

# *ITS*Newsalert

## Australian Federal Budget 2013/14

International  
Tax Services  
(ITS) Newsalert,  
Australia

May 2013

The Australian 2013 – 2014 Federal Budget, released on May 14, 2013, contains a number of measures aimed to increase the Australian tax revenue, including a number of changes in particular relevant for in- and outbound investors in Australia. Most notably, the Budget proposes to amend the Australian thin capitalisation rules by reducing the safe-harbor debt amount from 75% to 60% of adjusted Australian assets (an effective debt/equity ratio of 1.5:1 compared to the current 3:1 ratio).

The Budget further contains proposals to limit the deductibility of debt in Australia raised for foreign investments and proposed to remove the existing participation exemption for dividends received from foreign companies on shares which for Australian tax purposes qualify as debt interests under the Australian debt/equity rules.

All the proposals discussed below are set to apply for income years commencing on or after July 1, 2014, which would defer the application for companies with a December year end to the year beginning January 1, 2015.

### ***Thin capitalisation rules***

The biggest changes for inbound investors in Australia coming out of this budget are the proposed changes to the Australian thin capitalisation rules.

Australian thin capitalisation rules operate to disallow tax relief for interest relating to debt that exceeds the thin capitalisation threshold. Generally, for non-Australian tax resident companies with Australian subsidiaries, the current thin capitalisation threshold is a debt level of 75% of the adjusted Australian assets ("safe harbor debt test"), or an arm's length level of debt. Different rules apply if the relevant entity is a financial institution.

The Government proposes that the safe harbor debt to equity ratio for general entities will be reduced to 1.5:1 (60%) and for non-bank financial entities to 15:1. It is also proposed that for banks, the capital limit will be increased to 6% of their risk weighted assets of the Australian operations as well as for outbound investors, the worldwide gearing ratio will be reduced to 100% but will now also be available to inbound investors. Additionally, the existing de minimis threshold should be increased from AUD 250k to AUD 2m of debt deductions.

The existing arm's length test will remain, but a review has been foreshadowed to improve its operation and make it easier to comply with and administer.

### ***Deduction for interest expense relating to foreign investment denied***

A very significant change which the Government says is the third part of a package of measures designed to tackle "artificial loading of debt in Australia by multinationals". The Government proposes to remove the deductions currently available within the limits of the thin capitalisation rules for interest expense incurred in relation to investments in foreign companies that generate exempt dividends. This will be a fundamental change for Australian companies with foreign investments.

### ***Removal of exemption for certain dividends***

The government proposes to remove the income tax exemption for dividends received by Australian companies in relation to certain interests in foreign companies where that interest is classified as "debt" for Australian tax purposes.

Currently, the exemption is available for dividends received from all "non-portfolio" interests in foreign companies (i.e. interests of 10% or more) which are legal form shares. The proposed amendment will remove the exemption for legal form shares that are treated as debt interests for Australian tax purposes under the Australian debt/equity rules, such as certain types of redeemable preference shares.

It is not clear from the announcements whether there will also be a change for interest payments on legal form debt interests which are treated as equity for Australian tax purposes.

The Government is however proposing to extend the existing participation exemption for non-portfolio dividends to dividends received through partnerships and trusts.

### ***Other international tax changes.***

With regard to non-resident capital gains tax ("CGT"), the government proposes that from July 1, 2016, a 10% non-final withholding tax is to be introduced with regard to disposals by foreign residents of certain taxable Australian property.

Further in this respect, it is proposed that amendments be made in relation to "indirect Australian real property interests" for CGT purposes, including removing the ability to use transactions between members of a tax consolidated group to duplicate assets and amendments to value mining, quarrying and prospecting information and goodwill together with the mining rights to which they relate. This will prevent non-residents from not triggering an Australian capital gains tax liability as a consequence of the recognition of intercompany receivables and the exclusion of certain mining information when determining indirect Australian real property assets.

The government is also proposing measures to prevent foreign investors from taking advantage of the rules relating to multiple entry consolidated ("MEC") groups, compared with ordinary tax consolidated groups. The unjustified advantages identified by the government include the ability of tax free transfers of assets between members of a MEC group and subsequent disposals. While the measures to equalise the treatment of MEC and ordinary consolidated groups will also apply from July 1, 2014, the government reserves the right to take legislative action earlier, potentially from the date of the budget announcements, where it identifies aggressive tax minimisation strategies involving MEC groups.

Finally, the government will instigate a post implementation review of the Australian debt / equity rules, which were enacted in 2001. One of its tasks is to examine whether there can be improvements made to address any inconsistencies between Australia's and other countries' debt /equity rules.

---

## **Contacts**

If you would like to discuss the implications for your organisation, please contact your usual PwC adviser or:

### ***PwC Global ITS Leader***

**Tony Clemens**  
+61 2 8266 2953  
tony.e.clemens@au.pwc.com

### ***PwC Australia***

**Peter Collins**  
+61 3 8603 6247  
peter.collins@au.pwc.com

**Chris Morris**  
+61 2 8266 3040  
chris.j.morris@au.pwc.com

**Christian Holle**  
+61 2 8266 5697  
christian.holle@au.pwc.com

**Robert Hines**  
+61 2 8266 0281  
robert.hines@au.pwc.com

**Matthew Budge**  
+61 8 9238 3382  
matthew.budge@au.pwc.com

### ***PwC Singapore***

**Alan Ross**  
+65 6236 7578  
alan.ross@sg.pwc.com

**Chris Woo**  
+65 6236 3688  
chris.woo@sg.pwc.com

**David Sandison**  
+65 6236 3675  
david.sandison@sg.pwc.com

**Paul Cornelius**  
+65 6236 3718  
paul.cornelius@sg.pwc.com

**Paul Lau**  
+65 6236 3733  
paul.st.lau@sg.pwc.com

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PricewaterhouseCoopers does not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2013 PwC. All rights reserved. Not for further distribution without the permission of PwC. "PwC" refers to the network of member firms of PricewaterhouseCoopers International Limited (PwCIL), or, as the context requires, individual member firms of the PwC network. Each member firm is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way. No member firm is responsible or liable for the acts or omissions of any other member firm nor can it control the exercise of another member firm's professional judgment or bind another member firm or PwCIL in any way.