LOCAL GOVERNMENT TAX EQUIVALENTS MANUAL

Queensland Treasury

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PART I

INTRODUCTION

The National Competition Policy ("NCP") is a set of policy reforms being adopted by governments throughout Australia. The objective is to encourage a better use of the country's resources - and hence provide a higher standard of living - through increasing competition.

At the 1992 Head of Government Conference the Commonwealth, State and Territory Governments agreed to the appointment of an independent inquiry into competition in the Australian economy. A Committee of Inquiry chaired by Professor Fred Hilmer was appointed in October 1992. Its purpose was to develop proposals for a national policy which would promote and maintain competitive forces to increase efficiency and community welfare, while accommodating other social goals.

The committee subsequently issued their report in August 1993.

In February 1994, the recommendations of the Hilmer Report were accepted in principle by the Council of Australian Governments ("COAG").

A package of legislative and administrative arrangements reflecting many of the Hilmer committee recommendations was endorsed by COAG in April 1995 in the form of the NCP. The policy appropriately gives the States and Territories considerably more latitude with regard to implementation of the competition reforms than was originally envisaged in the Hilmer Report.

At the 1995 COAG meeting, the Queensland Government became a signatory to three Agreements which comprise the NCP:

- the Conduct Code Agreement;
- the Competition Principles Agreement ("CPA"); and
- the Agreement to Implement NCP and Related Reforms.

Under the Conduct Code Agreement, COAG agreed to extend the competitive conduct provisions of Part IV of the *Trade Practices Act* ("TPA") to those activities previously not caught, i.e. Government business activities and the unincorporated sector (including the professions) which have to date only been subject to limited application of Part IV.

While the Conduct Code Agreement essentially deals with restrictions on competition arising from anti-competitive conduct, the CPA establishes principles to address other forms of restriction on competition. This agreement commits the parties to a number of competition reforms impacting on all sectors of the economy. A specific policy element included in the competition reforms is competitive neutrality. The purpose of competitive neutrality reform is to remove benefits which accrue to government business activities as a result of their public ownership, such as the exemption from taxation.

All governments have agreed that NCP reform is best undertaken on a national basis.

A desired outcome of NCP is that certain business undertakings of Queensland's largest Local Governments be assessed for possible corporatisation or commercialisation or ensuring that the prices charged for services reflect the true cost of provision. Under any of these options, there is a requirement for prices to include a component to cover the advantages which, by virtue of their government ownership, Local Governments have traditionally enjoyed through exemption from taxation and other imposts.

South East Queensland Water Reforms

In May 2007, the Queensland Water Commission delivered a report to the Queensland Government recommending major structural and regulatory reform of urban water supply arrangements in South East Queensland (SEQ). The report identified a number of opportunities to improve economic and service delivery outcomes, and to deliver significant benefits to the community including:

- improved regional coordination and management of water;
- more efficient delivery of water services in South East Queensland;
- enhanced customer service for consumers across the region; and
- a clearer accountability framework for water supply security.

Among the general policy objectives underpinning the review was a commitment to achieve consistency, as far as practicable, with the direction and spirit of the national water reform agenda under the National Water Initiative. The NWI framework accords with NCP commitments of the States and Territories.

The central elements of the reforms recommended in the Water Commission's final report were endorsed by the Government in September 2007. Stage One of the reform program focussed on the bulk water industry, and was given effect on 1 July 2008 through the *South East Queensland Water (Restructuring) Act 2007*.

Stage Two – which became operational on 1 July 2010 – focuses on downstream water reform. The core of the Stage Two Reform Program is the separation of the retail and distribution functions from SEQ local governments and the establishment of three vertically-integrated distribution-retail authorities (Distributor-Retailers). The beneficial interests in the authorities are held by Participating Local Governments, as prescribed at section 5 of the Restructuring Act:

- Northern SEQ Distributor-Retailer Authority (trading as Unitywater) – Sunshine Coast Regional Council and Moreton Bay Regional Council;
- Central SEQ Distributor-Retailer Authority (trading as Queensland Urban Utilities) – Brisbane City Council, Ipswich City Council, Scenic Rim Regional Council, Lockyer Valley Regional Council and Somerset Regional Council; and
- Southern SEQ Distributor-Retailer Authority (trading as Allconnex Water) – Gold Coast City Council, Redland City Council and Logan City Council.

The relationships between commercially-focussed, expertise-based boards of the Authorities and Participating Local Governments are governed by Participation Agreements approved under the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009* (Restructuring Act). Among other things, the Participation Agreements must provide the proportions in which Local Governments are to receive tax equivalents paid by the Distributor-Retailers under section 100 of the Restructuring Act.

This Manual sets out the basis for calculating and administering tax equivalents for Local Government and the Distributor-Retailers. The Manual has application to an entity classified as a "Subject Entity". Broadly speaking, the object of the tax equivalents regime is to:

- ensure that a Subject entity operates in an environment which promotes competitive neutrality with other Subject Entities, the private sector, and similar entities operating in other jurisdictions;
- take a pragmatic approach wherever possible in order to minimise compliance costs;
- enable a Subject Entity to operate in an environment where there is as much certainty as possible; and
- ensure that there is no financial transfer from Local to State Government by way of tax equivalent payments. That is, tax equivalent payments will be paid by the Subject Entity to its Local Government or Participating Local Government, in the case of the Distributor-Retailers.

It is acknowledged that the Tax Equivalents Regime to be adopted by Local Governments and Distributor-Retailers must be sufficiently flexible to respond to the unique environment that a Subject Entity will operate in. In particular, the taxation implications of contributed assets is recognised as a significant issue. It is the intention that the Tax Equivalent Regime will not operate in a manner that will adversely affect the ability of Subject Entities to receive these types of assets in the future.

Implicit in the operation of NCP is that the Tax Equivalents Regime must have a solid integrity, particularly in comparison to the tax regime that private sector competitors are required to operate under. Accordingly, in relation to Commonwealth income equivalents, it is necessary to appoint one body, the Tax Assessor, to have the carriage of this component of the Local Government's Tax Equivalents Regime. While Local Governments would be involved in all decisions and processes of the Tax Assessor that affect them, the appointment of an independent third party to supervise and maintain the Tax Equivalents Regime is vital to ensure transparent compliance with NCP, ease of administration and a uniform approach. Subject Entities will be required to submit returns etc to the Office of State Revenue.

PART II

GLOSSARY OF COMMON TERMS

In this Manual, unless the contrary intention appears --

"Accounting Profit Model" means the model prescribed by Division A of Part IV of this Manual for the imposition, assessment and collection of income tax equivalents from a Subject Entity.

"Arbitrator" means the Arbitrator appointed by the Treasurer pursuant to this Manual.

"ATO" means the Australian Taxation Office.

“Commonwealth Tax Laws” means the list of Commonwealth tax legislation listed in the Preamble to Division 1 and Division 2 of Part IV of this Manual

"Income Tax Equivalents Regime" means the regime set out in this Manual for determining the amounts of income tax equivalents to be paid by a Subject Entity as the value of benefits derived by the Subject Entity because it is not liable to pay Commonwealth income tax.

The Income Tax Equivalents Regime which applies to a particular Subject Entity comprises Part IV of this Manual, together with any Private Rulings issued by the Tax Assessor, or Review decisions issued by the Arbitrator to the particular Subject Entity.

"ITAA" means the *income tax legislation*.

"ITAA 1936" means the *Income Tax Assessment Act 1936 (Cth)*, as amended from time to time.

"ITAA 1997" means the *Income Tax Assessment Act 1997 (Cth)*, as amended from time to time.

Local Government Tax Equivalents Regime - means the tax equivalents regime which applies to a Subject Entity pursuant to this Manual and comprises the Income Tax Equivalents Regime and State Tax Equivalents Regime.

OSR means the Office of State Revenue.

“Participating Local Governments” means the participating local governments for each Distributor-Retailer as defined at section 5 of the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009*, insofar as they hold participation rights in the Distributor-Retailers pursuant to section 20 of that Act.

"Public officer" means the public officer appointed for the Subject Entity in accordance with this Manual.

State Tax Acts means the *Duties Act 2001*, *Land Tax Act 2010*, *Payroll Tax Act 197*1 and *Taxation Administration Act 2001*.

State Tax Equivalents Regime means the regime set out in this Manual for determining the amounts of State tax equivalents to be paid by a Subject Entity as the value of benefits derived by the Subject Entity because it is not liable to bear State duty, payroll tax and land tax.

The State Tax Equivalents Regime which applies to a particular Subject Entity comprises Part VI of this Manual, together with any rulings issued by the relevant State Tax Commissioner, advice on assessments issued by the relevant State tax Commissioner, or decisions on objections notified by the relevant State tax Commissioner to the particular Subject Entity.

State Tax Commissioner means the Commissioner of State Revenue and Land Tax.

"Subject Entity" means an entity to which this Manual applies and includes a corporatised or commercialised entity, irrespective of whether the entity is a member of a group of entities or a stand alone entity, which has received a Notice from the Treasurer advising that the entity is to be subject of the Local Government Tax Equivalent Regime.

"Substantive ITAA Model" means the model prescribed by Division B of Part IV of this Manual for the imposition, assessment and collection of income tax equivalents.

"TAA" – means the Taxation Administration Act 1953 (*C'wealth*) as amended from time to time

"TAA – Q" - means the Taxation Administration Act 2001 (*Queensland*) as amended from time to time

Tax Assessor - means the Tax Assessor appointed by the Treasurer for the purpose of the administration of the income tax equivalent section of this manual.

"The Manual" means this Local Government Tax Equivalents Manual (as amended from time to time).

PART III

OVERVIEW OF THE LOCAL GOVERNMENT TAX EQUIVALENTS REGIME

This Manual, which is issued under the *Local Government Act 2009* (LG Act) and the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2010* (Restructuring Act), sets out the bases for calculating and administering tax equivalents for local governments in Queensland and for SEQ water distributor-retailer authorities.

Application to Local Governments

Part 2, Division 2 within Chapter 3 of the LG Act relates to the application of competitive neutrality principles to local government businesses. Under section 44 of the Act, 'commercialisation' includes, among other things, pricing a significant business activity on a commercial basis. Pursuant to section 44(5), a regulation may provide for:

a) matters relating to corporatisation, commercialisation or full cost pricing; or
b) any other matter relating to the application of the competitive neutrality principles to the significant business activities of a local government.

The provisions of section 23 of the *Local Government (Beneficial Enterprises and Business Activities) Regulation 2010* take account of government taxes that apply to a commercialised business unit or corporate entity that is applying full cost pricing to a significant business.

Subsection (1) requires a local government commercial business unit or corporate entity that is applying full cost pricing to a significant business to account for tax equivalents as required under the tax equivalents manual.

Subsection (2) authorises the Treasurer to issue a manual (the 'Tax Equivalents Manual') about the tax equivalents that must be taken into account in applying full cost pricing as the value of benefits derived if there is no liability to pay a government tax that would be payable if the activity were not carried on by the local government.

Under subsection (5), the Tax Equivalents Manual may provide for:

- rulings by a tax assessor (appointed by the Treasurer) on issues about tax equivalents;
- lodging of returns;
- assessing returns;
- appointment of the tax assessors; and
- objections and appeals against assessments and rulings.

Application to Distributor-Retailers

A fundamental element of the institutional model given effect through the Restructuring Act is the establishment of commercially-focussed entities accountable to Council owners, ratepayers and customers.

In line with the reform policy objectives, the Distributor-Retailers will be subject to competitive neutrality principles, including arrangements to remove the tax benefits enjoyed by virtue of their corporate status.

Chapter 5 of the Restructuring Act authorises the Treasurer to issue a Manual that fixes Commonwealth and State tax equivalents to be paid by distributor-retailers to their participating local governments, and to appoint a person to be the tax assessor under the Manual.

Section 100(2) of the Act enumerates those matters that may be provided for in a Manual issued by the Treasurer under the Act, and mirrors the provisions described above at section 23(5) of the *Local Government (Beneficial Enterprises and Business Activities) Regulation 2010.*

As required under the Manual, Distributor-Retailers must pay Participating Local Governments in proportions provided under the participation agreements prepared pursuant to section 20 of the Restructuring Act.

In recognition of the institutional relationship between local governments and the Distributor-Retailers, and to facilitate greater administrative ease in transitioning to the new structural model, section 100(5) of the Restructuring Act provides that the Tax Equivalents Manual for Distributor-Retailers may be made together with, or form part of, a tax equivalents manual issued by the Treasurer for Local Governments.

In line with the approach contemplated in the Restructuring Act, the Manual will continue to be referred to as the Local Government Tax Equivalents Manual.

(A) TAX EQUIVALENT MODELS

The most appropriate tax equivalent model for a particular Subject Entity embraces all or some of the following attributes:

- competitors and potential competitors are reassured that the Subject Entity is not gaining an undue advantage;
- the Subject Entity has no greater degree of uncertainty regarding its operation than its competitors have;
- the minimisation of compliance costs;
- the acceptability to the Commonwealth in terms of its willingness to continue existing tax exemptions and in terms of the NCP; and
- where necessary, the acceptability that the model meets uniformity and effectiveness criteria.

(1) Income Tax Equivalents Regime

The application of the full ITAA model to Subject Entities is not regarded as being feasible for the following reasons:

- the lack of appropriate transitional rules in the Commonwealth Tax Laws to provide for a managed transition from exempt to tax paying status;
- the failure of the Commonwealth Tax Laws to deal with certain aspects of a Subject Entity's operations which are unique to Local Governments;
- the lack of access to the same appeal mechanism as exists under the Commonwealth Tax Laws; and
- the non-viability of a parallel administrative structure.

Notwithstanding these problems, Subject Entities will be subjected to a tax equivalents regime which mirrors the Commonwealth Tax Laws as far as practicable - the "substantive ITAA" model.

However, special circumstances applying to certain Subject Entities may warrant a more flexible approach by applying the tax rate to an entity's accounting profit - the "accounting profit" model.

(a) Substantive ITAA Model

The substantive ITAA model involves a Commonwealth Tax Laws based model but with departures from the strict terms of the Commonwealth Tax Laws in order to facilitate practical solutions where considered necessary. The extent of modification from the full ITAA model is dictated by the need to avoid disadvantaging Subject Entities as a result of past arrangements in a tax-exempt environment or to clarify the approach to be adopted in situations not covered by the Federal tax regime.

The move away from the Commonwealth Tax Laws basis in respect of the administrative aspects is necessary because of the on-going relationship between the Subject Entity and its predecessor Local Government and the different relationship which exists between the Tax Assessor and the Subject Entities. This difference in relationship means that it is not strictly necessary to follow all the Commonwealth Tax Laws concepts in order to maintain the integrity of the system. However, the solutions proffered should mirror Commonwealth Tax Laws concepts as closely as possible in order to comply with the requirements of Competitive Neutrality.

In relation to the technical aspects, in order for the regime to have integrity, the solutions should also, as far as possible, mirror Commonwealth Tax Laws concepts and provide a result which is generally consistent with the ambit of these concepts.

Accordingly, under the substantive ITAA model, it is the stated intention of the regime that:

- where the Commonwealth Tax Laws law is clear, the Tax Assessor is to follow that law unless this Manual has prescribed that the law is not considered appropriate for the Local Government Tax Equivalents Regime. This Manual will therefore be updated from time to time in order that the Subject Entities have certainty regarding the areas where the Commonwealth Tax Laws does not apply;
- where the ITAA law is unclear but the ATO has adopted a clear interpretation, the Tax Assessor will follow the ATO's interpretation unless this Manual has prescribed that interpretation is not considered appropriate for the Local Government Tax Equivalents Regime. Again, this Manual will be updated from time to time to make it clear where there is a departure from the ATO's interpretation; and

- where there is no clear interpretation, the Tax Assessor will determine a reasonable interpretation having regard to the manner in which the matter has been treated within the private sector and the likely interpretation of that law in the future.

Application of the Substantive ITAA model

The substantive ITAA model is to apply to a Subject Entity which receives a Notice from the Treasurer advising that the entity is to be subject to the substantive ITAA Model of the Local Government Tax Equivalents Regime.

Broadly speaking, the substantive ITAA model is regarded as the appropriate method for these entities on the basis that:

- it attempts to mirror the provisions of the full Commonwealth Tax Laws, whilst providing appropriate administrative and technical solutions for those aspects of the full ITAA model which cannot be adopted as part of a tax equivalent regime;
- it provides a smooth transition path if the Subject Entity becomes subject to the full ITAA at a later date. That is, the adoption of the substantive ITAA model will require a Subject Entity to adopt systems and approaches similar to those which would apply if they become subjected to the full Commonwealth Tax Laws;
- it facilitates modifications to suit the requirement of specific Subject Entities where those modifications are desirable;
- it permits certain concessions allowed or specific treatment of income or expenses adopted under the Commonwealth Tax Laws to be excluded or amended for "policy reasons" and, in particular, to overcome the situation where additional profit is gained by the Subject Entity at the expense of a disproportionate loss of tax equivalents. Any departures from the Commonwealth Tax Laws will generally only be made on a prospective basis (usually by way of public ruling); and
- each Local Government is primarily responsible for imposing a tax equivalents regime upon their relevant Subject Entities.

(b) Accounting Profits Model

The accounting profit model involves applying a rate of tax to the audited accounting profit (after abnormal but before extraordinary items) of the Subject Entity. That is, there is no adjustment to the accounting treatment of a Subject Entity’s assets, liabilities, income or expenses. Accordingly, the various alternative treatments set out in this Manual (such as for contributed assets which are excluded from income and depreciation calculations in the circumstances set out in LITER 97/20) will not be available to the Subject Entity.

Application of Accounting Profits model

The accounting profits model will apply to a Subject Entity which receives a Notice from the Treasurer advising that the entity is to be subject to the accounting profits model of the Local Government Tax Equivalents Regime.

The accounting profit model will only be considered for adoption in circumstances where:

- it is expected that there would only be nominal variations between the Subject Entity's accounting profit and its taxable income if the substantive ITAA model were to apply;
- the cost of compliance with the substantive ITAA model cannot be justified when considering the amount of tax equivalents to be paid by the Subject Entity;
- the Subject Entity is not presently (and unlikely in the future) to be subject to private sector competition; and

- similar entities in other States are unlikely to pay tax equivalents under a substantive ITAA model.

Government Imposed Restructures & Transfers

A renegotiation of arrangements or a restructure by a LGTER entity may be the result of requirements externally imposed on the LGTER entity by the State government. A transfer of assets (including an entity) owned by an LGTER entity may be externally imposed on the LGTER entity by the State government, as evidenced by a parliamentary process or public announcement by that government, in circumstances where all of the resultant sale proceeds, net of any agreed sale related costs, are compulsorily repatriated to the State government or the relevant Council.

Such an imposed renegotiation, restructure or transfer will be treated in a tax neutral manner for LGTER purposes. (For example, on an imposed transfer of CGT assets, there will be no CGT consequences for the transferor and the transferee will inherit the CGT cost bases of the transferor.)

Alternatively, such an imposed renegotiation, restructure or transfer may be treated in a manner which the LGTER administrator approves as appropriate in the circumstances, including taking into account:

(i) whether the proposed tax treatment gives an LGTER entity involved an unfair advantage over its competitors; and
(ii) the arrangements and structures that have previously existed in relation to the business operations of the LGTER entities involved.

(For example, on an imposed remerging of two LGTER entities to form a new LGTER entity, the LGTER administrator may approve a tax treatment which allows the new LGTER entity to utilise any carry forward losses of the two former LGTER entities.)

(2) State Tax Equivalents Regime

Application

The State Tax Equivalents Regime applies to a Subject Entity which receives a Notice from the Treasurer advising that the entity is to pay State tax equivalents at the rates specified in, or by, the relevant State Acts and Regulations.

Any entities which are subject to State taxes (i.e. duty, payroll tax and land tax) will remain so. Any activities and transactions of the Subject Entity, or goods and services purchased or sold by the Subject Entity, which are subject to State taxes (i.e. duty, payroll tax and land tax) will remain so.

Exemptions under Local Government Act 2009

The *Local Government Act 2009* provides a process for making a local government change, which is a change of the boundaries of a local government area, or any divisions of a local government area other than the city of Brisbane, or the number of councillors for a local government, or the name of a local government area, or the classification of a local government area (from a town to a city, for example).

Under section 20 of the *Local Government Act 2009*, a local government is not liable to pay a State tax in relation to a transfer or other arrangement made to implement a local government change.

This exemption would cover the State taxes (e.g. tax, charge, fee or levy), other than a duty, otherwise payable because of the amalgamation of business entities, transfer of assets etc, arising from amalgamations, boundary changes etc. Because such changes would not be in the nature of normal business transactions, the Subject entity will not be liable for the relevant State tax equivalent under this Local Government Tax Equivalent Regime.

For local government corporate entities under section 58B of the *Local Government Act 2009*:

(i) State taxes are not payable for anything done to corporatise a significant business activity of a local government (including in relation to a legal instrument made, executed, lodged or given, for example).

(ii) A corporate entity is not liable to pay an amount of State taxes for a thing that is more than the amount of State taxes for the thing that a local government would have been liable to pay.

State tax equivalents will be payable in relation to (ii) above, but will not be payable in relation to (i).

However, to remove any doubt in relation to (i), once a Subject Entity has entered the Local Government Tax Equivalent Regime, State tax equivalents will be payable where changes to its operations entail the acquisition of new assets or operations as part of normal business practice, or assets or operations are transferred to other entities (e.g. through the establishment of subsidiaries). It may be that in some instances, chapter 10, part1 corporate reconstruction exemption provisions in the *Duties Act 2001* (Duties Act) will apply - in each case, Subject Entities should prepare a full proposal and seek a prior ruling from the Commissioner of State Revenue.

Exemptions under the South-East Queensland (Distribution and Retail Restructuring) Act 2009

Under section 71 of the Restructuring Act, Distributor-Retailers are not liable to pay a tax under the *Duties Act 2001* or another Queensland Act, or a charge or fee under the *Land Act 1994*, *Land Title Act 1994* or another Queensland Act for anything done under a "transition document". A transition document is a transfer scheme, transfer notice or transfer direction issued under the Restructuring Act.

The exemption applies only to transactions relating to transfers under the Restructuring Act, and will not apply to the Distributor-Retailers for future transactions.

(a) Duty

Other than the exemptions in relation to local government changes and local government corporate entities outlined earlier, local governments are required to pay duty under the *Duties Act 2001* on all documents, statements or transactions to which the Act applies, with two exceptions, namely:

(i) under section 390(1)(g) (chapter 9 part 4- Exemptions for Vehicle Registration Duty, duty is not payable by a local government on an application for registration or transfer of a motor vehicle to it; and

(ii) Under section 508(3) (Chapter 16- Miscellaneous Provisions) a regulation may exempt an instrument or transaction for a financial arrangement entered into by a local government as a statutory body under the *Statutory Bodies Financial Arrangements Act 1982* as provided in that Act or another Act.

The transfer of land from the Crown or local government to another entity is dutiable. If the land is transferred by Deed of Grant, ss. 8, 9 & 10 of the *Duties Act 2001* will apply; if it is a transfer of

freehold land, s. 8, 9 & 10 will apply. Therefore, in the absence of the exemptions under section 58B of the *Local Government Act 2009*, the transfer of land to a LGOC may be liable for duty.

Section 426 of the *Duties Act 2001* provides an exemption for the State. As the Distributor-Retailers do not represent the State, they will be liable to pay duty under that Act, except in relation to transfers made pursuant to a transition document under section 71 of the Restructuring Act.

Subject Entities will need to examine any land use arrangements which are made possible by their public ownership, but which would not be available to a comparable private sector entity, to determine if duty equivalents are payable on transfer.

Under this tax equivalent regime, for each financial year, Subject Entities will be required to compile a list of all transactions (which, except for the exemptions, would attract duty), including the type of transaction, the amounts for duty purposes, and the Subject Entity's self-assessment of its duty liability. This would form the duty component of the Subject Entity's State Tax Equivalent annual return, to be lodged with OSR by 31 October of the following financial year with any payments to be made to the Local Government before 1 December of that same year.

(b) Payroll Tax

Under the *Payroll Tax Act 1971,* payroll tax is levied by the State Government on the annual taxable payroll of liable employers, including wages, non-cash wages and fringe benefits. Local governments are exempt from paying payroll tax, except where wages relate to:

- electricity generation, distribution or supply; water supply and sewerage; the conduct of transport services (including ferries); abattoirs and public markets; parking stations; quarries; cemeteries; picture theatres; milk supply and bakeries; hotels and hostels; any other prescribed activity; and
- the construction of buildings or works, the installation of plant, machinery or equipment for use or in connection with any of the above.

Most Subject Entities, being significant business activities which are among those not exempt from payroll tax (e.g. water supply and sewerage, transport services), should already be paying payroll tax through the local government on most, if not all, of their payrolls. The only significant business activities where payroll tax is not currently being paid, and where the payment of payroll tax equivalents will be required, are waste management services. However, for nearly all Subject Entities whose main business is providing waste management services, the bulk of the operations are contracted out, thereby making the contractors liable for the payroll tax.

In certain circumstances (e.g. where the same person has or the same persons have a controlling interest in more than one business) businesses may be grouped for the purpose of determining taxable wages.

Distributor-Retailers do not fall within the list of exemptions provided under section 14 of the *Payroll Tax Act 1971*, and will therefore be liable to pay payroll tax.

For each financial year, Subject Entities will be required to submit, by 31 October of the following financial year, a return which uses an approved form to identify the Subject Entity's taxable wages for that financial year and its self-assessment of associated payroll tax equivalent liability. This would form the payroll tax component of the Subject Entity's State Tax Equivalent annual return lodged with OSR. Payments for each financial year will be made to the Local Government before 1 December following the due date of the relevant annual return.

(c) Land Tax

Under the *Land Tax Act 2010,* the State Government may levy land tax on all freehold land in Queensland. An individual person or other entity's land tax liability is based on the aggregate unimproved value of all their interests in freehold land. A taxpayer may be liable for land tax if the aggregate value of landholdings exceeds a set threshold specified in Section 16 of the Act *(currently $600,000 for natural persons or $350,000 for an absentee, company or trustee for the 2007-2008 financial year).* Rural land used all or in part for the business of agriculture, pasturage or dairy farming generally attracts deductions from land tax.

For each financial year, land tax is payable on land owned by the taxpayer as at midnight on 30 June immediately preceding the financial year in and for which the tax is levied. Under the Act, in each financial year, every owner of land with an unimproved value which exceeds the thresholds must furnish a return, in the prescribed manner and within the time prescribed, which sets forth: a full and complete statement of all lands owned as at the preceding 30 June; and the unimproved value of every parcel.

In practice, submission of a return is often not required because the Commissioner automatically issues assessments of the amount of land tax payable. Such assessments are generally issued around August of the financial year, and include the amount payable and date the tax is due and payable. However, because of the exemption outlined below and the fact that land is often held in tenures other than freehold, such a process cannot be used for the land tax component of the Local Government Tax Equivalent Regime.

