PART 6 -

Manual for the

National Tax Equivalent Regime

January 2022

(Version 12)

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[**Archived:**
History notes for amendments to the Manual made by Versions 2, 3, 4, 5 & 6 have been archived. For the wording of these history notes, see Version 8.]

PART 6: NTER TECHNICAL FEATURES

GOVERNMENT EXEMPTIONS DO NOT APPLY

86. The relevant taxation laws are to be applied in all respects as if the following provisions were not applicable to the NTER entities:
    (i) Section 50-25 of the ITAA 1997 (dealing with the income tax exemption afforded to public authorities); and
    (ii) Division 1AB of the ITAA 1936 (dealing with the income tax exemption afforded to State/Territory bodies)

87. For example, whether or not a tax deduction is allowed under section 8-1 of the ITAA 1997 is to be considered as if the reference in paragraph 8-1(2)(c) to gaining or producing exempt income did not apply to the extent that the above exemptions are involved.

88. As a further example, section 51AD of the ITAA 1936 and Division 16D of the ITAA 1936 and Division 250 of the ITAA 1997, to the extent that these provisions might otherwise apply in relation to various arrangements (e.g. leases) under the NTER, do not apply if they are invoked only by virtue of the above exemptions applying to NTER entities.

COMMENCEMENT POSITIONS

89. Division 57 of schedule 2D of the ITAA 1936 requires corporate entities making the transition from exempt to taxable to ensure that only income, deductions, gains and losses relating to the taxable period are taken into account to determine their taxable position.

90. Division 58 of the ITAA 1997 sets out special rules that apply in calculating depreciation deductions and balancing adjustments in respect of depreciating assets previously owned by an exempt entity.

91. An NTER entity will be taken not to be a transition taxpayer for the purposes of Division 57 of schedule 2D of the ITAA 1936, nor a transition entity for the purposes of Division 58 of the ITAA 1997, where the following conditions apply:
    (i) the NTER entity ceased participation in a State or Territory TER on or before 30 June 2002; and
    (ii) immediately thereafter, commenced participation in the NTER.

    In those circumstances, the NTER entity's commencing positions for the purposes of the NTER will be equal to its closing positions in the TER.

91A. An NTER entity will be taken not to be a transition taxpayer for the purposes of Division 57, nor a transition entity for the purposes of Division 58 where the following conditions apply: ‘The NTER entity commenced participation in

the NTER immediately after ceasing to be actually subject to federal income tax.'

92. For all other NTER entities (i.e. those which do not meet the above conditions) commencement in the NTER will be taken to be a transition event for the purposes of Division 57 and Division 58.

GRANDFATHERED TER RULES

93. Unless provided for otherwise in this Manual, certain NTER entities will be able to grandfather the rules of their predecessor TERs to apply to certain of their transactions occurring under the NTER.

94. Grandfathering is intended to be a transitional measure available only to those NTER entities which commenced in the NTER on or before 1 July 2002 immediately after ceasing to participate in a TER. Grandfathering will apply only to transactions which arise out of pre-existing contractual or other formal arrangements – i.e. those which were entered into by the NTER entity during the time it was subject to the TER. It would normally be the case that those pre-existing contracts or arrangements will be finite in nature and reflected in the NTER entity's closing balance sheet at the time of its cessation in the TER.

95. NTER entities may choose not to apply grandfathering, except where the result of that choice, in the NTER, would be income not being assessable, or expenditure being deductible, where otherwise that income would have been assessable or that expenditure would not have been deductible.

96. When it applies, grandfathering will include all tax treatments permitted under the relevant TER by way of instructions, public rulings, private determinations or otherwise. For the relevant NTER entities, grandfathering will determine the manner in which their opening assets and liabilities (at commencement in the NTER) are depreciated, amortised, written down or otherwise brought to account as assessable income or allowable deductions, or a capital gain or loss.

