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This edition of Sharp Tax reviews some of the more significant **legislative changes** that have been brought about over recent times that may influence either you, your business or even your employees.

Black hole expenditure regime

New legislation has been passed that provides for "blackhole" business costs to be deductible over a period of five years. The provisions were introduced after a lot of lobbying to provide some tax deductions for many non-deductible business related costs. Since 2001, a five year write off has been allowable for capital costs in limited circumstances; for example costs incurred to establish or convert a business structure or to defend a takeover.

The amendments generally provide that capital expenditure incurred in relation to a business is deductible over a period of five years where the expenditure is not otherwise deductible or is part of the cost base of an asset for CGT purposes. The new provisions only apply to a business which is, or was proposed to be, carried on for a taxable purpose. No deduction is available at all where it is denied by some other specific provision.

Accordingly, where a business capital cost is not addressed elsewhere within the tax laws, a deduction is likely to be available over a five year period. This applies to costs incurred on or after 1 July 2005.

New share capital tainting provisions

The share capital tainting provisions are an anti-avoidance measure aimed at preventing a company from re-characterising amounts that would otherwise be paid as "dividends" into "capital" returns. This could occur, for example, where the company transfers an amount of profits to its share capital account, and subsequently returns the amount as a return of capital. Where this arises, the capital account becomes "tainted" and all returns to shareholders out of this account are assessable.

Not all transfers to the share capital account will result in a tainting of the "share capital account". The provisions provide for a limited number of exceptions, including:

- amounts that are always share capital
- option premium reserve transfers
- amounts subject to a debt/equity swap

A company can choose to untaint its share capital account. Upon making this choice, a franking debit may occur. Where the company chooses to untaint its share capital account, the company may have a liability to pay untainting tax. The untainting tax rate depends on whether the members of the company are considered to be "lower tax" or "higher tax" members.

The new tainting provisions predominantly replicate the measures they have replaced. The measures will only apply to transfers made to a share capital account after the day on which the Bill was introduced into parliament (i.e. after 25 May 2006).

Temporary resident regime

A new temporary resident regime has been implemented. The regime seeks to exempt temporary residents, who have never been permanent residents, working in Australia from Australian

tax on their foreign income. The purpose of this measure is to attract skilled staff to Australia and make Australia more competitive in a global environment where employees and executives have become more mobile.

For the purposes of these provisions, a temporary resident is a person holding a valid temporary resident visa under the Migration Act 1958 unless that individual and his/her spouse is an Australian resident within the meaning of the Social Security Act 1991 (i.e. the individual or his/her spouse is entitled to Australian social security benefits).

Where an individual is a temporary resident, that individual's ordinary and statutory income (except for employment income and a net capital gain) from a foreign source is treated as non-assessable, non-exempt income of the individual for Australian tax purposes. A capital gain or loss is disregarded where the individual would not have made a capital gain or loss if the individual was in fact a foreign resident at the time of the CGT event.

Capital gains tax and non-residents

Changes are proposed to the CGT regime, to make only assets of a non-resident that are subject to Australian CGT to include:

- taxable Australian real property, including all real property located in Australia and mining, quarrying and prospecting rights where the underlying materials are located in Australia;
- an indirect interest in Australian real property (unless it is an interest covered by a choice made under s104-165(2) - this is, where a gain made by an individual ceasing to be an Australian resident can be disregarded until such time as there is a CGT event in relation to the asset, or the individual again becomes an Australian resident);
- a CGT asset that has been used at any time in carrying on a business through a permanent establishment in Australia, unless it is an asset covered by either of the above two points, or one for which an individual has made a choice under s104-165(2). A reduction of the gain is made for the time the asset is not used in carrying on a business through a permanent establishment in Australia;
- a right or option to acquire any of the CGT assets noted in the above points; and
- any CGT asset taken to be a taxable Australian asset by virtue of a choice made by an individual under s104-165(2) on ceasing to be an Australian resident.

Under the existing rules it was possible for a non-resident to hold assets that would otherwise have had the necessary connection to Australia through interposed entities and sell the interests in those interposed entities without crystallising an Australian CGT liability. A CGT liability would only arise when the Australian asset was ultimately sold by the foreign entity. However, as an integrity measure to strengthen the narrower CGT base arising from the concessions, the proposed rules will apply to direct and indirect property interests (held through other entities). The changes will be effective from the date of Royal Assent to a bill currently before the Federal Parliament.

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