1 April 1999

Dr Alan Preston
Secretary
Review of Business Taxation
Department of Treasury
Parkes Place
CANBERRA ACT 2600

Dear Dr Preston

**A Platform for Consultation – Second Submission**

Thank you for the opportunity to meet with yourself and John Ralph on 31March 1999 to discuss our first submission to the Review. As we discussed Lend Lease will be making a series of submissions in response to the proposals outlined in the Review's second discussion paper.

This second submission is concerned with those issues affecting Lend Lease as an Australian based multi-national real estate and funds management company. Our comments focus on the significant disparity between residents and non-residents caused by Australia's current tax system.

By way of background more than 40% of Lend Lease's assets are outside Australia (in more than 36 countries held through more than 440 entities) and approximately 40% of our shareholders are non-residents.

From Lend Lease's perspective the most compelling reason for reform of the current system is that it inhibits Australian companies seeking to compete overseas and disadvantages both foreign and domestic shareholders. Specifically, the existing tax regime:

- restricts the ability of Australian companies to raise capital from sources outside Australia (due to both the imposition of capital gains tax on non-portfolio investments and because profits from foreign sources are subject to foreign tax, foreign withholding tax and, when distributed to non residents, absorb franking credits earned on domestic profits);
- allows our treaty partners to impose withholding tax at the rate

of 15% on dividends remitted to Australia;

- provides for an additional layer of Australian tax on already taxed foreign profits;
- imposes a corporate tax rate significantly higher than our competitors in the region;
- Unlike our competitors:
    - ◊ provides no tax relief on the acquisition of goodwill (which is highlighted when non residents gain an advantage over residents when acquiring Australian assets);
    - ◊ includes complex and costly CFC and FIF compliance provisions;
    - ◊ does not allow tax relief for reasonable corporate expenditures including bid costs, greenfields expenditures etc.

The cumulative effect of these existing features puts Australian companies at a significant disadvantage. Lend Lease's objective through the review process, is to contribute to the development of a tax system which promotes the growth of Australian corporates and allows them to compete on an even basis both within Australia and offshore.

In considering the proposals outlined in the second discussion paper and in formulating this submission we acknowledge that this is a unique opportunity to provide Australia with a tax regime which encourages Australian companies to compete internationally and promotes Australia as the preferred location for corporates in the region. Some of the proposals we have put forward are innovative but we believe are balanced and have regard to the interests of all taxpayers and the Government.

***Submission***

The key features of Lend Lease's second submission are:

- Support for a reduction in the corporate tax rate towards 30%. To fund the reduction in the corporate tax rate we agree that tax preferences should be removed for business entities. Collective Investment Vehicles ("CIVs"), superannuation entities (including life companies superannuation and Pooled Superannuation Trusts) and individuals should continue to enjoy the benefit of tax preferences. We will be lodging a separate submission on this point shortly after Easter.
- Taxed foreign income should give rise to Australian franking credits when the foreign income is remitted to Australia. This measure would provide a real opportunity for Australian multi-nationals to continue to operate with Australia as their base.

The current system is a disincentive and could force further Australian companies overseas.  While there is a cost to this measure, we consider it is reasonably capable of estimation and could be traded against a reduction in the corporate tax rate to, say, 32%.  We will separately provide you with specific examples of how this proposal could operate.

- Support for the introduction of a resident dividend withholding tax (“RDWT”) in preference to a deferred company tax.
- Amendment and simplification of the CFC and FIF regimes including the introduction of an exemption for “eligible activities” conducted in the existing list of 7 broad-listed exemption countries and the expansion of the range of eligible activities to include real estate and funds management activities.
- The introduction of scrip for scrip rollovers and the removal of Australia’s right to tax gains on non-portfolio investments of non-residents.
- Deferral of the introduction of consolidated tax return.  At this time Lend Lease is not convinced that there is a sufficiently strong support for the introduction of consolidated tax returns. In any event we consider this measure should be deferred as business manages the competing demands of Y2K, GST and the substantial changes likely to stem from the Review of Business Taxes.

I would appreciate if senior officers of Lend Lease were able to meet and discuss this submission with you at your earliest convenience.