Section 52 of the Act provides that local governments and public authorities are exempt from land tax on freehold land owned by them unless the local government or authority is subject to State taxation under an Act of the Commonwealth or State. Consequently, a local government or Distributor-Retailer will only be subject to pay land tax if other State legislation expressly provides that the entity is subject to State taxation.

Where parcels of land which are controlled or used by a Subject Entity are held in freehold title, the Subject Entity will be liable to pay land tax equivalents in relation to such parcels. In addition, where parcels of land which are controlled or used by the Subject Entity are not held in freehold title, but would normally be so held if used for similar purposes by a comparable private owner, those parcels are deemed to be freehold for the purposes of determining the land tax equivalents payable (for the purposes of the Local Government Tax Equivalents Regime, a reasonable estimate of the unimproved value of such non-freehold land is sufficient).

For the purposes of the Local Government Tax Equivalent Regime in relation to land tax, Subject Entities will be required to lodge, by 31 October following the end of each financial year, a return which identifies:

(i) the Subject Entity's assessable landholdings as at 30 June of the preceding financial year (ie. for the 2010-11 financial year, the return to be lodged on 31 October 2010 will be based on assessable landholdings at 30 June 2010 ;

(ii) the unimproved value of each land parcel (or an estimate in the case of land not held as freehold, but deemed to be so held for tax equivalent purposes); and

(iii) the Subject Entity's self-assessment of its land tax equivalent liability for the financial year.

(B) ROLE OF THE TAX ASSESSOR

(1) General

As with the ATO in the Federal regime, a single external Tax Assessor is appointed by the Treasurer, who will be charged with the authority of administering the Local Government Tax Equivalents Regime for income tax purposes.

Similarly to the ATO, it is not the function of the Tax Assessor to "make" the law. For the purposes of the Local Government Tax Equivalents Regime, this power rests with the Treasurer and is carried out through this Manual.

The role of the Tax Assessor is merely to provide a review mechanism in order to ensure that the Subject Entities correctly self-assess the amount of the tax equivalents payable each year and to assist them in clarifying any "grey" areas of the Commonwealth Tax Laws which apply. This latter part is achieved by the issue of rulings, prepared at the request of an affected Subject Entity.

It is not the intention of the regime that the Tax Assessor should conduct audit activities or interpret the law in a manner that seeks to maximise the amounts of tax equivalents payable by the Subject Entities each year. Rather, the appointment of a single Tax Assessor will ensure consistency, efficiency and integrity.

Secrecy provisions, similar to those contained in section 16 of the ITAA 1936, will be included in the Tax Assessor's contract to protect the confidentiality of information received by the Tax Assessor.

(2) Public Rulings and Private Rulings under the Tax Equivalents Regime

As part of the administering function, the ATO issues public rulings as a method of disseminating decisions on its interpretation of the laws which it administers. Furthermore, a private ruling system is administered by the ATO.

For the purposes of the Local Government Tax Equivalents Regime, a public ruling system will apply as a means of "making" the law or clarifying the position of the Commonwealth Tax Laws where that law has some broad application to most Subject Entities.

Given the fact that the public ruling is in the nature of "making" the law, the Treasurer is the appropriate party to issue (through this Manual) Local Government Income Tax Equivalents Rulings (LITERs).

(a) Status of ATO Public Rulings in the Local Government Tax Equivalents Regime

Under the Commonwealth Tax Laws, public rulings apply equally to all taxpayers in relation to the transaction, or class of transactions, that are the subject of the public ruling. These public rulings are issued by the ATO and are binding on the Commissioner of Taxation, even if incorrect at law. The Commissioner is prohibited from subsequently acting in a manner contrary to the public ruling on issues covered by the ruling, until amendment or withdrawal of the ruling, or by amendment to the relevant legislation. Any amendments to ATO public rulings may only apply prospectively.

Public binding rulings may only be issued by the ATO in relation to laws affecting the calculation of a taxpayer's tax liability. Accordingly, rulings on administrative or procedural aspects of the law

are not binding on the Commissioner of Taxation, as they will not satisfy the requirements of public rulings system.

There is presently no direct review procedure for public rulings issued by the ATO. If the Commissioner of Taxation applies a ruling in assessing the taxpayer, the taxpayer would be required to use the objection and appeal procedures to bring the ruling into dispute.

ATO public rulings are applicable to the Local Government Tax Equivalents Regime, unless overridden by:

- the Income Tax Equivalents Regime contained in Part IV of this Manual;
- a *Local Government Income Tax Equivalents Ruling* (LITER) contained in Part IV of this Manual; or
- a "private ruling" obtained by a Subject Entity from the Tax Assessor.

The Tax Assessor is bound by ATO public rulings unless the ATO public rulings have been overridden by the Local Government Tax Equivalents Regime. This is most likely to occur with issues arising in the transitional phase.

The Treasurer may, subsequent to the initial issue of this Manual, amend the Manual for a number of reasons including the issue of additional rulings (i.e. LITERs) to cover issues as and when they arise.

Where the Tax Assessor and/or a Subject Entity believe that a particular issue warrants the issue of a LITER public ruling by the Treasurer, a request should be made to the Treasurer to address the issue. Such a request shall be considered and, where appropriate, a public ruling will be issued. Generally, the types of issues which should be considered for a LITER public ruling should by their nature have the potential to have a broad application to most Subject Entities or a particular class of Subject Entities.

(b) Private Rulings

Under the Commonwealth Tax Laws private rulings obtained by a taxpayer are:

- applicable only to the taxpayer making the application in relation to the transaction, or class of transactions, that are the subject of the application;
- binding on the ATO if favourable to the taxpayer;
- reviewable (i.e. the taxpayer can object against an unfavourable ruling in the same way as he or she can object against an assessment); and
- taken into account when assessing applicable penalties (ie. ignoring a private ruling will prima facie increase the penalties imposed in relation to an assessment of tax).

Under the Local Government Tax Equivalents Regime, a Subject Entity will be able to obtain private rulings from the Tax Assessor. These Rulings are to have the same status as "private rulings" accorded under the *Taxation Administration Act (1953).* These private rulings are also reviewable under the Objection and Review procedures.

A Subject Entity may request the Tax Assessor to provide a private ruling on interpretational aspects of the law. The request for private ruling is to be made in writing and follow the same format as that which currently applies under the Commonwealth Tax Laws (that is, the request would outline the statement of issues to be considered and the Subject Entity's own opinion on the matter including reasons therefor).

Requests for private rulings can be made either prior to or in conjunction with the lodgement of the Subject Entity's income tax return.

Provided full details of the relevant facts and documents are submitted by the Subject Entity in conjunction with the Ruling request, and the Tax Assessor is satisfied that the issue should not be dealt with in a public ruling, the Tax Assessor will be required to provide a written response within 60 days of the date of receipt of the request for the Private Ruling subject to a reasonable request for further information from the Tax Assessor (except where the consent of the Subject Entity is obtained for a longer period).

Provided full details of the relevant facts are submitted by the Subject Entity, the Tax Assessor will be bound by the private ruling.

(3) Audit Guidelines and Access Power

It is necessary for the Tax Assessor to carry out an effective review of a Subject Entity's tax equivalent payments each year coupled with a periodic audit as required. Although this requires the allocation of a significant level of resources and specialised expertise, this role is considered necessary to support the overall integrity of the Local Government Tax Equivalents Regime.

(C) ROLE OF THE OFFICE OF STATE REVENUE (OSR)

(1) General

As with private sector firms and other entities subject to State taxes, the OSR will be charged with the authority of administering the State Tax Equivalents Regime component of the Local Government Tax Equivalents Regime.

It is not the function of OSR to "make" the law. For the purposes of the Local Government Tax Equivalents Regime, this power rests with the Treasurer and is carried out through this Manual.

The role of the OSR is merely to provide an overseeing role in order to ensure that the Subject Entities correctly self-assess the amount of the tax equivalents payable each year and to assist them in clarifying any "grey" areas of the State tax laws which apply.

In reviewing a Subject Entity's assessment of its State tax equivalent liability, to protect the confidentiality of information received by the OSR, OSR will observe all the confidentiality provisions which apply in relation to such information provided by entities subject to State taxes.

(2) Rulings under the State Tax Equivalents Regime

Private rulings by the State Tax Commissioner under the respective State Tax Acts are only provided in a limited number of cases. The State Tax Commissioner does provide public rulings in respect of the State Tax Acts from time to time.

(3) Investigation Powers

Each of the State Tax Acts includes specific investigation powers. Under the Local Government Tax Equivalent regime, these powers will not apply. They will be replaced by a general investigation power that requires Subject Entities to make all relevant information and documentation which OSR might reasonably require, available on request to OSR within a reasonable time.

(D) OUTLINE OF THE ADMINISTRATIVE ASPECTS OF LOCAL GOVERNMENTS TAX EQUIVALENTS REGIME

(1) Income Tax Equivalents Regime

(a) Record Keeping Requirement*s*

Section 262A of the ITAA 1936 requires every business to keep records that record and explain all transactions and other acts engaged in or by the taxpayer that are relevant for taxation purposes. The ITAA also requires the taxpayer to keep documents specifying particulars of any election, estimate, determination or calculation made by the taxpayer for taxation purposes.

Under subsection 262A(4) of the ITAA, these records must be retained for five years after completion of the transaction to which they relate, or the end of the assessment period, whichever is the later. Failure to keep such records makes the taxpayer liable for fines and, in the event of failure to keep records containing particulars of the basis of the calculation of taxable income and tax payable, additional tax.

The Commonwealth Tax Laws statutory requirements outlined above apply to Subject Entities from the date upon which they become subject to the Local Government Tax Equivalents Regime.

(b) Working Papers

Similarly to the Commonwealth Tax Laws, the Local Government Tax Equivalents Regime requires Subject Entities to retain detailed working papers, schedules and elections used in the calculation of taxable income and to supply these to the Tax Assessor on request.

(c) Preparation of Income Tax Equivalent and Franking Account Returns

Under the ITAA, corporate taxpayers self-assess their liability. A simplified return is prepared and generally lodged by the due date for the final payment of the assessed tax. In broad terms, no other information is required to be lodged with this return. The return form only provides a minimal amount of information concerning the taxpayer's financial position.

The Local Government Tax Equivalents Regime requires the same return to be lodged by the Subject Entities. No schedules or working papers would be submitted with the return form although a declaration regarding these papers would be signed by the Public Officer of the Subject Entity.

The payment of tax equivalents would not be regarded as an eligible "franking credit" for the purposes of the imputation system under the Commonwealth Tax Laws. Furthermore, the franking credits which attach to franked dividends received from a company in the private sector have little practical significance in a tax equivalents regime as the ultimate shareholder of each Subject Entity is tax-exempt for Commonwealth Tax Laws purposes.

Accordingly, Subject Entities are not required to maintain a franking account or submit a franking account return. However, this does not prevent a Subject Entity maintaining an annual franking account return at its discretion if it so desires.

(d) Payment of Income Tax Liability

Substantive ITAA Model

The timing for payment of income tax equivalents by Subject Entities under this model will mirror the timing prescribed for companies under the Commonwealth Tax Laws.
The timing of payments for income years commencing after 1 July 2000 will be determined under the PAYG Instalment System contained in Chapter 2 of Schedule 1 to the *Taxation Administration Act 1953*.

Under this system, most Subject Entities (except those that satisfy certain criteria for annual payment) will be required to make quarterly payments of income tax equivalents 21 days after the end of each instalment quarter for a given income year. The amount of the payment will be determined by applying an “instalment rate” (notified by the Tax Assessor) to the “instalment income” of the quarter in respect of which a payment is due.

Accounting Profits Model

For Subject Entities operating under the accounting profit model, an alternative payment system applies. In these circumstances, the whole of the Subject Entity's tax equivalent liability is to be paid in conjunction with the lodgement of the annual tax equivalent return.

(e) Lodgement of Income Tax Equivalent Returns

The timing for lodgement of income tax equivalents returns by Subject Entities will mirror the timing prescribed for companies under the Commonwealth Tax Laws.

(f) Assessments

The tax equivalents regime adopts the self-assessment system such that Subject Entities self assess their liability. As stated above, the income tax equivalent return is prepared and lodged by the Subject Entity, together with payment of the assessed tax. The self assessment system, supported by a mechanism for audits and penalties, is considered to be the most efficient methodology.

The return is deemed to be an assessment of the Subject Entity's taxable income and the amount of tax payable thereon. Accordingly, the Tax Assessor will not issue a formal notice of assessment after a Subject Entity has lodged its return.

The assessment is deemed to have been made on the later of:

- the due date for the final instalment of tax equivalents for the income year; or
- the date when the return is actually lodged.

(g) Amendment of Assessments

The mechanism for issuing amended assessments under the Local Government Tax Equivalents Regime closely follows that of the Commonwealth Tax Laws.

The ability of the Tax Assessor to issue amended assessments depends on the reason underlying the need for amendment of the assessment. In cases of tax avoidance involving fraud or evasion, an amended assessment can be issued by the Tax Assessor at any time. In any other case of tax avoidance (defined generally as an underpayment of tax), there is a four year limit on the issuance of amended assessments. This four year limit runs from the date on which the assessment is deemed to have been made.

The Local Government Tax Equivalents Regime will follow the Commonwealth Tax Laws in providing that this four year limit can be extended in various circumstances including, at the discretion of the Tax Assessor, where a Subject Entity applies for an amendment:

(i) to give effect to an objection; or

(ii) where various anti-avoidance provisions are applied.

However, the Local Government Tax Equivalents Regime will not adopt the Commonwealth Tax Laws approach [set out in subsection 170(7) of the ITAA 1936] of allowing the Tax Assessor to apply to the Federal Court of Australia for an extension where, in examining a Subject Entity's affairs, the Tax Assessor has been unable to complete the review within the four year limit as a result of action taken by the Subject Entity.

(h) Penalties

Given the more co-operative spirit in which the Local Government Tax Equivalents Regime operates, the need for a penalty regime is lessened. However, in order to demonstrate integrity in the Local Government Tax Equivalents Regime, it is implicit in a self assessment system that penalties apply for failure to properly report taxable income.

The Commonwealth Tax Laws imposes a range of penalties for different breaches of the law. In addition, the ATO has issued various rulings on the extent of the penalties which will be applied in different circumstances.

The mechanism for imposing penalties under the Local Government Tax Equivalents Regime closely follows that of the Commonwealth Tax Laws. A broad summary of these provisions is set out below:

- All taxpayers are required to exercise "reasonable care". Failure to exercise such care will attract a penalty of 25% of any tax shortfall (defined as the difference between the tax properly payable and the tax actually paid);
- Notwithstanding that the taxpayer has exercised "reasonable care" taxpayers are required to have a "reasonably arguable" position where the tax shortfall exceeds a certain threshold. Failure to satisfy this standard of care will attract a penalty of 25% of the tax shortfall. The threshold for the application of this penalty is the greater of:
    - $10,000; or
    - 1% of the tax payable based on the taxpayer's return.
- There are a range of other criteria which impact on the quantum of the penalties, e.g.:
    - reckless behaviour 50%
    - deliberate evasion 75%
- Voluntary disclosure will reduce the applicable penalty by 80%; and
- The Tax Assessor retains a general discretion to further remit penalties in accordance with the guidelines for remission published by the ATO.

In addition to penalties, interest is charged for late payment. Interest is imposed for the period of underpayment at a rate equal to the Commonwealth Treasury Note rate (as defined) plus 4 percentage points. Interest is payable whether or not a penalty (as referred to above) is imposed and is specifically made deductible to the taxpayer.

(3) Appeal and Review Mechanism

The ITAA regime provides an extensive appeal mechanism to challenge the determinations or opinions of the Commissioner of Taxation. This appeal mechanism is not able to be adopted or copied cost effectively under the Local Government Tax Equivalents Regime. Furthermore, the most appropriate mechanism is one which enables disputes to be resolved quickly in an independent and unbiased manner and with a minimum of cost.

The Appeal and Review mechanism which applies under the Local Government Tax Equivalents Regime will be as follows:

Appeal

- a Subject Entity which is dissatisfied with an assessment or any other "taxation decision" commences the process by lodging an appeal with the Tax Assessor;

- the Tax Assessor must (within 60 days of receipt of the appeal, or such other period as the Subject Entity consents to) provide the Subject Entity with notice stating whether the appeal has been allowed (in whole or in part) or disallowed; and

- unlike the Federal regime, a failure by the Tax Assessor to provide the Subject Entity with the notice within the prescribed time does not result in an automatic disallowance of the appeal.

Review

- A Subject Entity which is dissatisfied with the appeal decision may request a Review of the decision, which is made as follows:

  - the Subject Entity lodges a notice in writing with the Tax Assessor requesting a Review of the appeal decision; and

  - the request for Review must be lodged with the Tax Assessor within 90 days of the Subject Entity being served with the appeal decision.

- The Tax Assessor and the Subject Entity are to prepare a Review Submission which sets out:

  - a statement of agreed facts by both parties;
  - the technical arguments of the Subject Entity and the Tax Assessor; and
  - the issues in dispute.

- The Review Submission is to be served on the Arbitrator for consideration;

- The Arbitrator may request further information from either or both parties;

- If all parties agree, the Arbitrator, the Subject Entity and the Tax Assessor may meet (in a joint sitting) to discuss the Review Submission; and

- The Arbitrator is required to issue a written opinion, together with reasons for the decision, within 60 days (or such other period as the Subject Entity consents to) of being served with the Review Submission.

In relation to the 60 day time limits imposed on the Tax Assessor (to make an Objection decision), and the Arbitrator (to make a Review decision), the Tax Assessor or the Arbitrator may seek an extension of time from the Subject Entity to issue a decision.

Where a particular issue is before the Courts in the Federal regime, or is the topic of a draft ATO public ruling, a Subject Entity has the right to lodge a "protective objection" which is held in abeyance until the matter is finally resolved (ie. until a final court decision is handed down, or the ATO issues the final public ruling). Accordingly, this mechanism will enable precedents from the Federal regime to be applied in a similar manner as under the Commonwealth Tax Laws.

The Arbitrator is to be appointed by the Treasurer. The Arbitrator will be appointed on the commencement of the Local Government Tax Equivalents Regime, and will be on call to act as needed.

The written opinion of the Arbitrator constitutes a decision on the matter which is binding on the Tax Assessor and the Subject Entity. The decision of the Arbitrator is final.

Where the relevant Subject Entity approves, decisions made by the Arbitrator will be distributed to all other Subject Entities, together with a brief statement of the facts.

This Appeal and Review mechanism is considered the most appropriate for the Local Government Tax Equivalents Regime for the following reasons:

- it provides an independent decision based on a review by an Arbitrator;
- it provides a quick and efficient resolution to the disputed matter; and
- it does not require costly infrastructure to be created and maintained (in the form of an appellate framework which mirrors the Federal regime). Furthermore, the costs in proceeding through the Appeal and Review mechanism are reduced.

(4) State Tax Equivalents Regime

(a) Record Keeping Requirements

Under the State Tax Equivalents Regime, Subject Entities are required to:

(i) keep records and working papers that record and explain all transactions and other acts engaged in by taxpayer that are relevant for substantiation purposes;

(ii) keep documents specifying particulars of any election, determination or calculation made by the taxpayer for substantiation purposes; and

(iii) supply these to the State Tax Commissioner on request.

Subject Entities are required to keep such records and documents for a minimum of 5 years after the date returns relating to the relevant transactions have been lodged.

These requirements replace the provisions relating to record keeping and working papers in the various State Tax Acts.

(b) Preparation of State Tax Equivalent Returns

Given that a different approach has been adopted under the Local Government Tax Equivalents Regime, a flexible approach has been adopted in relation to preparation of State tax returns by Subject Entities. Whereas State taxes are paid in a number of ways (e.g. transaction-based, monthly and annually), it is proposed that Subject Entities submit one return each year covering the three State taxes. Where possible, the requirements in relation to tax equivalent returns have been chosen to simplify and streamline the process. Specific requirements for the preparation of returns in relation to each State tax equivalent are provided in Part VI: State Tax Equivalents Regime.

(c) Payment of State Tax Equivalents

Specific requirements for the payment of State tax equivalents in relation to each State tax equivalent are provided in Part VI: State Tax Equivalents Regime.

(d) Lodgement of State Tax Equivalent Returns

Specific requirements for the lodgement of State tax equivalents returns in relation to each State tax equivalent are provided in Part VI: State Tax Equivalents Regime.

(e) Assessments

The tax equivalents regime adopts the self-assessment system such that Subject Entities self assess their liability. The self assessment system, supported by a mechanism for audits/reviews and penalties, is considered to be the most efficient methodology. The return is deemed to be an assessment of the Subject Entity's liability in terms of State tax equivalents. Accordingly, the State Tax Commissioner will not issue a formal notice of assessment after a Subject Entity has lodged its return.

(f) Amendment of Assessments

Rather than adopting the formal assessment amendment or reassessment procedures provided under the various State Tax Acts, the State Tax Commissioner will advise a Subject Entity if the State Tax Commissioner is of the opinion that the Subject Entity's assessment is incorrect on matters of fact, interpretation or calculation. The Subject Entity shall, within one month of receiving such advice from the State Tax Commissioner:

(i) adjust its assessment accordingly and resubmit its assessment to the State Tax Commissioner; or

(ii) if it disagrees with the State Tax Commissioner's advice in relation to its assessment, may lodge an objection with the State Tax Commissioner in relation to that advice.

(g) Penalties

Given the more co-operative spirit in which the Local Government Tax Equivalents Regime operates, the need for a penalty regime is lessened. However, in order to demonstrate integrity in the Local Government Tax Equivalents Regime, it is implicit in a self assessment system that penalties apply for failure to properly report and assess taxable wages, transactions and landholdings etc. Any such penalties are to be paid to the Local Government.

The various State Tax Acts impose a range of penalties for different breaches of the law, and where Subject Entities are currently liable for State taxes, such penalties will continue to apply. However, for the purposes of the State Tax Equivalent Regime, the penal provisions of the various State Tax Acts do not apply. Instead, a Subject Entity which -

(i) fails or neglects to lodge a return as and when required under the State Tax Equivalent Regime, is liable to pay, for each month (or part thereof) beyond the due date for lodging a return, an additional 5% of the amount of tax equivalent payable for the financial year;

(ii) fails or neglects to pay the State tax equivalent for which it is liable, as and when required under the State Tax Equivalent Regime, is liable to pay, for each month (or part thereof) beyond the due date for payment of the tax equivalent, an additional 5% of the amount of tax payable for the financial year; and

(iii) fails to exercise reasonable care in assessing its State tax equivalent liability, is liable to pay a penalty equal to any tax shortfall (defined as the difference between the tax properly payable and the tax actually paid).

Payment of a penalty under this State Tax Equivalent Regime does not relieve a Subject Entity from the liability to any tax equivalent for which that Subject Entity would otherwise be liable.

The State Tax Commissioner may waive or reduce a penalty at the Commissioner's discretion.

(h) Objections

The objections and appeals provisions in the various State Tax Acts do not apply under the State Tax Equivalent Regime.

As outlined in paragraph (f) of this section, a Subject Entity may lodge an objection with the State Tax Commissioner where the Subject Entity does not agree with the advice provided by the State Tax Commissioner in relation to the Subject Entity's State tax equivalent assessment. The State Tax Commissioner must ensure that a tax officer who has not been materially involved in reviewing the assessment or providing advice on the assessment is assigned to consider the Subject Entity's objection. The decision by the tax officer who has considered the objection is not appealable.

PART IV

INCOME TAX EQUIVALENTS REGIME

DIVISION 1 - TAXATION UNDER THE ACCOUNTING PROFITS MODEL

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INCOME TAX EQUIVALENTS REGIME

DIVISION 1 - TAXATION UNDER THE ACCOUNTING PROFITS MODEL

100. Preamble

Except to the extent set out in this Manual, the imposition, assessment and collection of income tax equivalents upon entities subject to the Local Government Tax Equivalents Regime shall be determined in accordance with:

(i) Income Tax Assessment Act 1936
(ii) Income Tax Regulations 1936
(iii) Income Tax Assessment Act 1997
(iv) Income Tax Assessment Regulations 1997
(v) Taxation Administration Act 1953
(vi) Taxation Administration Regulations 1976
(vii) Taxation (Interest on Overpayments and Early Payments) Act 1983
(viii) Taxation (Interest on Overpayments and Early Payments) Regulations 1992
(ix) Income Tax Rates Act 1986
(x) International Tax Agreements Act 1953
(xi) Income Tax (Transitional Provisions) Act 1997
(xii) General Interest Charge (Imposition) Act 1999
(xiii) Income Tax Act 1986
(xiv) Shortfall Interest Charge (Imposition) Act 2005, and
(xv) other legislation as notified,

as amended from time to time (including any new Acts replacing [in whole or part] any of the above Acts, Regulations or other legislation which may result from the recommendations of the Tax Law Improvement Program), together with public Income Tax Rulings issued by the Commissioner of Taxation.

101. Avoidance of Double Taxation

(a) A Subject Entity which is either not exempt or not entitled to exemption from Commonwealth income tax on certain income will not also be liable for the payment of income tax equivalents in respect of that income derived by the Subject Entity.

102. Removal of exemptions under the Commonwealth Tax Laws

(a) For the purposes of the Local Government Income Tax Equivalents Regime, Section 50-25 ITAA 1997 and Division 1AB of Part III of the ITAA do not apply. As such, a Subject Entity shall not be entitled to any exemption [which otherwise would have been available by virtue of Section 50-25 or Division 1AB or the operation of any other provision which relies on, or refers to, Section 50-25 or Division 1AB] from the Income Tax Equivalents Regime in relation to its revenue and capital gains.

(b) Except as provided in any LITER, Division 57 of the ITAA 1936 shall not apply to a Subject Entity. As such, upon transition into the TER, a Subject Entity will not be required to determine its tax equivalents with regard to Division 57. The effect of this will be that the

Subject Entity will determine its tax equivalents as if it had always been subject to the TER.

(c) Except as provided in any LITER, Division 58 of the ITAA 1997 shall not apply to a Subject Entity. As such, upon transition into the LGTER, a Subject Entity will not be required to determine its tax equivalents with regard to Division 58. The effect of this will be that the Subject Entity will determine its tax equivalents as if it had always been subject to the LGTER.

103. Application of the Accounting Profits Model

(a) A Subject Entity is required to adopt the Accounting Profits Model as the basis for the determination of its income tax equivalents liability where the entity receives a Notice to that effect from the Treasurer.

104. Commencement Date of Income Tax Equivalents Regime

(a) The Income Tax Equivalents Regime shall apply to each Subject Entity to whom the Accounting Profits Model applies for the financial year commencing 1 July 1998 and ending on the next succeeding 30 June, and for each subsequent financial year.