97. For example, an item of plant on hand at commencement will retain its unit status, historical cost and written down value, and continue to be depreciated at the rate which applied in the TER. Should that plant be the subject of a disposal in the NTER period, balancing adjustments will be calculated in accordance with the TER rules. A CGT asset on hand at commencement will retain its acquisition date details and cost base determined according to TER rules.

98. The same reasoning applied in the above examples on depreciation and CGT can also be applied in relation to other commencement items, including carried forward losses, deferred income, accrued expenses, undeducted capital expenditure, investment assets etc.

99. To the extent that there is otherwise any difference in treatment as between the NTER and a State or Territory TER, the rules of the NTER are to take priority. This priority is subject to the rights of NTER entities to seek private rulings in respect of matters which do not translate directly from the pre-existing tax equivalent system to the NTER.

COMMENCEMENT POSITIONS – IF A FEDERAL TAXPAYER IMMEDIATELY BEFORE ENTRY

99A. Where paragraph 91A applies, the NTER entity's closing positions on all items for federal income tax purposes (e.g. adjustable values of depreciating assets, cost bases of CGT assets, carry forward losses, etc) will become its commencement positions on those items for the purposes of the NTER. Where the NTER entity joins an existing NTER consolidated group immediately after commencing in the NTER, Part 3-90 of the ITAA 1997 will apply to its commencement positions.

COMMUNITY SERVICE OBLIGATIONS

100. Costs incurred by an NTER entity in satisfying community service obligations as part of its total charter will be treated as necessary incidents of the broader activities conducted by the NTER entity. As a result, deductions are available for community service expenditure which is of a revenue character.

101. NTER entities which have responsibilities and/or obligations imposed upon them by external agencies of their State or Territory government will ordinarily be entitled to treat any related costs or losses as an ordinary incident of their conventional business activities. On this basis, a deduction will typically be claimable by the NTER entity in respect of such costs or losses of a revenue nature.

102. This treatment will not extend to costs or losses which so clearly relate to the restructuring or reorganisation of the NTER entity in any significant sense. Where there is any debate regarding the proper treatment of costs or losses arising in these situations, then an application for a private ruling should be lodged with the Commissioner.

GOVERNMENT IMPOSED RESTRUCTURES & PRIVATISATIONS

103. A renegotiation of arrangements or a restructure by an NTER entity may be the result of requirements externally imposed on the NTER entity by its State or Territory government. This includes a renegotiation or a restructure involving the transfer of assets for no consideration from an NTER entity to another entity of its State or Territory government that does not have commercial returns as a primary objective and is not an NTER entity.

A privatisation of an asset owned or business activity carried on by an NTER entity may be externally imposed on the NTER entity by its State or Territory

government, as evidenced by, for example, a parliamentary process or public announcement by that government, in circumstances where all of the resultant privatisation proceeds, net of any agreed privatisation related costs, are compulsorily repatriated to its State or Territory government. This is limited to the following:

(i) a privatisation by way of an asset sale, an entity sale, the grant of a long term lease, the grant of a long term licence, or the grant of a long term statutory or other right;

(ii) restructuring to facilitate such a privatisation that occurs within a reasonable time of the privatisation (for example, the use of a non-NTER vehicle entity); and

(iii) compulsory repatriation of the net privatisation proceeds by way of dividend payments, capital repayments or debt repayments.

[**History:** Paragraph 103 amended by February 2012 (Version 8), by substituting the second paragraph, with effect from 1 July 2008.

The second paragraph of paragraph 103 formerly read:

A privatisation of assets (including an entity) owned by an NTER entity may be externally imposed on the NTER entity by its State or Territory Government, as evidenced by a parliamentary process or public announcement by that government, in circumstances where all of the resultant sale proceeds, net of any agreed sale related costs, are compulsorily repatriated to its State or Territory government.]

[**History:** Paragraph 103 amended by March 2010 (Version 7), with effect from 1 July 2007, by inserting the second sentence.]

