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The Secretary
Review of Business Taxation
Department of Treasury
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Submission on Discussion Paper 2

This is a submission confined to **"Scrip-for-scrip" rollover relief** in Volume 1 of the DP.

1. Executive Summary

1.1 The case for granting a rollover concession is not made out. The commentary in *paragraphs 11.46 to 11.67* is unbalanced since it does not adequately deal with inequities and economic disadvantages of the proposal which are against the public interest.

1.2 If the concession were to proceed notwithstanding the case against it, the need to restrict the rollover to publicly listed companies – *paragraph 11.63, first bullet point* – is so self evident that it is accepted as an assumption which does not require elaboration.

1.3 There is no justification for the rollover on the pretext of increasing economic efficiency. Takeovers do not necessarily increase the economic efficiency of capital. Economic concentration should not be assisted through the tax law. The attraction for speculative bids by raiders which are listed overseas would need special consideration.

1.4 The proposition that a *lock-in* effect operates to impede "*mergers*" is wrong.

1.5 The rollover is misleadingly presented as relief for shareholders subject to non-cash takeover bids. In reality, the rollover would be a tax concession to takeover raiders faced with "small" shareholders reluctant to accept the offer.

1.6 The cash flow impediment factor is overstated.

1.7 The proposal lacks coherence in the context of taxation policy, and the objective of *Simplification* stated as a National Objective in *"A Strong Foundation"*.

My submission in response to the DP is set out below on the assumption that it is proposed to consider shareholdings in publicly listed companies only.

2. Introduction

2.1 In my submission to *"A Strong Foundation"*, I argued against the extension of rollover relief on the grounds that:

> *A form of CGT avoidance arises when the tax system permits non-recognition of gains in "scrip-for-scrip" exchanges in company takeovers. A tax system that is biased in favour of non-cash disposals is tantamount to sanctioned tax avoidance; it distorts capital markets and market values, and is anti-competitive. In this area of the Terms of Reference, Item 3.(c)(ii) should be rejected.*

2.2 As I understand it, taxation policy for rollover relief is that it should be confined to corporate and other reorganisations where there are no changes in the underlying economic ownership of assets. If this is the general rule there is no reason to make a concession where shares are sold in response to a takeover offer.

2.3 Deconsolidations as referred to in *paragraph 11.64* seem to be within the existing policy rule even if excluded from existing rollover provisions on technical grounds.

2.4 If a relaxation is warranted it would be reasonable to first consider gains which are reinvested in productive business assets. This is alluded to in *paragraph 11.56.*

3. Clarification of terminology required

3.1 The DP uses the words 'takeover' and 'merger' as synonyms. There are no definitions of these words in the current tax law. (Mergers of superannuation funds are dealt with but this is not relevant here.)

3.2 In business parlance, generally, somewhat different meanings are given to these words.

A 'merger' suggests the combination of 2 or more businesses of a similar kind or the integration of business activities under a single ownership without either previous owner(s) being the dominating party in a voluntary combination.

'Takeovers' signify the acquisition of a company by another company accompanied by a change in management and statutory control.

Furthermore, there is a distinction between the word ‘takeover’ used loosely by business people and a ‘takeover’ regulated by the Corporations Law and ASX rules. ‘Mergers’ have a special meaning in the context of the Trade Practices Act.

3.3 The scrip-for-scrip consideration which would qualify excludes a mixture of cash and shares [*paragraph 11.46*]. This is a necessary qualification. However, the DP fails to mention mixtures of (1) shares and debt and (2) shares and hybrid instruments.

4. Economic justification

4.1 The case for the rollover is simplistically stated in *paragraph 11.48* as facilitating a more efficiently functioning domestic capital market. This is a mere assertion without any reasoning. Other possibilities are also relevant to arrive at a balanced view.

4.2 There is an implied assumption that takeovers are a ‘good thing’. Undoubtedly, to vested interests in the stockbroking and related industries, a high level of *“Merger & Acquisition”* activity yields economic gains. In any event, there is a distinction between efficient capital markets and the real rate of return on the capital stock in the economy.

4.3 The assumption of “continuing interest in the same assets” – see *paragraph 11.47* - seems entirely inappropriate. A current illustration of a “takeover” was the “unfriendly” but eventually successful cash bid by *Pasminco Investments Pty Limited* for the shares in *Savage Resources Limited*. The intention of *Pasminco* is to retain a core asset owned by *Savage* and to sell unwanted assets.

4.4 Non-cash takeovers with CGT rollover attached will create a bias in favour of very large corporations commanding substantial premiums in the stock market from 100% weightings in ASX and other Indexes to “gobble up” or to break-up small to medium sized listed companies.

