receipts under the current law.

5.53 There would be no impact on compliance costs where a taxpayer disposes of their interest in the project at the cessation of the production licence.

Partial use proposal

5.54 This measure may reduce the compliance cost impact of such petroleum production operators, as there will no longer be a requirement to apportion capital and separately identify receipts and expenditures associated with processing of third party petroleum in tolling and sale situations. However, any such reduction would be likely to be negligible because taxpayers may choose to continue to hold such information for internal accounting purposes.

5.55 The consistent treatment of anticipated and unanticipated partial use situations will improve equity across all partial use situations.

Consultation

Infrastructure licence proposal

5.56 Petroleum industry representatives have been consulted and are supportive of ensuring deductibility of closing down expenditures where a facility moves from a production licence to an infrastructure licence.

Partial use proposal

5.57 Petroleum industry representatives have been consulted on this proposal and support the method of implementation.

Conclusion and recommended option

Infrastructure licence proposal

5.58 This proposed implementation proposal ensures all relevant receipts and expenses are included in PRRT calculations and that the PRRTAA 1987 does not deter tolling arrangements by way of an infrastructure licence or influence commercial decision making.

Partial use proposal

5.59 This proposed implementation proposal clarifies and simplifies the treatment of expenditures and receipts incurred where the same facilities are used for petroleum sourced from two or more petroleum projects.

Outline of chapter

6.1 Schedule 6 to this bill makes a number of technical amendments to the ITAA 1936, the ITAA 1997 and other tax-related legislation.

Detailed explanation of new law

6.2 A number of minor technical amendments are made to the:

- *A New Tax System (Family Assistance and Related Measures) Act 2000;*
- *A New Tax System (Goods and Services Tax) Act 1999;*
- *A New Tax System (Pay As You Go) Act 1999;*
- *A New Tax System (Tax Administration) Act (No. 2) 2000;*
- ITAA 1936;
- ITAA 1997;
- *Superannuation Legislation Amendment Act (No. 3) 1999;*
- *Taxation Administration Act 1953*;
- *Taxation Laws Amendment Act (No. 3) 1999;*
- *Taxation Laws Amendment Act (No. 4) 1997;*
- *Taxation Laws Amendment Act (No. 4) 2000;*
- *Taxation Laws Amendment Act (No. 7) 2000;* and
- *Tax Law Improvement Act (No. 1) 1998.*

[Schedule 6, items 1 to 45]

6.3 The amendments, which are self-explanatory, primarily:

- correct incorrect Division or section numbering or lettering;
- correct grammatical errors;

- correct incorrect cross-references; and
- repeal redundant provisions.

Application and transitional provisions

6.4 The amendments have various dates of effect which are detailed in section 2 of this bill.

Outline of chapter

7.1 Clause 5 of this bill will ensure that generally no taxation consequences arise for any person under any Commonwealth taxation laws as a result of the corporate conversion of AGL or from its registration under the *Corporations Act 2001*.

Context of measure

7.2 AGL and the NSW Government jointly undertook a process to convert AGL from an unincorporated company of proprietors established under NSW legislation dating back to 1837 to a company registered under the *Corporations Act 2001* on the same basis as other companies. Legislation to give effect to this conversion has been passed by the NSW Parliament.

7.3 The legislation passed by the NSW Parliament, the Conversion Act, made provision for AGL to be constituted as a body corporate and enabled it to seek registration as a company under the *Corporations Act 2001*. AGL was constituted as a body corporate under the Conversion Act on 11 October 2002 and was also registered as a public company limited by shares under the *Corporations Act 2001* on that date.

7.4 The provisions contained in this bill give effect to the announcement in Minister for Revenue and Assistant Treasurer's Press Release No. C60/02 of 23 May 2002 that the Government would legislate to ensure that there will be no taxation consequences resulting from the corporate conversion of AGL or from its registration under the *Corporations Act 2001.*

Summary of new law

7.5 These provisions will ensure that generally no taxation consequences arise for any person under any Commonwealth taxation laws as a result of the corporate conversion of AGL or from its registration under the *Corporations Act 2001*. This is achieved by deeming AGL, corporatised AGL and registered AGL to be, and to have

always been, the same company and the same entity for the purposes of all Commonwealth taxation laws.

7.6 However, the share capital tainting rules will apply to ensure that the merger of AGL's share premium account with AGL's share capital account will not result in that account becoming tainted as a result of the merger.

Detailed explanation of new law

7.7 Clause 5 is structured in the following way:

- the main rules are set out in subclauses 5(3), 5(4) and 5(6);
- specific cases are set out in subclauses 5(7) and 5(8);
- the application of the share capital tainting rules is set out in subclauses 5(9) and 5(10); and
- the meaning of terms is set out in subclauses 5(11) and 5(12).

The main rules

7.8 The main rules are:

- AGL, corporatised AGL and registered AGL are deemed to be, and to have always been, the same company and the same entity ***[subclause 5(4)]***;
- there will generally be no taxation consequences in relation to any person as a result of AGL's corporate conversion, registration of AGL under the *Corporations Act 2001*, or the operation of any provision or any action taken under the Conversion Act ***[subclause 5(6)]***; and
- the measure applies for all Commonwealth laws relating to taxation ***[subclause 5(3)]***.

7.9 Subclause 5(4) operates in conjunction with subclause 5(6) to ensure that broadly for the purposes of all Commonwealth taxation laws, both AGL's corporate conversion and AGL's registration:

- are tax neutral from the point of view of AGL, its subsidiaries, its shareholders or any other person;

- do not give rise to any tax liabilities or implications for AGL, its subsidiaries, its shareholders or any other person that would not arise if AGL’s corporate conversion or registration did not occur; and
- do not extinguish, accelerate or defer any existing tax liability of those persons.

