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Article Information

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- *The capital vs revenue distinction – what was the money really paid for?*
- *Foreign resident CGT withholding tax*
- *Changes to transfer pricing documentation – countering multinational tax avoidance*

The capital vs revenue distinction – what was the money really paid for?

A recent High Court judgement highlights the difficulties in characterising a payment as either capital or revenue and the importance, when characterising a payment, of looking from a practical and business point of view at what the money was really paid for.

Facts

The taxpayer purchased assets from Power Net Victoria ("PNV"), a stateowned electricity transmission company. PNV's assets included a transmission licence which had been issued pursuant to the *Electricity Industry Act 1993* (Vic) ("Transmission Licence").

Certain statutory charges were imposed on PNV as holder of the Transmission Licence and were payable to the State. The terms of the asset sale agreement included that the taxpayer would pay the statutory charges to the State in addition to the total purchase price agreed to be paid by the taxpayer to PNV for its assets.

Issues

The taxpayer contended that the payment of the statutory charges to the State was deductible expenditure, and in particular, was not payment of capital or of a capital nature. The Commissioner however had disallowed the deductions.

Decision

The High Court by majority held that the payment of the statutory charge by the taxpayer was capital or of a capital nature and therefore not deductible.
According to the majority of the High Court, the critical question was "what was the character of the advantage sought," that is, *"what was the money really paid for."* Addressing this question from a *"practical and business point of view,"* the majority of the High Court found that the taxpayer assumed the liability to pay the statutory charge as part of the price of acquiring the assets of PNV, including the Transmission Licence, which was an essential element of the transmission business.

Impact

This judgement highlights the difficulty and sometimes unpredictability in the outcome of characterising a payment as capital or revenue. Neither the fact that a payment is payable once and for all, nor on a recurrent basis, is determinative of its character. A taxpayer should look to what the money was really paid for from a practical and business point of view. When drafting transaction documents, it is imperative to have regard to the above critical question, and to ensure that the

transaction documents correctly reflect what the money is really paid for.

Foreign resident CGT withholding tax

Exposure Draft Legislation to introduce a 10% non-final withholding tax on the disposal, by foreign residents, of certain taxable Australian property has been released for consultation. The intended purpose is to assist in the collection of foreign residents' capital gains tax (CGT) liabilities.

The current CGT rules for foreign residents

The CGT rules operate to disregard a capital gain or capital loss made by a foreign resident unless the relevant CGT asset is "taxable Australian property." If a foreign resident has derived such Australian assessable income, the foreign resident must lodge a tax return and assessments proceed in the usual course.
The Australian Taxation Office considers voluntary compliance with this requirement to be extremely low. In response to this, on 6 November 2013 the Federal Government announced that it would introduce new measures to assist in the collection of such tax.

Proposed new law

The draft legislation proposes that a purchaser must pay an amount equal to 10% of the total purchase price to the Commissioner and may withhold the same amount from the payment made to the vendor, if the following conditions are satisfied:

- the purchaser acquires an asset that is taxable Australian real property (this broadly includes real property situated in Australia and certain mining rights), an indirect Australian real property interest or an option or right to acquire such property or interest
- the vendor is a relevant foreign resident, being a person who the purchaser has reason to believe is a foreign resident and who has not made a relevant declaration, and
- the transaction is not an excluded transaction, being a transaction involving residential property valued less than $2.5 million, an arrangement conducted through the stock exchange and an arrangement that is already subject to an existing withholding obligation.

The amount paid to the Commissioner is not a final tax. Instead, the amount will be credited against the foreign resident's Australian tax liability once a tax return has been lodged.

Whilst there is no obligation to withhold as such, the obligation to pay the amount to the Commissioner is described as a withholding obligation because the payment amount may be withheld from the vendor.

The amendments are proposed to apply to CGT assets acquired on or after 1 July 2016.

Implications

If enacted, the new legislation will have implications both for foreign residents who intend to dispose of certain Australian assets and purchasers who intend to acquire certain Australian assets.

It will be important for purchasers to consider whether they have reason to believe that a vendor is a foreign resident, and if so, for appropriate steps to be taken.

Changes to transfer pricing documentation – countering multinational tax avoidance

Exposure Draft legislation to introduce the revised Organisation for Economic Co-Operation (OECD) standards for transfer pricing documentation and Country-by-Country reporting has been released, having potential implications for multinational enterprises with annual global revenue above the $1 billion threshold.

Background

Multinational tax avoidance is a topical issue globally, with the OECD at the forefront of efforts to counter international tax avoidance and evasion.

In 2013, the OECD and G20 Countries adopted the Action Plan on Base Erosion and Profit Shifting (the BEPS Action Plan),

a fifteen-point plan designed to ensure that profits are taxed where activities that generate profits are performed.

Action 13 recognises that enhanced transparency for tax administrations, by providing them with adequate information to conduct transfer pricing risk assessments, is an essential part of tackling profit shifting. It outlines a standardised, three-tiered approach to transfer pricing documentation.

Proposed changes

The recently released exposure draft legislation intends to implement Action 13 of the BEPS Action Plan into Australian law.

Under the proposed legislation, Australian residents or foreign residents with an Australian permanent establishment that have annual global revenue of $1 billion or more will be required to provide a statement to the Commissioner. This is intended to apply to both Australian headquartered multinational enterprises and Australian subsidiaries of multinational enterprises headquartered outside of Australia.

The statement may be required to include one or more of the following:

- a Country-by-Country report, requiring high-level information relating to the global allocation of a multinational group's income and taxes paid, as well as information about the location and main business of each constituent entity within the group,
- a master file, requiring an overview of the multinational group's business operations, and
- a local file, focusing on specific transactions between the reporting entity and their associated enterprises in other countries.

The statement is intended to provide the Commissioner with relevant and reliable information to carry out a transfer pricing risk assessment.

The amendments are proposed to apply in relation to income years commencing on or after 1 January 2016.