(b) With respect to a Significant Business Activity of a Local Government that becomes commercialised or corporatised following the commencement of the Income Tax Equivalents Regime, the Income Tax Equivalents Regime shall apply to each such Subject Entity to whom the Accounting Profits Model applies from the date that the Subject Entity becomes commercialised or corporatised, as the case may be.

105. Income Tax Equivalents Payable

(a) Sections 4-1 and 4-10 of the ITAA 1997 do not apply to the Income Tax Equivalents Regime.

(b) The income tax equivalents payable by a Subject Entity for a year of income shall be calculated in accordance with this Manual.

(c) Income tax equivalent amounts are payable at the rates specified for a company as set out in the applicable *Rating Act* upon the taxable income derived during the year of income by the Subject Entity.

106. Determination of Taxable Income

(a) The taxable income is equivalent to the accounting profit of the Subject Entity. The accounting profit means the operating profit (after abnormal items before extraordinary items) as audited by the Auditor General for Queensland.

(b) No adjustments are to be made to the accounting profit where permitted by this Manual or any LITER.

107. Method for payment of Income Tax Equivalent amounts / tax refunds

(a) The income tax equivalent amounts are payable by a Subject Entity to the Local Government.

(b) Where Subject Entities share a bank account with their core council, a journal entry or an internal memorandum evidencing any payment by the Subject entity shall be lodged with the Tax Assessor at the time of payment.

(c) Where separate bank accounts are maintained, payment should be made by transfer and confirmation of such transfer (in the form of a confirmation letter or memorandum) shall be lodged with the Tax Assessor.

(d) The method for refunding overpayments of income tax equivalent amounts will depend on the bank account arrangement.

(e) Where a bank account is shared, the Tax Assessor will advise the Chief Executive officer of the relevant council in writing that the Subject Entity is entitled to receive the refund.

(f) Where separate bank accounts are maintained, the Tax Assessor will advise the Chief Executive Officer of the relevant council in writing that an amount is to be refunded by transfer to the Subject Entity

108. Timing for payment of Income Tax Equivalents

(a) The whole of the Subject Entity's tax equivalents liability is due for payment on or before 1 December following the end of the year of income.

109. Lodgement of Income Tax Equivalents Returns

(a) A Subject Entity must lodge with the Tax Assessor its Income Tax Equivalents Return (in this section referred to as the **"Tax Return"**).

The address for lodgement of the Tax Return is:

Mr Adrian Carroll
Tax Assessor
KPMG
Riparian Plaza
71 Eagle Street
BRISBANE QLD 4000

GPO Box 223
BRISBANE QLD 4001

(b) The Tax Return shall be signed by the Public Officer and, for the purposes of this Division, shall include a copy of the audited accounts for the Subject Entity for the relevant year of income.

(c) Unless an extension for time for lodgement has been granted by the Tax Assessor, a Subject Entity is required to lodge its Tax Return (together with a copy for the Local Government) in accordance with the timing prescribed for companies under the Commonwealth Tax Laws.

(d) The Tax Assessor may (at its discretion) grant an extension of time for lodgement of a Subject Entity's Tax Return. To be considered for an extension for lodgement, the Subject

Entity must make an application to the Tax Assessor in writing stating the reason(s) for the inability to lodge on or before the prescribed date. Penalties for late lodgement will not be imposed where the application for an extension of time to lodge:

(i) is made before the due date for lodgement of the return; and
(ii) is successful.

(e) The granting of an extension of time for lodgement does not, in itself, grant an extension to the time for payment of the Subject Entity's tax liability which was due on the prescribed date for payment. Requests for an extension of time for payment of the tax liability will be determined by the Tax Assessor in accordance with the Commissioner of Taxation's guidelines.

(f) Where in relation to the granting of extension of time for lodgement of the Tax Return, an extension of time for payment is either not sought, or is sought but is not granted, the Subject Entity will be required to pay an amount of tax representing an estimate of the balance of tax liability due on the prescribed date for payment.

(g) Upon lodgement of the Tax Return, adjustments may be necessary (either in the form of a further payment of tax by the Subject Entity or a refund of tax to it) to reflect the difference between the assessment of tax liability set out in the Tax Return and the amount paid as an estimate of the balance of tax liability pursuant to paragraph (f). Where the Subject Entity is required to make a further payment of tax, late payment penalty tax and late payment penalty interest may be imposed on the difference (but subject to the Tax Assessor's discretion to remit under section 298-20 of the TAA, and pursuant to the Commissioner of Taxation's guidelines in relation thereto).

110. Format of Income Tax Equivalents Return

(a) Income tax equivalents returns for Subject Entities subject to the accounting profits model may be adapted to suit the requirements of the Subject Entity, provided that the return form includes a copy of the Subject Entity's financial statements and indicates:-

(a) The financial year of the return;
(b) The date on which the return is made;
(c) The name of the Subject Entity;
(d) The income tax equivalent rate;
(e) The income tax equivalents payable;
(f) A declaration in the following form:

"I declare that the particulars shown in this return and the relevant records used to ascertain the income tax equivalents payable by the entity are true and correct, in accordance with the Local Government Tax Equivalents Manual.

Name of public officer
Signature
Date"

111. Assessments

(a) Where a Subject Entity lodges its Income Tax Equivalents Return (in this section referred to as the "**Tax Return**") in respect of a year of income, the Tax Assessor (in accordance with subsection 166A(2) of the ITAA 1936) is deemed to have made an assessment of the taxable income, and the income tax equivalents payable on that income, equal to those respective amounts specified in the Tax Return on the later of:

(i) the due date for the final instalment of tax equivalents for the year of income; or
(ii) the date when the return is lodged.

112. Amendment of Assessments

(a) The Tax Assessor may amend an assessment or further amend an amended assessment in accordance with section 170 of the ITAA 1936.

(b) For the purposes of the Income Tax Equivalents Regime, subsection 170(7) of the ITAA 1997 does not apply, and accordingly, the Tax Assessor does not have the power (pursuant to that subsection) to extend the period in which to amend an assessment.

113. Appeal and Review Process

(a) A Subject Entity which is dissatisfied with an assessment of income tax equivalents or any other "taxation decision" may lodge an appeal with the Tax Assessor in accordance with this section. A taxation decision has the same meaning as that in section 14ZQ of the Taxation Administration Act.

(b) The appeal must:

(i) be made in writing;

(ii) be lodged with the Tax Assessor within the period set out in section 14ZW of the *Taxation Administration Act 1953*; and

(iii) state, fully and in detail, the grounds that the Subject Entity relies on.

(c) Within 60 days of receipt of the appeal (or such longer period as the Subject Entity consents to), the Tax Assessor must decide (the "appeal decision") whether to allow the appeal (in whole or in part), or to disallow it, and serve written notice of the appeal decision, together with reasons therefor, upon the Subject Entity.

(d) A Subject Entity which is dissatisfied with the Tax Assessor's appeal decision may request a Review of the appeal decision. A request for Review is to be made as follows:

- the Subject Entity must lodge a notice in writing on the Tax Assessor requesting a Review of the appeal decision;

- the request for Review must be lodged with the Tax Assessor within 90 days of the Subject Entity being served with the appeal decision;

- the Tax Assessor and the Subject Entity are to prepare a Review Submission which sets out:

  - a statement of agreed facts by both parties;
  - the technical arguments of the Subject Entity and the Tax Assessor; and
  - the issues in dispute;

- the Review Submission is to be served on the Arbitrator for consideration;

- either or both parties are to respond to my further requests for supplementary information received from the Arbitrator;

- if all parties agree, the Arbitrator, the Subject Entity and the Tax Assessor may meet (in a joint sitting) to discuss the Review Submission; and

- the Arbitrator is required to issue a written opinion, together with reasons for the decision, within 60 days of being served with the Review Submission or supplementary information (or such longer period as the Subject Entity consents to).

(e) The decision of the Arbitrator is binding on the Tax Assessor and the Subject Entity.

(f) Where the relevant Subject Entity agrees, Review decisions of the Arbitrator will be made available to all other Subject Entities, together with a brief statement of the relevant facts.

(g) Sections 14ZY, 14ZYA and 14ZZ of Division 3 of Part IVC of the *Taxation Administration Act 1953* do not apply to the Income Tax Equivalents Regime.

Divisions 4 (AAT Review) and 5 (Federal Court Appeals) of Part IVC of the *Taxation Administration Act 1953* do not apply to the Income Tax Equivalents Regime.

114. Penalties

(a) The penalty regime (including interest) as prescribed by Schedule 1 of the TAA shall apply to the Income Tax Equivalents Regime.

(b) The taxation offences created by Part III of the *Taxation Administration Act 1953* shall not apply.

(c) Where penalties and or interest is imposed on Subject Entities for incorrect or late returns and / or payments, similar arrangements to that in respect of tax payments will apply. The Tax Assessor will notify both the core council and the Subject Entity of the application of penalties and / or interest and seek confirmation of payment.

115. Public Rulings

(a) Public Ruling means an applicable ATO public ruling.

(b) An "applicable ATO public ruling" means a public ruling issued by the ATO [including the *Income Tax Ruling* (IT) series, the *Taxation Ruling* (TR) series, the *Taxation Determination* (TD) series and the *Miscellaneous Tax Ruling* (MT) series] which has not been overridden (either expressly or by implication) by:

- the Income Tax Equivalents Regime; or
- a "private determination" obtained by a Subject Entity from the Tax Assessor.

(c) A public ruling is binding on the Tax Assessor.

(d) Where the Tax Assessor and/or one or more Subject Entities are of the opinion that a particular matter warrants the issue of a Local Government Income Tax Equivalents Ruling, a request is to be made in writing by the particular party to Queensland Treasury seeking the issue of a public ruling to address the matter.

116. Private Rulings

(a) A reference to the term "Private Ruling" in the ITAA or the *Taxation Administration Act 1953* shall be read as a reference to a "Private Ruling" for the purposes of the Local Government Tax Equivalents Regime.

(b) A Subject Entity may apply to the Tax Assessor for a Private Ruling pursuant to the terms of Division 359 of Schedule 1 to the *Taxation Administration Act 1953*.

(c) Where a valid application for a Private Ruling has been made (within the terms of Division 359 of Schedule 1 to the *Taxation Administration Act 1953*), the Tax Assessor is required to provide a written response to the Subject Entity within 60 days of receipt of the application (unless the consent of the Subject Entity is obtained for a longer period).

117. Reference to the "Commissioner" in Commonwealth Tax Laws to be construed as Tax Assessor

(a) Unless a contrary intention appears, a reference to the "Commissioner" or the "Commissioner of Taxation" in the Commonwealth Tax Laws shall be read as a reference to the "Tax Assessor" for the purposes of the Income Tax Equivalents Regime.

118. Public Officer

(a) Each Subject Entity is required to appoint a public officer by notice in writing to the Tax Assessor. Such notice shall disclose the name of the public officer and the address for service of notices upon the Subject Entity.

(b) Such appointment must occur within three months after the commencement date of the Subject Entity into the Local Government Tax Equivalents Regime.

(c) Each Subject Entity shall keep the office of the public officer constantly filled. A public officer is to be appointed when and as often as such an appointment becomes necessary.

(d) Where a Subject Entity has been subject to the Commonwealth Tax Laws, the appointment of a public officer pursuant to the Commonwealth Tax Laws shall represent a valid appointment for the purposes of the Income Tax Equivalents Regime.

(e) The public officer of a subject entity will not be held answerable or made liable for penalties for defaults by the subject entity under any provision of the Relevant Taxation Laws, including section 252A(9) of the ITAA 1936

119. Certain Parts of the Commonwealth Tax Laws have no application

(a) Parts II (Administration) and VA (Tax File Numbers) of the ITAA 1936 do not apply to the Income Tax Equivalents Regime.

(b) Part 3-6 of the ITAA 1997 does not apply to the Income Tax Equivalents Regime.

(c) Parts IA, II, III, IIIA, IV, IVA of the *TAA* do not apply to the Income Tax Equivalents Regime.

INCOME TAX EQUIVALENTS REGIME

DIVISION 2 - TAXATION UNDER THE SUBSTANTIVE ITAA MODEL

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DIVISION 2 - TAXATION UNDER THE SUBSTANTIVE ITAA MODEL

200. Preamble

Except to the extent set out in this Manual, the imposition, assessment and collection of income tax equivalents upon entities subject to the Local Government Tax Equivalents Regime shall be determined in accordance with:

(i) Income Tax Assessment Act 1936
(ii) Income Tax Regulations 1936
(iii) Income Tax Assessment Act 1997
(iv) Income Tax Assessment Regulations 1997
(v) Taxation Administration Act 1953
(vi) Taxation Administration Regulations 1976
(vii) Taxation (Interest on Overpayments and Early Payments) Act 1983
(viii) Taxation (Interest on Overpayments and Early Payments) Regulations 1992
(ix) Income Tax Rates Act 1986
(x) International Tax Agreements Act 1953
(xi) Income Tax (Transitional Provisions) Act 1997
(xii) General Interest Charge (Imposition) Act 1999
(xiii) Income Tax Act 1986
(xiv) Shortfall Interest Charge (Imposition) Act 2005, and
(xv) other legislation as notified

as amended from time to time (including any new Acts replacing [in whole or part] any of the above Acts, Regulations or other legislation which may result from the recommendations of the Tax Law Improvement Program), together with public Income Tax Rulings issued by the Commissioner of Taxation.

201. Avoidance of Double Taxation

(a) A Subject Entity which is either not exempt or entitled to exemption from Commonwealth income tax on certain income will not also be liable for the payment of income tax equivalents in respect of that income derived by the Subject Entity.

202. Removal of exemptions under the Commonwealth Tax Laws

(a) For the purposes of the Local Government Income Tax Equivalents Regime, Section 50-25 ITAA 1997 and Division 1AB of Part III of the ITAA 1936 do not apply. As such, a Subject Entity shall not be entitled to any exemption [which otherwise would have been available by virtue of Section 50-25 or Division 1AB or the operation of any other provision which relies on, or refers to, Section 50-25 or Division 1AB] from the Income Tax Equivalents Regime in relation to its revenue and capital gains.

(b) Except as provided in any LITER, Division 57 of the ITAA 1936 shall not apply to a Subject Entity. As such, upon transition into the TER, a Subject Entity will not be required to determine its tax equivalents with regard to Division 57. The effect of this will be that the Subject Entity will determine its tax equivalents as if it had always been subject to the TER.

(c) Except as provided in any LITER, Division 58 of the ITAA 1997 shall not apply to a Subject Entity. As such, upon transition into the LGTER, a Subject Entity will not be required to determine its tax equivalents with regard to Division 58. The effect of this will be that the Subject Entity will determine its tax equivalents as if it had always been subject to the LGTER.

203. Application of the Substantive ITAA Model

(a) A Subject Entity is required to adopt the Substantive ITAA Model as the basis for the determination of its income tax equivalents liability where the entity receives a Notice to that effect from the Treasurer.

204. Commencement Date of Income Tax Equivalents Regime

(a) The Income Tax Equivalents Regime shall apply to each Subject Entity to whom the Substantive ITAA Model applies for the financial year commencing 1 July 1998 and ending on the next succeeding 30 June, and for each subsequent financial year.

(b) With respect to a Significant Business Activity of a Local Government that becomes commercialised or corporatised following the commencement of the Income Tax Equivalents Regime, the Income Tax Equivalents Regime shall apply to each such Subject Entity to whom the Substantiative ITAA Model applies from the date that the Subject Entity becomes corporatised or commercialised, as the case may be.

205. Income Tax Equivalents Payable

(a) Sections 4-1 and 4-10 of the ITAA 1997 do not apply to the Income Tax Equivalents Regime.

(b) The income tax equivalents payable by a Subject Entity for a year of income shall be calculated in accordance with this Manual.

(c) Income tax equivalent amounts are payable at the rates specified for a company as set out in the applicable *Rating Act* upon the taxable income derived during the year of income by the Subject Entity.

206. Determination of taxable income

(a) The taxable income of a Subject Entity is to be determined in the same manner as the taxable income is determined under the Commonwealth Tax Laws for each year of income except where the Commonwealth Tax Laws has been amended by this Manual (including a LITER) for the purposes of the Local Government Tax Equivalents Regime.

207. Subject Entity to be treated as a Company

(a) Unless otherwise stated, each Subject Entity shall be regarded as a "company" within the definition of that term in Section 995-1(1) ITAA 1997.

208. Method for payment of Income Tax Equivalent amounts / tax refunds

(a) The income tax equivalent amounts are payable by a Subject Entity to the Local Government.

(b) Where Subject Entities share a bank account with their core council, a journal entry or an internal memorandum evidencing any payment by the Subject entity shall be lodged with the Tax Assessor at the time of payment.

(c) Where separate bank accounts are maintained, payment should be made by transfer and confirmation of such transfer (in the form of a confirmation letter or memorandum) shall be lodged with the Tax Assessor.

(d) The method for refunding overpayments of income tax equivalent amounts will depend on the bank account arrangement.

(e) Where a bank account is shared, the Tax Assessor will advise the Chief Executive officer of
the relevant council in writing that the Subject Entity is entitled to receive the refund.

(f) Where separate bank accounts are maintained, the Tax Assessor will advise the Chief Executive Officer of the relevant council in writing that an amount is to be refunded by transfer to the Subject Entity

209. Timing for Payment of Income Tax Equivalents

(a) The timing for payment of income tax equivalents shall mirror the timing for companies under the Commonwealth Tax Laws.

(b) “Instalment taxpayer” has the same meaning as that in subsection 221AZK(1) of the ITAA.

210. Lodgement of Income Tax Equivalents Returns

(a) Section 161 of the ITAA 1936 is replaced by this section.

(b) A Subject Entity must lodge with the Tax Assessor its Income Tax Equivalents Return on the applicable return form (in this section referred to as the **"Tax Return"**). The income tax return form required to be lodged in respect of each income year is to be in the format specified by the Australian Taxation Office in respect of each year, with the exception of the following:

(i) the section with respect to Tax File Numbers is not required to be completed; and
(ii) any other requirements as notified by the Tax Assessor.

The Subject Entity must lodge with the Tax Assessor in conjunction with its tax return a schedule containing those items set out in Schedule 1.

The address for lodgement of the Tax Return (with the Tax Assessor) is:

Mr Adrian Carroll
Tax Assessor
KPMG
Riparian Plaza
71 Eagle Street
BRISBANE QLD 4000

GPO Box 223
BRISBANE QLD 4001

(c) The Tax Return shall be signed by the Public Officer and contain such information as is required by the applicable return form in relation to:

(i) the income (other than income upon which withholding tax is payable), and profits or gains of a capital nature, derived by the Subject Entity during the year of income; and
(ii) any deductions or losses, being losses of a capital nature, claimed by the Subject Entity.

(d) Unless an extension for time for lodgement has been granted by the Tax Assessor, a Subject Entity is required to lodge its Tax Return on or before the due date for payment of its final tax liability for the relevant year of income.

(e) Where a Subject Entity has no tax liability for a particular year of income, it is required to lodge its annual Tax Return, on or before 28 February following the end of the relevant year of income (unless an extension for time for lodgement has been granted by the Tax Assessor).

(f) The Tax Assessor may (at its discretion) grant an extension of time for lodgement of a Subject Entity's Tax Return. To be considered for an extension for lodgement, the Subject Entity must make an application to the Tax Assessor in writing stating the reason(s) for the inability to lodge the Tax Return on or before the prescribed date. Penalties for late lodgement will not be imposed where the application for an extension of time to lodge:

(i) is made before the due date for lodgement of the return; and
(ii) is successful.

(g) The granting of an extension of time for lodgement does not, in itself, grant an extension to the time for payment of the Subject Entity's tax equivalents liability which was due on the prescribed date for payment. Requests for an extension of time for payment of the tax equivalents liability will be determined by the Tax Assessor in accordance with the Commissioner of Taxation's guidelines.

(h) Where in relation to the granting of extension of time for lodgement of the Tax Return, an extension of time for payment is either not sought, or is sought but is not granted, the Subject Entity will be required to pay an amount of tax representing an estimate of the balance of tax liability due on the prescribed date for payment.

(i) Upon lodgement of the Tax Return, adjustments may be necessary (either in the form of a further payment of tax by the Subject Entity or a refund of tax to it) to reflect the difference between the assessment of tax liability set out in the Tax Return and the amount paid as an estimate of the balance of tax liability pursuant to paragraph (h). Where the Subject Entity is required to make a further payment of tax, late payment penalty tax and late payment penalty interest may be imposed on the difference (but subject to the Tax Assessor's discretion to remit under section 298-20 of the TAA, and pursuant to the Commissioner of Taxation's guidelines in relation thereto).

211. Assessments

(a) Where a Subject Entity lodges its Income Tax Equivalents Return (in this section referred to as the "**Tax Return**") in respect of a year of income, the Tax Assessor (in accordance with subsection 166A(2) of the ITAA 1936) is deemed to have made an assessment of the taxable income, and the income tax equivalents payable on that income, equal to those respective amounts specified in the Tax Return on the later of:

(i) the due date for the final instalment of tax equivalents for the year of income, or

(ii) the date when the return is lodged.

212. Amendment of Assessments

(a) The Tax Assessor may amend an assessment or further amend an amended assessment in accordance with section 170 of the ITAA 1936.

(b) For the purposes of the Income Tax Equivalents Regime, subsection 170(7) of the ITAA 1997 does not apply, and accordingly, the Tax Assessor does not have the power (pursuant to that subsection) to extend the period in which to amend an assessment.

213. Appeal and Review Process

(a) A Subject Entity which is dissatisfied with an assessment of income tax equivalents or any other "taxation decision" may lodge an appeal with the Tax Assessor in accordance with this section.

(b) The appeal must:

(i) be made in writing; and

(ii) be lodged with the Tax Assessor within the period set out in section 14ZW of the *Taxation Administration Act 1953*; and

(iii) state, fully and in detail, the grounds that the Subject Entity relies on.

(c) Within 60 days of receipt of the appeal (or such longer period as the Subject Entity consents to), the Tax Assessor must decide (the "appeal decision") whether to allow the appeal (in whole or in part), or to disallow it, and serve written notice of the appeal decision, together with reasons therefor, upon the Subject Entity.

(d) A Subject Entity which is dissatisfied with the Tax Assessor's appeal decision may request a Review of the appeal decision. A request for Review is to be made as follows:

- the Subject Entity must lodge a notice in writing on the Tax Assessor requesting a Review of the appeal decision;
- the request for Review must be lodged with the Tax Assessor within 90 days of the Subject Entity being served with the appeal decision;
- the Tax Assessor and the Subject Entity are to prepare a Review Submission which sets out:
  - a statement of agreed facts by both parties;
  - the technical arguments of the Subject Entity and the Tax Assessor; and
  - the issues in dispute;
- the Review Submission is to be served on the Arbitrator for consideration;
- either or both parties are to respond to any further requests for supplementary information received from the Arbitrator;
- if all parties agree, the Arbitrator, the Subject Entity and the Tax Assessor may meet (in a joint sitting) to discuss the Review Submission; and
- the Arbitrator is required to issue a written opinion, together with reasons for the decision, within 60 days of being served with the Review Submission or supplementary information (or such longer period as the Subject Entity consents to).

(e) The decision of the Arbitrator is binding on the Tax Assessor and the Subject Entity.

(f) Where the relevant Subject Entity agrees, Review decisions of the Arbitrator will be made available to all other Subject Entities, together with a brief statement of the relevant facts.

(g) A Subject Entity may lodge a "protective objection" with the Tax Assessor in the following circumstances:

- where a particular issue is before the Courts in the Commonwealth regime;
- where a particular issue is on appeal to the Courts in the Commonwealth regime; and
- where a particular issue is the subject of a draft ATO Public Ruling.

The lodgement of a "protective objection" has the effect of placing in abeyance determination of the issue for the purposes of the Local Government Tax Equivalents Regime for the relevant Subject Entity until the matter is finally resolved in the Commonwealth regime.

A matter is finally resolved when the final court decision is handed down, or the ATO issues its public ruling as the case may be.

(h) Sections 14ZY, 14ZYA and 14ZZ of Division 3 of Part IVC of the *Taxation Administration Act 1953* do not apply to the Income Tax Equivalents Regime. Divisions 4 (AAT Review) and 5 (Federal Court Appeals) of Part IVC of the *Taxation Administration Act 1953* do not apply to the Income Tax Equivalents Regime.

214. Penalties

(a) The penalty regime (including interest) as prescribed by the Commonwealth Tax Laws shall apply to the Income Tax Equivalents Regime.

(b) The taxation offences created by Part III of the *Taxation Administration Act 1953* shall not apply.

(c) Where penalties and or interest is imposed on Subject Entities for incorrect or late returns and / or payments, similar arrangements to that in respect of tax payments will apply. The Tax Assessor will notify both the core council and the Subject Entity of the application of penalties and / or interest and seek confirmation of payment.

215. Public Rulings

(a) Public Ruling means an applicable ATO public ruling.

(b) An "applicable ATO public ruling" means a public ruling issued by the ATO [including the *Income Tax Ruling* (IT) series, the *Taxation Ruling* (TR) series, the *Taxation Determination* (TD) series and the *Miscellaneous Tax Ruling* (MT) series] which has not been overridden (either expressly or by implication) by:

- the Income Tax Equivalents Regime; or
- a "private determination" obtained by a Subject Entity from the Tax Assessor.

(c) A public ruling is binding on the Tax Assessor.

(d) Where the Tax Assessor and/or one or more Subject Entities are of the opinion that a particular matter warrants the issue of a Local Government Income Tax Equivalents Ruling, a request is to be made in writing by the particular party to Queensland Treasury seeking the issue of a public ruling to address the matter.

216. Private Rulings

(a) A reference to the term "private ruling" in the Commonwealth Tax Laws or the *Taxation Administration Act 1953* shall be read as a reference to a "private ruling" for the purposes of the Local Government Tax Equivalents Regime.

(b) A Subject Entity may apply to the Tax Assessor for a Private Ruling pursuant to the terms of Division 359 of Schedule 1 of the TAA.

(c) Where a valid application for a Private Ruling has been made (within the terms of Division 359 of Schedule 1 of the *TAA*), the Tax Assessor is required to provide a written response to the Subject Entity within 60 days of receipt of the application (unless the consent of the Subject Entity is obtained for a longer period).

217. Reference to the "Commissioner" in Commonwealth Tax Laws to be construed as Tax Assessor

(a) Unless a contrary intention appears, a reference to the "Commissioner" or the "Commissioner of Taxation" in the Commonwealth Tax Laws shall be read as a reference to the "Tax Assessor" for the purposes of the Local Government Tax Equivalents Regime.

218. Public Officer

(a) Each Subject Entity is required to appoint a public officer by notice in writing to the Tax Assessor. Such notice shall disclose the name of the public officer and the address for service of notices upon the Subject Entity.

(b) Such appointment must occur within three months after the commencement date of the Subject Entity into the Local Government Tax Equivalents Regime.

