

EXPOSURE DRAFT

EXPLANATORY MATERIALS

Income Tax Assessment Act 1936

Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022

Section 266 of the *Income Tax Assessment Act 1936* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The purpose of the *Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022* (the Amending Regulations) is to amend the *Income Tax Assessment (1936 Act) Regulation 2015* (the Regulations) to exclude certain entities with particularly complex tax affairs or significant international tax dealings from a shortened two-year period of review in respect of income tax assessments.

The *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* increased access to several small business entity tax concessions by expanding eligibility to include medium business entities (entities with an aggregated turnover of \$10 million or more and less than \$50 million). This enabled medium business entities to access some concessions that were previously only available to small business entities, including a shortened period of review of two years instead of four years. However, the shortened period of review is not appropriate for entities with complex affairs or significant international tax dealings, and therefore will continue to have a four-year amendment period.

The Amending Regulations amend section 14 of the Regulations to exclude certain entities with particularly complex tax affairs or significant international tax dealings from a two-year period of review.

The Act does not specify any conditions that need to be met before the power to make the Amending Regulations may be exercised.

Details of the Amending Regulations are set out in [Attachment A](#).

The Amending Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*. As an amending instrument, the *Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022* is subject to the automatic repeal provisions under section 48A of the *Legislation Act 2003*.

The Amending Regulations commence on the day after the instrument is registered on the Federal Register of Legislation. The amendments apply to income years beginning on or after 1 July 2021, where the assessment for that income year is made after commencement of the Amending Regulations.

Details of the *Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022*

Section 1 – Name of the Regulations

This section provides that the name of the Regulations is the *Income Tax Assessment (1936 Act) Amendment (Period of Review) Regulations 2022* (the Amending Regulations).

Section 2 – Commencement

The Amending Regulations commence on the day after the instrument is registered on the Federal Register of Legislation.

Section 3 – Authority

The Amending Regulations are made under the *Income Tax Assessment Act 1936* (the Act).

Section 4 – Schedule

This section provides that each instrument that is specified in the Schedules to this instrument will be amended or repealed as set out in the applicable items in the Schedules, and any other item in the Schedules to this instrument has effect according to its terms.

Schedule 1 – Amendments to the *Income Tax Assessment (1936 Act) Regulation 2015*

Section 14 of the *Income Tax Assessment (1936 Act) Regulation 2015* (the Regulations) prescribes a number of scenarios that result in an entity that is an individual, a company that is a small or medium business entity or a person acting in the capacity of a trustee of a trust that is a small or medium business entity (the assessed entity) being excluded from the shortened two-year period of review. Where an entity is excluded from the two-year period of review, the Commissioner is permitted to amend an assessment of the relevant entity within the standard four years after the day on which the Commissioner gives notice of the assessment to the entity, unless a longer amendment period applies.

Section 14 of the Regulations is amended to exclude relevant assessed entities with particularly complex tax affairs or significant international tax dealings from accessing the shortened two-year period of review and instead subjects impacted entities to the standard four-year period of review.

The amendments are intended to ensure there is sufficient time to gather necessary information to form an accurate decision for relevant assessed entities with complex tax affairs or significant international tax dealings who otherwise accessed the shortened two-year period of review. With limited time to undertake reviews and gather information from foreign revenue authorities, the two-year period of review has potential to result in an increased number of disputes as amended assessments may be issued based on limited information. Therefore, the standard four-year period

of review is appropriate for these entities with complex tax affairs or significant international tax dealings.

Item 1 and 2: Related party dealings

Item 1 of the Amending Regulations amends paragraph (b) in column 2 of item 1 in section 14 of the Regulations to include a condition for transactions between related parties that relate to assets or non-cash benefits with a market value of at least \$50,000. The amendment provides a simplified mechanism to apply the four-year period of review when significant transactions between related parties occurs, provided the existing conditions are met.

