



TAX UPDATE – APRIL 2010

Recent Tax Announcements

There have been significant tax announcements made by Treasury recently in relation to the release of the *Australia's Future Tax System Review* and the *Board of Taxation Review* into the valuation of shares and rights issued under Employee Share Schemes.

Furthermore, the ATO released their view in terms of applying PAYGW and FBT to foreign employers.

Australia's Future Tax System Review

The Hon Wayne Swan announced that Treasury will release the *Australia's Future Tax System Review*, known as the 'Henry Review' on Sunday 2 May 2010. The Government's initial response to the results of the review will also be announced at this time.

The review was commissioned in May 2008 as a result of the Government's 2020 Summit, which proposed a comprehensive review of State and Federal taxes. The Government has stated that the Henry review will be an extremely comprehensive review of the Australian taxation system. It is expected the review will propose changes to the franking credit system, superannuation contribution provisions and the treatment of trusts under Division 7A amongst other changes.

Speculation centres on a complete overhaul of the taxation of resources with recommendations that federal taxes should be levied on all onshore mining and resource projects; optional tax returns; a new incentive for savings; and a range of reforms to state taxes such as royalty resource tax, land tax and payroll.

The review was completed in December 2009 and the Government has been under political pressure to release the review since this time. The announcement will be via a media lock-up which only approved media will attend. The Treasurer will hold a press conference under embargo inside the lock-up at a time to be advised.

We will keep you informed of developments once the Report has been released and we have considered the practical consequences.

What it means for you

In our view, it is unlikely any changes will be effective from the release of the Henry Review due to the need for further industry consultation. Nevertheless, should you have concerns regarding the commencement date of any changes, there may be benefits in considering your tax affairs prior to the announcement.

- For example, if it is intended that companies declare dividends in relation to the 2010 income year, it may be beneficial to make any necessary Directors' resolutions and declare any fully franked dividends prior to 2 May 2010 in light of potential changes to the franking system expected under the Henry Review.
- Taxpayers intending to make deductible concessional superannuation contributions for the 2010 income year may wish to make these contributions prior to 2 May 2010 in order that where superannuation laws are amended, the contributions are subject to the current rules. For example, it has been speculated that the contributions tax rate should be increased from 15% to 30% for high income earners. Again, we believe it is unlikely that such a change will be effective from 2 May 2010, and if introduced would be more practical if effective from 1 July 2010.

- With the potential ratification of the Tax Office's position that unpaid present entitlements owed to companies from Trusts be treated as loans, Trustees may wish to make interim distributions prior to 2 May 2010 in order to mitigate the impact of these changes.

Employee Share Scheme Valuation Methods

The Assistant Treasurer Senator Nick Sherry released the Board of Taxation's review into valuation methods used to calculate the market value of shares and rights issued under Employee Share Schemes ("ESS"). The review also considered whether ESS interests issued by certain companies should be subject to a tax deferral arrangement regardless of being at real risk of forfeiture.

There were five recommendations made by the Board, four of which have been accepted by the Government:

1. The market value of listed shares and listed options is to be determined using the ordinary meaning of market value. The Board has recommended that guidance on acceptable valuation methods be developed in consultation with interested stakeholders and published by the Commissioner;
2. The market value of unlisted shares is to be determined using the ordinary meaning of market value;
3. The market value of unlisted options is to be determined using the ordinary meaning of market value or using a statutory 'safe harbour' valuation method at the choice of the taxpayer;
4. The current statutory valuation methodology will be used as the safe harbour valuation method. However, the Board has recommended that the current tables be updated to more accurately reflect current market conditions. The amendments suggested relate to assumptions regarding volatility, dividend yield and risk free rate of interest which underpin the calculations used to originally create the statutory tables. In addition, the Board recommends that the tables be reviewed from time to time to ensure they remain reflective of market conditions and that the Commissioner develop an on-line tool to assist taxpayers in applying the safe harbour valuation methods.
5. The Board considered if ESS interests issued by speculative companies, start-up companies or Research and Development companies should be subject to automatic tax deferral, however the Board subsequently decided against making this recommendation.

The Government has agreed to recommendations 1 to 3 and recommendation 5 in full. In relation to recommendation 4, the Government has agreed to retain the use of the statutory valuation methodology as a safe harbour, however rather than adopt the amendments suggested to the table assumptions, Government will enter into a consultation process with stakeholders over the next 12 months before making a decision on the amendment of the tables in time for the 2011-12 budget.

Foreign Employers

On Monday, 26 April 2010, the Australian Taxation Office ("ATO") released a draft Taxation Determination ("TD 2010/D1") in relation to the application of Australian Pay As You Go ("PAYG") withholding and Fringe Benefits Tax ("FBT") to *foreign employers* who employ Australian resident employees in offshore operations.

This TD is a response to uncertainty as a result of the recent amendments to s23AG which have resulted in many Australian taxpayers being subject to Australian income tax on foreign employment earnings which were previously tax free in Australia. From a technical position, such foreign employment income is now also subject to PAYG withholding and FBT. Prior to the release of the TD, there was no distinction between foreign and Australian employers albeit that it may prove difficult for the ATO to impose taxes on foreign employers.

The TD clarifies that there will only be a PAYG withholding obligation for foreign resident employers where the employer has a sufficient connection with Australia. A sufficient connection will exist where the employer carries on a business or income producing activities in Australia and has a physical presence in Australia. A foreign employer will also be deemed to have a sufficient connection with Australia if the employer is already registered for PAYG withholding in Australia.

Pursuant to the TD, a FBT liability will only exist where there is an obligation to PAYG withholding.

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