[Subclauses 5(4) and 5(6)]

7.10 The provisions are intended to operate broadly to prevent a range of tax effects that could potentially arise for AGL, its subsidiaries, its shareholders or any other person, if AGL was treated as a new company or a new entity as a result of the corporate conversion or registration. Examples of the consequences for tax purposes that will arise from the operation of subclauses 5(4) and 5(6) include:

- all the actions of AGL before conversion will be attributed to corporatised AGL or registered AGL;
- all the actions of the Secretary of AGL in relation to AGL’s assets, rights and liabilities will be attributed to corporatised AGL or registered AGL;
- no CGT events will occur as a result of AGL’s corporate conversion or AGL’s registration;
- no alteration in ownership or control of AGL, or change in legal and beneficial ownership in any interest in any entity held by AGL, either directly or indirectly, will occur as a result of AGL’s corporate conversion or AGL’s registration;
- all taxation attributes of AGL, and where applicable, any entities in which AGL has an interest, either directly or indirectly, such as franking accounts, foreign dividend accounts, dividend rebates, tax losses and taxation liabilities will remain unchanged as a result of AGL’s corporate conversion or AGL’s registration.

7.11 This measure applies for the purposes of all Commonwealth laws relating to taxation. Commonwealth taxation laws cover a broad range of Commonwealth Acts and regulations, including those dealing with the assessment, administration, imposition and collection of taxation. Subclause 5(3) lists a number of Commonwealth taxation laws but the list is not exhaustive. ***[Subclause 5(3)]***

Specific cases

Shares and interests in shares in AGL

7.12 Neither AGL's corporate conversion nor its registration as a company under the *Corporations Act 2001* will give rise to any taxation consequences in relation to shares in AGL, or interests in shares in AGL because the legal and beneficial ownership of those shares or interests in shares are taken not to have altered. ***[Subclause 5(7)]***

7.13 For example, this means that shareholders in AGL will be considered for the purposes of taxation laws to have acquired their shares in corporatised AGL and registered AGL at the same time and for the same cost as they acquired shares in AGL. Shareholders who acquired their shares before 20 September 1985 will continue, for taxation purposes, to do so despite the corporate conversion and registration of AGL.

Anything done by or to AGL's Secretary

7.14 The Conversion Act provides for the assets, rights and liabilities of AGL before conversion to be vested in, or become assets, rights and liabilities of corporatised AGL immediately on conversion. Where this is not possible, the assets, rights and liabilities remain vested in, or rights and liabilities of AGL's Secretary and the provisions of Schedule 3 to the Conversion Act apply. For example, assets are required to be held on trust for corporatised AGL and registered AGL until such time as they can be transferred to corporatised AGL or registered AGL.

7.15 Subclause 5(8) provides that, for taxation purposes, anything done by or to AGL's Secretary in relation to assets, rights and liabilities of AGL which were not able to be dealt with under the Conversion Act are taken to have been done by or to corporatised AGL or registered AGL. ***[Subclause 5(8)]***

Application of the share capital tainting rules

7.16 The share capital tainting rules will apply to the corporate conversion and registration of AGL to allow the merger of AGL's share

premium reserve with corporatised AGL's share capital in accordance with Schedule 4 to the Conversion Act. This is an exception to the general principle that there will be no taxation consequences arising from AGL's corporate conversion or registration.

7.17 The Conversion Act provides for any amount standing to the credit of AGL's share premium reserve on the conversion day to become part of AGL's share capital. This is identical to the merger of share premiums and share capital that occurred with the abolition of the concept of par value under the *Company Law Review Act 1998* for companies registered under the *Corporations Law* at that time.

7.18 Subclause 5(9) ensures that transitional provisions to the consequential amendments made to the taxation laws as a result of the changes to company law made by the *Company Law Review Act 1998* will also apply to AGL. The transitional provisions referred to in subclause 5(9) apply to tainted share capital provisions contained in Division 7B of Part IIIAA of the ITAA 1936. ***[Subclause 5(9)]***

7.19 As a result of the introduction of the simplified imputation system with effect from 1 July 2002, Part IIIAA of the ITAA 1936 does not apply to events occurring after that date. On 27 September 2002, the Minister for Revenue and Assistant Treasurer announced that the Government would introduce as soon as practicable, further imputation amendments including amendments dealing with share capital tainting, to apply from 1 July 2002.

7.20 Subclause 5(10) operates to ensure that when the imputation amendments dealing with share capital tainting are re-enacted, that the effect of the transitional provisions referred to in subclause 5(9) apply appropriately to AGL's circumstances. ***[Subclause 5(10)]***

Meaning of terms

7.21 Subclauses 5(11) and 5(12) deal with the meaning of relevant terms in the provisions. In particular:

- 'AGL' is defined as having the same meaning as in the Conversion Act, which defines 'AGL' as meaning the company of proprietors known by the name "The Australian Gas Light Company" that was originally established by the *Australian Gas Light Company Act 1837*.
- 'Corporatised AGL' is defined as meaning AGL after it is constituted as a body corporate under the Conversion Act.

- 'Registered AGL' is defined as meaning corporatised AGL after it is registered as a public company limited by shares under Part 5B.1 of the *Corporations Act 2001* of the Commonwealth.

[Subclauses 5(11) and 5(12)]

Application and transitional provisions

7.22 The provisions apply from 11 October 2002, which is the date of AGL's corporate conversion.