4.5 The encouragement of concentration of economic power in the Australian environment should not be facilitated by the tax law. This is anti-competitive.

4.6 Neither does it seem to be an economic benefit nor an aid to business efficiency to invite a US style of leveraged buyout industry to grow in Australia.

4.7 It needs to be noted that the existence of the ACCC does not necessarily regulate the types of business takeovers and asset strips which are encouraged by CGT rollover relief in the circumstances discussed in the DP.

4.8 In *paragraph 11.63*, the third bullet point refers to "….shares in [*sic*] overseas companies." The design issue there is appropriate in the context of justification for the rollover. But, more relevant, indeed, critical, is whether overseas [non-resident] companies should be able to make scrip takeover offers including partial bids so that shareholders of the Australian company have no immediate tax liability. If this is facilitated, interesting consequences will arise, notwithstanding the Foreign Takeovers Act.

5. Assuming there is a "lock-in" effect in the absence of rollover relief, does this make a barrier to takeovers?

5.1 The argument as expressed in *paragraph 11.48* is likely to be illusory. The following classes of taxpayers are unlikely to reject takeover offers simply because of a potential CGT liability:

- Pre-CGT owners
- Shareholders who hold shares on revenue account
- Non-residents with portfolio holdings
- Superannuation funds taxable at a nominal rate of 15% and/or having an effective tax rate in the range of 5-10%
- Taxpayers with realised or unrealised capital losses

5.2 In practice, the shareholder profile of most listed companies would be such that these types of taxpayers make up a simple majority of shareholdings and, probably a majority representing 70% to 80%. Therefore, the success of the bid would be unaffected by the alleged *"lock-in"* effect. It makes no difference whether the takeover bid is cash or scrip-for-scrip or a mixture of both.

5.3 According to media reports this year, the 1998 year was a record year for M&A activity, self-evidently, without CGT concession for a small sector of listed public company shareholders.

5.4 The question then arises whether the remaining "small" shareholders subject to CGT should be treated differently to allow the successful takeover bid to be completed.

Since an exemption threshold of $1,000, and a reduction in effective rate on capital gains, is proposed, this question answers itself.

6. No help is warranted to a bidder through the tax law

6.1 The impression is created by the discussion in the DP that rollover relief is warranted for shareholders who may have to pay tax currently in a scrip-for-scrip sale of their shares even though no cash is received.

6.2 The other side of the coin, so to speak, is that shareholder behaviour from the *lock-in* effect impedes takeovers which create economic benefits.

6.3 It is impractical to attempt a discussion whether takeovers *per se* yield economic benefits. As explained above, the absence of rollover relief will not impede the success of a takeover bid. The great majority of shareholders will not make a decision to accept or to not accept the offer because of the potential CGT liability since this is not the critical tax consideration for the majority.

6.4 However, if rollover relief were available, the time taken to "mop up" dissenting small shareholders by compulsory acquisition or other methods would be shortened and costs reduced for bidders. Such assistance seems to be entirely outside the framework of tax reform and an unwarranted tax aid to the bidder.

6.5 *Paragraph 11.52* refers takeover premiums and suggests that lowering the premium to facilitate a bid will generate more takeovers. This suggestion, if correctly understood, should be eliminated without trace. It borders on the outrageous that a change be made in the tax law to interfere in market values and to lower the cost of assets acquisitions by takeover and to artificially encourage takeovers.

7. The cash flow argument

7.1 Prima facie, there is an issue for accepting shareholders who have to find cash to pay the CGT liability arising from a scrip bid. However, the effect of this can be overstated.

7.2 It would be expected that the cash flow argument draws sympathy only where an individual has a shareholding in the target company which represents a large proportion of that person's wealth.

7.3 This situation cannot be easily put aside even when it is considered that the tax liability to be funded is no more than approximately 50% of the paper profit.

7.4 However, it is more difficult to extend the sympathy to holders who are family companies, family trusts or other business entities which hold portfolio investments on capital account. Such entities normally hold a 'balanced' portfolio which includes cash and liquid assets.

8. Integrity of tax reform

8.1 Introduction of scrip-for-scrip rollover would be contrary to integrity in the tax system. It would add to complexity and run counter to Simplification which was stated to be an Objective at the time the process started.

8.2 A case for economic efficiency is not made out in the DP. The push for this rollover comes from a narrow self-interest group under the guise of “better functioning capital markets”. There is no evidence that scrip-for-scrip rollover would have any discernible positive influence on the stock market and economic efficiency.

Yours sincerely

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