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16 January 2009

Manager
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Dear Sir

Exposure draft of the National Urban Water and Desalination Plan – urban water tax offset

The Taxation Institute of Australia (Taxation Institute) welcomes the opportunity to make this submission on the Exposure Draft (ED) legislation and accompanying Explanatory Materials (EM) for the National Urban Water and Desalination Plan – urban water tax offset, released on 9 December 2008.

Capitalised terms used and not defined herein have the meanings given in the ED. Unless otherwise stated, references to legislation in this submission are to the provisions of the ED.

General comments

The Taxation Institute generally supports the Government's initiative to encourage major desalination, water recycling and stormwater harvesting projects (eligible projects) by providing a refundable tax offset (urban water tax offset) to private sector entities for eligible projects approved under the National Urban Water and Desalination Plan (Plan), as proposed in the ED.

While the Taxation Institute is generally supportive of the approach in the ED, there are a number of key aspects of the ED which the Taxation Institute recommends should be amended prior to enactment if the urban water tax offset scheme is to meet the Government's stated objectives. In summary, our submission is that:

1. the scope of the ED and the types of entities to which the urban water tax offset is available is too narrow, in that the urban water tax offset is not available to any private sector entity that is not a company and that does not directly carry out the eligible project;
2. the cut-off date for claiming the urban water tax offset is arbitrary and inflexible, effectively meaning that taxpayers will be unable to claim an urban water tax offset for any milestones for the eligible project met, even 1 day, after the end of the 2012-13 income year;
3. the time limits for amending assessments claiming an urban water tax offset are unreasonably long and will leave taxpayers uncertain with respect to their tax position for an unreasonably long period of time;
4. key aspects of the urban water tax offset scheme are to be governed by yet to be released guidelines that may be amended or varied after taxpayers have been issued with a certificate

under proposed section 402-760, leaving taxpayers with ongoing uncertainty as to their ability to claim urban water tax offsets; and

5. the assumption of obligations in return for the tax offset should be treated as not being taxable for GST and the amount of the offset needs to be calculated on a GST exclusive basis.

Specific comments

Scope of the urban water tax offset

Proposed section 402-760(1) provides that:

the *Water Minister may certify, in writing, to a **company** that a project is eligible for the urban water tax offset for an income year..." [emphasis added]

Therefore, under the ED, eligibility for the urban water tax offset is limited to private sector entities that are companies (or private sector entities that are treated as companies for tax purposes). As a result, other forms of private sector entity are not eligible for the urban water tax offset and, as such, the urban water tax offset will not be available to individuals or taxpayers that are members of collective "flow-through" vehicles such as partnerships or trusts.

The Taxation Institute notes that the Government's initial policy statement (titled "National Urban Water and Desalination Plan", released on 29 October 2007) in relation to the Plan, released during the 2007 Federal election campaign, does not state that eligibility for the urban water tax offset is intended to be limited to companies. Rather, this policy statement indicates that the urban water tax offset should be available to all entities in the private sector. Moreover, the EM does not explain the Government's policy of limiting the urban water tax offset to private sector entities that are companies. The EM relevantly states (at paragraph 1.11) that:

The private sector, water utilities companies and governments are eligible to apply for assistance under the plan as only the private sector falls within the income tax system, there is no need to include entities other than companies in these provisions.

What this paragraph ignores, however, are the other forms of private sector entities other than companies (ie, individuals, partnerships and trusts) that are within the income tax system and that may carry out eligible projects and that are rendered ineligible for the urban water tax offset under the ED.

The Taxation Institute submits that the ED is not consistent with the Government's 29 October 2007 policy statement with respect to eligibility for the urban water tax offset and recommends that the ED be amended accordingly.

Submission 1: The ED should be amended to extend eligibility for the urban water tax offset to all forms of private sector entities.

If, despite the Government's 29 October 2007 policy statement, the Government's policy is to restrict the urban water tax offset to private sector entities that are companies, the drafting of proposed section 402-760(1) effectively means that the urban water tax offset is not available to companies that are members of collective "flow-through" vehicles, such as partnerships and trusts, that carry out eligible projects. This drafting restricts a company, or groups of companies, in their flexibility to choose an appropriate vehicle to carry out eligible projects. In effect, the ED restricts eligibility for the urban water tax offset to private sector entities that are companies and that directly carry out eligible projects themselves.

The Taxation Institute submits that this restriction is not necessary even if the Government seeks to restrict eligibility for the urban water tax offset to private sector entities that are companies. The Taxation Institute submits that even if the Government's policy is to restrict eligibility for the urban water tax offset to companies, the ED should be amended so that the urban water tax offset is available to companies that are members of collective "flow-through" vehicles (such as companies that are partners in partnerships or beneficiaries of trusts).

Submission 2: The ED should be amended so that the urban water tax offset is available to companies that are members of collective "flow-through" vehicles (such as companies that are partners in partnerships or beneficiaries of trusts).

Cut-off date for claiming the urban water tax offset

Under the ED:

- the Water Minister issues a certificate for one of the income years specified in proposed section 402-760(2), the last of which is the 2012-13 income year;
- the certificate specifies the amount of the urban water tax offset (proposed section 402-765(1); and
- the urban water tax offset will be available upon completion of certain milestones (EM, paragraph 1.8 and Example 1.1).

