

Latest income tax developments

JULY 2021



In this month's update we look at the key Australian income tax developments impacting business over the last two months.

ATO Updates

Taxation Administration Excluded Classes of Transactions and Entities for Third Party Reports on Shares and Units Determination 2021

- The ATO released this draft determination on 3 May 2021 along with its draft explanatory statement.
- The determination exempts certain classes of transactions from being reported to the Commissioner and certain entities from having to prepare and lodge reports under the third party reporting regime. It replaces (once in force) an earlier determination registered in 2018, which gave fewer exemptions.
- The determination will commence retrospectively on 1 July 2017.
- Taxpayers who will be covered by the new entity exemptions or are likely to undertake excluded transactions (such as transactions where an entity has reporting obligations under Div 392 of Sch 1 to the *Taxation Administration Act 1953*, which deals with employee share schemes) should note these reduced reporting requirements.

Practice Statement PS LA 2020/1 Commissioner's discretion to allow further time for an entity to register for an ABN or provide notice to the Commissioner of assessable income or supplies

- In response to the case of *Commissioner of Taxation v Apted* [2021] FCAFC 45, the ATO updated this Practice Statement which sets out the circumstances where the Commissioner will exercise his discretion to allow an entity further time to hold an ABN or report business income for the purposes of satisfying the cash flow boost or JobKeeper payment eligibility criteria.
- In *Apted*, the Full Court of the Federal Court held that the AAT did not err in exercising its discretion to allow Mr Apted to hold an ABN after 12 March 2020 in considering whether he was eligible for JobKeeper payments under s 11(6) of the *Coronavirus Economic Response Package (Payments and Benefits) Rules 2020*.
- The updates generally concern the relevant factors for assessing whether or not the Commissioner's exercise of his discretion is appropriate.

Draft Law Companion Ruling LCR 2021/D1 Temporary full expensing

- This draft Ruling deals with temporary full expensing (ie immediate write-off of costs) of depreciating assets as introduced by the JobMaker tax plan legislation.
- The draft Ruling covers the eligible entities for temporary full expensing, the eligible assets, the rules for full expensing, the operation of the rules for consolidated groups, the interaction of the newly introduced temporary full expensing with previously introduced instant asset write-off and backing business investment, and the operation of temporary full expensing for small business entities.
- Taxpayers who are seeking to rely on the temporary full expensing measures should consider whether their relevant entities are eligible for the measure and whether their assets may be eligible for full expensing.

Practice Statement PS LA 2001/13 Franking credits and part payment of liabilities notified on activity statements

- This practice statement concerning the effect that a part payment of activity statement liabilities has on an entity's entitlement to franking credits has been withdrawn with effect from 17 June 2021.

Taxation Ruling TR 2021/2 Fringe benefits tax: car parking benefits

- Taxation Ruling TR 2021/2 sets out the Commissioner's view on when the provision of car parking is a car parking benefit for the purposes of the *Fringe Benefits Tax Assessment Act 1986*.
- For car parking benefits provided on or after 1 April 2022, the Ruling overturns the previous view that car parking facilities with a primary purpose other than providing all-day parking were not commercial parking stations.
- In light of the decision in *Virgin Australia Airlines Pty Ltd & Anor v FC of T* [2021] FCA 523, the ruling does not address the meaning of "primary place of employment", but states that it will be amended to include further guidance on this point in due course.
- Taxpayers should consider the guidance provided in this ruling and the impact it has on their fringe benefits tax liability for car parking facilities they provide or that are nearby.

Draft Taxation Determination TD 2021/D1 Income tax: when working out your aggregated turnover, are the relevant annual turnovers of entities connected with you, or entities that are affiliates of yours, determined by reference to your income year?

- This Draft Tax Determination provisionally indicates that when working out a taxpayer's aggregated turnover under s 328-115 of the *ITAA 1997*, the taxpayer ought to calculate the annual turnovers of its connected entities and its affiliates for the relevant period that aligns with the taxpayer's income year, even if those entities operate under an accounting period inconsistent with the taxpayer's.
- Taxpayers who are relying on falling above or below aggregated turnover thresholds (eg to fall outside TOFA) should consider whether their assessment of aggregated turnover is impacted by different accounting periods for connected entities and affiliates.

