

New Australian Budget includes corporate tax rate cut, but new levy offsets benefits

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In brief

The Australian 2014 – 2015 Federal Budget (Budget), released on May 13, 2014, contains a number of measures designed to increase tax revenue and reduce the projected Federal Budget deficit.

These changes were generally expected and are consistent with previous government announcements. Several of the changes could affect US multinational corporations (US MNCs) with investments in Australia.

Notably, the Budget proposes to increase the scope of Australia's foreign resident capital gains tax (CGT) by removing the ability to use inter-group transactions that generate non-land assets in determining whether an entity sold is Australian 'land-rich' and therefore subject to Australian CGT.

The Budget also proposes to reduce the Australian corporate tax rate from 30% to 28.5%. However, any expected benefits from the rate cut will be largely offset for companies with taxable income in excess of A\$5 million by the imposition of a levy on such companies to pay for a proposed Paid Parental Leave (PPL) scheme.

The Australian government is still in consultation regarding its proposal to introduce a targeted anti-avoidance measure to deny certain Australian interest deductions for debt funding costs associated with investments in foreign companies that generate exempt dividends.

In detail

Key tax changes

Increased scope of non-resident capital gains tax and removal of ability to 'double count' certain assets

Nonresidents that hold equity investments on capital account ordinarily are subject to Australian CGT on these equity investments only when the equity represents 'taxable

Australian property.' This generally means that more than 50% of the value of the entity's underlying assets relates to Australian land or interests in land, under the 'principal assets test'.

As part of the 2013-14 budget, the previous government announced that it would amend the foreign resident CGT provisions. It proposed amendments

related to 'indirect Australian real property interests' for CGT purposes.

These included:

- strengthening an existing provision to ensure that transactions within a tax consolidated or multiple entry consolidated (MEC) group are ignored for the purposes of applying the principal assets test when

the effect of the transaction is to create or duplicate an asset, such as a debt that is not taxable Australian real property, and thereby potentially avoiding Australian CGT; and

- proposing to treat mining, quarrying, and prospecting information and goodwill together with mining rights as real property for the purposes of the principal asset test.

As part of the Budget, the government has confirmed that it will proceed with strengthening the foreign resident CGT integrity provisions by preventing double counting of assets. It also announced that it will refine the provision to apply to interests held by foreign residents in both unconsolidated and consolidated groups. Draft legislation has been released in conjunction with the Budget.

For interests held by foreign residents in unconsolidated groups, the measure will apply to CGT events occurring on or after May 13, 2014.

With respect to interests held in a consolidated group or MEC group, the measure will take effect retroactively from the date on which it was announced in last year's budget (May 14, 2013).

Proposed amendments to asset valuations have been deferred pending the outcome of ongoing litigation.

Reduction in the corporate tax rate effectively offset by PPL levy for large corporate taxpayers

The government confirmed in the Budget its commitment to reduce the Australian company tax rate from its current rate of 30% to 28.5%, effective for tax years beginning on or after July 1, 2015.

However, for companies with taxable income in excess of A\$5 million, any expected benefits from the rate cut will be largely offset by the imposition of a 1.5% PPL levy on taxable income that exceeds A\$5 million. Therefore, for companies subject to the PPL levy, the effective combined tax rate will remain close to 30%.

The government also announced that it will increase the Fringe Benefits Tax rate payable by employers from 47% to 49%, beginning April 1, 2015, through March 31, 2017. This is a counterpart to the proposed Temporary Budget Repair Levy that will apply in addition to the top personal income tax rate.

No decision yet on targeted anti-avoidance provision regarding debt funding foreign investment

As part of the 2013-14 budget, the previous government announced a proposal to deny interest deductions for debt funding costs, such as interest payable on debt, associated with investments in foreign companies that generate exempt dividends.

The current government subsequently announced that it would not proceed with this proposal and instead would introduce a targeted anti-avoidance measure.

The government has confirmed in the Budget that it is still seeking advice on this issue and has yet to make a final decision.

Changes to the tax consolidation regime

The government proposes to proceed with certain changes to the tax consolidation regime announced by the previous government in the 2013-14 budget.

Proposed measures relevant to MNC investors include:

- removing the ability to claim certain 'double deductions', and
- providing that future deductible liabilities, such as employee leave entitlements, of a joining entity would result in the head company of the joined group including a corresponding amount in its assessable income (the 'deductible liabilities' measure).

These measures are proposed to take effect May 14, 2013. Given the start date, these proposals should be reviewed by taxpayers who have undertaken a consolidation on or after May 2013 or are planning a consolidation.

Measures to prevent foreign investors from taking advantage of the rules relating to MEC groups, compared with those for ordinary tax consolidated groups, will not proceed as announced by the previous government. However the current government has indicated that it will begin consultation on some measures identified by a report on MEC groups commissioned last year, including an amendment to extend a modified form of the unrealized loss rules to MEC groups.

Another deferral of the start date for the new MIT regime

The Managed Investment Trust (MIT) regime is a concessional tax regime used mainly by real estate investment trusts and investment funds that results in reduced withholding tax on certain types of net rental payments and capital gains.

The previous government announced in July 2012 that the start date of the new MIT regime, which is designed to increase certainty, reduce complexity, and lower costs, would be deferred to July 1, 2014.

The current government has announced it will defer the start date for the new MIT regime to July 1, 2015.

Reduction in the research and development (R&D) tax offset

In conjunction with the cut in the company tax rate by 1.5% to 28.5% effective July 1, 2015, the government proposes to preserve the relative value of the R&D tax incentive by also reducing the rates of the refundable and nonrefundable R&D offsets by 1.5%, effective July 1, 2014.

This means that:

- the refundable R&D tax offset will be reduced from 45% to 43.5% for eligible companies with turnover less than A\$20 million; and
- the nonrefundable R&D tax offset will be reduced from 40% to 38.5% for eligible companies with turnover of greater than A\$20 million.

Note: The reduction in the R&D tax offset rates would commence one year earlier than the corresponding cut in the corporate tax rate.

The takeaway

Taxpayers should study the proposed changes when the draft legislation is released. PwC will seek to be involved to the extent possible in the consultation and feedback process for any draft legislation.

US MNCs with Australian investments should reassess their Australian positions with regard to the proposed changes and consider their impact.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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