Yours faithfully,

David Higgins
**Chief Executive Officer**

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# *Corporate Tax Rate*

Lend Lease fully supports the move for a reduction in the corporate tax rate. The corporate tax rate should be:

(a) Comparable to the rates in the region for our competitors;

(b) Comparable with (or better than) the UK and US;

(c) Stable in the long term; and

(d) Funded by the removal of tax preferences as outlined in Appendix 2.

**Comparable in the Region**

Our benchmark for the corporate tax rate should not only be the rate applicable to domestic profits but also have regard to the manner in which foreign profits are taxed and the imposition of withholding tax. Our comments on foreign profits and withholding tax are set out in detail in Appendix 3.

The comparable jurisdictions in the region are Singapore (26%) and New Zealand (33%). A move to a 30% rate would enhance the Government's strategy of becoming the key financial centre in the Asia-Pacific.

The Review could consider the phased introduction of a lower corporate tax rate in a similar manner to the way in which the reduction in the corporate tax rate was phased into Singapore. A phased reduction reduces the impact of the elimination of tax preferences that could also be phased out. A phase reduction eliminates the effect of strategies that seek to take advantage of the reduction in rates.

**A Rate Comparable with UK and US**

Whilst the US corporate rate of 35% is comparable with Australia's current rate, a 30% rate in the UK is sufficiently less than the existing Australian rate to provide an incentive to retain profits in the UK or route profits through the UK rather than remit the profits directly to Australia.

**Stable Corporate Tax Rate**

Since 1986 the corporate tax rate has been adjusted frequently; 46%, 49%, 39%, 33% and 36%. By 1996 the corporate tax rate had been changed 5 times in 10 years. This is very disruptive to long term planning and can create the opportunity for avoidance.

Lend Lease recommends that the Government provide a

commitment to the business community that any change in the corporate tax rate will be for the longer term. If the tax rate is to be phased down towards 30%, the manner in which the rate will be reduced needs to be clearly understood, should be orderly in its introduction and be a strategy to which the Government is committed.

**Removal of Tax Preferences**

Business should not be encouraged to make investment decisions that are driven by tax benefits. Incentives should not be provided through the tax system. Incentives for industry should be provided directly to those industries that merit assistance.

The flow on consequences of removing tax preferences from the tax system includes;

- Simplicity
- Transparency
- More targeted benefits which reward results and specific economic goals including employment and exports.

To the extent tax preferences remain for individuals these preferences should continue to be available for CIVs where the benchmark is that of an individual.

We will be providing separate comment on this point immediately after Easter.

# *Taxation of Entity Distributions*

## Summary

Lend Lease supports the introduction of a resident dividend withholding tax ("RDWT") on unfranked distributions provided the excess franking credits are refundable to individuals, complying superannuation funds, approved deposit funds pooled superannuation trusts ("PSTs") and the policyholder funds of life companies.

For reasons of simplicity the refund should be available on lodgment of the income tax return.

However to provide relief for low income earners, superannuation entities and CIVs we suggest that the Review consider a mechanism where taxpayers who meet eligibility criteria are able to make a once only election to have tax withheld at either a 15% or 0% rate rather than the corporate tax rate. This proposal is a modification of the concept outlined on page 364 of the second discussion paper.

We strongly oppose the introduction of a deferred company tax ("DCT") regime. A DCT would:

- be a charge against corporate profits. In this regard we are concerned that analysts and investors (particularly those offshore) would have no regard to the fact that profits are "franked" and would downgrade the attractiveness of Australian equities because of the imposition of the DCT;
- give rise to concerns over the operation of aspects of our double tax treaties creating uncertainty for foreign shareholders.

For the reasons identified in **A Platform for Consultation** we agree that the taxation of inter entity distributions is not effective.

## Treatment of Tax Preferred Income

Our concern with RDWT (and DCT) is that it can lead to double taxation on tax preferred income. The alternatives outlined in **A Platform for Consultation** for addressing this concern are not feasible. Addressing the issue of double taxation on tax preferred income as suggested in Chapter 15 does not provide a meaningful answer to a company operating as a going concern, distributing realised profits where the tax preferences (ie, accelerated depreciation etc) will be an ongoing issue.

We submit therefore that tax preferences should not be a feature of a new tax system (other than for individuals, CIVs, all entities undertaking superannuation business, including PSTs and the policyholder funds of life companies) which incorporates RDWT (refer also to the discussion in Appendix 4).