(c) Each Subject Entity shall keep the office of the public officer constantly filled. A public officer is to be appointed when and as often as such an appointment becomes necessary.

(d) Where a Subject Entity has been subject to the Commonwealth Tax Laws, the appointment of a public officer pursuant to the Commonwealth Tax Laws shall represent a valid appointment for the purposes of the Income Tax Equivalents Regime.

219. Certain Parts of the Commonwealth Tax Laws have no application

(a) Parts II (Administration) and VA (Tax File Numbers) of the ITAA 1936 do not apply to the Income Tax Equivalents Regime.

(b) Part 3-6 of the ITAA 1997 does not apply to the Income Tax Equivalents Regime.

(c) Parts IA, II, III, IIIA, IV, IVA of the *TAA* do not apply to the Income Tax Equivalents Regime.

SCHEDULES TO THE INCOME TAX EQUIVALENTS REGIME

Schedule

1 Reconciliation of Operating Profit and Taxable Income

2 PAYG Instalment Activity Statement (IAS)

3 2010 Transitional PAYG Instalment Arrangements

SCHEDULE 1

RECONCILIATION OF OPERATING PROFIT AND TAXABLE INCOME

		$	$
OPERATING PROFIT/(LOSS)			_________
ADD:			
LABEL A	**NET CAPITAL GAINS**		_________
LABEL B	**OTHER ADDBACK ITEMS***		
	Amortisation of leased assets	__________	
	Book depreciation	__________	
	Book loss on sale of assets	__________	
	Borrowing costs deducted in accounts	__________	
	Capital items written off as repairs	__________	
	Capital items expensed	__________	
	Decrease in consumables	__________	
	Decrease in prepayments	__________	
	Foreign exchange losses (book)	__________	
	Goodwill amortised	__________	
	Increase in provisions	__________	
	Lease interest	__________	
	Non deductible entertainment	__________	
	Non deductible legal expenses	__________	
	Non deductible subscriptions and donations	__________	
	Penalties and fines	__________	
	Realised foreign exchange gains (tax)	__________	
	Superannuation charged in accounts	__________	
	Tax depreciation recouped on asset disposals	__________	
TOTAL ADDITIONS			__________

* Note this list of items is not exclusive and the reconciliation schedule included with the tax equivalents return will need to be tailored to each Subject Entity's particular circumstances.

SCHEDULE 1 (Continued)

RECONCILIATION OF OPERATING PROFIT AND TAXABLE INCOME

		$	$
LESS:			
LABEL C	**TAX DEPRECIATION DEDUCTED**		________
LABEL D	**SPECIAL BUILDING WRITE-OFF**		________
LABEL H	**INVESTMENT ALLOWANCE**		________
LABEL I	**RESEARCH & DEVELOPMENT CONCESSION**	________	
LABEL E	**OTHER SUBTRACTION ITEMS***		
	Actual lease payments	________	
	Allowable superannuation fund payments	________	
	Book profit on disposal of assets	________	
	Decrease in provisions	________	
	Exempt income	________	
	Foreign exchange gains (book)	________	
	Increase in consumables	________	
	Increase in prepayments	________	
	R&D expenditure	________	
	Realised foreign exchange losses (tax)	________	
	Tax loss on disposal of assets	________	
	Tax deductible borrowing costs	________	
TOTAL DEDUCTIONS			________
LABEL F	**TOTAL PRIOR YEAR LOSSES**		________
LABEL G	**LOSSES TRANSFERRED IN**		________
LABEL J	**TAXABLE INCOME/(LOSS)**		________

* Note this list of items is not exclusive and the reconciliation schedule included with the tax equivalents return will need to be tailored to each Subject Entity's particular circumstances.

SCHEDULE 2

PAYG INSTALMENT ACTIVITY STATEMENT (IAS)

Name of Subject Entity:

Year of Income:

Quarter ended:

Instalment income for quarter:

Current notified instalment rate:

Varied instalment rate (where applicable):

Instalment payment:
(instalment income x instalment rate)

Quarterly instalment of deferred income tax equivalents payable:

Declaration:

I declare that the information given on this form is accurate and complete, and that I am authorised to make this declaration.

Signed:
Public Officer

SCHEDULE 3

2010 TRANSITIONAL PAYG INSTALMENT ARRANGEMENTS

The SEQ Water Distributor-Retailer Authorities (Distributor-Retailers; the Authorities) were established on the date of assent of the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009* (Restructuring Act), being 3 November 2009.

From 1 July 2010, the Authorities assumed responsibility for the water and wastewater functions previously undertaken by their Participating Local Governments. To give operational effect to the structural reforms and facilitate the transmission of business from Participating Local Governments, assets, liabilities, employees and instruments were transferred to the Distributor-Retailers from 1 July 2010 in accordance with the transfer provisions under Chapter 3 of the Restructuring Act.

The Distributor-Retailers will not be liable to make any PAYG instalments until they are issued with a positive PAYG instalment rate. As they did not assume operational responsibilities or commence trading until 1 July 2010, no instalment rate would, under normal circumstances, be issued by the Tax Assessor for the 2009-10 year. A positive PAYG instalment rate would not be expected to be issued to the Distributor-Retailers until lodgement and processing of their 2010-11 returns, which is likely to occur in the March 2012 Quarter. Accordingly, the Authorities would not be required to make their first PAYG instalments to their Participating Local Governments until April 2012.

To facilitate continuity of PAYG instalments following the transmission of business to the Distributor-Retailers on 1 July 2010 and pending the issuance of PAYG instalment rates in the March Quarter 2012, the Authorities may, subject to approval by the Tax Assessor, adopt an interim instalment rate.

For the purposes of setting the interim instalment rate, the Authorities will be required to adopt a weighted average instalment rate (WAIR) based on the instalment rates of Participating Local Governments which were previously Subject Entities. The WAIR will be issued by the Tax Assessor and will apply until it is amended by the Subject Entity or until a new instalment rate is issued by the Tax Assessor following the lodgement and processing of the first taxable income tax equivalents return.

It is acknowledged that, for a variety of reasons, the WAIR may not reflect the circumstances of the Subject Entity. If the Subject Entity believes there are reasonable grounds to seek a variation to the WAIR, it may:

1) self assess a variation to the WAIR subject to the normal general interest charge and penalties that apply under the Commonwealth Tax Laws if an instalment rate variation is too low; or
2) seek the approval of the Tax Assessor to adopt a varied instalment rate. If such a variation is sought, the onus is on the Subject Entity to provide sufficient documentation to the Tax Assessor to show that the WAIR is not appropriate and that a varied instalment rate should be issued. Such documentation would include forecast financial information and a reconciliation of accounting profit before tax to taxable income based on that forecast financial information. In the event that such documentation was deficient, there is potential for general interest charge and penalties to apply.

PART VI

STATE TAX EQUIVALENTS REGIME

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DIVISION 4 - TAXATION UNDER THE STATE TAX EQUIVALENTS REGIME

400. Preamble

Except to the extent set out in this Manual, the imposition of State tax equivalents upon entities subject to the Local Government Tax Equivalents Regime shall be determined in accordance with:

- the *Local Government Act 2009*;
- the *South-East Queensland Water (Distribution and Retail Restructuring) Act 2009*;
- the *Duties Act 2001*;
- the *Taxation Administration Act 2001*;
- the *Payroll Tax Act 1971*;
- the *Land Tax Act 2010*;
- relevant Regulations to the above Acts; and
- other legislation as notified.

as amended from time to time (including any new Acts replacing in whole or in part any of the above Acts, Regulations, together with any rulings issued by the Treasurer/ State Tax Commissioner.

401. Double Taxation

(a) A Subject Entity which is either not exempt or not entitled to exemption from State taxes in relation to any activities or transactions of the Subject Entity, or goods and services purchased or sold by the Subject Entity, will not also be liable for the payment of State tax equivalents in respect of these activities, transactions or the purchases or sales.

402. Application of State Tax Equivalents Regime

(a) A Subject Entity is subject to the State Tax Equivalents Regime where the entity receives a notice to that effect from the Treasurer.

403. Commencement Date of State Tax Equivalent Regime

(a) The State Tax Equivalents Regime shall apply to each Subject Entity for the financial year commencing 1 July 1998 and ending on the next succeeding 30 June, and for each subsequent financial year, or from the date that a Significant Business Activity of a Local Government becomes corporatised or commercialised (as per Chapter 3, Parts 4 and 5 of the *Local Government (Beneficial Enterprises and Business Activities) Regulation 2010*) following the commencement of the State Tax Equivalents Regime.

404. Subject Entity to be treated as a Company

(a) Unless otherwise stated, for each State tax, each Subject Entity shall be regarded as a Company within the definition of that term in the State Tax Act under which the relevant tax is levied.

405. Public Officer

(a) Each Subject Entity is required to appoint a public officer in writing to the OSR. Such notice shall disclose the name of the public officer and the address for service of notices upon the Subject Entity.

(b) Such appointment must occur within three months after the commencement date of the Subject Entity into the Local Government Tax Equivalents Regime.

(c) Each Subject Entity shall keep the office of the public officer constantly filled. A public officer is to be appointed when and as often as such an appointment becomes necessary.

(d) Where a Subject Entity has been subject to the State tax laws, the appointment of a public officer pursuant to those laws shall represent a valid appointment for the purposes of the State Tax Equivalents Regime.

406. Method of Payment of State Tax Equivalent Amounts

(a) The State tax equivalent amounts payable by a Subject Entity are required to be paid to the Local Government of which the Subject Entity forms a part (for commercialised business units) or the local government which owns the Subject Entity (for LGOCs).

407. Lodgement of State Tax Equivalents Returns

(a) For each financial year ending 30 June after a Subject Entity enters the Local Government Tax Equivalent Regime, a Subject Entity which has a State tax equivalents liability for assessable dealings or land holdings must lodge, by 31 October following the end of the financial year, a return in relation to the duty, payroll tax and land tax components of the State tax equivalents regime.

Note:

In relation to land tax equivalents, the return to be lodged as above, would be based on the assessable landholdings as at 30 June of the preceding financial year (i.e. for the 1999-2000 financial year, a return will be lodged on 31 October 1999 based on assessable landholdings as at 30 June 1999)

The address for lodgement of the State Tax Equivalents Return is:

Office of State Revenue
33 Charlotte Street
BRISBANE QLD 4000

[GPO Box 2593]
[BRISBANE QLD 4001]

or other address as notified from time to time.

408. Timing for Payment State Tax Equivalent Liabilities

(a) A Subject Entity shall:

(i) subject to (ii) and (iii), pay the amount of its State tax equivalents liability on or before 1 December following the due date of lodgement of the relevant return;

(ii) where the Subject Entity lodges a revised return following advice from the State Tax Commissioner, pay the amount of its State tax equivalents liability within 1 month of lodging the revised return, or on or before 1 December following (whichever is the later); and

(iii) where the Subject Entity lodges an objection, pay the amount of its State tax equivalents liability within 1 month of being advised of the outcome of the objection, but no later than 1 December.

409. Format of State Tax Equivalents Return

(a) The format of State tax equivalents returns for Subject Entities may be chosen to suit the requirements of the Subject Entity, provided that the return form indicates:

(i) the financial year of the return;
(ii) the date on which the return is made;
(iii) the name of the Subject Entity;
(iv) the details of assessable transactions for duty purposes, taxable wages for payroll tax purposes and landholdings (including value) for land tax purposes;
(v) the Subject Entity's assessment of stamp duty, payroll tax and land tax equivalents payable; and includes
(vi) a declaration in the following form:

"I declare that the particulars shown in this return and the relevant records used to ascertain the State tax equivalents payable by the entity are true and correct, in accordance with the Local Government Tax Equivalents Manual.

Name of public officer
Signature
Date"

(b) For some taxes, an approved form is available from the State Tax Commissioner and may be used by Subject Entities. In other instances, Subject Entities should seek advice from the State Tax Commissioner in relation to the most appropriate format in relation to the particular State tax.

410. Review and Objection Process

(a) A Subject Entity which does not agree with advice from the State Tax Commissioner in relation to its self-assessment of State tax equivalents may lodge an objection with the State Tax Commissioner in accordance with this section.

(b) The objection must:
(i) be made in writing;
(ii) be lodged with the State Tax Commissioner within 1 month of receipt of the advice from the State Tax Commissioner; and
(iii) state, fully and in detail, the grounds that the Subject Entity relies on.

(c) On receipt of the objection, the State Tax Commissioner must decide whether to allow the objection (in whole or in part), or to disallow it, and serve written notice of the decision, together with reasons therefore, upon the Subject Entity.

411. Investigations

(a) A Subject Entity is required to make all information and documentation, which the State Tax Commissioner might reasonably require to review the Subject Entity's assessment or consider any objection, available to the State Tax Commissioner on request.

(A) DUTY

412. Removal of Exemptions under the *Duties Act 2001* and Other Acts

(a) For the purposes of the Local Government State Tax Equivalents Regime the exemption from duty under section 390 (chapter 9 part 4 – Exemptions for Vehicle Registration Duty *Duties Act 2001*) for an application to register after a vehicle in the name of, or an application to transfer registration of a motor vehicle to, a local government under the *Duties Act 2001* does not apply. As such, a Subject Entity shall not be entitled to claim that exemption.

(b) Subject to (c), the exemptions from State taxes under section 58B of the *Local Government Act 2009* do not apply for the purposes of the Local Government State Tax Equivalents Regime. As such, a Subject Entity shall not be entitled to claim any exemption under those exemptions.

(c) To remove any doubt, for the purposes of the Local Government State Tax Equivalents Regime, the exemptions from State taxes under section 58B(1) of the *Local Government Act 2009* do apply. As such, a Subject Entity shall be entitled to claim any exemption under those exemptions.

(d) For the purposes of the Local Government State Tax Equivalents Regime, the exemption for Distributor-Retailers under section 71 of the Restructuring Act for anything done under a "transition document" issued under the Restructuring Act does apply.

413. Duty Equivalents Payable

(a) For the purposes of the Local Government Tax Equivalent Regime, a reference to "duty" means "a duty equivalent" in the *Duties Act 2001*.

(b) Subject to paragraph (d) of this section, the duty equivalents payable by a Subject Entity shall be calculated:
- (i) for applications for registration or transfer of registration of a motor vehicle - as set out in sections 377 to 384 of the *Duties Act 2001*;
- (ii) for any transactions, arrangements or instruments connected with financial arrangements entered into by the Subject Entity (which has been exempted under s.508(3) of the *Duties Act 2001*- as if the provisions of the *Duties Act 2001* applied; and
- (iii) for any transactions exempted under s.707 of the *Local Government Act 1993* (other than those exempted under the Local Government Tax Equivalents Regime) - as if the provisions of the *Duties Act 2001* applied.

(c) Where transactions by a commercialised Subject Entity, which if entered into by a comparable corporatised Subject Entity, would make the entity liable for duties equivalents, the Subject Entity must make an estimate of the consideration involved and calculate the duty equivalent payable as set out in paragraph (b) of this section.

(d) Where a Subject Entity was subject to a previous State Tax Regime for duty purposes, and continues to be subject to the State Tax Regime for duty purposes following transition into the Local Government Tax Equivalents Regime, the entity will be exempt from the application of the Local Government Tax Equivalents Regime for duty equivalent purposes.

414. Certain Sections of the *Duties Act 2001* have no application

(a) For the purposes of the Local Government Tax Equivalent Regime, the following sections of the *Duties Act 2001 and TAA-Q* do not apply:

- Sec.19, 240, 241 & 255 Lodging requirements
- Chapter 12 Registered Persons
- Chapter 13 Reviews and Appeals
- Chapter 14 Enforcement and Legal Proceedings
- Chapter 15 Signing and Stamping of Instruments
- Sec.482 Obligations relating to unstamped instruments
- Sec.487 Receipt of instruments in evidence
- Sec.492 Way instruments are stamped
- Sec.494 Copies of instruments
- Sec.495 Instrument must not be delivered until duty or fee paid
- Sec.496 Lodging declaration stating facts and circumstances
- Sec.497 Recognition of duty paid for Commonwealth places
- Sec.499 Reassessments of duty in particular circumstances
- Sec.500 Application of Administration Act, pt 6, to particular decisions
- Sec.505 Valuation or evidence of value of property
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- Sec.18 (*TAA-Q*) When commissioner must make reassessment - general
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- Part 3 Div 2 (TAA) Self assessments
- Sec.24 (*TAA-Q*) Reassessments by self assessors
- Sec.26 (*TAA-Q*) Assessment notice to be given to taxpayer
- Part 4 (*TAA-Q*) Payments and refunds of tax and other amounts
- Part 5 (*TAA-Q*) Interest and penalty tax
- Part 6 (*TAA-Q*) Objections and appeals against assessments
- Part 7 (*TAA-Q*) Investigations
- Sec.87 (*TAA-Q*) Power to require information or documents
- Part 9 (*TAA-Q*) Record keeping
- Part 10 (*TAA-Q*) Enforcement and legal proceedings
- Sec.145 (*TAA-Q*) When lodging requirement complied with
- Sec.148 (*TAA-Q*) Ways document given by commissioner

- Sec.149 (*TAA-Q*) When document given by commissioner

(B) PAYROLL TAX

415. Removal of Exemptions under the *Payroll Tax Act*

(a) For the purposes of the Local Government State Tax Equivalents Regime, exemptions provided under Section 14(2)(e) of the *Payroll Tax Act* do not apply. As such, a Subject Entity shall not be entitled to claim any exemption under that Section.

416. Payroll Tax Equivalents Payable

(a) For the purposes of the Local Government Tax Equivalent Regime, a reference to "payroll tax" means "a payroll tax equivalent" in the *Payroll Tax Act 1971*.

(b) Subject to paragraph (c) of this section, the payroll tax equivalents payable by a Subject Entity shall be calculated as set out in:
  (i) Part 2 and Part 3 of the *Payroll Tax Act 1971* (except that the tax is payable to the local government rather than being charged, levied and paid for the use of Her Majesty as provided for under Section 10 of the Act); and
  (ii) Part 4 (Grouping Provisions) of the *Payroll Tax Act 1971*.

(c) Where a Subject Entity was subject to a previous State Tax Regime for payroll tax purposes, and continues to be subject to that State Tax Regime for payroll tax purposes following transition into the Local Government Tax Equivalents Regime, the entity will be exempt from the application of the Local Government Tax Equivalents Regime for payroll tax equivalent purposes.

417. Certain Sections of the Payroll Tax Act and Taxation Administration Act have no application

(a) For the purposes of the Local Government Tax Equivalent Regime, the following sections of the *Payroll Tax Act 1971* and the *Taxation Administration Act 2001* (*TAA-Q*) do not apply:

- Sec.59 to 64 - returns
- Sec.62 - exemption from furnishing returns
- Sec.30 - time for payment of tax (*TAA-Q*)
- Part 3 – Assessments of tax (*TAA-Q*)
- Part 4 – Payments and refunds of tax and other amounts (*TAA-Q*)
- Sec.34 - time to pay - extensions and instalments (*TAA-Q*)
- Part 5 – Interest and penalty tax (*TAA-Q*)
- Sec.45 to 47 - recovery of tax (*TAA-Q*)
- Sec.50 to 53 – Collections of amounts from a garnishee (*TAA-Q*)
- Part 6 – Objections and appeals against assessments (*TAA-Q*)
- Sec.69 to 74 – Appeals (*TAA-Q*)
- Sec.114 - books, accounts etc to be preserved (*TAA-Q*)
- Sec.115 - access to books (*TAA-Q*)

(C) LAND TAX

418. Removal of Exemptions under the *Land Tax Act*

(a) For the purposes of the Local Government State Tax Equivalents Regime, Section 52 of the *Land Tax Act* does not apply. As such, a Subject Entity shall not be entitled to claim any exemption under that Section.

(b) Where parcels of land which are controlled or used by the Subject Entity are not held in freehold, but would normally be held in freehold if used for similar purposes by a comparable private owner, those parcels are deemed to be freehold for the purposes of determining the land tax equivalents payable.

419. Land Tax Equivalents Payable

(a) For the purposes of the Local Government Tax Equivalent Regime, a reference to "land tax" means "land tax equivalent" in the *Land Tax Act 2010*.

(b) Subject to paragraph (c) of this section, the land tax equivalents payable by a Subject Entity shall be calculated as set out in Part 2 (Imposition of land tax) of the *Land Tax Act 2010*.

(c) Where a Subject Entity was subject to a previous State Tax Regime for land tax purposes, and continues to be subject to that State Tax Regime for land tax purposes following transition into the Local Government Tax Equivalents Regime, the entity will be exempt from the application of the Local Government Tax Equivalents Regime for land tax equivalent purposes.

420. Certain Sections of the Land Tax Act have no application

(a) For the purposes of the Local Government Tax Equivalent Regime, the following sections of the *Land Tax Act 2010* do not apply:
- Part 4 – payments (TAA-Q)
- Part 3 – assessment of tax (TAA-Q)
- S.90 - entry of places (TAA-Q)
- Part 6 – appeals (TAA-Q)
- Part 4 - collection and recovery of tax (TAA-Q)
- Part 10 - offences and fines (TAA-Q)

(b) For the purposes of the Local Government Tax Equivalent Regime, Land Regulations 8A, 8B and 23 to 32 do not apply:

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LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/1

LITER 98/1: DERIVATION OF INCOME - GENERAL PRINCIPLES

Date of Effect: Immediate

Preamble

The ITAA involves an annual basis of taxation which depends on the concept of "derivation" in recognising income during a particular income period. Accordingly, it is not only necessary to consider whether an item is ***income*** but also whether it has been ***derived***. There are two rival bases which determine the timing of income derivation for tax purposes. These are the Cash Receipts basis and the Earnings or Accruals basis.

Issue: What is the appropriate basis for a Subject Entity to bring to account its income

As stated above, there are two bases which determine the timing of income derivation for tax purposes. Briefly stated, these bases will operate upon the Subject Entity as follows:

(a) **The Cash Receipts Basis** under which income is recognised when it is actually or constructively received. This basis is used by most individuals and small scale businesses. Due to the scale of business generally carried on by a Subject Entity, the cash receipts basis would not be the appropriate basis for a Subject Entity to compute its ***trading income*** unless specific approval for its adoption was received from the Tax Assessor. However, until the ITAA is amended, the cash receipts basis may be the appropriate basis for bringing to account ***passive income,*** such as interest, royalties and rent, unless the Subject Entity's business would normally include the derivation of such income.

(b) **The Earnings or Accruals Basis** under which income is accounted for when the right to receive it comes into being. That is, when the income has been earned. Due to the scale of business generally carried on by a Subject Entity, the earnings or accruals basis would be the appropriate basis for a Subject Entity to bring to account its ***trading income***.

Subject to any special statutory provision in the ITAA or this Manual, the timing of the derivation of income (that is, whether it is derived before actual receipt) differs according to the **nature** of the income-producing activities of the taxpayer who derived it.

As stated above, ***trading income*** is generally derived when the right to receive the income arises as a debt due and owing. In many cases, this will not coincide with the actual receipt of monies and also may not coincide with the recognised accounting method for accruing the income. On the other hand, ***passive income*** (in general) does not become assessable until it has been received or the debt has been in some way discharged.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/2

LITER 98/2: DEFERRED INCOME – WHEN IS DEFERRED INCOME "DERIVED" FOR TAX PURPOSES

Date of Effect: Immediate

Preamble

In some cases, a Subject Entity may have deferred the recognition of income (for accounting purposes) received prior to its entry into the tax equivalents regime until after commencement in the regime. That is, an amount of income has not been taken up as income in the Subject Entity's accounts prior to entry into the regime.

A question arises as to the basis on which the income brought to account as revenue after entry into the regime should be treated for tax equivalent purposes.

Transitional Issue: How should a Subject Entity treat (for tax purposes) income which has been deferred for accounting purposes while the Subject Entity was tax-exempt and is recognised as accounting revenue after the Subject Entity has entered into the tax equivalents regime?

Current ITAA/ATO Approach

As stated in *Local Government Income Tax Equivalents Ruling* LITER 98/1, the ITAA involves an annual basis of taxation which depends on the concept of "derivation" in recognising income during a particular income period. Accordingly, it is not only necessary to consider whether an item is ***income*** but also whether it has been ***derived***.

Accordingly, a deferral in recognising income for ITAA purposes can occur, but it will generally only arise when it can be shown that the taxpayer has not **derived** the relevant amount in the particular income period.

In relation to corporatisations/privatisations, the ATO has applied the derivation principles strictly. In this regard, the position with respect to moneys received in advance of the supply of services was considered by the High Court in Arthur Murray (NSW) Pty Limited v. FCT (1965) 114 CLR 314, where it was held that fees received by the taxpayer in advance of tuition did not have the character of assessable income until the services were provided. As such, the High Court stated that the receipt of money as a prepayment under a contract for future services did not, of itself, constitute a derivation of assessable income. An important factor in the High Court reaching its decision was the agreed fact that "according to established accounting and commercial principles, in the case of a business either selling goods or supplying services, amounts received in advance of the goods being delivered or the services being supplied are not regarded as income."

As stated above, the ATO approach has been to apply the principles of derivation. Accordingly, whether or not the Arthur Murray case would be appropriate must be determined on an individual basis, having regard to the facts discussed by the High Court in that case.

Transition from Income Tax Exempt to Tax Payable Status

Division 57 of the ITAA 1936 provides specific rules in relation to the transition of an entity from income tax exempt status to taxable status. In particular, the Division is designed to deal with various transitional issues which arise due to the change in status. Broadly, the Division ensures that only income, gains, losses and outgoings which relate to the period subsequent to transition into the Federal regime shall be taken into account in determining the taxable income of the entity. However, certain transitional rules are provided with respect to timing of the derivation of income and the incurring of losses and outgoings.

Pursuant to section 57-15, where income is derived by a transition taxpayer before transition time but is in respect of goods provided, services rendered or any other thing done after transition time, the relevant income is deemed to have been derived at the time of provision of the goods or services or when the thing was done. Likewise, where income is derived after transition time but it relates to services rendered, goods provided or any other thing done before transition time, it will be deemed to have been derived before transition time.

Position to be adopted

Under the ITAA approach, deferred income is recognised for income tax purposes upon the principles of derivation. A number of complexities are foreshadowed in applying the strict ITAA principles to this situation. Accordingly, for the purposes of transition into the tax equivalents regime, a Subject Entity (irrespective of whether it is corporatised or commercialised) may elect to adopt either of the following options:

(1) Adopt a strict ITAA approach, not reflecting the application of Division 57

This will require the Subject Entity determining the actual point of derivation in relation to deferred income (ie. before or after entry into the tax equivalents regime). In this regard, the principles in the Arthur Murray case may determine that the income received in advance is not properly derived until the services are provided. A persuasive factor in this regard is the accounting policy adopted by the Subject Entity (or its predecessor tax-exempt body) in booking the income received in advance as "Deferred Income".