Draft Taxation Ruling TR 2021/D3 Income tax: research and development tax offsets - the at risk rule

- The ATO has issued provisional guidance on the "at risk rule" for expenditure on R&D.
- The at risk rule in s 355-405 of *ITAA 1997* denies or reduces a notional deduction for the R&D tax offset if, at the time an entity incurs the expenditure, the R&D entity or one of its associates had received (or could reasonably be expected to receive) consideration as a direct or indirect result of expenditure being incurred, and regardless of the results of the activities on which the entity incurs the expenditure.
- When determining whether the "at risk rule" is satisfied, the amount of consideration comprises of the value of both monetary and non-monetary benefits. The Commissioner stated that a broad interpretation of the term "consideration" is applicable to Div 355.
- This Draft Taxation Ruling follows on from Draft Taxation Determination 2020/D1 in which the ATO expresses the view that research and development activities subsidised by JobKeeper payments do not satisfy the "at risk" rule.
- Taxpayers seeking to rely on the R&D tax offset should be conscious of this draft ruling and any subsequent developments when entering into arrangements whereby R&D expenditure is incurred and direct or indirect consideration is received as a result of the expenditure being incurred. Since "consideration" now has a broader interpretation to include both monetary and non-monetary benefits, taxpayers are more likely to be subject to the "at risk rule".

Draft Taxation Ruling 2021/D4 Income tax: royalties - character of receipts in respect of software

- The ATO has issued provisional guidance on when receipts from licensing and distribution of software are royalties. This Draft Taxation Ruling replaces Taxation Ruling TR 93/12, which has been withdrawn.
- According to draft TR 2021/D4, an amount is a royalty to the extent that it is paid or credited as consideration for the:
 1. grant of a right to do something in relation to software that is the exclusive right of the owner of the copyright in the software;
 2. supply of know how in relation to software; or
 3. supply of assistance furnished as a means of enabling the application or enjoyment of a supply of software.
- Taxpayers who license or distribute computer software should consider whether receipts from their transactions may be considered royalties once this ruling comes into force. In particular, software distributors who sub-licence software should note that payments for the right to sub-licence will be considered royalties even when the payment is for the right to grant licences for the simple use of the software.

CGT improvement threshold for 2021–22

- The capital gains tax (CGT) improvement threshold for the 2021–22 year is \$156,784 (up from \$155,849 for the previous year).

Draft Practical Compliance Guideline PCG 2021/D4 Intangibles Arrangements

- The Commissioner has released preliminary guidance on the ATO's compliance approach to international arrangements connected with the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangible assets. The preliminary guidance is open to comments until 16 July 2021.
- The guideline emphasises ATO's role in reviewing the aforementioned type of arrangements, and in particular, any arrangements which do not accurately represent the nature and extent of Australian activities connected with the DEMPE of intangible assets. The ATO considers that these arrangements may be structured to avoid tax obligations.
- The guideline also advises on compliance risks associated with the potential application of transfer pricing provisions, withholding tax provisions, capital gains tax, capital allowances, the general anti-avoidance rule and the diverted profits tax.
- The ATO has also stipulated a two part risk assessment framework in relation to these risks. The first part sets

out the criteria used to conduct the risk assessment while the second part outlines the level of documentary evidence the ATO expects when assessing arrangements against the criteria.

- Taxpayers who have entered into international agreements associated with DEMPE functions relating to intangible assets should consider undertaking a risk assessment under the PCG.

Legislative Updates

Junior Minerals Exploration

- Legislation extending the Junior Minerals Exploration Incentive (JMEI) by four more years as announced in the Budget, has been passed into law.
- The JMEI is a tax credit arrangement which allows junior mineral exploration companies to pass future tax deductions to Australian resident investors for greenfield mineral exploration in Australia. It was otherwise due to end in 2020-21.