As put forward in our submission of 29 March 1999 tax preferences

should remain a function of the tax system for individuals, CIVs and superannuation entities. In the case of CIVs the benchmark, for flow through taxation, which is acknowledged in paragraphs 16.4 and 16.8 of **A Platform for Consultation**, is that of an individual **not** an entity. On this basis we consider there is justification for tax preferences to continue to be available for CIVs whilst excluding entities from the benefit of tax preferred income.

We will be providing a more detailed response on this issue after Easter.

# *Taxation of International Income*

This appendix considers the derivation of foreign income by Australian residents and distributions made to non-resident shareholders (where a component of the distribution relates to income derived outside Australia). This appendix does not consider the treatment of the FIF provisions which is dealt with in Appendix 4 under the heading of Taxation of Income by Residents from Non Portfolio Investments.

**Summary**

The Australian tax system should not disadvantage Australian companies seeking to compete offshore. The tax system should not limit Australian companies to Australia. Similarly the changes to the tax system should not be limited to only that which has been done elsewhere or that which will fit within the parameters of the existing legislation.

We recommend the Review adopt the following proposals:

- A franking credit should arise for foreign tax paid on foreign dividends remitted to Australia.
- recommend that the Government publicly commit itself to the renegotiation of Australia's double tax treaties with a view to abolishing or sharply reducing withholding tax.

## 1. Recognition of Foreign Underlying Tax

There are two methods by which relief from foreign tax can be achieved.

### (a) Credit for Foreign Tax

Assuming the recommendation to introduce a RDWT is adopted, there needs to be a mechanism within the tax system to ensure that a layer of Australian tax is not levied on income that has already borne tax in a foreign jurisdiction. If no relief is provided, resident taxpayers would suffer:

- foreign underlying tax
- foreign withholding tax
- RDWT on the foreign profits

The accumulation of these taxes can result in an effective tax rate in excess of 70%, a driving force in pushing Australian based global companies that have growing foreign sourced income to consider relocating overseas. This is the largely the current position, however, under a RDWT the tax would be paid

earlier.

To overcome the present difficulties Lend Lease proposes that a franking credit arise in respect of foreign tax (both withholding tax and underlying tax) incurred on dividends remitted to Australia. The amount of the credit would be restricted to, say, no more than the credit that would arise if the tax was equal to the Australian corporate tax rate.

This proposal does have a revenue cost which is equal to the Australian income tax that would have otherwise been paid by resident shareholders ultimately in receipt of these profits. The existing foreign dividend account provisions already reduce the withholding tax on distributions to non residents in these circumstances.

The cost of this measure could be reasonably estimated and factored into the proposals. If a credit of 100% of the foreign tax and withholding tax was allowed, the cost could be determined by reference to the section 23AJ income. On the assumption that some part of the foreign income would be retained, the franking credit could be effectively limited to, say, 70% of the section 23AJ distribution and still provide a meaningful outcome.

Alternatively the credit could be limited to circumstances where the taxpayer has an interest of 10% or greater in the foreign company. A further alternative, though one which is more complex, is to consider the non-refundability of franking credits which have arisen through the receipt of foreign tax.

A proposal to provide real franking credits for foreign tax (especially when coupled with a zero withholding tax regime) does have a cost, but one which is reasonably capable of estimation. The benefits of a proposal of this type are significant:

- The incentive for Australian based multi-nationals to relocate offshore would be substantially removed.

- In our opinion this would make Australia a significantly more attractive location for multi-nationals currently based in Singapore, Hong Kong or New Zealand.

- The measures would facilitate investment in Australian companies directly by US and UK investors rather than through the use of “stapled” arrangements in lower tier subsidiaries.

Lend Lease considers that whilst we have the opportunity to review our tax system the initiatives proposed should be bold and forward thinking. Our belief is that Australia has the ability to promote domestic companies to become more

international in their outlook whilst still remaining as Australian companies. Our tax system should promote Australia as a jurisdiction of choice in the Asia Pacific region.

The funding of these proposals would flow from the elimination of tax preferences from the tax system for active businesses in the manner outlined in appendix 2.

We will be providing detailed examples of how this proposal could operate after Easter.