Where a Subject Entity determines that the deferred income is derived prior to entry into the tax equivalents regime, it will be necessary to "trap" the expenditure which is incurred after entry into the tax equivalents regime and which relates to providing the goods or services to which that deferred income relates. Pursuant to subsection 51(1), this expenditure will not be deductible because it relates to the production of exempt income.

(2) Adopt the position adopted in Division 57

Where income is derived by a Subject Entity before entry into the tax equivalents regime but is in respect of goods provided, services rendered or any other thing done after entry into the regime, the relevant income is deemed to have been derived at the time of provision of the goods or services or when the thing was done and thus all such income will be assessable to the Subject Entity.

Likewise, where income is derived after entry into the tax equivalent regime but it relates to services rendered, goods provided or any other thing done before entry into the regime, it will be deemed to have been derived prior to entry into the tax equivalents regime and thus will not form part of the assessable income of the transition entity.

(3) Adopt accounting principles approach

In recognition of the complexities involved with (1) and (2) above, a Subject Entity may recognise all existing deferred income as assessable income in accordance with accounting principles. In these circumstances, expenditure incurred in providing the goods or services will be an allowable deduction.

Issue: How will income which is deferred for accounting purposes *after* a Subject Entity is subject to the tax equivalents regime be treated ?

The treatment of income which is deferred once the Subject Entity becomes subject to the tax equivalent regime, will occur in accordance with ITAA principles. In this regard, reference should be made to the principles in the Arthur Murray case and *Local Government Income Tax Equivalents Ruling* LITER 98/1.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/3

LITER 98/3: TRADING STOCK – OPENING VALUE ON ENTRY INTO THE TAX EQUIVALENTS REGIME

Date of Effect: Immediate

Preamble

Trading stock is defined in section 70-10 of the ITAA 1997 as including anything produced, manufactured, acquired or purchased for the purposes of manufacture, sale or exchange in the ordinary course of a business. The definition is not exhaustive and is not restricted to goods in the nature of a commodity. In this regard, it is possible for land, shares and items such as raw materials, labels, containers and parts which become integrated in articles produced for sale or further manufacture to be regarded as trading stock. Furthermore, crops, timber and fruit may constitute trading stock ***once severed*** from the land (as trading stock does not include ***standing or growing*** crops, timber or fruit).

In relation to trading stock, established commercial and accounting practice requires that the value of stock on hand at the beginning and end of the year of income be taken into account in ascertaining the profit for the year so as to match the cost of goods sold with the sales revenue for the relevant period. The ITAA includes specific provisions to enable a consistent approach with the established commercial and accounting principles.

Section 70-35 of the ITAA 1997 provides that where a taxpayer carries on business, the value of all trading stock on hand at the beginning and end of the year of income must be brought to account. Where the value of closing stock exceeds the value of opening stock, the excess is included in assessable income. Conversely, where the value of opening stock exceeds the value of closing stock, the excess is an allowable deduction.

Section 70-40 of the ITAA 1997 provides that the opening value of trading stock in any income year is to be taken as the closing value at the end of the last income year.

Transitional Issue: Upon entry into the tax equivalents regime, what value should a Subject Entity adopt as the opening value of trading stock given the ITAA requirement that the opening value of trading stock must be the same as the closing value in the previous year and given the requirements of Division 57, as modified by the TER Manual?

Current ITAA/ATO Approach

Strictly applied, in the absence of Division 57, the trading stock provisions in the ITAA would result in an opening stock value (on entry into the tax equivalents regime) of nil. This is because section 70-40 of the ITAA 1997 requires that the value of closing stock at the beginning of the year must match the value ***as ascertained under the ITAA*** at the end of the prior year. Accordingly, as a Subject Entity which enters a tax equivalents regime would have no value for prior year closing stock ***ascertained under the ITAA***, the opening value for trading stock upon entering the tax equivalents regime should, strictly speaking, be nil. However, Division 57 of the ITAA 1936 corrects this position to ensure that an entity entering the Federal income tax regime will have an opening value of trading stock equal to the value of that stock immediately prior to entry into the regime.

Division 57 of the ITAA 1936

Section 57-115 of the ITAA 1936 modifies the trading stock provisions in so far as they apply to a transition taxpayer (i.e. a taxpayer entering the Federal income tax regime). Specifically, it provides that, for the purpose of applying the trading stock provisions of the ITAA to the transition year (being the first year under the Federal regime) of such a taxpayer, the only trading stock to be taken into account under section 70-35 as being trading stock of the transition taxpayer on hand at the beginning of the transition year is such stock as was on hand at the time of transition into the Federal regime.

Further, the purpose of working out the value at which trading stock is to be taken into account, the year of income preceding the transition year is taken to have ended immediately before the transition time and thus it is necessary to determine the closing value of trading stock in the prior year of income under section 70-45 of the ITAA 1997 as the value immediately prior to transition time.

Section 70-45 of the ITAA 1997 provides three bases for valuing trading stock: cost, market selling value or replacement price. In relation to the ***cost of an item of trading stock***, the ATO is of the view that cost refers to the full absorption cost of the stock, rather than its direct cost. In relation to full absorption costing, regard should be had to *Taxation Ruling* IT2350.

Position to be adopted

A Subject Entity which has not been subject to a predecessor tax equivalents regime may choose between the ATO (Division 57) approach (as noted above) and an existing book value approach. Accordingly, each Subject Entity (irrespective of whether it has been corporatised or commercialised) has the option of:

(1) Applying the rules in Division 57 of the ITAA 1936 and making a valuation of each item of trading stock at the end of the period immediately preceding entry into the tax equivalents regime based on one of the valuation methods permitted by the ITAA 1997; or

(2) alternatively, the Subject Entity may ***in the year of transition only*** adopt the existing book valuation of trading stock immediately prior to entry into the tax equivalents regime as the opening value for tax purposes.

Transitional Issue: Entities where trading stock is acquired as a result of the corporatisation or commercialisation process

Strict application of the ITAA would result in an opening value of trading stock upon entry into the tax equivalents regime of nil. Such a result would not lead to harsh tax consequences where the trading stock acquired by the Subject Entity from its predecessor tax-exempt body is an allowable deduction. However, this would not be the case where the Subject Entity remains exempt for a period after its date of corporatisation or commercialisation. Furthermore, a strict application of the ITAA may result in Subject Entities taking a different approach depending on their mode of corporatisation or commercialisation.

Accordingly, in the interests of adopting a consistent approach to the establishment of opening values for trading stock amongst all entrants into the tax equivalents regime, a Subject Entity is deemed (for these purposes) to have been the same entity prior to corporatisation or commercialisation such that upon entry into the tax equivalents regime it may adopt either (1) or (2) above in establishing its opening value for trading stock.

Accordingly, upon entry into the tax equivalents regime, section 70-95 of the ITAA 1997 will have no application (to deem the entity to have acquired the trading stock at market value). Furthermore, section 70-20 of the ITAA 1997 will have no application for these purposes.

Issue: Determination of Closing Value for Trading Stock

Following entry into the Local Government Tax Equivalents Regime, a Subject Entity will be required to follow the ITAA 1997 in valuing its closing trading stock.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/4

LITER 98/4: BORROWING COSTS

Date of Effect: Immediate

Preamble

Expenditure incurred in borrowing money is normally capital in nature, and accordingly, would not fall within the scope of the general deduction provisions of section 8-1 of the ITAA 1997. However, section 25-25 of the ITAA 1997 is a specific statutory provision which allows a deduction for such expenditure where the money is used for the purpose of producing assessable income.

Under section 25-25, the expenditure is deductible over the term of the loan or five years, whichever is the shorter. Where the term of the loan is not fixed, the deduction should be spread over five years. Furthermore, the deduction is not limited to payments made or due at the time of the loan; it also includes payments to be made during the life of the loan pursuant to a contractual obligation incurred at the time of borrowing.

Pursuant to subsections 25-25(2) and (3), a deduction is only allowed for borrowing expenses to the extent that the money borrowed is actually used to produce assessable income for the particular year in which the deduction is claimed.

In the context of section 25-25, borrowing costs refers to the actual expenditure incurred by a Subject Entity in borrowing funds. These costs will typically include procuration fees, legal expenses and fees, stamp duty, valuation and survey fees, broker's commission, underwriter's fees, the cost of arranging bank overdrafts, and guarantee fees. Borrowing costs would not generally include any loss accrued in a Subject Entity's accounts as a result of any mark-to-market adjustment to the book value of the loan which is taken up at year end for accounting purposes. Any mark-to-market adjustments are to be treated under the income tax equivalents regime in accordance with ITAA principles.

Transitional Issue: **Upon entry into the tax equivalents regime, is a deduction available in respect of any portion of borrowing expenses incurred whilst the Subject Entity (or its predecessor tax-exempt body) was tax exempt?**

Current ITAA/ATO Approach

As noted above, the ITAA 1997 contains specific rules for the claiming of deductions for borrowing costs by artificially creating a point of deductibility outside the time of incurring such expenditure. Furthermore, subsection 25-25(3) of the ITAA 1997 provides that borrowing expenses are not fully deductible if the borrowed money is used by the taxpayer only partly for the purpose of producing assessable income. In such a case, the deduction is limited to the amount which the Commissioner considers reasonable. Accordingly, a deduction would be available for that portion of the borrowing costs incurred which reflects borrowings being used to produce assessable income.

Position to be adopted

For simplicity, the accounting treatment adopted by the Subject Entity (or its predecessor tax-exempt body) in respect of loans and their associated borrowing costs will determine the eligibility for deductions for borrowing costs which were incurred prior to entry into the tax equivalents regime.

Accordingly, borrowing costs incurred by a Subject Entity (or its predecessor tax-exempt body) prior to entry into the tax equivalents regime may be deductible where those costs are being amortised for accounting purposes. As such, the balance of unamortised borrowing costs remaining upon entry into the tax equivalents regime may be deductible for tax purposes as it is charged to the P&L account of the Subject Entity.

The position adopted by the Subject Entity (or its predecessor tax-exempt body) in prior accounting periods should not be amended, even if it results in elements of borrowing costs incurred during pre-tax equivalents periods, being expensed after they became subject to tax equivalents.

Alternatively, Subject Entities which have fully expensed borrowing costs in earlier periods for accounting purposes will not be able to reinstate and amortise those costs for tax purposes following entry into the tax equivalents regime.

The principal value of the loan is to be the book value of the loan to the Subject Entity on the date that the Entity enters the tax equivalents regime. That is, if for accounting purposes a Subject Entity adjusts the value of the loan to its market value at that date, that market value becomes the appropriate base value.

Issue: Borrowing Costs incurred after entry into a tax equivalents regime

Borrowing costs incurred after entry into the tax equivalents regime are to be treated in accordance with ITAA 1997 principles.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/5

LITER 98/5: DEDUCTIBILITY OF SALES TAX EQUIVALENT PAYMENTS

Date of Effect: Withdrawn December 2007

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/6

LITER 98/6: EMPLOYEE LEAVE ENTITLEMENTS AND REDUNDANCY PAYMENTS

Date of Effect: Immediate

Preamble

For ITAA purposes, subsection 51(3) provides that a deduction for employee leave entitlements (e.g. long service leave, annual leave, sick leave, etc) may be claimed only where actual payment is made, rather than when provisions are created.

Transitional Issue: Can a deduction be claimed for payments made after entry into a tax equivalents regime in respect of leave entitlements which have accrued whilst a Subject Entity was tax-exempt ?

Current ITAA/ATO Approach

In the case of corporatisations and commercialisations, the ATO has traditionally taken the view that payments made after an entity has become taxpaying in respect of leave entitlements which accrued prior thereto will be deductible in the year in which the employee takes the leave, as this is the year in which they are incurred for tax purposes. This position results from a strict application of the ITAA.

Division 57 of the ITAA

Division 57 modifies this traditional view in that section 57-60 of the ITAA operates to limit the deduction otherwise allowable in respect of long service leave payments or annual leave payments made to a person who was an employee of the transition taxpayer at any time before transition into the Federal income tax regime. Broadly, it denies a deduction to the extent that at the time the payment is made to the employee, an amount of leave provided for prior to transition remains unpaid.

Position to be adopted

The traditional ATO position is to be followed. That is, as provided in the TER Manual, the requirements under Division 57 of the ITAA do not have application. This position reflects the time at which this item is properly deductible for tax purposes. Further, it recognises that there is a cash outflow at the time of payment that should be reflected in the tax and tax effect accounting position for that year.

It is noted that this is an issue that is not limited to the transitional year (unlike other items such as accruals and prepayments) since there is no guarantee that these payments will be made in the year of transition, but may occur over a substantial period of time.

Transitional Issue: **What is the position upon entry into the Local Government Tax Equivalents Regime for those Subject Entities where the corporatisation or commercialisation process involved the transfer of assets and liabilities from the existing tax-exempt body to the Subject Entity?**

Current ITAA/ATO Position

Various rules apply depending on the nature of the arrangements for the transfer of the assets and liabilities (including employee leave entitlements).

Where the transfer of employee leave entitlements involves an "accrued leave transfer payment" from the existing employer (that is, the predecessor tax-exempt body) to the subsequent employer (that is, the Subject Entity), section 15-5 of the ITAA 1997 requires the subsequent employer to return the payment as assessable income. The subsequent employer is not entitled to a deduction for the accrued leave entitlement except as set out section 26-10 of the ITAA 1997.

Where the purchase price of a business is reduced to take account of accrued leave entitlements (and thus, reflect the liabilities assumed by the purchaser), the amount of the reduction is not assessable to the purchaser because no amount was received by the purchaser (*Taxation Ruling* IT 2557). Similarly, the purchaser will only be entitled to deductions in respect of subsequent leave payments made to the employees concerned.

Position to be adopted

The ITAA/ATO position is to be followed. Accordingly, the nature of the arrangements upon corporatisation or commercialisation will be determinative in this regard. However, it should be noted that the tax deductibility of the accrued employee leave entitlements is the same for all entities upon entry into a tax equivalents regime (that is, deductible pursuant to the terms of section 26-10 of the ITAA 1997).

REDUNDANCY PAYMENTS

Transitional Issue: **Will a redundancy payment (made after entry into the tax equivalents regime) which includes a component calculated by reference to an employment period whilst the entity (or its predecessor entity) was tax-exempt be treated as being wholly incurred at the time the payment is made ?**

Position to be Adopted

To the extent that a redundancy payment meets the general test of deductibility imposed by section 8-1 of the ITAA 1997, it will be regarded as being wholly incurred by the Subject Entity after entry into the tax equivalents regime.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/7

LITER 98/7: BAD DEBTS

Date of Effect: Immediate

Preamble

A bad debt deduction may be claimed under the special provisions of section 25-35 of the Income Tax Assessment Act 1997 (the 1997 Act) or alternatively under the general deduction provisions of section 8-1 of the 1997 Act. Reserves and provisions for doubtful debts are not deductible.

To be deductible the debt must be written off as bad. In most cases, this is a question (to be ascertained objectively) as to whether there is little or no likelihood of the debt being recovered (refer *Taxation Ruling* TR 92/18). Furthermore, companies (including Subject Entities) wishing to claim a bad debt deduction under either section 8-1 or section 25-35 of the ITAA 1997 must (in addition to writing off the debt as bad in the year it is claimed) satisfy either the continuity of beneficial ownership test (section 63A of the ITAA) or the continuity of business test (section 63C of the ITAA).

To obtain a deduction for a bad debt under section 25-35 the following conditions must be satisfied:

- there must be a debt which is written off as bad during the year of income in which the deduction is claimed; and

- the debt must have been brought to account by the taxpayer as assessable income; or

  the debt must be in respect of money lent in the ordinary course of a money lending business carried on by the taxpayer.

A bad debt which is not deductible under section 25-35 of the ITAA 1997 may nevertheless be deductible under subsection 8-1 of the ITAA 1997. To be deductible under section 8-1, the bad debt must have been incurred and must be a loss (or non-receipt) relating to the production of the taxpayer's assessable income. Accordingly, the bad debt would not qualify for deduction under section 8-1 if it is a loss of a capital, private or domestic nature, or is incurred in relation to earning exempt income.

Transitional Issue: **Can a debt which becomes *bad after entry* into the tax equivalents regime *which relates to debts which arose prior to entry* into the tax equivalents regime be claimed as a deduction ?**

Current ITAA/ATO Approach

As noted in the Preamble above, bad debt deductions are available pursuant to the terms of section 25-35 or section 8-1 of the ITAA 1997. In relation to this transitional issue, the strict application of the ITAA would deny bad debt deductions *where the debt itself arose prior to* entry into the tax equivalents regime. This is because *principal conditions* for claiming the deduction are not satisfied, as follows:

- in relation to section 25-35 the debt has not been brought to account by the Subject Entity previously as assessable income;
- in relation to section 8-1 the debt was incurred in relation to the earning of exempt income.

In relation to corporatisations and commercialisations, the ATO have applied these principles strictly.

Division 57

Division 57 of the ITAA 1936 confirms this position in relation to previously income tax exempt entities which become subject to the Federal income tax regime. Specifically, section 57-65 of the ITAA 1936 provides that a deduction is only available if the *"doubtful debt provision limit"* (as defined in subsection 57-65(4)) has been fully absorbed. Broadly, this relates to the doubtful debt provision in existence at transition time.

Position to be adopted

The ITAA technical position would require the entities to separately identify and exclude from deductibility bad debts arising in respect of income earned whilst they were exempt from tax. Given the likely relative immateriality of debt write offs by Subject Entities, the transitional nature of the problem and the possible administrative burden, the ITAA position will not be adopted.

Accordingly, debts of the nature referred to in this ruling (i.e. debts which arose prior to entry into the tax equivalents regime) will be allowable as a deduction for tax equivalents purposes without reference to the *principal conditions* noted above. However, debts which are capital in nature will not be eligible for the bad debt write-off.

Deductions for bad debts in relation to *debts arising after entry into the tax equivalents regime* will be determined according to the ITAA principles.

Transitional Issue: **What is the position upon entry into the Tax Equivalents Regime for those entities where the corporatisation or commercialisation process involved the transfer of assets and liabilities from an existing tax-exempt body to the Subject Entity or from a predecessor Subject Entity to the Subject Entity.**

Current ITAA/ATO Approach

Where a business (other than a money lending business) is sold and the purchaser (the Subject Entity) takes over the debts of the vendor (a predecessor tax-exempt body or a predecessor Subject Entity), the purchaser is not entitled to a deduction under section 25-35 of the ITAA 1997 in respect of any such debts which are or subsequently become bad. This is so because of the principal condition contained in section 25-35 that the debts must have been brought into account as *assessable income by the taxpayer* who is claiming a deduction.

Position to be Adopted

On the same basis, as noted above, the ITAA approach will not be followed in respect of transferred debtor balances of the predecessor tax-exempt body or predecessor Subject Entity which subsequently become bad. Accordingly, debts of this nature (i.e. debts which arose to a tax-exempt body or a predecessor Subject Entity prior to entry into the tax equivalents regime) will be allowable as a deduction for tax equivalents purposes to the Subject Entity without reference to the *principal conditions* noted above. However, debts which are capital in nature will not be eligible for the bad debt write-off.

Deductions for bad debts in relation to *debts arising to the Subject Entity after entry into the tax equivalents regime* will be determined according to the ITAA principles.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/8

LITER 98/8: ACCRUALS

Date of Effect: Immediate

Preamble

Section 8-1 of the ITAA 1997 contains the general principles for the allowance of deductions. Section 8-1 allows a deduction for expenditure incurred in income-producing activities (except to the extent that the expenditure is of a capital, private or domestic nature or is incurred in deriving exempt income). To be deductible in a particular year, the expenditure must generally have been ***incurred*** in that year.

The meaning of ***incurred*** has been the subject of much debate. Broadly speaking, a liability will be ***incurred*** provided the taxpayer is "definitively committed", or has "completely subjected" itself to the liability, even though it remains unpaid. A taxpayer can completely subject itself to a liability, notwithstanding that the quantum of the liability cannot be precisely ascertained, provided that it is capable of reasonable estimation. However, it is noted that ***incurred*** does not include a loss or expenditure which is "no more than impending, threatened or expected" (*New Zealand Flax Investments Ltd v. FC of T*).

An issue often arises as to whether expenses which have been accrued in the books for accounting purposes have been ***incurred*** for tax purposes. In many instances, expenditure is deductible (that is, incurred) in the year in which the accrual is made, provided the principles for incurred have been satisfied.

Transitional Issue: May a previously tax exempt body claim deductions for expenses accrued prior to becoming taxable?

Current ITAA/ATO Approach

Accrued expenses will generally be regarded as having been incurred at the time the accrual is made. Accordingly, no deduction will be allowable once a Subject Entity enters the tax equivalents regime for expenses accrued whilst it was tax exempt but actually paid after entry into the tax equivalents regime.

Position to be adopted

The ITAA position is to be followed. Accruals will be deductible once they are incurred. Accordingly, expenses which have been accrued (and which represents expenditure ***incurred*** for tax purposes) by a Subject Entity (or its predecessor tax-exempt body) prior to entry into the tax equivalents regime will not be allowed as a deduction even though actual payment of the expense was made after the entity entered into the tax equivalents regime.

Where an accrual was made whilst the entity was tax-exempt, and that accrual did not become ***incurred*** until after entry into the tax equivalents regime, a deduction will be allowed for the expenditure where the other requirements for deductibility under section 8-1 of the ITAA 1997 are met. An example of such an accrual may be accrued audit fees in which case the Commissioner has laid out his views as to when such accruals are incurred in *Taxation Ruling* IT 2625. Accordingly, where audit fees have been accrued prior to entry into the tax equivalents regime which are not properly incurred until after entry into the tax equivalents regime, those fees may be deductible for tax purposes.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/9

LITER 98/9: PREPAYMENTS

Date of Effect: Immediate

Preamble

Broadly speaking, there is a difference between the tax concept and accounting concept of prepayments. For accounting purposes, prepayments of a Subject Entity represent Current Assets and are not expensed upon payment. For tax purposes, a deduction for prepaid expenditure will ordinarily arise to the taxpayer at the time the expenditure is incurred (that is, at the time of payment). This position is qualified under the ITAA where the service to which the prepayment relates last for more than 13 months. In these circumstances, the deduction for the prepayment is amortised over the lesser of 10 years or the period of the prepayment.

Transitional Issue: Can prepaid expenditure incurred by a Subject Entity whilst it is tax exempt be deductible when it relates to services to be rendered after the Subject Entity becomes tax paying?

Current ITAA/ATO Approach

Strictly applied, the ITAA will not ordinarily allow a deduction for expenditure incurred in a particular income year where that expenditure is incurred for the purposes of producing exempt income. Accordingly, where a prepayment is incurred in an income year throughout which the Subject Entity was tax-exempt no deduction is available in that period; nor can a deduction be claimed in a subsequent period when the Subject Entity is taxable (unless the "13 month" rule applied to spread the entitlement to a deduction over the lesser of 10 years or the period of the prepayment).

However, where the tax-exempt body becomes taxable in the same year, the ATO has taken the view that prepaid expenditure incurred prior to the Subject Entity becoming taxable will be deductible to the extent that it is incurred in gaining or producing assessable income earned after the Subject Entity becomes taxable.

Division 57 of the ITAA 1936

Section 57-20 of the ITAA 1936 deems a particular loss or outgoing to be incurred after transition time (i.e. the time of entry into the Federal income tax regime), notwithstanding that it is incurred before transition time, where it is in respect of services rendered, goods provided or any other thing done after transition time. Conversely, where a loss or outgoing relates to services rendered, goods provided or any other thing done before transition time, it will be deemed to have been incurred before transition time.

Thus, in the case of prepayments, if an amount of deductible expenditure is prepaid prior to transition time and that expenditure relates to services to be rendered, goods to be provided or any other thing to be done after transition time, then to the extent that the expenditure relates to the period prior to sale, an income tax deduction would not be available. However, to the extent that the expenditure relates to the period post transition an income tax deduction would be available. The effect of this section is broadly to override the principles dealing with the deductibility of prepaid expenditure which, without modification, would result in a transition taxpayer being denied an income tax deduction in

full where the prepayment relates to something to be done within a 13 month period following.

Position to be adopted

The current ITAA/ATO approach is to be adopted. Accordingly, a deduction for a prepayment which was incurred whilst the Subject Entity was exempt will generally not be deductible to the Subject Entity upon becoming taxable and the expenditure which is charged as an expense to the P&L after entry into the tax regime cannot be claimed as a deduction.

An exception to this rule applies such that where:

(1) the entity moved from being tax-exempt to taxable in the same income year as the prepayment was made; and
(2) the expenditure is incurred in gaining or producing assessable income upon becoming taxable;

In these circumstances, a deduction will be allowable to the extent that it is incurred for income producing purposes.

Where the corporatisation or commercialisation process involves the transfer of assets from the predecessor tax-exempt body to the Subject Entity, the Subject Entity would not be able to satisfy (1) above. Furthermore, in relation to the sale of a business, it is the normal practice of the ATO to disallow a deduction for prepayments acquired.

However, as a transitional concession, the Subject Entity and the predecessor tax-exempt body will be treated as the same entity. Accordingly, based on this concession where the "entity" can satisfy the requirements set out above, a deduction will be allowed to the extent that the prepayment is incurred for income producing purposes.

In later years, prepayments will be deductible in the year incurred, subject to the restrictions imposed by the ITAA.

Transitional Issue: What position is to be adopted where the prepayment (made whilst the entity was exempt) would invoke the "13 month" rule?

In such a case, the Subject Entity may claim a deduction on the balance of the expenditure entitlement which would remain upon entry into the tax equivalents regime on the assumption that the Subject Entity was always taxable.

In relation to a Subject Entity where the corporatisation or commercialisation process involved the transfer of assets (including the prepayment), this result is effectively achieved under section 82KZN by deeming the predecessor tax-exempt body to be the "original taxpayer".

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/10

LITER 98/10: IMPACT OF PROVIDING TAX-EXEMPT BODY ENTERTAINMENT FRINGE BENEFITS

Date of Effect: Immediate

Preamble

Broadly speaking, a tax-exempt body entertainment fringe benefit will arise where entertainment is provided to an employee (or an associate of an employee) by an income tax-exempt employer (that is, exempt from *Federal* income tax).

A deduction is allowed for entertainment expenditure to the extent that it was incurred in providing a fringe benefit. Accordingly, both tax-exempt bodies and taxpaying entities will be subject to Fringe Benefits Tax ("FBT") on the provision of entertainment to an employee (or an associate of an employee). Furthermore, a tax deduction will be allowed for the FBT paid.

LITER 98/17 considers the tax deductibility of FBT on entry into the tax equivalents regime.

Issue: What is the impact for a Subject Entity on the provision of tax-exempt body entertainment fringe benefits following entry into the tax equivalents regime?