103A. Such an imposed renegotiation, restructure or privatisation will be treated in a tax neutral manner for NTER purposes. (For example, on an imposed transfer of CGT assets, there will be no CGT consequences for the transferor and the transferee will inherit the CGT cost bases of the transferor.)

103B. Alternatively, such an imposed renegotiation, restructure or privatisation may be treated in a manner which the NTER administrator approves as appropriate in the circumstances, including taking into account;

(i) whether the proposed tax treatment gives an NTER entity involved an unfair advantage over its competitors in other States or Territories; and

(ii) the arrangements and structures that have previously existed in relation to the business operations of the NTER entities involved.

(For example, on an imposed remerging of two NTER entities to form a new NTER entity, the NTER administrator may approve a tax treatment which allows the new NTER entity to utilise any carry forward losses of the two former NTER entities.)

GOVERNMENT EQUITY CONTRIBUTIONS

104. A State or Territory government may make contributions in the nature of equity to its NTER entities, notwithstanding that those contributions are not made in connection with an issue of shares.

105. For the purposes of the NTER, a contribution in the nature of equity, by a State or Territory government to one of its entities, which is properly documented and accounted for as such, will not be assessable as ordinary or statutory income under any provision of the relevant taxation laws, including section 6-5 of the ITAA 1997 and section 15-10 of the ITAA 1997. This treatment applies to all such contributions in the nature of equity, including by way of asset contribution, notwithstanding the equity contribution did not relate to a government imposed restructure envisaged by paragraphs 103 to 103B.

105A. For the purposes of Division 40 of the ITAA 1997, the cost of a depreciating asset to which paragraph 105 applies will be its value at the contribution time recognised in the audited accounts of the NTER entity.

105B. For the purposes of section 70-120 of the ITAA 1997, the amount you paid to acquire land carrying trees or a right to fell trees to which paragraph 105 applies will be its value at the contribution time recognised in the audited accounts of the NTER entity.

105C. For the purposes of Subdivision 40-F of the ITAA 1997, the amount of capital expenditure you incurred on the acquisition of a water facility to which paragraph 105 applies will be its value at the contribution time recognised in the audited accounts of the NTER entity.

[**History:** Paragraph 105C inserted by March 2010 (Version 7), applicable to equity contributions made on or after 1 July 2004.]

DEDUCTIONS IN RELATION TO DEPRECIATING ASSETS

106. Pursuant to Division 40 of the ITAA 1997, a taxpayer is entitled to a deduction for an amount equal to the decline in the value of a 'depreciating asset' that the taxpayer 'holds'.

107. The meaning of the term 'hold' in relation to a depreciating asset, which is found in section 40-40 of the ITAA 1997, extends beyond strict legal ownership. For example, the owner of a quasi-ownership right over an improvement to land and a lessee with a right to recover an asset fixed to land in each case can be the holder of a depreciating asset.

108. On that basis, an NTER entity with contractual or statutory rights of severance, or other quasi-ownership rights, in relation a depreciating asset affixed to private land (e.g. electrical poles on rural land), can be the holder of that depreciating asset for the purposes of Division 40 of the ITAA 1997.

109. To ensure certainty of treatment for NTER entities' depreciating assets located on Crown land, for NTER purposes the NTER entity will be taken to be the holder of such assets for the purposes of Division 40.

110. [Archived.]

111. [Archived.]

[**Archived:** Paragraphs 110 & 111 concerning 'DIVIDEND REBATES' archived in February 2012 (Version 8). For the wording and application of paragraphs 110 & 111, see March 2010 (Version 7).]

FRANKED DIVIDENDS AFTER 30 JUNE 2002

111A. The 'gross-up' and tax offset treatment provided for by Division 207 of ITAA 1997 will apply to franked dividends paid to NTER entities after 30 June 2002. An NTER entity must gross up any dividend by an amount equal to the franking credit on the dividend. The grossed up amount is included in assessable income and the NTER entity is entitled to a tax offset (non refundable) equal to the amount of the gross up.