**(b) Foreign Dividend Accounts**

The alternative proposal to provide relief from foreign tax within the context of RDWT (or DCT) is to use the foreign dividend account ("FDA") mechanism.

Unless the FDA balance converted to a franking credit, the use of the FDA in its current form does not provide relief from taxation for Australian residents.

Alternatively the FDA credits could be streamed to non-residents and franking credits streamed to residents. Such a proposal has a number of obvious drawbacks and would not be effective unless the proportion of resident shareholders to non-resident shareholders was perfectly aligned to the proportion of domestic income to foreign income. Furthermore, it does not contemplate Australian shareholders enjoying the benefit of foreign profits.

In our view the use of the FDA mechanism is a poor substitute to the full credit for foreign tax considered above. The benefits of the FDA account would be utilised in the short term until corporates found more permanent solutions.

## 2. Withholding Tax

With the introduction of dividend imputation in 1987 Australia gave up the ability to impose withholding tax on dividends without obtaining a similar concession from our treaty partners. This change in tax legislation advantaged non residents investing in Australia but was of no assistance to Australian companies seeking to compete internationally.

In recent years there has been a shift away from (or a reduction in) the imposition of withholding taxes. Notable examples include distributions within the European community in many instances subject to zero withholding tax and the 5% withholding tax rate between the UK and US.

In some circumstances it is possible for an Australian corporate, through the judicious use of double tax treaties, to minimise

withholding tax. For instance, an investment by an Australian company in the US can be routed through the UK reducing the total withholding tax burden from 15% to 5% divided. Multinationals do structure investments to legitimately minimise withholding tax.

We recommend that the Review put forward a plan to phase in the abolition of withholding tax on dividends.

We acknowledge that the renegotiation of Australia's double tax treaties is a protacted process requiring support from the treaty country and that many of these countries will have their own agenda. It is nonetheless a critical step in the tax reform process and will promote Australia as a country in which to invest and from which a multinational may effectively operate.

Given that it is not possible for Australia to renegotiate our double tax treaties in the short term the Review should recommend that the Government publicly commit itself to this course of action as a positive statement of its intent.

We note that the if the double tax treaties were able to be renegotiated to abolish or reduce withholding tax the cost to the Revenue of the proposal we have outlined in 1 above would be reduced.

**Appendix 4**

# *Taxation of Income of Residents from Non Portfolio Investments*

## Summary

The Foreign Investment Fund ("FIF") rules in their current form are a significant impediment to the offshore expansion of the Lend Lease Group. The FIF rules discriminate against Lend Lease's core property, funds management and financial services competencies.

To provide some perspective to our comments Lend Lease has interests in more then 440 Controlled Foreign Corporations ("CFCs") and FIFs in over 36 countries. The annual cost of complying with the CFC and FIF provisions is significant and growing.

We recommend that the exemption for certain US FIFs, introduced in Tax Laws Amendment Bill No. 4 (1998), be extended to the remaining 6 broad exemption listed countries.

The CFC rules should be amended to reduce their impact on offshore reorganisations.

## Foreign Investment Fund Rules

The aspects of the FIF rules (principally as they apply to non-portfolio investments) which are of most concern to Lend Lease are:

- Where a FIF is held by a CFC, there is often both current Australian FIF taxation and taxation in the country of residence of the CFC. As an example, the effective tax rate for Lend Lease's holding of certain FIFs in the United States in the year ended 30 June 1998 was in excess of 70 percent due to the combined effect of Australian tax under the FIF rules and US tax. In such instances foreign tax credits cannot always be obtained and utilised to alleviate this double taxation.

- The substantial compliance burden of completing FIF calculations, particularly where Lend Lease inherits FIFs through its offshore acquisitions, far outweighs the integrity concerns the FIF measures seek to address.

- There is absolutely no justification for funds management activities and most activities in connection with real property to be excluded from the "active business exemption" as such activities are as much an active business as any other form of labour intensive enterprise.

In order to address these issues, Lend Lease submits that the FIF provisions should be amended as follows:

- The FIF provisions should not apply where a FIF is held by a CFC which is a resident of a broad exemption listed country. The comparability of the tax rules of the relevant broad exemption listed country, which have already been accepted for CFC purposes, should be given precedence in such a situation.

- The "active business exemption" should include funds management activities and be extended to further include property funds management and other defined property transactions.