Current ITAA/ATO Approach

A Subject Entity is (for *Federal* income tax purposes) still regarded as a tax-exempt body. Accordingly, those entities will continue to be subject to FBT on the provision of entertainment under the specific tax-exempt body entertainment fringe benefits provisions. However, the Subject Entity will be entitled to a tax deduction for the costs of providing that entertainment (to the extent that it is subject to FBT) and the FBT paid.

Position to be adopted

The ITAA position is to be followed. Accordingly, entertainment expenditure which constitutes the provision of a fringe benefit will continue to be subject to FBT (under the specific tax-exempt body entertainment fringe benefits provisions). Both that entertainment expenditure and the whole of any FBT will also be deductible under the tax equivalents regime.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/11

LITER 98/11: PRIOR YEAR LOSSES

Date of Effect: Immediate

Preamble

Tax losses incurred in the 1989/90 and subsequent years of income may be carried forward indefinitely and set-off against future assessable income.

Transitional Issue: May any notional accumulated tax losses incurred by a tax exempt entity be carried forward for taxation purposes into the tax equivalents regime ?

Current ITAA/ATO Approach

Broadly speaking, the ITAA will only allow a deduction where the relevant expenditure has a nexus with income-producing activities. Furthermore, an exempt body cannot incur a "loss" (within section 36-10 of the ITAA 1997) to carry forward.

In the case of privatisations, the ATO has applied this principle strictly such that notional accumulated tax losses incurred by an entity as an exempt body cannot be carried forward for taxation purposes. This is on the basis that to allow a previously tax exempt entity to deduct net accumulated prior year (notional) tax losses from future assessable income would mean that the entity's income during an exempt period would not be subject to tax while losses would generate tax advantages through their ability to offset future tax liabilities.

Division 57 of the ITAA 1936

Section 57-75 of the ITAA 1936 denies a transition taxpayer the ability to carry forward a loss incurred prior to transition into the Federal income tax regime. Additionally, any exempt income derived by the transition entity prior to transition time will not be taken into account in calculating the net exempt income for the purposes of determining future available revenue losses.

Position to be adopted

In general, the ATO approach is to be adopted. Accordingly, a Subject Entity will generally not be able to carry forward notional accumulated tax losses into the tax equivalents regime. Additionally, for the purposes of determining the quantum of future revenue losses under the TER, any income derived prior to entry into the regime is not to be included as exempt income in determining the net exempt income of the Subject Entity for the purposes of calculating the available carry forward loss pursuant to subsection 36-10(3) of the ITAA 1997.

However, it is recognised that in exceptional circumstances, a situation may arise where the notional losses reflect deductions incurred by the Subject Entity whilst it was tax exempt, but the income is derived after entry into the tax equivalents regime. An example of this occurs in relation to forestry operations where plantations are not expected to produce income for up to 15 years. In such a case, if relief is not provided under other provisions of the ITAA for losses arising in respect of expenditure incurred to produce that income, a significant mismatch of income and expense will result. Accordingly, where the Tax Assessor becomes aware of such circumstances, amendment to this ruling or issue of a separate Local Government Income Tax Equivalents Ruling may occur.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/12

LITER 98/12: FOREIGN EXCHANGE GAINS AND LOSSES

Date of Effect: Immediate

Preamble

A foreign exchange gain or loss realised by a taxpayer on the discharge of liabilities are generally assessable or deductible.

Transitional Issue: Is a Subject Entity assessed or allowed a deduction for realised exchange gains or losses where the foreign exchange contract has been entered into whilst the entity was tax exempt?

Current ITAA/ATO Approach

In relation to foreign exchange gains or losses, the ITAA applies only at the point of realisation. This would effectively include gains/losses referrable to a tax exempt period. The ATO, however, has expressed the view that a notional realisation of any foreign exchange dealings at the date of transition may be appropriate, in order to establish a base for the purpose of calculating the extent of any assessable gain or deductible loss which occurs after the corporation becomes taxable.

Position to be adopted

The approach of the ATO is to be adopted. Accordingly, the date of entry into the tax equivalents regime is to be treated as a notional realisation date, so as to exclude gains/losses which accrued during the period when the entity was tax-exempt.

It is noted that a roll-over or extension of a pre-transition borrowing contracted for on or after transition will constitute a new borrowing and realisation will occur at the time of the roll-over.

Transitional Issue: What is the position where the corporatisation or commercialisation process involved the transfer (realisation) of liabilities from the predecessor tax-exempt body to the Subject Entity ?

In these circumstances, the corporatisation or commercialisation process will involve a realisation of the borrowings by the predecessor tax-exempt body. Accordingly, the borrowing represents a new borrowing to the Subject Entity, and only the foreign exchange gains or losses which accrue from the date of corporatisation or commercialisation to eventual realisation will be taken into account for the purposes of the tax equivalents regime.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/13

LITER 98/13: SUPERANNUATION

Date of Effect: Immediate

Preamble

Contributions made after 30 November 1988 by an employer to an eligible superannuation fund are deductible provided an amount has actually been paid to the superannuation fund. Prior to this date, a deduction could be claimed if an amount were "set aside" to a fund without actually having been paid to the fund. The mere creation of a provision does not constitute the setting aside of funds for these purposes.

Transitional Issue: **Following entry into the tax equivalents regime, may a Subject Entity claim deductions in respect of superannuation contributions referrable to unfunded liabilities which accumulated in a period when the Subject Entity was tax exempt?**

Current ITAA/ATO Approach

A deduction will be allowed for superannuation contributions paid after entry into the tax equivalents regime unless the amount paid relates to a contribution "set aside" prior to 30 November 1988. For taxation purposes, such expenses are regarded as having been incurred in the year of income in which they were set aside.

Position to be adopted

The current ATO position is to be followed.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/14

LITER 98/14: RESEARCH AND DEVELOPMENT

Date of Effect: Immediate

Preamble

Special tax concessions (by way of a maximum 125% deduction) are available under the ITAA for expenditure incurred by an "eligible company" on research and development ("R&D") activities carried out in Australia that satisfy certain criteria.

Issue: To what extent is the concession available and, if available, how is it to be regulated?

Current ITAA/ATO Approach

The R&D concession is made available through the operation of the ITAA. The responsibility for administering the incentive is divided between the Commissioner of Taxation and the Industry Research and Development Board (IR&D Board). To be eligible for the R&D concession, a company must be registered with the IR&D Board in the relevant year of income. Generally, lodgment of the registration application and the tax return occur at the same time.

The IR&D Board has responsibility for determining whether a number of conditions have been fulfilled. These include:

- that the activities constitute R&D activities as defined in the ITAA;
- that the results are or will be exploited on normal commercial terms and in a manner which benefits the Australian economy;
- that the activities have adequate Australian content; and
- that there are no ineligible finance schemes relating to the activities.

Decisions of the IR&D Board on these questions are binding on the Commissioner of Taxation.

Position to be adopted

The R&D concession is available to Subject Entities under a similar regime as set out in the ITAA. Accordingly, the concession is available on a self-assessment basis using the ITAA provisions. As such, responsibility rests primarily with the Subject Entity to determine the eligibility of its R&D activities for the concession.

The function of the IR&D Board will be filled by the Tax Assessor (as utilisation of the IR&D Board is not available under the tax equivalents regime). Accordingly, a Subject Entity should lodge the appropriate IR&D Board forms with the Tax Assessor (generally at the same time as lodgment of the income tax equivalents return) to seek registration of the Subject Entity's R&D claim.

As a matter of clarification, plant which is acquired by the Subject Entity as part of the corporatisation or commercialisation process may qualify for the R&D plant concession where the requirements of section 73B of the ITAA 1936 are satisfied. In particular, to qualify as "plant expenditure" under subsection 73B(1), the plant must have been acquired for use by the Subject Entity exclusively for the purpose of carrying out R&D by or on behalf of the entity.

Where the unit of property qualifies as "plant expenditure", the amount incurred is "qualifying plant expenditure" in the first year it is used by the Subject Entity for R&D and in the following two years. Where the Subject Entity acquires the R&D plant pursuant to corporatisation or commercialisation, the cost of the plant to the Subject Entity is the value allocated to the plant in the Asset Schedule. This value will be regarded as an arm's length value for the purposes of subsection 73B(31) of the ITAA 1936.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/15

LITER 98/15: TAXATION OF DIVIDENDS - INTER-ENTITY DIVIDEND REBATE

Date of Effect: Immediate

Preamble

Subsection 46(2) provides that a resident company is entitled to a rebate of tax in respect of dividends received from other resident companies. The extent of the rebate is dependant on whether the recipient is a "public company" or a "private company". In broad terms:

A *Resident Public Company* (subject to qualifications) is entitled to a rebate of tax on dividends included in its taxable income;

A *Resident Private Company* is entitled to the same rebate. However, pursuant to section 46F of the ITAA, the rebate does not usually apply to the unfranked portion of dividends received by a private company (unless the paying and recipient companies form part of a wholly-owned corporate "group").

Issue: How are dividends received from a resident company (including a resident Subject Entity) to be treated in the tax equivalents regime ?

Current ITAA/ATO Approach

Under the ITAA the extent of the rebate available depends on the classification of the recipient company (as set out above).

Accordingly, where a Subject Entity is regarded as a "private company" (as is a likely consequence under the ITAA) the dividend rebate will not apply to the unfranked portion of dividends received.

Position to be adopted

For the purposes of the income tax equivalents regime, a Subject Entity is to be regarded as a "public company" when applying Subdivision D of Division 2 of Part III of the ITAA 1936. Accordingly, the dividend rebate provisions will operate such that dividends received by a Subject Entity from a resident company (including a resident Subject Entity) will be eligible for a full rebate [subject to the same qualifications contained in the ITAA other than subsection 46(9)].

Under the ITAA, subsection 46(9) denies the rebate where the dividend is paid by a company which is exempt from tax on its income under section 50-25 of the ITAA 1997. For the purposes of the tax equivalents regime, subsection 46(9) can be disregarded where the dividend is received from another Subject Entity (since the paying Subject Entity is not entitled to exemption pursuant to section 50-25 under the tax equivalents regime).

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/16

LITER 98/16: LONG TERM CONSTRUCTION CONTRACTS

Date of Effect: Immediate

Preamble

Long term construction contracts are contracts relating to construction work where construction extends beyond a year of income.

Transitional Issue: **How should a Subject Entity account for income arising from long term construction contracts, entered into whilst the entity was tax exempt and extending into the non exempt period.**

Current ITAA/ATO Approach

The ATO accepts two valuation methods for bringing to account income derived from long term construction contracts. They are:

(1) Basic method - all progress and final payments received during a year of income and all amounts billed and billable during the year are included in assessable income. Further, losses and outgoings are allowable as deductions only once incurred;

(2) Estimated profits/losses method - the estimated ultimate profits or loss on the contract is brought to account proportionately over the life of the contract.

Regardless of the method adopted, it must be applied consistently during each year of the contract and to all similar contracts entered into by a taxpayer.

Position to be adopted

In the case of an entity that enters into a long term construction contract prior to transition and that contract has not been completed at the date of transition, the Subject Entity will determine the amount of assessable income derived or losses incurred from the contract in the same manner as the income or loss is recognised for accounting purposes. That method is to apply consistently to all years of the contract.

In the case of long term construction contracts entered into after transition, revenue (or losses) from such contracts should be derived (or incurred) for tax purposes in accordance with those methods acceptable to the ATO.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/17

LITER 98/17: TAX DEDUCTIBILITY OF FRINGE BENEFITS TAX - PRO RATA ALLOCATION

Date of Effect: Immediate

Preamble

Fringe Benefits Tax ("FBT") paid to the Commonwealth is tax deductible to employers under section 8-1 of the ITAA 1997.

Subject Entities generally enter the TER at 1 January or 1 July. This can pose administrative difficulties in determining the quantum of their allowable deductions for FBT in the year they become liable to tax equivalents. For example a Subject Entity entering the TER at 1 July 1997 can calculate its FBT for the period from 1 July 1997 to 31 March 1998 by either preparing a pro forma FBT return for the period (that is, taking odometer readings, getting declarations etc) or by apportioning the FBT for the year ending 31 March 1998 into exempt and tax equivalents periods.

Current ITAA/ATO Approach

There is no published ATO policy on this issue.

Position to be adopted

As Subject Entities are likely to face significant administrative difficulties in preparing a pro forma FBT return, where it can be demonstrated that there is no material misstatement of their FBT liability for the period, the allowable deduction for FBT may be determined by apportioning the total FBT liability into the exempt and taxable (under the TER) periods.

In following years, FBT will be deductible according to ATO guidelines.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/18

LITER 98/18: PENALTIES - LIABILITY OF PUBLIC OFFICER

Date of Effect: Immediate

Preamble

Under paragraph 252(1)(f) of the Income Tax Assessment Act 1936 (the Act):

> *"The public officer shall be answerable for the doing of all such things as are required to be done by the company under this Act or the regulations, and in case of default shall be liable to the same penalties."*

The question arises as to whether this provision should apply under the tax equivalents regime.

Issue: Are public officers of a Subject Entity to be subject to the same penalties under the TER as public officers of private companies are under the ITAA.

Current ITAA/ATO Approach

The public officer is responsible for the doing of all things that are required to be done by the company under the Act and Regulations, and in the case of default, is liable to the same penalties.

This responsibility does not extend to the liability for payment of tax due by the company. The responsibilities inferred to the public officer involve returns, assessments and ancillary matters, but do not make the officer personally liable for the income tax of the company; *(Lean v Brady* (1937) 58 CLR 328; 4 ATD 431).

Position to be adopted

Penalties are adopted under the tax equivalents regime on broadly the same basis as those imposed under the ITAA. Given the more co-operative spirit of the tax equivalents regime in general, public officers will not be held personally liable for penalties under paragraph 252(1)(f).

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/19

LITER 98/19: ADOPTION OF CURRENT COST ACCOUNTING

Date of Effect: Immediate

Preamble

At present, the Local Government Finance Standard 1994 of the Local Government Act 1993 incorporates Australian Accounting Standard ("AAS") 27 as subordinate legislation. This Standard permits Local Government Reporting Entities to account for certain non-current assets using a current cost accounting approach and specifies the recognition criteria for liabilities, revenue and expenses. This Standard does not apply in the Private Sector. On occasions, changes and additions to the Standard have permitted an alternative treatment for non-current assets than that prescribed under AAS27.

Where a Local Government adopts this Standard for non-current assets, the purchase cost of the asset is recognised as non-current and annual depreciation charged as an expense in the Subject Entity's Profit and Loss Account. Subsequent repairs to the asset are either treated as "maintenance"and expensed or "capital" with the outlay added to the cost of the asset.

At an appropriate time, the asset will be revalued with any increment in value above the then written down value credited to an "Asset Revaluation" or "Current Cost" Reserve. Future depreciation will be based on this higher revalued base. Any decrease in the value of the asset as a result of the revaluation is recognised as a loss in the Subject Entity's Profit and Loss Account.

When the asset is sold, any loss on disposal is also charged to the Subject Entity's Profit and Loss Account. On the other hand, a gain on disposal will be treated as revenue and the unrealised portion included in the Asset Revaluation Reserve transferred to a Capital Profits Reserve.

Issue: To what extent are the accounting adjustments required in order to comply with the Local Government Finance Standard able to be taken into account in the determination of the taxable income/loss of a Subject Entity?

Current ITAA/ATO Approach

Under the ITAA, the assessment of any gains and entitlement to deductions for any losses in respect of fixed assets is based on historic cost. That is, the historic acquisition cost of an asset is the basis for any entitlement for depreciation deductions, capital gains/losses, capital write-off allowances and any other form of taxation entitlement/liability. The ITAA does not permit adjustments to the book value of assets to impact the taxation value of that asset.

With respect to the recognition of revenue and expenses, subject to any statutory provisions, the ITAA is specific in requiring that expenses are only deductible for income tax purposes when incurred, and revenue is only assessable when derived.

Position to be adopted

A Subject Entity may elect to adopt either of the following options:

1. the strict ITAA approach with respect to all its non-current assets (as that term is applied in the Local Government Finance Standard or its equivalent), such that any adjustments taken up by a Subject Entity in its Profit and Loss Account in order to comply with the Standard or its equivalent, are reversed and cannot have an impact on the calculation of the taxable income/loss of the Subject Entity. The Subject Entity's taxable income is then calculated using ITAA principles for all assets owned by the Subject Entity, thereby requiring the maintenance of at least two sets of asset records. In these circumstances, repairs expenditure will need to be dissected between capital and revenue in accordance with ITAA principles; or

2. the accounting treatment required by the Local Government Finance Standard or its equivalent for qualifying non-current assets in the Subject Entity's calculation of its taxable income/loss. That is, the Subject Entity's taxable income can be calculated using current cost accounting principles for applicable non-current assets for as long as this basis continues to be required for accounting purposes by the Local Government Finance Standard, thereby avoiding the need to maintain another set of asset records. Further, this option can only be elected if all of the accounting transactions required by the Standard or its equivalent are included in the Subject Entity's calculation of its taxable income for that year. That is, during the year of income:

    - the annual depreciation, repairs, loss on disposal and any revaluation decrement charged to the Subject Entity's Profit and Loss Account will be an allowable deduction;
    - any revaluation increment credited to an Asset Revaluation or current cost Reserve will be assessable income;
    - any profit on disposal of an asset which has not previously been credited to an Asset Revaluation or Current Cost Reserve will be assessable income;
    - Part IIIA of the ITAA will not apply to the extent that an increase in value of the disposal asset has been assessed as income to the Subject Entity. Accordingly, a Subject Entity will not be entitled to exclude from assessable income the indexation component of any gain pursuant to the accounting adjustments required by the Standard or its equivalent; and
    - the market value of any contributed assets or cash contributions are taken up as revenue.

If a Subject Entity wishes to elect to adopt Option 2, the election must be lodged with the Tax Assessor on or before the date of lodgement of a Subject Entity's first income tax equivalents return. This election is irrevocable unless the Standard or its equivalent is no longer applied by the Subject Entity. Balancing adjustments will be required at that time.

It is also noted that Option 2 may not be available on a prospective basis only if the Federal Government does not permit the tax equivalent regime to continue with this option being available or if the Subject Entity obtains an unfair tax advantage as a result of its application and the principles of competitive neutrality are breached.

With respect to the recognition of revenue and expenses, the approaches outlined at LITER 98/1 and LITER 98/8 are required to be complied with by a Subject Entity, regardless of the option chosen in relation to this issue.

LITER 98/20 and LITER 98/24 set out the guidelines for establishing the opening value of non-current assets. If Option 2 is elected, the opening value of non-current assets will be the book value of the assets at the date of entry into the tax equivalents regime provided that the value of the asset is appropriate for the Local Government Finance Standard or its equivalent.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/20

LITER 98/20: ASSETS ACQUIRED FREE OF CHARGE (CONTRIBUTED ASSETS)

Date of Effect: Immediate

Preamble

In the course of its business, a Subject Entity may receive non-refundable contributed asset(s) or non-refundable contribution(s) towards assets as part of a business arrangement with a private sector party. The contributed assets or the non-refundable contribution(s), which may include government grants or community service obligations, may not generate any cash flow in the income year in which they are received and this could create timing issues and cash flow problems if the transactions have a tax effect.

Issue: How may a Subject Entity recognise the receipt of an asset contribution or non-refundable contribution to the cost of an asset for tax purposes?

Current ITAA/ATO Approach

The proper tax treatment of non-refundable assets acquired free of charge or of non-refundable contributions towards the cost of assets is not entirely clear. It is probable that the value of the contributed asset or the amount of the contribution will be assessable income in the year of receipt. In ITO 1217 and IT 2308 the Commissioner of Taxation expressed the opinion that where assets were received free of charge, the recipient of the asset will be allowed to depreciate the asset but the amount of depreciation which may be claimed over the life of the asset will be limited to that which would have been available to the donor had the donor retained the asset.

However, under the ITAA 1997, doubt exists as to whether depreciation would be available in respect of contributed assets. Specifically, section 42-25 of the ITAA 1997 provides that the calculation of the deduction available in respect of depreciation of a unit of plant is based on the cost of the plant. Section 42-65 provides further that the cost is the cost to the relevant taxpayer. Thus, where an item of plant is gifted to a taxpayer, doubt exists as to whether depreciation would be available on the basis that the taxpayer has borne no cost in acquiring the plant. Whereas section 42-90 provides the Commissioner of Taxation (the Commissioner) with a discretion to limit the cost of plant for the purposes of the depreciation provisions, the ITAA contains no discretion for the Commissioner to increase the cost base or to impute a cost to plant for which there is no actual cost.

Even if depreciation would be allowed on the value of contributed assets, treating such assets or contributions towards assets as assessable with depreciation being allowed on their usage will result in significant timing differences and unacceptably large impacts on the cash flows of a Subject Entity.

Position to be adopted

For the purposes of the tax equivalents regime, assets acquired free of charge by a Subject Entity which has elected to adopt Option 1 of LITER 98/19 are to be treated in a revenue neutral manner. The value of the asset or the amount of the contribution towards an asset will not be assessable to the Subject Entity and no deductions of any kind will be allowed in respect of the initial value of the contributed asset or in respect of the amount of the contribution towards an asset.

The following methodologies should therefore be adopted by a Subject Entity which has elected to adopt Option 1 of LITER 98/19 in individual cases:

- The value of contributed assets or of cash contributions which are specifically made toward the acquisition of identified assets at the date of receipt of the cash contribution is not assessable to the Subject Entity and contributed assets or the amount of any cash contributions towards the acquisitions of the assets are not depreciable.
- Where a Subject Entity has acquired an asset free of charge before it enters the tax equivalents regime, that asset is to be treated in accordance with the transitional provisions set down in LITER 98/24.
- Where a Subject Entity acquires an asset free of charge or receives a contribution towards an asset after it has been corporatised or commercialised, but before it enters the tax equivalents regime, it will not be entitled to a deduction for depreciation in respect of that asset or that contribution.
- The cost base for CGT purposes of a contributed asset will be determined in accordance with section 160ZH(9) of the ITAA. Where a contributed asset is sold and the proceeds of sale exceed its tax written down value, the proceeds of its sale up to its cost base will be assessable under section 42-190 of the ITAA 1997 with the normal CGT indexation applying to any amounts received which are over the asset's cost base.
- This LITER does not apply to expenditure incurred by a Subject Entity in the nature of repairs or capital improvements to a contributed asset (whether acquired pre or post corporatisation or commercialisation).

If a Subject entity has elected to adopt Option 2 of LITER 98/19, the treatment of assets acquired free of charge or cash contributions towards the acquisition of an asset are to be treated in the same manner as prescribed in the Local Government Finance Standard or its equivalent. That is, the value of the contribution will be assessable income with deductions allowed in accordance with the accounting treatment. Where a Subject Entity has acquired an asset free of charge before it enters the tax equivalents regime, that asset is to be treated in accordance with LITER 98/24.

Issue: How will other cash contributions that are received from Local Government or are not specifically referrable to the acquisition of an asset be treated?

Where any cash contribution is received by a Subject Entity that is not specifically referrable to the acquisition of an asset which is identified at the date of receipt of the cash or is received from Local Government (such as a community service obligation receipt), that cash is assessable income to the Subject Entity.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/21

LITER 98/21: SPARE PARTS AND CONSUMABLE STORES

Date of effect: Immediate

Preamble

Broadly speaking, the ATO allows a deduction for the cost of spare parts and consumable stores in the year in which the expenditure is incurred provided such items are not being stockpiled. The deduction is claimable in the year of purchase where the intention is simply to ensure continuity of production and the purchases do not exceed the normal operational requirements of the business. However, where longer term reserves of these items are being maintained (i.e. stockpiles), the deduction should be claimed on a "usage" basis (i.e. in the year in which the particular item is used).

Generally, spare parts held for maintenance and repair purposes are not regarded as depreciable plant. However, in practice, it is accepted that spare parts which are purchased with plant as an integral part of the plant (such as an initial component of spares) will themselves represent plant and are therefore depreciable.

"Rotatable spares" (i.e., spares which are repairable and consequently reusable) are considered to represent plant and commence to depreciate from the year in which they are placed in the pool of rotating spares at the same depreciation rate as the principal asset for which they are used.

> This ruling does not apply to stocks of spare parts and consumable stores which constitute trading stock of the entity. In this respect, regard must be had to the nature of the business being carried on by the entity and the context in which an item is used, in making a determination as to whether an item held constitutes trading stock or is a spare part or consumable store item.

Transitional Issue: **Can a deduction be claimed by a Subject Entity for expenditure which was incurred on spare parts and consumable stores prior to entry into the tax equivalents regime, but which are used after entry into the regime (ie. can a stock of such items be deducted on a "usage" basis)?**

Current ITAA/ATO Approach

Where tax-exempt bodies are corporatised or commercialised, the ATO has expressed the view that the "usage basis" for deductibility of expenditure on spare parts and consumable stores is not allowable where the expenditure was incurred whilst the entity was a tax-exempt body. This view is based on the fact that the expenditure was incurred when the entity was exempt and accordingly, was not incurred in carrying on a business for the purpose of gaining or producing assessable income.

Position to be adopted

(a) *Corporatisation or commercialisation involving a transfer of assets (including stocks of spares/consumables) and liabilities from the predecessor tax-exempt body to the Subject Entity*

Broadly speaking, this process involves the sale of the tax-exempt body's business to the Subject Entity.

For the purposes of the Local Government Tax Equivalents Regime, a transitional concessionary measure is to apply upon entry into the regime which is based on the accounting treatment adopted by the tax-exempt body to its spares/consumables.

Accordingly, where a Subject Entity has elected to adopt Option 1 of LITER 98/19 and where the tax-exempt body has a balance of spares/consumables on its books immediately prior to the transfer of assets to the Subject Entity (that is, for accounting purposes, the tax-exempt body treats these items on a "usage" basis), the balance of stocks of spares/consumables remaining on entry into the tax equivalents regime can be claimed for tax purposes on a usage basis. This treatment is considered equitable given the fact that the Subject Entity has given consideration for those stocks which are on the balance sheet of the tax-exempt body at the date of corporatisation or commercialisation, as the case may be.

Where the tax-exempt body has expensed the cost of spares/consumables for accounting purposes, the cost of any stocks of those items which are transferred to a Subject Entity which has elected to adopt Option 1 of LITER 98/19 on entry into the tax equivalents regime may be reinstated for tax purposes and subsequently claimed on a usage basis.

(b) *Corporatisation or Commercialisation of a business unit of an existing entity where the Subject Entity was not subject to a predecessor tax equivalents regime*

Where a Subject Entity has a balance of spares/consumables on its books immediately prior to its entry into the tax equivalents regime (that is, for accounting purposes, it has treated these items on a "usage" basis) and the Subject Entity has elected to adopt Option 1 of LITER 98/19, the balance remaining on entry into the tax equivalents regime can be claimed for tax purposes on a usage basis. Where the Subject Entity has previously claimed these items in full for accounting purposes, it will be allowed to reinstate the relevant part of the expenditure for tax purposes and claim the balance of spares and consumables on hand so reinstated on a usage basis.

