



13 August 2012

General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: SRWUIP@treasury.gov.au

Tax Treatment of Water Infrastructure Improvement Payments

Dear Sir/Madam

The Institute of Chartered Accountants in Australia (**the Institute**) welcomes the opportunity to make a submission to the exposure draft legislation and draft explanatory memorandum (**the proposed arrangement**) in relation to the tax treatment of water infrastructure improvement payments.

The announced purpose of the proposed arrangement is to “eliminate the timing difference between when payments are taxed and when deductions are available for water efficiency investment grants under the Sustainable Rural Water Use and Infrastructure Program (**SRWUIP**). The amendments will apply from 1 April 2010.

Specifically, the Institute wishes to make comments on the retrospective changes to the current law. The effect of the law change will likely retrospectively benefit one group of taxpayers while detriming another group of taxpayers. The Institute does not consider that this outcome can be justified on either a policy or revenue integrity basis.

Accordingly, the proposed arrangement should not proceed in its current form, or at a minimum, should only apply on a prospective basis.

If you would like to discuss any aspect of this submission, please contact me on 02 9290 5609.

Yours sincerely

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Comments

Retrospective legislation

The Institute is concerned that retrospective amendment to tax legislation is gradually becoming a feature of the Australian tax system. The proposed arrangement follows a long line of recently back-dated amendments to the tax law, including changes to the tax consolidation regime rights to future income, the Petroleum Resource Rent Tax regime and the cross-border transfer pricing measures.

It has been a long-standing practice of the legislature that retrospective tax laws will only be passed in exceptional circumstances where the integrity of the tax system would be fundamentally jeopardised if not for the introduction of back-dated tax laws. Recent reviews into the policy-making processes surrounding the development of tax law in Australia have supported the conclusion that tax measures introduced by the government should generally operate on a prospective basis only.

Where retrospective tax laws have been contemplated, it has been broadly accepted that such situations would be limited only to instances where taxpayers were either not adversely impacted (i.e. neither worse off nor better off), or were in fact, favourably impacted.

The Tax Design Review Panel Report 2008 does acknowledge (at paragraph 3.21) that in rare cases, retrospective tax laws may be appropriate where the changes 'rectify technical deficiencies from the date of the original legislation or where there is a serious risk to the revenue'.

Proposed arrangement

The proposed arrangement may not achieve the desired outcome for all taxpayers and in fact may have adverse tax consequences to certain types of taxpayers. Specifically those individual irrigators who have sold water shares to the Commonwealth as part of a SRWUIP program and those who have received a qualifying water infrastructure improvement payment and are eligible for the Small Business CGT Concessions may be adversely affected by the proposed arrangement.

The Institute understands that for these taxpayers, the receipt of payments from the Commonwealth (either by way of sale of water shares or under the SRWUIP program) is a capital receipt rather than ordinary income. As such, they are able to benefit from the 50% CGT discount, or utilise various Small Business CGT Concessions under the current law, to reduce their net capital gains by half or in certain cases, to nil. At the same time, they are also entitled to deductions over three years for eligible water infrastructure expenditure.

The retrospective changes to the current law will mean that these taxpayers who had correctly applied the current law at the time:

- Will no longer be eligible for the deductions in relation to eligible water infrastructure expenditure
- Will need to amend their tax returns for income years ended 30 June 2010, 2011 and 2012 (where applicable) and incur additional tax liability and costs associated with the amendments;
- Will not fully benefit from the CGT exemption provided under the proposed arrangements as these taxpayers were able to reduce their CGT liability (by half or to nil in certain cases) under the current law.

The stated objective of the proposed arrangements, (to eliminate the timing difference between when the payment is taxed and when deductions are available) is not achieved for these taxpayers. In fact, the proposed arrangement will have a significant detrimental impact to individual or smaller irrigators as compared to large irrigators. This is because for large irrigators, receipt of payment under SRWUIP would generally be taxable in the year they are received, either as ordinary income or as a subsidy. At a high level, the large irrigators would appear to benefit from the proposed arrangement, as the timing difference noted above would be rectified by the proposed arrangement.



Accordingly, the proposed arrangement does not provide a level playing field as between the large irrigators and the individual or small irrigators. More importantly, the retrospectivity of the proposed arrangement may even have inadvertently provided for an economic advantage to those large irrigators because of the way the proposed measure apply to them.

Conclusion

In the absence of any technical deficiencies in the current law, nor a serious risk to the revenue (in fact the Budget Measures 2011-12 cited that “this measure has no net cost to the Budget over the forward estimates period”), and at the expense of having a significant detrimental impact to certain groups of taxpayers and in particular individual irrigators and small businesses, the Institute believes that the proposed arrangement should be enacted on a fully prospective basis only.