FRANKING CREDITS

112. The issue of franking credits in relation to dividends is not expected to arise in the NTER since ultimately the only shareholder in NTER entities will be a State or Territory government.

RESEARCH & DEVELOPMENT EXPENDITURE

For income years starting before 1 July 2011

113. There are a number of pre-requisites to claiming deductions for research and development expenditure under sections 73B and 73BA of the ITAA 1936. However, for the purposes of applying the R&D provisions in the NTER;
   (i) all NTER entities will be deemed to be 'eligible companies'; and
   (ii) registration with the IR&D Board will not be necessary.

114. On those bases, it will be the primary responsibility of an NTER entity to determine whether its research & development activities are eligible under section 73B of the ITAA 1936. NTER entities seeking to claim tax deductions under sections 73B and 73BA, in relation to projects commencing after 30 June 2001, are to complete an IR&D Board registration form and lodge that form with the Commissioner. Grandfathering will apply to R&D projects approved and begun prior to 1 July 2001.

RESEARCH & DEVELOPMENT TAX OFFSET

For income years commencing on or after 1 July 2011

115. Under section 355-100 of the ITAA 1997, an R&D entity is entitled to an R&D tax offset for income years commencing on or after 1 July 2011.

The R&D tax offset is designed to operate on a self assessment basis. Therefore, NTER entities will need to assess for themselves whether any activities conducted during an income year are eligible R&D activities under Division 355 of the ITAA 1997.

For NTER purposes, the R&D tax offset provisions in Division 355 of the ITAA 1997 will be applied with the following modifications:

(i) every NTER entity will be deemed to be an "R&D entity";

(ii) NTER entities will not be required to register R&D activities with Innovation Australia under section 27A of the *Industry Research and Development Act 1986*. However, NTER entities will be required to complete the approved application form for registering R&D activities and lodge that form with the NTER Administrator within 10 months after the end of the income year or such further period allowed by the NTER Administrator;

(iii) item 2 of the table in subsection 355-100(1) (R&D entity controlled by an exempt entity) will be deemed not to apply to any NTER entity; and

(iv) an NTER entity's "aggregated turnover" for an income year will be worked out under section 328-115 of the ITAA 1997 as if the NTER entity was not controlled by its State or Territory government in a way described in section 328-125 of the ITAA 1997.

[**History:** Paragraph 115 amended by April 2014 (Version 9), with effect from the 2012 income year, by inserting subparagraph (iv).]

[**History:** New paragraph 115 inserted by February 2012 (Version 8), with effect from the 2012 income year.]

SUPERANNUATION

116. Under section 290-60 of the ITAA 1997, employers are entitled to a deduction for contributions to a fund to provide superannuation benefits payable to an employee. Section 290-60 of the ITAA 1997 provides that a deduction is allowed in this respect only where an actual payment has been made, and not for mere provision of an amount.

117. For NTER purposes, the employer superannuation contribution provisions will be applied with the following modifications:

(i) the employee need not be currently employed by the NTER entity; and

(ii) the fund need not be a complying superannuation fund within the meaning of the ITAA 1997.

[**History:** Paragraph 117 amended by February 2012 (Version 8), with effect from 1 February 2012, by replacing reference to 'Part IX of the ITAA 1936' with reference to 'the ITAA 1997'.]

118. Apart from those modifications, in all other respects NTER entities are required to follow Division 290 of the ITAA 1997 in relation to claiming deductions for contributions to superannuation funds for the benefit of employees.

FOREIGN INCOME

119. Primarily due to the compliance burden imposed by the controlled foreign corporation and foreign investment funds provisions contained in the ITAA 1936, all foreign source income derived by NTER entities until 30 June 2003 will be ignored for the purposes of the NTER.