Issue: Purchases of Spare Parts and Consumable Stores *after entry* into the tax equivalents regime

Expenditure incurred on spare parts and consumable stores by a Subject Entity (which has elected to adopt Option 1 of LITER 98/19) after entry into a tax equivalents regime shall be claimed according to ITAA principles and ATO practice (that is, in the year of purchase where the spare parts and consumables are part of the normal operational requirements, or on a "usage basis" where they are being stockpiled).

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/22

LITER 98/22: CAPITAL GAINS TAX

Date of Effect: Immediate

Preamble

The capital gains provisions of the ITAA ("CGT") apply to assets acquired (or deemed acquired) on or after 20 September 1985. Broadly speaking, assets acquired by an entity prior to 20 September 1985 are not subject to the CGT provisions.

Under the ITAA, where a previously tax exempt entity disposes of a post CGT asset after its entry into the tax equivalent regime, it would prima facie realise a capital gain/loss. However, such a capital gain/loss may include a portion of gains/losses which accrued to the Subject Entity whilst it was tax exempt.

Transitional Issue: Upon corporatisation or commercialisation, what will be the cost base of the existing assets of a Subject Entity ?

Current ITAA/ATO Approach

The elements that enter into the calculation of a capital gain or capital loss on disposal of an asset by a Subject Entity are the following:

- the consideration in respect of the disposal of the asset; and
- the cost base of the asset (or indexed cost base, or reduced cost base as the case may be).

The cost base of an asset comprises not only the cost of the acquisition of the asset and the incidental costs of acquisition and disposal, but also capital expenditure which either enhances the value of the asset and is reflected in the state or nature of the asset at the time of disposal, or is incurred in establishing, preserving or defending the taxpayer's title to, or right over, the asset.

Division 57 of the ITAA 1936

Section 57-25 of the ITAA 1936 applies to the disposal of any asset by a transition taxpayer (i.e. a taxpayer entering the Federal income tax regime) after transition into the Federal regime where the taxpayer owned the asset at all times from transition until disposal. Broadly, the relevant asset is treated as having been disposed of by the transition taxpayer immediately before entry into the Federal regime and immediately re-acquired for its “adjusted market value”. The “adjusted market value” is defined in subsection 57-25(3) as the market value of the asset at the time of transition, adjusted by the amount of any income received in respect of the asset (increased where such income received before transition time in respect of the asset is assessable; and reduced where such income received after transition time in respect of the asset is not assessable)

Thus, under the ITAA, assets are deemed to be acquired at an “adjusted market value” by the Subject Entity at the time of transition into the Federal income tax regime, pursuant to Division 57 of that Act. This cost would then be adjusted by any incidental costs of acquisition and

disposal, capital expenditure which enhances value (as discussed) or expenditure of a capital nature which is incurred in establishing, preserving or defending the taxpayer's title to, or right over, the asset.

Position to be adopted

In relation to the cost of the acquisition of the asset by a Subject Entity which has elected to adopt Option 1 of LITER 98/19, the relevant cost will depend on the method of corporatisation or commercialisation.

(a) *Corporatisation or commercialisation involving the transfer of assets and liabilities from a predecessor tax-exempt body to a Subject Entity*

The cost associated with the acquisition of each asset by the Subject Entity upon corporatisation or commercialisation will form part of the cost base of each asset for CGT purposes. Accordingly, the value (as adjusted) allocated to the asset in the Asset Schedule will form part of the cost base of the asset.

(b) *Corporatisation or commercialisation of a business unit of an existing entity where that entity was not subject to a predecessor tax equivalents regime*

In these circumstances, the Subject Entity will adopt, as the cost base of an asset for CGT purposes, the "adjusted" written down book value of the asset as at the date of corporatisation or commercialisation, provided that the written down book value approximates market value for the asset. It is envisaged that where the asset has been valued in accordance with The Local Government Finance Standard or its equivalent, its written down book value will approximate its market value. The adjusted written down book value is to be adopted in order to avoid the possible double counting of income on disposal of the asset and the calculation follows that prescribed by subsection 57-25(3) of the ITAA 1936. The following example illustrates the effect of the "adjusted market value":

> A Subject Entity becomes subject to the TER on 1 July 1998. At that time, the Subject Entity is owed $2,000 by the council with interest accrued as at 1 July 1998 of $120, although such interest is not payable until 1 December 1998. The market value of the asset (being the debt owed by council) at 1 July 1998 is therefore $2,120. On 1 December 1998, interest of $240 for the preceding 12 months is received. Of this amount $120 is not assessable as it was derived prior to entry into the TER. Thus, in order to avoid a double exclusion from assessable income in respect of that $120, the cost base of the debt as at 1 July 1998 must be reduced by $120 to eliminate any capital loss attributable to the interest on a subsequent disposal of the debt.

This approach therefore deems there to have been a disposal and re-acquisition of each asset of the Subject Entity for its "adjusted written down book value". The result for CGT-purposes is similar to a "section 160ZZS" event (being a deemed market value acquisition of pre-CGT assets on a change in the majority beneficial ownership in an entity) and the bringing of all assets within the ambit of the CGT provisions.

If a Subject Entity has elected to adopt Option 2 of LITER 98/19, upon entry into the tax equivalents regime the opening cost base will be the book value of the asset at the date of entry provided that the value of the asset is appropriate for the Local Government Finance Standard or its equivalent.

Transitional Issue: Upon corporatisation or commercialisation, will the assets of a Subject Entity retain their pre-CGT status ?

Current ITAA/ATO approach

Assets acquired by a Subject Entity prior to 20 September 1985 are outside the CGT provisions unless some event occurs that triggers a deemed acquisition of the asset on or after that date.

Position to be adopted

The question of retention of the pre-CGT status of assets of a Subject Entity which has elected to adopt Option 1 of LITER 98/19 upon entry into the tax equivalents regime depends on the method of corporatisation or commercialisation.

(a) Corporatisation or commercialisation involving transfer of assets and liabilities from a predecessor tax-exempt body to a Subject Entity

This process involves an actual disposal by the predecessor tax-exempt body and an acquisition by the Subject Entity. Accordingly, upon acquisition of those assets by the Subject Entity the pre-CGT status of those assets is lost and all asset disposals after entry into the tax equivalents regime will be subject to the CGT provisions. Furthermore, no roll-over relief is available in such a case to preserve the pre-CGT status.

(b) Corporatisation or commercialisation of a business unit of an existing entity where the entity was not subject to a predecessor tax equivalents regime

There is a deemed acquisition and disposal so that the pre-CGT status of those assets is lost and all asset disposals after entry into the tax equivalents regime will be subject to the CGT provisions.

If a Subject Entity has elected to adopt Option 2 of LITER 98/19, upon entry into the tax equivalents regime there is a deemed acquisition and disposal so that any subsequent movement in the value of the asset, as reflected in the Subject Entity's accounting records, will be similarly reflected in the calculation of the Subject Entity's taxable income.

Transitional Issue: Upon ultimate disposal of a post-CGT asset, will a Subject Entity be subject to CGT on that portion of a capital gain (or loss) which arose to the Subject Entity whilst it was tax exempt?

Current ITAA/ATO Approach

The ITAA would result in a capital gain (or loss) which arose to a Subject Entity whilst it was tax exempt being subject to CGT. It is noted that, in relation to some Federal corporatisations or commercialisations, special relieving legislation was enacted to ensure that the appropriate proportion of a realised gain (or loss) which is referrable to the tax exempt period is not subject to tax. The practical effect of this legislation has been that a valuation must be undertaken at transition date of all assets subject to CGT so that the portion of any gain (or loss) arising prior to the entity becoming a taxpayer is effectively grandfathered.

Position to be adopted

The ITAA/ATO position is to be adopted by a Subject Entity which has elected to adopt Option 1 of LITER 98/19. However, as result of the approach taken above (that is, assigning book value

as the cost of the asset for cost base purposes upon corporatisation or commercialisation), the effect is that the portion of any gain (or loss) arising prior to entry into the tax equivalents regime is effectively grandfathered.

Accordingly, where the corporatisation or commercialisation process involves either (a) above [that is, the transfer of assets from the predecessor tax-exempt body to the Subject Entity for a consideration equal to its book value], or (b) above [deemed transfer of assets for their adjusted written down book value, where the predecessor tax-exempt body is corporatised or commercialised], the pre-tax equivalent gains (and losses) will be effectively grandfathered.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/23

LITER 98/23: DEPRECIATION – OWNERSHIP OF ASSETS

Date of Effect: Immediate

Preamble

Pursuant to the ITAA, two critical factors to a tax depreciation claim on plant are that the taxpayer:

(1) must incur a cost in acquiring or constructing the plant; and

(2) must own a "unit of property" in order to claim tax depreciation.

In relation to (2), an issue arises as to the availability of tax depreciation where an entity has access to an asset sufficient to allow it to use and maintain it, but does not have ownership thereof.

Issue: How is ownership of an asset to be determined, sufficient to sustain a depreciation deduction for tax purposes?

Current ITAA/ATO Approach

Section 42-15 of the ITAA 1997 provides that a deduction is available for depreciation in respect of plant that is owned or held as quasi owner. A person is the quasi owner of plant if it is attached to land held under a quasi ownership right granted by an exempt Australian government agency or an exempt foreign government agency. Broadly, a quasi ownership right is defined as a lease of the land, an easement in connection with land, or any other right, power or privilege over the land, or in connection with the land (s995-1 of the ITAA 1997). Thus, a person is not the quasi owner of plant if the quasi ownership right in relation to the land on which the plant is situated is granted by anyone other than an exempt Australian or foreign government agency (eg a private landholder).

There may be circumstances where a question arises as to whether a Subject Entity has ownership of assets sufficient to sustain a depreciation deduction for tax purposes. In particular, the issue arises in relation to fixtures installed by the lessee to leasehold property. Fixtures installed by the lessee on leased land are commonly treated by the law as part of the land and, consequently, owned by the lessor.

Fixtures installed on Crown lease land

In relation to fixtures installed by a lessee on land held under a "Crown lease" or other quasi ownership right, special provisions of the ITAA apply to enable the lessee to obtain depreciation deductions by deeming the taxpayer to be the owner of those fixtures.

For the purposes of these provisions, a Crown lease is included in the definition of a quasi ownership right which, pursuant to section 995-1 of the ITAA 1997, has an extended meaning which includes a lease of land, an easement in connection with land or other right, power or privilege (such as under a right of way, licence or permit) over, or in connection with land. As discussed, for a person to be the quasi owner of a fixture, the quasi ownership right must be granted by an "exempt Australian government agency" or an “exempt foreign government

agency". An "exempt Australian government agency" includes the various governments of Australia (including municipal corporations or other local governing bodies) and their tax-exempt authorities.

Fixtures installed on other leasehold land

In relation to fixtures annexed to non-Crown leasehold land, it is more difficult for the lessee to establish sufficient ownership of the asset to support a depreciation claim.

While the issue is not directly addressed by the ITAA, the Commissioner of Taxation's practice is to generally allow claims for depreciation in respect of tenant's fixtures in the following circumstances:

(i) where the lessee has a legal right (such as a statutory, contractual or common law right) to remove fixtures annexed by him. The right of removal may be provided for by the lease. In the case of trade, ornamental and domestic fixtures, the common law recognises that the tenant has a right of removal even if the lease is silent on the matter;

(ii) where the lessee has a right to receive compensation for the value of fixtures annexed by him; and

(iii) where the lessee has made structural improvements and fixtures on land used for agricultural or pastoral pursuits.

Assets acquired under Hire Purchase

Furthermore, in the case of a unit of property being acquired under a hire purchase transaction, recent amendments to the ITAA 1997 in Division 240 treat the hirer as the legal owner of the asset for depreciation purposes. Depreciation will be available on the amount which effectively is equal to the consideration for the sale of the property to the purchaser provided the parties are dealing at arms length.

Position to be adopted

The current ITAA/ATO approach is to be adopted by a Subject Entity which has elected to adopt Option 1 of LITER 98/19. Accordingly, a Subject Entity will be able to establish ownership sufficient to sustain a depreciation claim in relation to fixtures on leasehold land where:

(a) the fixture is installed on land held as quasi owner subdivision 42-I of the ITAA 1997; or

(b) the fixture is installed on other leasehold land and the Subject Entity can establish the ownership rights set out in *Taxation Ruling* IT 175.

For the purposes of the tax equivalents regime, subdivision 42-I of the ITAA 1997 is extended to ensure that it applies to fixtures installed on land pursuant to a statutory right (such as where a statute grants a Subject Entity access to any land for the purposes of installing power poles). This clarification is designed to ensure that a grant by an "eligible government body" includes the granting of a right pursuant to statute.

Furthermore, the current ITAA/ATO approach will be adopted in relation to assets acquired under Hire Purchase.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/24

LITER 98/24: DEPRECIATION – OPENING VALUE FOR DEPRECIATION

Date of Effect: Immediate

Preamble

The basis for tax depreciation of a unit of property (being plant or articles within the meaning of section 42-18 of the ITAA 1997) is the ***cost*** of that unit to the taxpayer claiming the depreciation allowance. The cost of a unit of property includes not only its purchase price or construction cost but also such items as customs duty, transportation and delivery costs, in-transit insurance, and installation costs.

Any subsequent revaluations of a unit of property (such as may occur pursuant to an accounting policy required under the Local Government Finance Standard or its equivalent) do not increase its depreciable value for tax purposes if the strict ITAA approach is adopted and the Subject Entity elects to adopt Option 1 of LITER 98/19. Accordingly, it may be necessary for Subject Entities to maintain a separate depreciation register for tax purposes to ensure that a proper record of the tax depreciable cost base is maintained (that is, on historical cost rather than reflecting movements for accounting revaluations), especially where those Subject Entities have elected to adopt the ITAA approach for the treatment of non-current assets rather than to follow the accounting treatment required by the Local Government Finance Standard or its equivalent using current cost accounting (refer LITER 98/19).

Transitional Issue: **Upon entry in to the tax equivalents regime, what is the appropriate opening depreciable value to be adopted by a Subject Entity for each item of plant held by the Subject Entity (or its predecessor) immediately prior to corporatisation or commercialisation (that is, what is to be the depreciable value of existing assets) ?**

Current ITAA/ATO approach

Where a previously tax-exempt entity enters a taxpaying regime, the ITAA requires the adoption of a notional written-down value (NWDV) for assets based on the original historical cost. This is so irrespective of the method of corporatisation or commercialisation.

Proposed Division 58

New Division 58 of the ITAA 1997 is to change the way in which depreciation is to be calculated in respect of assets owned by an income tax exempt entity where those assets are transferred to a tax paying entity. The need to introduce such a change was driven by the different depreciation treatment afforded where the assets were transferred as opposed to a previously tax exempt entity being sold or privatised. In particular, where privatisation is undertaken by way of an “entity sale”, Division 57 of the ITAA 1936, Division 42 of the ITAA 1997 and the proposed section 61A of the ITAA 1936 each confirm the long standing practice of the Commissioner of Taxation (the Commissioner) that in such circumstances the depreciable cost base of the plant owned by the entity at the time of sale is limited to NWDV.

Division 58 provides a choice of two methods for establishing the depreciable cost base of plant acquired from a previously tax exempt entity. Broadly, these are as follows:

- calculate opening value under the NWDV method which involves ascertaining the original cost of the unit to the previously exempt entity and deducting accumulated depreciation as if the plant had at all times since acquisition been used in producing assessable income;
- calculate opening value under the pre-existing audited book value (PABV) which is specified as the audited value given in respect of the unit of plant (as at the end of the accounting period) which was prepared as part of the final accounts of the exempt entity. It should be noted that a PABV for a unit of plant will exist notwithstanding that the unit is disclosed in the final accounts as part of a total value specified for 2 or more units of plant. Under the PABV approach a qualified independent auditor must have prepared and signed an unqualified final audit report on the exempt entity's final accounts before 4 August 1997; and
- in each case the cost is adjusted for any incidental costs of acquisition

Position to be adopted

The opening value of non-current assets for calculating future depreciation entitlements of a Subject Entity which has elected to adopt Option 1 of LITER 98/19 following entry into the tax equivalents regime depends on the method of corporatisation or commercialisation as set out below. We note that the determination of the opening value of non-current assets for the purposes of the TER is based on the current ITAA/ATO position (i.e. exclusive of the impact of the proposed Division 58). However, it should be noted that this LITER may be amended should Division 58 be ultimately inserted into the ITAA.

If a Subject entity has elected to adopt Option 2 of LITER 98/19, the Subject entity would use the book value of the non-current assets at the date of corporatisation/commercialisation as its opening depreciable value.

It is acknowledged that certain Subject Entities would have difficulties in ascertaining an opening depreciable value as at the date of commercialisation. Accordingly, it has been decided to permit Subject Entities to determine asset values after 1 July 1998 but "as at" 1 July 1998, regardless of whether Option 1 or Option 2 of LITER 98/19 is used. This is subject to the condition that only one increment to the asset revaluation reserve or the current cost reserve will be regarded as non-assessable, provided the revaluation occurs on or before 30 June 2000.

In the instance where the Subject Entity has selected Option 2 under LITER 98/19 and revalued as at 1 July 1998, but booked this revaluation at a later date ("the revaluation date"), the allowable depreciation expense between 1 July 1998 and the revaluation date must be based on the book value of plant and equipment during that time.

That is, a Subject Entity cannot recalculate depreciation before the revaluation date based on the revalued amount as at 1 July 1998.

Further, if the asset values under the revaluation are not representative of the asset values at the revaluation date, another revaluation may be necessary. Where this revaluation increases the Current Cost Reserve or Asset Revaluation Reserve, this increase will be assessable in accordance with LITER 98/19. However, where there is a downward revaluation and the Current Cost Reserve or Asset Revaluation Reserve is reduced, or the accumulated depreciation increases, this amount will not be deductible. Future

depreciation claims will then be based on the revised asset valuation as at the revaluation date.

(a) *Corporatisation* or commercialisation *involving a transfer of assets and liabilities from the tax-exempt body to the Subject Entity*

For the purposes of the Local Government Tax Equivalents Regime, a Subject Entity will adopt as the original cost of a unit of property transferred as part of the corporatisation or commercialisation process, the value (as adjusted) shown in the Subject Entity's Asset Schedule for the transfer of that unit of property. In essence, this value (as adjusted) will represent the cost of the asset to the Subject Entity.

The value to be shown in the Subject Entity's Asset Schedule represents the book value (as determined in accordance with the Local Government Finance Standard or its equivalent) of each asset of the predecessor tax-exempt body immediately prior to the transfer of the assets to the Subject Entity. This value is considered to be equivalent to the market value of the asset at the date of corporatisation or commercialisation.

As stated above, as this value represents the cost of the asset in the hands of the Subject Entity, it will be the appropriate base for depreciation purposes in relation to assets which represent depreciable units of property.

It is to be noted that in relation to certain types of assets, transfer cost is not the appropriate base from which to claim tax deductions where the asset has been transferred from an initial owner to a subsequent owner. For example, in relation to tax claims on income-producing buildings and structural improvements under Division 43 of the ITAA 1997, a subsequent owner makes a claim based on the original cost of construction of the asset in the initial owner's hands, rather than the cost to the subsequent owner. (For further information regarding arrangements to be adopted in relation to income-producing buildings and structural improvements, refer to *Local Government Income Tax Equivalents Ruling* LITER 98/27).

Where the corporatisation or commercialisation process allows the value shown in the Asset Schedule to be adjusted within 12 months from the date of corporatisation or commercialisation, the value (as finally adjusted) represents the cost base for depreciation from the date of commencement of the tax equivalents regime.

Furthermore, the value of the asset as shown in the Asset Schedule will be regarded as sufficiently close to its arm's length market value for the purpose of avoiding the operation of sections 41-65 and 42-75 of the ITAA 1997.

In relation to depreciable plant which was expensed by the predecessor tax-exempt body (under its accounting policy), and which transferred to a Subject Entity (which has elected to adopt item 1 of LITER 98/19) on corporatisation or commercialisation, the

ability of the Subject Entity to re-capitalise those assets and claim tax depreciation is set out in *Local Government Income Tax Equivalents Ruling* LITER 98/26.

Where a Subject Entity's entry into the tax equivalents regime is deferred for some period subsequent to its date of corporatisation or commercialisation, it is not required to notionally depreciate its assets for tax purposes for the period between corporatisation or commercialisation and its commencement in the tax equivalents regime. As such, upon entry into the tax equivalents regime, the Subject Entity will be able to depreciate "units of property" from their full value (as adjusted) as shown in the Asset Schedule.

(b) Commercialisation of a business unit of an existing entity where the Subject Entity was not subject to a predecessor tax equivalents regime

In these circumstances, the ATO requires the opening depreciated value to be determined by applying notional depreciation to the original historical cost of the asset to the Subject Entity.

In view of the administrative burdens associated with the ATO approach, upon entry of a Subject Entity which has elected to adopt Option 1 of LITER 98/19 into the tax equivalents regime, the Subject Entity will be allowed to adopt as the cost base for depreciation of an asset, the written down book value of the asset as at the date of commercialisation, provided that the written down book value approximates market value for those depreciable assets. It is envisaged that where the asset has been valued in accordance with the Local Government Finance Standard or its equivalent its written down book value will approximate its market value. Accordingly, this approach assumes there has been a notional disposal and acquisition of the assets at the date of commercialisation.

Issue: Depreciable value of assets acquired by a Subject Entity after the date of corporatisation or commercialisation

The depreciable value of assets acquired by a Subject Entity (which has elected to adopt Option 1 of LITER 98/19) after the date of corporatisation or commercialisation are to be determined in accordance with ITAA principles (that is, cost).

LOCAL GOVERNMENT TAX EQUIVALENTS RULING NO: LITER 98/25

LITER 98/25: DEPRECIATION – DEPRECIATION RATES

Date of Effect: Immediate

Preamble

It is possible for substantial variances to arise between the applicable tax and accounting depreciation rates utilised in relation to various assets. Under the ITAA, the applicable tax depreciation rate for an item of plant is calculated based on the **"effective life"** of the unit of property, as determined by the taxpayer.

Effective Life

The effective life relates to the total estimated income-producing life of the plant, notwithstanding that the taxpayer intends to dispose of the plant before its effective income-producing life is over. In determining the effective life, the relevant question is: for what period of time could the particular item be used for income-producing purposes, assuming that it continues to be used under the taxpayer's conditions of use until it is no longer capable of being used to produce income by the taxpayer or any other person ?

For administrative convenience (to provide taxpayers with an alternative to "self-assessing" effective lives), the ITAA requires the Commissioner of Taxation to publish recommended periods of effective life, which taxpayers may optionally (but irrevocably) adopt as a "safe harbour" estimate for any particular unit of property. The Commissioner's determination for this purpose has been published in *Taxation Ruling* IT 2685. It should be noted that in some instances the usage put to an asset by a particular taxpayer might result in a shorter effective life (and thus, a higher depreciation rate) than that which the Commissioner has set out in IT 2685. In these circumstances, the more appropriate rate of depreciation (based on the taxpayer's usage) could be self assessed by the taxpayer.

Where the Commissioner has not made a determination in respect of a particular type of plant, a taxpayer can either (a) self-assess the effective life of the item or, (b) make a written request under the ITAA requiring the Commissioner to make such a determination.

Applicable Tax Depreciation Rate

The ITAA provides for seven broadbanded tax depreciation rates which are to apply for most items of plant. The tax depreciation rate applicable to a particular item is determined by reference to the "effective life" of the unit of property. These depreciation rates are as follows:

Effective Life in Years	Diminishing Value (%)	Prime Cost (%)
Fewer than 3	100	100
3 to less than 5	60	40
5 to less than 6 2/3	40	27
6 2/3 to less than 10	30	20
10 to less than 13	25	17
13 to less than 30	20	13
30 or more	10	7

In broad terms, the ITAA methodology for utilising these rates is as follows:

1. Calculate the effective life of the asset, as if the asset were newly acquired. (Alternatively, the Subject Entity can elect to utilise the effective life rates published by the Commissioner).

2. Determine the depreciation rate applicable to the unit of property (from the table above) based on its effective life. Special rates of depreciation apply in relation to eligible motor vehicles, employees' amenities, works of art, scientific research plant, plant used exclusively for research and development and Australian trading ships.

3. If the asset costs $300 or less, or has an effective life of less than 3 years, it is 100% deductible. It should be noted that an immediate deduction may be available pursuant to the terms of *Local Government Income Tax Equivalents Ruling* LITER 98/26).

4. The diminishing value rate will apply, unless an election is made to use the appropriate prime cost rate.

5. Pursuant to certain rules in the ITAA, a permanent election can be made to utilise a lower depreciation rate than that determined by the above table. However, the lower rate may not be less than 150% divided by the effective life of the unit (that is, if the effective life is 10 years, the minimum rates will be 15% diminishing value, or 10% prime cost).

This methodology applies under the ITAA in respect of assets acquired after 26 February 1992. In years prior to this, there have been a range of depreciation regimes in existence.

Transitional Issue: Upon entry into the tax equivalents regime, what rate of depreciation is to be adopted by a Subject Entity in relation to "existing assets" (that is, assets acquired by the Subject Entity [or its predecessor tax-exempt body where corporatisation involves the transfer of assets] prior to entry into the regime) ?

Current ITAA/ATO Approach

Under the ITAA, the applicable tax depreciation rate for a particular asset can vary according to the date when it was acquired (or where the asset was constructed, the date when construction commenced). Accordingly, upon entry into the tax equivalents regime, an issue arises as to whether a Subject Entity is required (in accordance with a strict application of the ITAA) to determine the appropriate tax depreciation rate on the basis of these key dates.

Accordingly, a transitional policy has been established to address these matters.

Position to be adopted

The appropriate depreciation rates to be adopted by a Subject entity which has elected to adopt Option 1 of LITER 98/19 depends on the method of corporatisation or commercialisation.

(a) Corporatisation or commercialisation involving the transfer of assets and liabilities from the tax-exempt body to the Subject Entity

The Subject Entity has the option of continuing to utilise the existing accounting depreciation rates (as used by the predecessor tax-exempt body), or applying the concessionary post-26 February 1992 tax depreciation rates.

Where a Subject Entity chooses to apply a post-26 February 1992 depreciation rate to an asset acquired as part of the corporatisation process, the tax equivalents regime will not invoke the revenue protection provisions contained in section 66 of Act No. 80 of 1992 which seek to prevent a taxpayer converting pre-26 February 1992 property to post-26 February 1992 property through the transfer of assets between associates.

(b) Commercialisation of a business unit of an existing entity (which was not subject to a predecessor tax equivalents regime)

The Subject Entity may adopt the rates being applied for accounting purposes immediately prior to entry into the tax equivalents regime as the rates to be utilised for tax purposes. Alternatively, the Subject Entity may adopt the concessionary post-26 February 1992 tax depreciation rates (which is justified on the basis that a notional disposal and re-acquisition is deemed to occur for the purposes of establishing opening values for depreciation and CGT cost bases).