A taxpayer's eligibility for the full amount of the urban water tax offset specified in the certificate issued under proposed section 402-760 therefore depends upon the taxpayer meeting all of the milestones for the eligible project by the end of the 2012-13 income year. To the extent that any milestones are not met by the end of the 2012-13 income year (even by 1 day), an urban water tax offset will not be available.

The Taxation Institute submits that cutting off eligibility for the urban water tax offset at the end of the 2012-13 income year is arbitrary and inflexible, and could result in taxpayers being denied an urban water tax offset for missing a milestone by a period as short as 1 day. The Taxation Institute recommends that the ED be amended to provide some flexibility to enable taxpayers to claim urban water tax offsets beyond the end of the 2012-13 income year, for example, by providing the Water Minister with the discretion to issue certificates to taxpayers for income years beyond that 2012-13 income year, so that taxpayers are not arbitrarily and inflexibly denied the urban water tax offset for missing milestones by immaterial periods of time.

Submission 3: The ED should be amended to provide for flexibility to enable taxpayers to claim urban water tax offsets beyond the end of the 2012-13 income year.

Time limits for amending assessments

Under proposed section 402-770, the Water Minister may revoke a certificate issued to a company under proposed section 402-760. Where this is the case, the certificate is taken to never have been issued (proposed section 402-770(5)). Moreover, proposed section 402-770 provides that section 170 of the *Income Tax Assessment Act 1936* (Cth) does not prevent the amendment of an assessment for the purposes of giving effect to proposed Subdivision 402-W if the amendment is made within 4 years from the time that the certificate is revoked. Proposed item 19 of the ED provides that section 402-770 continues to apply until 10 years after the certificate was issued to the company under proposed section 402-760.

The combined effect of proposed section 402-770 and proposed item 19 of the ED is that an assessment claiming an urban water tax offset can be amended by the Commissioner of Taxation (Commissioner) for up to 14 years after the time that the certificate was issued to the taxpayer under proposed section 402-760. The Taxation Institute submits that this time period for amending an assessment claiming an urban water tax offset is unreasonably long, leaves taxpayers in an uncertain situation with respect to their tax position for an unreasonably long period of time and recommends that the time period be significantly shortened.

Submission 4: The ED should be amended to significantly shorten the period of time within which an assessment claiming an urban water tax offset can be amended by the Commissioner.

Variation and amendment of the guidelines

A number of key elements of the urban water tax offset scheme will be contained in yet to be released guidelines to be made by the Water Minister under proposed section 402-780. For example:

- the "eligible upfront capital costs of the project" which are eligible for the urban water tax offset will be defined in the guidelines; and
- the circumstances in which the certificate issued to the taxpayer under proposed section 402-760 may be revoked by the Water Minister under proposed section 402-770 will be set out in the guidelines.

The guidelines are a legislative instrument that may be amended or varied by the Water Minister, possibly adversely to a taxpayer, after the issue of a certificate to the taxpayer under proposed section 402-760. The Taxation Institute submits that the effect of this is that taxpayers will be left with ongoing uncertainty with respect to their eligibility to claim an urban water tax offset even after a certificate has been issued to them to the extent that key aspects of the urban water tax offset scheme are incorporated in the guidelines and are subject to change. The Taxation Institute recommends that the ED be amended so that the guidelines which apply to a taxpayer are those guidelines in force at the time that a certificate is issued to the taxpayer under proposed section 402-760.

Submission 5: The ED should be amended so that the guidelines which apply to a taxpayer are those guidelines in force at the time that a certificate is issued to the taxpayer under proposed section 402-760.

GST issues arising out of tax offsets

The provision of a refundable tax offset is likely to give rise to GST consequences. If in return for the tax offsets, the taxpayer is obliged to do anything for example agree to complete a project by a particular date, the receipt of the tax offset is likely to give rise to GST. The amount of the GST will equal one eleventh of the amount of the offset. Effectively, in return for the offset, the taxpayer will be obliged to account for one eleventh for GST. The amounts in question could be significant. Calculated on the maximum offset of \$100 million, an amount of \$9.09 million approximately will need to be remitted as GST. This will effectively reduce the value of the tax offset.

One solution would be to calculate the value of the tax offset factoring in the GST cost. This will effectively require an increase by 10%. Another solution would be to legislate to provide that the obligations undertaken by the taxpayer in return for the tax offset is not a taxable supply. The second solution appears preferable to avoid unnecessary disruption to cash flows of the taxpayer.

A separate GST question arises in respect of calculation of the offset amount. If the offset amount is calculated with regard to capital costs, those capital costs will generally include an amount on account of GST. Clarification is required as to whether the "amounts referred" (e.g. the maximum of \$100 million) are inclusive or exclusive of GST.

Submission 6: The draft bill should be amended so that the assumption of obligations in return for the tax offset should be treated as not being taxable for GST. The amount of the offset needs to be calculated on the basis of the capital costs less the GST, that is on a GST exclusive basis.

If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely



Joan Roberts
President