Treasury Laws Amendment (2021 Measures No 4) Act 2021

- Various budget measures have been passed into law, including the FBT exemption for employers providing training or education to redundant or soon to be redundant employees, the extension of the Junior Minerals Exploration Incentive (see above), exempting granny flat arrangements from CGT and making the Low and Middle Income Tax Offset available in the 2021-22 year.

Tax treaty arbitration MoU with UK

- The ATO and the competent authority of the United Kingdom entered into a Memorandum of Understanding on 21 May 2021 to set out the procedural and operational details of an arbitration process for issues arising from a mutual agreement procedure case that remain unresolved for 2 years from the presentation of the case to the competent authorities.

Case Law Updates

Shell Energy Holdings Australia Limited v Commissioner of Taxation [2021] FCA 496 (12 May 2021) (Colvin J)

- In this case, the ATO had refused to grant Shell deductions claimed for the cost of acquiring additional proportional interests in 7 statutory titles from Chevron. These statutory titles gave a permission or authority to the holders to explore for petroleum.

- The Federal Court held that the cost of acquiring a further proportional interest in 6 of the 7 statutory titles held by Shell could be deducted immediately in accordance with Division 40 of the ITAA 97, albeit that this was when the statutory titles were registered in Shell's name in November 2012, not from the "effective date" of the transfer agreed between the parties in the relevant asset exchange agreement.

Mussalli v Commissioner of Taxation [2021] FCAFC 71 (14 May 2021) (McKerracher, Thawley and Stewart JJ)

- This case concerned a family trust (MFT) which entered into long term leases and licences to operate 7 McDonald's Family Restaurants in NSW.
- In respect of each restaurant, MFT paid an upfront amount (described as a "prepayment of rent") in order to obtain a reduction in the monthly rent. The amount of the prepaid rent reflected the difference between the value of the equipment used in the restaurant and the value of the business. MFT claimed deductions under s 8-1 of the ITAA 1997 for the upfront amounts paid.
- The full Federal Court dismissed the appeal from a judgment of the Federal Court and held that the upfront payments made by MFT were on capital account and non-deductible. While the payments purported to be for "prepayment of rent", the Court held that the payments were not referable to the lease and were instead made to secure a more favourable business structure.
- The taxpayers have since filed an application for special leave to appeal from the Full Court decision.

Franco v Deliveroo Australia Pty Ltd [2021] FWC 2818 (18 May 2021) (Commissioner Cambridge)

- The Fair Work Commission handed down a decision in which the relationship between Deliveroo and a Deliveroo rider was found to be an employment relationship rather than one of an independent contractor.

Virgin Australia Airlines Pty Ltd v FC of T [2021] FCA 523 (18 May 2021) (Griffiths J)

- The Federal Court ruled that aircraft and not home base airports were the primary place of employment for Virgin Australia Airlines Pty Ltd's (Virgin) flight and cabin crew. Consequently, Virgin was not liable to pay fringe benefits tax (FBT) for car parking facilities that were located near home base airports and provided to flight and cabin crew.
- The Commissioner has since filed a notice of appeal to the Full Federal Court.

McCarthy and Commissioner of Taxation (Taxation) [2021] AATA 1511 (28 May 2021) (Deputy President Boyle)

- The Tribunal considered a case involving the purchase, subdivision and sale of a property and held that the subdivision of the property amounted to carrying out a business operation or commercial transaction and that the profits from the sale of the subdivided lots were therefore assessable as ordinary income under section 6-5 of the *ITAA 1997*.
- The applicant had taken positive steps almost immediately after purchasing the Property to bring about the sale of the subdivided lots at a profit, evidence that they applicant had this potential profit as a purpose for the purchase at the time of purchase.
- The Tribunal applied the *Myer Emporium* principles – “a profit or gain so made will constitute income if the property generating the profit or gain was acquired in a business operation or commercial transaction for the purpose of profit-making by the means giving rise to the profit”.