In relation to assets acquired after entry into the tax equivalents regime by a Subject entity which has elected to adopt Option 1 of LITER 98/19, the ITAA requirements are to be followed.

Transitional Issue: Where (instead of adopting the accounting depreciation rate in respect of an "existing asset"), a Subject Entity chooses to determine the tax depreciation rate based on the effective life of the "existing asset", is the effective life determined by reference to:

(i) the remaining effective life of the asset (thus taking into account the condition of the asset upon entry into the tax equivalents regime); or

(ii) the effective life of the asset as if it were a newly acquired asset when the Subject Entity entered the regime ?

Current ITAA/ATO Approach

Where a taxpayer chooses to self-assess the effective life of an asset, subsections 42-105(1) and (2) of the ITAA 1997 require the effective life to be determined as if the asset was new as at the date it is *first used for income-producing purposes*.

In relation to "existing assets" of a Subject Entity, this would require the effective life of the asset to be determined as if it were acquired as new at the date of entry into the tax equivalents regime (since before this date, the asset was used for producing exempt income).

Position to be adopted

The ITAA approach is to be followed. Accordingly, the effective life of an "existing asset" is not to be reduced by a Subject Entity which has elected to adopt Option 1 of LITER 98/19 on account of the second hand condition of the item at the date of entering into the tax equivalents regime (that is, the rate is not determined by reference to the remaining effective life of the asset).

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/26

LITER 98/26: DEPRECIATION – WRITE-OFF OF LOW COST ASSETS

Date of Effect: Immediate

Preamble

For accounting purposes, some entities have adopted a policy of expensing low cost assets in the year of acquisition. However, these policies vary from one Subject Entity to another.

Issue: **Upon entry into the tax equivalents regime, what threshold for low cost plant is appropriate for a Subject Entity to claim an immediate deduction for tax purposes?**

Current ITAA/ATO Approach

Under section 42-130 of the ITAA 1997, for tax purposes, a taxpayer may adopt a rate of depreciation of 100% for assets which have a cost not exceeding $300 or which have an effective economic life of less than three years irrespective of cost. There is no obligation on the taxpayer to expense the assets for accounting purposes.

Furthermore, the ATO has stated in *Taxation Ruling* IT 2264 that it will allow large taxpayers an immediate write-off for tax of property costing between $300 and $500. However, IT2264 makes it clear that a taxpayer cannot adopt this policy for:

- assets involved in the establishment or major re-equipment of a business;
- assets capitalised in the books of account;
- non-depreciable assets; and
- assets which can be amortised for tax purposes under the mining provisions.

Position to be adopted

Subject to the optional transitional arrangement set out below, the ITAA/ATO approach is to apply to Subject Entities which have elected to adopt Option 1 of LITER 98/19 on their entry into the tax equivalent regime. That is, as a general rule, under section 42-130 of the ITAA 1997 only depreciable property which cost $300 or less, or has an effective life of less than three years may be expensed for tax purposes unless a Subject Entity can demonstrate that it can comply with IT2264. Where a Subject Entity complies with IT2264 it can expense depreciable property which cost $500 or less for tax purposes, provided that the property is also expensed for accounting purposes.

It is recognised that entry into the tax equivalents regime will impose administrative burdens on Subject Entities. Therefore, as a concession, a transitional policy has been adopted for Subject Entities which have not been subject to a predecessor tax equivalents regime.

The transitional policy operates for the first two income years immediately following the Subject Entity's entry into the tax equivalents regime. Briefly stated, the transitional policy involves a choice between adopting the strict ITAA/ATO approach or applying the entity's accounting write-off policy for tax purposes.

This transitional policy applies irrespective of the corporatisation or commercialisation process adopted and is on the basis that (consistent with the approach taken with establishing cost bases for depreciation and CGT purposes) the process involves a deemed or actual disposal and acquisition of assets respectively. The transitional policy for the first two income years

immediately following the entry into the tax equivalent regime of a Subject Entity which has elected to adopt Option 1 of LITER 98/19 is as follows:

Modified ITAA Approach

A Subject Entity may, at its discretion, for tax purposes, write off any depreciable plant and articles with a cost of $500 or less which are acquired as part of the corporatisation process irrespective of whether or not these assets are expensed for accounting purposes. Any assets acquired in the first two years following corporatisation must be dealt with under the ITAA approach. Alternatively,

Accounting Approach

A Subject Entity may, at its discretion, adopt the full ITAA approach for the assets is acquires at corporatisation and, for assets acquired in the first two years following corporatisation, it may adopt the same approach to expensing asset(s) for tax purposes as it has applied to those asset(s) for accounting purposes.

A summary of the transitional arrangements is set out below:

ASSET VALUE	Assets acquired as part of the corporatisation or commercialisation process		Assets acquired post-corporatisation or commercialisation	
	Strict ITAA Approach	Accounting Policy Approach	Strict ITAA Approach	Accountin g Policy Approach
Less than $300 or effective life of less than three years	expense	expense	expense	expense
Between $300 and $500 and expensed for accounting purposes	expense	capitalise	expense (if can comply with IT2264)	expense
Between $300 and $500 and not expensed for accounting purposes	expense	capitalise	capitalise	expense
Between $500 and the Subject Entity's accounting write-off threshold	capitalise	capitalise	capitalise	expense
Greater than the Subject Entity's accounting write-off threshold	capitalise	capitalise	capitalise	capitalise

The strict ITAA approach is to be applied in all years following the expiration of the transitional arrangement.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/27

LITER 98/27: CAPITAL WORKS EXPENDITURE

Date of Effect: Immediate

Preamble

Entities that were previously tax exempt may have incurred expenditure in relation to income producing buildings and structural improvements during that tax-exempt period.

Transitional Issue: On what basis can a Subject Entity claim a deduction for capital works purchased or constructed by the entity prior to entry into the tax equivalents regime ?

Current ITAA/ATO Approach

In terms of Section 124ZEB of the ITAA, the building and structural improvement amortisation provisions contained in Division 10D of the ITAA 1936 do not apply for the 1997/98 year of income or a later year of income.

Division 10D has been replaced by Division 43 (Deductions for Capital Works) in the *ITAA 1997*. Under Section 43-10(1) a capital works deduction may be available to a taxpayer in any income year. The deduction is limited to owners, quasi-owners and certain lessees of capital works. The term “capital works” includes a wide range of structures and extensions, alterations and improvements to such structures which have been broadly categorised in Section 43-20 as follows:

- buildings
- structural improvements; and
- environment protection earthworks

For a capital works deduction to be made available in respect of capital works expenditure, Section 43-10(2) requires that:

- the capital works have a “construction expenditure area” (Section 43-75)
- there is a “pool of construction expenditure” (Section 43-85) for that area; and
- the taxpayer uses the taxpayer’s capital works area (Subdiv 43-C) in a deductible way (Section 43-140),eg for the purpose of producing assessable income

Under Section 43-15(1), the amount of a taxpayer’s capital works deduction is a portion of the taxpayer’s construction expenditure. The deduction is calculated on the "construction expenditure" incurred in constructing the capital works, using set rates determined by the date and usage of the capital works.

Section 43-15(1) imposes a time limit on the period over which construction expenditure can be deducted and Section 43-25 specifies the rates of deduction at which a capital works deduction may be claimed. The time limits and rates vary depending on the usage

and the commencement date of the capital works and are summarised in the following table:

USAGE OF CAPITAL WORKS	COMMENCEMENT DATE OF CAPITAL WORKS	RATE OF DEDUCTION (% of construction expenditure)	WRITE OFF PERIOD (years)
To produce assessable income	(a) Between 21.8.84 and 14.12.87 (b) Post 27.2.92	4.0 2.5 2.5	25 40 40
Other uses (eg. for industrial activities)	(a) Pre 27.2.92 (b) Post 27.2.92	2.5 4.0	40 25

Broadly speaking, the "construction expenditure" comprises the costs associated with the actual construction of the building, including preliminary expenses such as architect's fees, engineering fees, as well as the cost of foundation excavations (*Taxation Ruling* IT 2640). Where a taxpayer is unable to determine precisely the actual cost of the asset the Commissioner will accept an estimate of the cost of construction by a quantity surveyor or "other qualified person". (Refer *Taxation Determination* TD 94/83).

The following items of expenditure would not qualify for a capital works deduction under Division 43 since "construction expenditure" (Section 43-70(2)) does not include:

- expenditure on acquiring land; or
- expenditure on demolishing existing structures; or
- expenditure on clearing, levelling, filling, draining or otherwise preparing the construction site prior to carrying out excavation works; or
- expenditure on landscaping; or
- expenditure on plant; or
- expenditure on property for which a deduction is available, or would be available if the property were used for the 'purpose of producing assessable income', under various sections of the ITAA 1997 and ITAA 1936 which deal with expenditure on mining and quarrying, scientific research, capital expenditure to prevent land degradation, capital expenditure on facilities to conserve or convey water and capital expenditure on forestry roads and/or mill buildings); or
- expenditure on property for which a deduction is allowable, or would be allowable if the property (acquired/constructed prior to 21 November 1987) were used for carrying on research and development activities, under Section 73B of the ITAA 1936; or
- expenditure on eligible heritage conservation expenditure within the meaning of Subdivision AAD of Division 17 of Part III of the ITAA 1936.

A taxpayer can only start claiming capital works deductions once construction of the relevant capital works is completed (Section 43-30). The write off deduction period commences on the day on which the building etc is first used for any purpose after construction. The deduction is only available, however, in respect of periods during which the capital works is being used or is available ready for use for income producing or R & D purposes.

The result of this is that buildings etc constructed by previously tax exempt entities will commence their time limit at the date of their first use, however no deduction is available until the property is used for income producing or R & D purposes.

Position to be adopted

The capital allowance is to be calculated in accordance with existing ITAA principles. The total construction expenditure is to be notionally reduced such that those amounts of the allowance remaining to be claimed as a deduction reflects the remaining eligible period of write off.

In the case of capital works purchased or constructed after transition, Division 43 is to have its ordinary application.

It is noted that the references above to “capital works” are to those items of capital expenditure to which Division 43 normally applies.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/28

LITER 98/28: DEPRECIATION - BLOCK ASSETS

Date of Effect: Immediate

Preamble

In some cases it is difficult for Subject Entities to separately identify assets. Identification is necessary to establish the right to depreciation (that is, an income-producing asset), and the opening depreciable value ("cost") of the asset. Often, this identification may only be achieved in respect of a unitised block of assets.

Transitional Issue: **Can a Subject Entity apply the depreciation provisions of the ITAA where individual identification of assets is difficult to achieve?**

Current ITAA/ATO Approach

Whilst the ITAA requires individual identification of assets for the purposes of claiming depreciation, a pragmatic approach is often taken by the ATO such that unitised (or "block") assets will be accepted provided that the categorisation is reasonable. Generally, the effective life and depreciation rate are pre-approved in negotiations with the ATO.

Position to be adopted

In relation to pre-existing plant items which are brought into the tax equivalents regime, it is recognised that a Subject Entity may have insufficiently detailed records. Accordingly, as a concession, a pragmatic approach is to be adopted such that where a block asset exists (the unidentifiable components of which may be subject to a number of depreciation rates) the effective life and depreciation rate maybe self assessed by a Subject entity which has elected to adopt Option 1 of LITER 98/19. In self-assessing, the depreciation rate should reflect the life of the unitised asset, adjusted to allow for the impact of concessions provided for under the ITAA.

Disposal of parts of a block asset will be treated as follows:

- Any consideration received will be offset against the written down value of the assets, or treated as assessable, at the election of the Subject Entity; and

- No loss will be allowed in respect of scrapping or other disposals.

This approach is justified given the indivisibility of the unitised asset. Under the ITAA, a sale of a depreciable asset for a value below its tax written down value will generally result in a deductible loss. Similarly, the recovery of depreciation will generally be assessable, subject to an election by the taxpayer to offset this gain against the depreciable value of other assets.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/29

LITER 98/29: DEPRECIATION – CAPITALISED EXPENSES

Date of Effect: Immediate

Preamble

Some entities adopt the practice of capitalising certain costs incurred in relation to the acquisition of assets (particularly in the period of construction of the asset). The two types of costs most commonly encountered are:

- interest incurred on borrowings undertaken to fund the purchase of the asset; and
- exchange gains and/or losses incurred in respect of an asset purchased under a contract denominated in a foreign currency which arises between the date the contract was concluded and the date payment was made to the overseas supplier.

These costs are then depreciated for accounting purposes.

Transitional Issue: **Can a Subject Entity include these expenses in the tax depreciable value of those assets ?**

Current ITAA/ATO Approach

For ITAA purposes, capitalised interest and exchange gains/losses generally do not form part of the cost of an asset for depreciation purposes as they are wholly deductible in the year in which they are incurred or realised.

Position to be adopted

In the case of assets being transferred to the Subject Entity as part of the corporatisation or commercialisation process, the tax depreciable cost of an asset is its value as shown in the Asset Schedule. For convenience, it will not be necessary to adjust the value of these assets transferred in as part of the corporatisation or commercialisation process for any capitalised interest or exchange gains/losses included therein.

In relation to assets acquired by a Subject Entity which has elected to adopt Option 1 of LITER 98/19 after entry into the tax equivalents regime, the Subject Entity must ensure that interest and exchange gains/losses are excluded from the tax depreciable cost of such assets (that is, the strict ITAA principles apply for assets acquired after entry into the regime).

Transitional Issue: What position is to be adopted where the tax-exempt body enters into a contract to purchase an asset which is denominated in a foreign currency, and payment on that contract is to occur after entry into the tax equivalents regime ?

In these situations, the Australian dollar liability under the contract must be determined at the date of entry into the tax equivalents regime and any subsequent assessable/deductible gains/losses will be calculated from that date provided appropriate notices are given.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 98/30

LITER 98/30: REPAIRS AND MAINTENANCE

Date of Effect: Immediate

Preamble

Under section 25-10 of the ITAA 1997 a taxpayer is entitled to a deduction for "repairs" to any premises, plant, machinery or articles held, occupied or used by him for the purpose of producing assessable income or in carrying on a business for that purpose, which are not of a capital nature. Additionally, expenditure on repairs may qualify as deductible under the general provision of section 8-1 of the 1997 Act.

The concept of repairs generally involves a restoration of a thing to its former condition. In this regard, a repair generally involves a restoration in efficiency of function. That is, a repair may involve a replacement or renewal of a worn-out or dilapidated part of something, but not of the thing as an entirety. However, where the work in question goes beyond being a "genuine repair" and amounts to an improvement to or an enhancement of the thing, no deduction will be allowable under section 25-10.

Transitional Issue: Can an entity claim a deduction for repairs under section 25-10 of the ITAA 1997 where some or all of the deterioration or damage giving rise to the repair is attributable to use by the entity in a tax exempt period?

Current ITAA/ATO Approach

Subsection 25-10(2) provides that a portion of expenditure incurred in repairing an item of property held partly for income producing purposes is deductible. The amount of the expenditure which is deductible is so much as is reasonable in the circumstances. In this regard, the Commissioner has stated (in *Taxation Ruling* IT2587) that expenditure is deductible to the extent to which the asset is used for income-producing purposes. Accordingly, repairs referrable to the tax exempt period would generally not be deductible.

Position to be adopted

Expenditure incurred on genuine repairs (as opposed to improvements to, or enhancements to assets) by a Subject Entity which has elected to adopt item 1 of LITER 98/19 after entry into the tax equivalents regime may be claimed as a deduction under section 25-10 notwithstanding that some portion of the wear and tear causing the expenditure occurred during a period when the property was used for tax-exempt purposes. This transitional ruling has been made to alleviate the administrative burdens foreseen if a strict ITAA approach was adopted (that is, requiring determinations of the pre- and post-TER portion of the wear and tear to the cost of the repairs).

Transitional Issue: Where the corporatisation or commercialisation process involves the transfer of assets and liabilities to a Subject Entity, will repairs to property acquired as a result of the corporatisation or commercialisation (where the defects were in existence at the time of the transfer) be regarded as "initial repairs" ?

Current ITAA/ATO Approach

Whilst not definitive, a number of decisions have espoused the principle that where an item of property is in a state of disrepair at the time of its acquisition, the cost of repairs to remedy those defects is of a capital nature and non-deductible. The rationale for the principle is founded on the view that a reduction will have been made in the purchase price to take into account the state of disrepair. However, English case law has held that genuine repairs (as distinct from improvements) effected subsequent to acquisition of an item in workable but poor condition are deductible, except where the condition of the item at the time of purchase is such that without fairly immediate repair it would be incapable of being put to commercial use. Accordingly, the tax treatment of initial repairs is somewhat clouded, and must be determined as matter of fact and degree in the circumstances.

Position to be adopted

For a Subject Entity which has elected to adopt Option 1 of LITER 98/19, the deductibility of expenditure on repairs to assets transferred to a Subject Entity on corporatisation or commercialisation is to be determined on the basis of the principles set out in the above transitional issue (that is, genuine repairs as distinct from improvements or enhancements will be deductible). Accordingly, a deduction will be allowable for genuine repairs even though the expenditure is incurred soon after the transfer of the item. However, where an immediate repair is more in the nature of an improvement to, or an enhancement of the asset, the expenditure should be capitalised to the asset and depreciated accordingly.

Additionally, repairs to assets acquired by a Subject Entity subsequent to the corporatisation process that are repaired soon after acquisition should still be examined to determine whether the repair is an “initial repair” and should be capitalised for tax purposes.

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 2000/1

LITER 2000/1: WATER AS TRADING STOCK

Date of Effect: Immediate

Preamble

The question has arisen as to whether water may constitute the trading stock of a Subject Entity. If water is trading stock, the value of water held as such at the beginning and end of each year needs to be taken into account when determining the Subject Entity's tax equivalents liability.

The issue of whether water is trading stock has been considered in light of the following two scenarios:

Scenario 1	The State Water Boards hold water in various catchment areas, such as Wivenhoe Dam. A Subject Entity (being a local government water authority) purchases water from the relevant State Water Board at which time the water is transported through pipes into a treatment plant where the water is treated to make it fit for consumption. The treated water is then transported to a reservoir owned by the Subject Entity where it is stored until it is supplied to end users.
Scenario 2	Water is collected in a catchment dam owned by the Subject Entity. When needed, the Subject Entity draws a quantity of water from the catchment dam and transports it through pipes into a treatment plant where it is made fit for consumption. The treated water is then transported to a reservoir where it is stored until it is supplied to end users.

Issue: **Is water trading stock?**

Current ITAA/ATO Approach

Trading stock takes its ordinary meaning and is also defined in the Income Tax Assessment Act 1997 (the ITAA 1997) as including:

> "anything produced, manufactured or acquired that is held for purposes of manufacture,
> sale or exchange in the ordinary course of a business".

By way of example, the following items are generally considered to be trading stock:

- Goods held for sale by a retailer
- Ore that has been extracted from the land.

The issue of whether water is trading stock has not been specifically considered under the Federal tax regime.

Position to be adopted

It is considered that water may constitute trading stock under the ordinary meaning of that term and as that term is defined in the ITAA 1997. Notwithstanding this, it is considered that untreated water held in a catchment dam should not be regarded as trading stock, irrespective of whether the Subject Entity owns the dam. However, a quantity of water which is drawn from a catchment dam by a Subject Entity and transported through pipes to

a treatment plant is considered to become trading stock of the Subject Entity. Similarly treated water contained in reservoirs, whether or not these reservoirs are owned by a Subject Entity, is considered to be trading stock of the Subject Entity.

This position is based on the following reasoning:

- water constitutes goods as it is tangible, capable of being physically acquired and it is not a fixture
- there is some doubt whether water constitutes goods when it is contained in a catchment dam
- it is difficult to measure water in a catchment dam due to the constant movement of water through precipitation, evaporation, appropriation from streams, etc
- whether or not water can be owned is unclear, although at law it is suggested that water is owned beneficially by the person who uses the water
- a local government (and, in particular, a Subject Entity water authority) has dispositive power over water when it is in its possession
- while there is some uncertainty as to whether it is water that is sold or **the right** to use water that is sold (or supplied) by a Subject Entity, it is considered that water is being sold due to the following:
- generally speaking, consumers are charged on a consumption basis, or will be charged on a consumption basis in the future, for water consumed
- once water is supplied to consumers it is used, whether this is an active use (ie collection in a cup for consumption) or a passive use (ie water flowing into a garden bed)
- water meets the definition of trading stock in the ITAA as demonstrated by the following:
- water is acquired via purchase from a State Water Board or by drawing a quantity of water from a catchment dam
- water is held for the purpose of manufacture when it is held prior to treatment and, post treatment, it is held for the purpose of sale to consumers
- water is held by a Subject Entity in the ordinary course of a business.

Transitional Issue:

Upon entry into the tax equivalents regime, what value should be ascribed to water held as trading stock by a Subject Entity.

Position to be Adopted

Reference should be made to LITER 98/3 which provides the transitional rules regarding the valuation of trading stock.

Issue: **Valuation of water as trading stock.**

Current ITAA/ATO Approach

Section 70-45 of the ITAA 1997 provides three alternative methods which may be used to value trading stock at the end of a year of income. These are:

(a) Cost

(b) Market selling value

(c) Replacement price

A taxpayer is not restricted to the adoption of any particular methodology and may change valuation methodologies between years of income. In relation to manufactured goods, it is appropriate to determine “cost” on an “absorption costing” basis. In this respect, regard should be had to IT2350 which confirms this methodology.

Position to be Adopted

Under the absorption cost method, both direct and indirect costs (eg production overheads) should be included in the cost price calculation. Thus, on the basis that treated water is a manufactured good, determination of the “cost price” for the purposes of the trading stock provisions will necessarily involve quantification of all direct and overhead costs reasonably attributable to the treatment process.

Reference should be made to IT2350 to determine the type of costs to be included in any calculation. In relation to overhead costs, it is expected that these will fall into one of two categories:

(a) Variable production overheads: and
(b) Fixed production overheads (including rent, insurance, depreciation of plant etc).

LOCAL GOVERNMENT INCOME TAX EQUIVALENTS RULING NO: LITER 2000/2

LITER 2000/2: DEPRECIATION – WHETHER WATER STORAGE DAMS CONSTITUTE PLANT FOR DEPRECIATION PURPOSES

Date of Effect: Immediate

Preamble

The question has been raised as to whether water storage dams are plant for the purposes of Subdivision 42-A of the *Income Tax Assessment Act 1997* (the 1997 Act) and, as such, eligible for depreciation. The term "plant" is not defined in Section 42-18, however, it has been extensively considered in case law to be the apparatus used to carry on a business, other than trading stock, being goods and chattels (whether fixed or moveable), which are kept for permanent employment in the business. *Yarmouth v France (1887) 19 QBD 647*.

The courts have adopted a "functional test", based on the function that the property performs in the taxpayer's business. An important distinction exists between items that fulfil an integral function in the taxpayer's business, which constitute plant, and items that merely provide a "conventional setting", by way of shelter or other suitable environment, which do not qualify as plant or articles. However, in determining whether an item may be classified as plant, it has been established that it is not enough merely to find that the property performs some function in enabling the taxpayer's operations to be carried on. The question that must be answered is whether the function performed by the property is so related to the taxpayer's operations or so special that it warrants being held to be plant.

In Federal Taxation Ruling TR 94/11, the Commissioner of Taxation stated that, although whether a particular item is a unit of property (ie plant) is a question of fact and degree, an item satisfies the description of plant if it has one or more of the following characteristics :

(a) it is an entirety in itself, capable of being separately identified or regarded as having a separate function;

(b) it is a function complete in itself. However, the item need not be self-contained or considered in isolation. It is not necessary that the item function on its own. It should, however, be capable of performing its intended discrete function;

(c) when attached to another unit of property having its own independent function, the item varies the performance of that unit; or

(d) it performs a definable identifiable function.

Current ITAA/ATO Approach

Although Section 43-20(3) of the ITAA 1997 mentions concrete or rock dams as examples of the types of structural improvements for which Division 43 (which deals with capital allowance deductions other than depreciation) applies, this should not be taken to mean that rock or concrete dams can-not be plant under Subdivision 42-A. This is acknowledged

by Section 43-50 which contains provisions precluding deductions under Division 43 in respect of structural improvements for which depreciation is allowable under another section of the ITAA.

Further, it is noted that the Commissioner accepts that tailings dams used in mining operations and chemical manufacturing are plant for the purposes of depreciation. It is stated under Draft Federal Taxation Ruling TR 98/D2 that because tailings dams have a storage, disposal and containment function directly connected with operating treatment plant, they are themselves plant. In addition, Section 42-18(1)(c) states that dams on land that is used for agricultural or pastoral operations are considered as plant.

Position to be Adopted

Water storage dams (whether concrete, rock or earth) are a functional unit in themselves used in a water authority's business operations. They are not merely a convenient setting in which the business is carried on but are, in fact, an essential "tool of the trade". Without them there could be no trade or business.

Therefore, in the absence of any public ruling on water dams by the Commissioner of Taxation, water dams are to be regarded as "plant" for the purposes of the Queensland Tax Equivalents Regime. It is noted that in IT2685 the Commissioner estimates the effective life of dams as 40 years.

Issue : What expenses will be considered to form part of the cost base of the dam and accordingly be eligible for depreciation.

The construction of a water storage dam will usually include such things as earthworks, the construction of the dam wall/spillway, other concrete walls and supports, excavation and clearing of areas around the dam, excavation of the dam itself, the construction of access roads etc. Accordingly, it must be considered which of the costs incurred in the construction of a water storage dam would be eligible to form part of the cost base of the plant and accordingly be eligible for depreciation.

Current ITAA/ATO Approach

The Commissioner of Taxation states in Federal Taxation Ruling IT31 that where a structure qualifies as wholly plant, this will be taken as including concrete foundations or footings. Further it was also stated that the cost of excavating for foundations is accepted as part of the depreciable cost, but not general site preparation (eg land levelling, land forming etc).

Position to be Adopted

Based on the Commissioner's guidelines in IT31, it is considered that all costs associated directly with the construction of the water storage dam (ie excavation of dam itself, construction of concrete supports, construction of dam wall/spillway etc) are eligible for depreciation under Division 42. Those costs incurred indirectly with the construction of the dam (ie access roads, levelling and clearing areas around the dams) will ordinarily not form part of the depreciable cost of the dam but may be eligible for a capital allowance deduction under Division 43, as a structural improvement, if construction commenced after 27 February 1992.

It is noted that expenditure covered by Division 42 is expenditure on plant and is not deductible under section 43-10 as expenditure on a structural improvement. "Concrete or rock dams" in subsection 43-20(3) refers to dams that are non-plant structural improvements and distinguishable from plant which is covered by this LITER.