120. In effect, foreign sourced income will be treated as 'non-income' for NTER purposes – i.e. it neither will be assessable nor used to reduce carried forward losses. As a consequence of that treatment, expenditure incurred to derive foreign source income will also be ignored for NTER purposes and will not be allowed as a deduction.

121. An NTER entity, including an entity that is carrying on an insurance type business, which subsequently disposes of an investment asset (e.g. foreign shares) that was on hand at 30 June 2003 will use the asset's original acquisition cost for the purposes of calculating the foreign source profit derived after 30 June 2003 to be included in the NTER entity's assessable income.

FOREIGN CURRENCY TRANSLATION RULES

122. For NTER purposes, NTER entities not subject to the *Corporations Act 2001* may apply the alternative foreign currency translation rule set out in clause 1.1 of Schedule 2 to the *Income Tax Assessment Regulations 1997* with the following modification: by substituting the references in that rule to the *Corporations Act 2001* with references to the comparable State or Territory legislation that applies to the NTER entity for financial reporting purposes.

[**History:** Paragraph 122 inserted by March 2010 (Version 7), with effect from 1 July 2003.]

COMMONWEALTH GRANTS

123. A Commonwealth grant received by an NTER entity, instead of a refundable tax offset received by a Federal taxpayer in the same circumstances (e.g. under the national urban water and desalination plan), will be treated as non-assessable non-exempt income for NTER purposes and any resulting

capital gain will be disregarded for NTER purposes. To avoid doubt, an NTER entity will not be entitled to a refundable tax offset for NTER purposes in these circumstances.

[**History:** Paragraph 123 inserted by March 2010 (Version 7), with effect from 1 July 2008.]

LOSS CARRY BACK TAX OFFSET

124. Under section 160-5 of the ITAA 1997, a corporate tax entity is entitled to the loss carry back tax offset for any income years between 2019-20 and 2022-23 if certain eligibility requirements are satisfied.

For NTER purposes, the loss carry back tax offset provisions in Division 160 of the ITAA 1997 will be applied with the following modifications:

(i) That in determining the NTER entity's franking account balance under subsection 160-10(1)(b) of the ITAA 1997, NTER entities will be assumed to have paid franked dividends, to the maximum extent possible, to their State or Territory shareholders. This is notwithstanding that franking credits have not historically been attached to distributions made to the shareholders pursuant to paragraph 112; and

(ii) NTER entities will be required to support their loss carry back (LCB) claim by providing details of their franking accounts for the relevant years to show that there would have been sufficient franking credits in their accounts to be eligible for the LCB claim.

[**History:** Paragraph 124 inserted by April 2014 (Version 9), with effect from the 2012-13 income year.

The phrase 'and later income years' deleted by April 2016 (Version 10) with effect from 1 July 2013 onwards.

The sentence 'The loss carry back offset rules were repealed and from 1 July 2013, a corporate entity can no longer claim a loss carry back tax offset' inserted by April 2016 (Version 10).

Paragraph 124 amended by January 2022 (Version 12). For the former version of this paragraph, see October 2019 (Version 11).]

NTER ENTITIES – ELIGIBILITY FOR A LOWER COMPANY TAX RATE

For income years commencing on or after 1 July 2017

125. As a result of the *Treasury Laws Amendment (Enterprise Tax Plan Base Rate Entities) Act 2018*, NTER entities can access a lower company tax rate. An NTER entity will be eligible for the lower tax rate from 2017-18 income year if:

- no more than 80% of its assessable income for that income year is base rate entity passive income; and
- its aggregate turnover is less than the relevant threshold ($25 million for the 2017-18 income year; $50 million from the 2018-19 income year).

For purposes of the terms 'relevant annual turnover' and 'aggregated turnover' in section 328-115:

- section 328-125(1) is modified so that the terms 'entity controls the other entity in a way described in this section' and 'the same third party' does not include a State or Territory government and non NTER entities connected with a State or Territory government.