Peter Greensill Family Co Pty Ltd (Trustee) v Commissioner of Taxation [2021] FCAFC 99 (Davies, Moshinsky and Colvin JJ)

- This case concerned two discretionary trusts with Australian resident trustees. Both trustees sold shares that were not “taxable Australian property” and then distributed the capital gain from those transactions to foreign resident beneficiaries of the trusts.
- The Commissioner assessed the trustee companies under s 98 of the *ITAA 1936* on the basis that that s 855-10(1) of the *ITAA 1997* did not operate to disregard the capital gain in calculating the amount to which a trustee is liable under s 98 in relation to the trust estate in respect of the beneficiary under s 115-220.
- The Commissioner also claimed that s 855-10(1) of the 1997 Act did not apply to disregard the capital gain in calculating the amount treated as Mr the capital gain of a foreign beneficiary under s 115-215.
- The Full Court held that the Federal Court had been correct to hold that s 855-10(1) had no application to the facts of either case because both trusts were resident trusts and because the capital gain attributed to the foreign beneficiaries was not a “capital gain ... from a CGT event” within the meaning of s 855-10.
- The trustees were assessable on capital gains from the non-taxable Australian property distributed to the foreign beneficiaries.
- An application for special leave to appeal to the High Court has since been lodged by the tax payers.

Appeal news – Glencore case

- The High Court refused the Commissioner’s applications for special leave to appeal against the decision of the Full Federal Court in *FC of T v Glencore Investment Pty Ltd* [2020] FCAFC 187.
- The Full Federal Court had dismissed the Commissioner’s appeal.

Appeal news – Addy case

- The High Court heard the taxpayer’s appeal from *Commissioner of Taxation v Addy* [2020] FCAFC 135 on 24 June and reserved its decision.
- The taxpayer (Ms Addy) was a UK national, resident in Australia for tax purposes, on a working holiday visa. Her foreign nationality and visa status made her a “working holiday maker” for Australian tax purposes. The key issue before the High Court was whether a non-discrimination clause in the Australia-UK double tax agreement applied so that she should not be subject to the more burdensome tax liability that she was assessed at as a working holiday maker, than if she had been a resident Australian national
- At first instance, the Federal Court ruled in favour of the taxpayer, but on appeal a majority of the Full Federal Court ruled in favour of the ATO - the “backpacker tax” applied.

Hot Topics

G7 finance ministers agree on global tax reform

- G7 finance ministers have identified and agreed upon two pillars as part of their global tax reform.
- Pillar One of the G7 agreement stipulates that large, profitable multinationals will be required to pay tax in all countries where they operate as opposed to merely countries in which their head offices are located. Firms with a profit margin of at least 10% will be captured by these rules. 20% of any profits above this 10% margin may be subject to tax in countries which the firm operates within.
- Pillar Two stipulates the principle of at least 15% global minimum corporation tax being applied to all member countries.
- 130 countries and jurisdictions including Australia have joined this tax reform plan.

Patent Box Discussion Paper

- Under the proposed “patent box” scheme, eligible income from patented Australian inventions in the medical and biotechnology sectors may be taxed at 17%.
- The Treasury has released a discussion paper seeking submissions from stakeholders on the design and implementation of the new scheme and importantly seeking comments from stakeholders in the clean energy sector on whether the scheme should be opened up to the clean energy sector too.
- Comments on the discussion paper are due by 16 August 2021.

Watching Brief

- Taxation Ruling 2017/D1, relating to composite items and identifying depreciating assets for capital allowance purposes, is expected to be finalised in August 2021.
- The *Privatisation and Infrastructure – Australian Federal Tax Framework*, which sets out the ATO’s views on a range of taxation issues including with respect to Division 6C, cross-staple arrangements, financing, and other issues that are relevant to infrastructure assets, is expected to be finalised in Mid 2021.
- Taxation Ruling 2019/D6, relating to whether certain labour and other costs associated with building and construction of capital assets are capital in nature, is expected to be finalised in July 2021.
- Draft Taxation Determination on when an employee is considered to be genuinely restricted from disposing of their beneficial interest in a right or share acquired under an employee share scheme is expected to be released in October 2021.

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