Item 2 of the Amending Regulations removes the requirement that a four-year period of review only applies where at least one of the related parties already has a four-year period of review. This simplifies the application of the item so that it does not require consideration of whether a related party has a four-year assessment period. Under the item as amended, even if all related parties have a two-year assessment period and the other conditions are satisfied, then a four-year period of review will apply to the relevant assessed entity.

Item 3: Foreign entities

Entities that derive more than \$200,000 of their assessable income from foreign sources

Item 3 of the Amending Regulations inserts an additional table item into section 14 of the Regulations to ensure that the standard four-year period of review will apply to certain relevant assessed entities that derive assessable income of at least \$200,000 from any source that is not an Australian source.

To prevent structuring arrangements being undertaken to avoid the four-year period of review, the \$200,000 threshold is assessed as a combined threshold including the assessable income from the relevant assessed entity and any entity affiliated with or connected with the entity (within the meaning of the ITAA 1997).

Foreign owned or controlled entities

Item 3 of the Amending Regulations excludes certain relevant assessed entities that are either foreign controlled Australian entities (as defined under sections 820-780 to 820-795 of the ITAA 1997) or non-resident entities at any time during the income year from the shortened two-year period of review. This definition captures Australian companies, trusts and partnerships that are controlled by foreign entities.

Items 4 and 5: Engaging in tax avoidance schemes

Items 4 and 5 of the Amending Regulations amend section 14 of the Regulations to exclude certain relevant assessed entities that engage in schemes captured by either the Diverted Profits Tax (DPT) or Multinational Anti-Avoidance Law (MAAL) from a shortened two-year period of review.

The MAAL and DPT anti-avoidance rules in Part IVA of the ITAA 1936 are dependent on fulfilling the principal purpose test of obtaining the scheme benefit

rather than a sole or dominant purpose test. The existing exclusions to the shortened two-year period of review in section 170 of the ITAA 1936 relies on the sole or dominant purpose of obtaining a scheme benefit. As a principal purpose does not need to be the sole or dominant purpose for entering a scheme, schemes captured by the MAAL or DPT may not attract the default four-year period of review under the existing qualifications in section 170 of the ITAA 1936. The addition of these two items in section 14 of the Regulations addresses this gap that the principal purpose test is not fulfilled when entities engage in DPT or MAAL schemes.

Item 6: Specific circumstances

Item 6 of the Amending Regulations inserts three additional table items into section 14 of the Regulations that apply to relevant assessed entities that meet certain conditions or participate in certain activities which are generally complex and warrant a four-year period of review.

At least 10 entities connected with or are an affiliate of the relevant assessed entity

Certain relevant assessed entities with at least 10 other entities connected with or affiliated with the entity are excluded from a shortened two-year period of review and are subject to a four-year period of review. This intends to capture administratively and financially connected groups of entities. This item will apply if the conditions are met at any point in the assessment year, accounting for changes in structure during the assessment year.

R&D tax incentive

Relevant assessed entities that may be entitled to the R&D tax offset or certain related deductions, recoupments and adjustments are excluded from a shorter two-year period of review. This accounts for circumstances where an entity has claimed the R&D incentive but after further investigation it is determined that the entity is not entitled to the amount claimed.

Capital gains tax (CGT) relief

Entities that claim the following CGT relief are excluded from a shortened two-year period of review.

- The restructure rollover relief claimed under Division 615 of the ITAA 1997 for entities that restructure their company or unit trust's business without any change in economic ownership.
- The demerger relief claimed under Division 125 of the ITAA 1997 that allows a CGT roll-over when original interests are transferred under a demerger and new or replacement interests are received in the demerged entity.
- Rollovers claimed under Subdivision 126-B of the ITAA 1997 relating to CGT asset transfers between two companies or the creation of a CGT asset between companies within the same wholly owned group, where one company is a non-resident.
- Entities subject to Division 855 of the ITAA 1997 which provides that a foreign resident can disregard a capital gain or loss in certain circumstances.

Item 7: Application provision

The amendments apply to assessments made after the Regulations commence for income years starting on or after 1 July 2021.