- The exemption for certain US FIFs should be expanded to both portfolio and non-portfolio interests in FIFs in all broad exemption listed jurisdictions.

Lend Lease also does not accept that the application of the FIF rules to non-portfolio investments should be more closely aligned with the active income test approach which is adopted for CFCs. Such an approach ignores the substantial difficulties in obtaining sufficiently detailed financial information in relation to non-controlling interests in offshore entities and would seriously escalate our current compliance costs.

**Controlled Foreign Company Rules**

**A Platform For Consultation** indicates that the breadth of the business tax reform proposals precludes immediate legislative reform of the CFC rules. However, you have invited comment on the policy issues that are of concern to business.

The major issue of concern to Lend Lease is that the combined application of the CFC rules and the capital gains tax provisions can trigger immediate Australian tax even though the relevant overseas jurisdiction provides a deferral of the local tax liability. Subsequent disposals would result in overseas jurisdiction tax based on the lower cost base, these representing double tax on the same gain.

Notwithstanding the existence of very limited "roll-over" relief in the form of existing Section 419, the combined application of the CFC and CGT provisions penalises Australian multinationals who seek to sensibly reorganise their overseas business operations. The proposal outlined in the consolidations chapter of the Discussion Paper (paragraph 26.52) to remove the limited "roll-over" relief which is currently available is rejected as it would only further entrench the current difficulties, rather than relieve them.

Lend Lease is also concerned that legislation has not been released implementing the changes to the interaction between the CFC and CGT provisions which were announced in the Treasurer's Press Release No. 51 on 13 May 1997.

**Appendix 5**

## *Consolidations*

Lend Lease does not accept the Review's summary on page 532 of **A Platform For Consultation** of the consequences of the current arrangements.

Of the concerns expressed in **A Platform For Consultation** we do not agree that the preparation of a consolidated tax return will reduce compliance costs. Experience to date would suggest that the Government has had little regard (if any) to the cost of compliance. Recent examples include the introduction of franking anti avoidance rules (including the 45 day rule) and the introduction of the FBT Reporting Bill. In each instance the Government has introduced (or is introducing) legislation which places an enormous compliance burden on business taxpayers where the risk/issue the Government was seeking to address could have been overcome more simply and at significantly less cost to business taxpayers.

The Lend Lease Group in the United States is required to lodge a consolidated tax return under US tax rules. Our experience, having operated under that regime, is:

- Absence of detailed records relating to individual entities forming part of a group leading to costly and time consuming reconstructions in the event of disposal;
- Complex rules relating to the part disposition of a consolidated group; and
- Significant costs of compliance.

Two other concerns relating to the duplication of losses and value shifting have already been addressed by specific anti avoidance legislation and are therefore not part of the existing regime.

To be effective any consolidation regime would need to include complex rules relating to:

- Existence of losses on entry and exit from a group
- Preservation and use of franking credits on entry and exit from a group
- Taxation of financial arrangements within a group by an in house financial services provider
- Treatment of policyholder and shareholder funds of a life company within a consolidated group and particularly in entering or leaving a group

- Transitional arrangements
- Definition of a group
- Whether the consolidation regime was mandatory

Many of the above issues are expressed in chapter 26 of **A Platform For Consultation.**

Given the enormous complexity that a consolidation regime will bring and the scope for inequity to be introduced into the tax system, we consider that the difficulties should be addressed within the context of the existing system.

One issue that is not developed in **A Platform For Consultation** is the consolidation of a life company within a group and the treatment of shareholder and policyholder assets and franking account balances. The transfer of assets between statutory funds and to and from shareholder funds of a life company is an issue that we are aware the ATO has had difficulty with. In order to protect the integrity of a consolidation regime the treatment of life companies would need to be specifically addressed.

Indeed special rules for financial services institutions would also need to be developed.

We detect no overwhelming desire on the part of business for the introduction of a consolidation regime. In Lend Lease's view we do not consider this to be a critical aspect of business tax reform and given the enormity and urgency of other business tax changes would not be opposed to this particular aspect being deferred.

# ***Revenue / Capital Distinction and Black Hole Expenditure***

The distinction between revenue and capital for an entity carrying on an active business is an anachronism. The distinction preserved in the 1936 Act was necessary whilst capital gains were outside the tax net.

The introduction of the capital gains tax provisions in 1985 makes the revenue capital distinction meaningless. It was retained as a revenue generating mechanism only. Since the introduction of CGT the revenue generated by the tax has consistently out paced Treasury estimates.

The cost of the removing the revenue capital distinction would eliminate the application of capital losses only as against capital gains.

On page 311 of **A Platform for Consultation** it is argued that the removal of the quaranting of capital losses would lead to taxpayers actively realising losses to reduce tax. This argument is fundamentally flawed. The loss has already economically occurred, it is a real loss where the tax benefit of the lost capital should be recognised through the tax system if the gain would have otherwise been taxed on realisation. We note that one of the alternatives contemplated is to allow losses in circumstances where gains are taxed on an annual basis. It is imperative that gains and losses other than for financial arrangements are taxed on a realisation basis.

The issue of black hole expenditure, ie expenditure on capital account but which does not relate to the disposal of an asset, needs to be addressed.

In the absence of an outright deduction for all expenditure incurred by a business entity for the purpose of deriving income (and capital gains) we accept that a statutory list as outlined on page 101 of **A Platform for Consultation** is a step forward. However, the concept of a statutory list is not comprehensive and is, therefore, incomplete, will cause disputes and will need to be amended from time to time.

Our preference, however, if an outright deduction is not available, is the adoption of a formulae approach on the following lines. A deduction would be available where the expenditure did not give rise to any lasting advantage based on an objective assessment of the advantage sought and the means used to obtain it. Furthermore, the expenditure must be written off in the accounts of the entity in the year in which it was incurred or in the year in

which the advantage sought failed to arise.

**Appendix 7**

## *Amortisation of Goodwill*

A deduction for acquired goodwill is available in:

- US
- Canada
- Europe

A foreign company resident in one of the above jurisdictions enjoys a significant absolute advantage when competing against Australian companies for the acquisition of assets or businesses.

The privatisation of the electricity industry in Victoria, the sale of infrastructure to the private sector and the rationalisation of the financial services industry has demonstrated the advantage enjoyed by foreign companies over Australian companies.

For example, a US investor acquiring an Australian financial services company (where it is expected a significant part of the purchase price will relate to goodwill) is able to “check the box” in the US to file a consolidated return, which incorporates the new Australian company, and then amortise the goodwill for tax purposes over 15 years.

We note and acknowledge that the Review is concerned that reliable revenue estimates are not available for the cost of providing a tax deduction over time for acquired goodwill. We submit that the cost to the revenue of this measure is not limited to the revenue forgone but should also include the lost opportunity for Australian companies to participate on an even footing with non residents operating in Australia.

We recommend that the Review consider the allowance of a tax deduction for acquired goodwill over 20 years. This recommendation would be consistent with accounting treatment in AASB 1013.

## *Capital Gains Tax*

There are two issues on capital gains tax that should be considered by the Review:

- The introduction of scrip for scrip rollovers
- The elimination of capital gains tax on non portfolio investments of non residents in Australian public companies

### Scrip for Scrip Rollovers

Where an investor accepts a public offer for the acquisition of scrip and the consideration is by way of scrip, rollover relief from capital gains tax and income tax (in the case of revenue based taxpayers) should be available. The extension of the rollover provisions would promote the ability of companies to compete in industries where there is a need to reach a certain critical size to survive.

The rationalisation of the financial services industry is an example of the extent of takeover activity in the market where gains are realised on substitution of one investment for another. In our view the legislation should not discriminate in the availability of the rollover in circumstances where the investor has ability to choose scrip or cash to those offers which are scrip only.

### Non Portfolio Investments

One of the concerns frequently encountered by non portfolio investors is the breadth of Australia's capital gains tax as it applies to non portfolio investments in public companies by non residents. The application of the capital gains tax provisions to these investments is a significant disincentive for non residents to invest in Australian companies.

In addition to the disincentive to invest, we understand there is a serious difference in opinion between the US and Australia as to whether the existing Australia / US double tax treaty gives Australia the right to tax a US resident on a gain on a non portfolio investment in an Australian public company.

We recommend that Australia concede this issue if it is able to negotiate a reduced rate of withholding tax between Australia and the US (refer our position in appendix 2).