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6 April 1999

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

Dear Alan

<u>"A Platform for Consultation" - Submission</u>

I am pleased to enclose two hard copies of our submission together with an electronic copy on disk. We are also sending a copy of this letter and the submission to you by email.

You will see that our submission covers Chapters 15 to 33. These chapters cover the areas which are most germane to our practice and upon which we feel best qualified to comment.

You will also see that our submission adopts the "checklist" approach which we have promoted since our meeting on 4 March 1999. The checklist for each chapter is supported by backing notes, where relevant; and each of the three groups of chapters is introduced by an Executive Summary.

If you or any member of your team would like to discuss any aspect of our submission, please do not hesitate to contact us on (03) 9650 4451.

Yours sincerely

<u>Richard Shaddick</u>

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Review of Business Taxation

Submission in Response to Chapters 15 to 33 of

"A Platform for Consultation"

The Second Discussion Paper issued by the Review of Business Taxation

Shaddick & Spence

6 April 1999

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TAXATION OF ENTITIES

TAXATION OF ENTITY GROUPS

EXECUTIVE SUMMARY

Chapters 15 to 24 raise a large and varied number of issues regarding the taxation of entities. Although we have not provided a written submission on all issues raised, we have provided our views in the attached checklist.

The major points we wish to reinforce in regard to the taxation of entities are as follows:

- We prefer the adoption of Option 3 for the introduction of full imputation being the taxing of unfranked inter-entity distributions. We believe this option offers simplicity in administration, avoids the difficulties for non-residents which may otherwise arise and minimises some of the adverse consequences of full imputation.

- Of the options proposed by the Review of Business Taxation ("Review") for the treatment of inter-entity distributions, the inter-entity dividend rebate is the least offensive.

- However, we do not believe that relief via the inter-entity dividend rebate is the best treatment for inter-entity distributions. We prefer as alternatives a similar treatment for entities as exists for individuals or the introduction of a dividend deduction regime.

- We believe the proposed reforms to the taxation of capital distributions are misguided and will be ineffective. We recommend that the Review consider the submissions made prior to the introduction of Taxation Laws Amendment (Company Law Review) Act 1998. We believe that notwithstanding the introduction of a profits first rule and slice approach, there will continue to be transactions undertaken to stream franking credits and capital benefits.

- We do not envisage any possibility for the repeal of the existing anti-avoidance provisions which deal with company distributions. We further envisage that additional anti-avoidance provisions may be required to deal with the weaknesses inherent in the profits first rule and slice approach.

- We believe that the taxation of entities does not fully address fundamental policy issues such as taxation of comprehensive income, the treatment of risk and the concept of neutrality. It is our view that the proposals made in regard to the taxation of entities violate the general principles expressed by the Review in regard to these issues.

CHAPTER 15
A FAIRER AND MORE CONSISTENT TREATMENT OF ENTITY DISTRIBUTIONS

15.16 The *Platform* correctly observes that achieving a consistent treatment of income earned in different entities would provide simplicity, fairness in treatment and improvements in integrity in the business tax system (refer paragraph 15.15). In our opinion, these observations identify probably the most significant challenge faced by the Review which is to achieve this consistent treatment. This challenge is made greater by the unfortunate presumption in ANTS that the method to achieve these goals is through entity taxation. This presumption means that only one solution is available to the Review. This is an enormous limitation upon the flexibility available to the Review and the review which can be undertaken.

It is inescapable that a substantial body of re-characterisation provisions will be necessary to make an entity taxation system apply consistently to companies and trusts. These provisions will inherently generate great complexity within the taxation system. The treatment of all entities on a consistent tax basis may be conceptually simple, but will prove practically difficult due to the inherent differences between the entities. To compensate for these concerns, we believe that the Review should attempt to minimise wherever possible the changes made to the current business tax system. In many instances, the simplest and most straight forward change to the taxation system may be the most appropriate.

It is recognised that on occasion, the most simple change to the business tax system may not be preferred according to the policy guidelines in *A Strong Foundation*. However, we believe that a significant factor in weighing the options available in any circumstance is the size and nature of the total range of changes proposed to the business tax system. There is a risk that the changes made to the taxation system will ultimately be, by the mere consequence of their own existence, its greatest difficulty. The benefit of these changes will only be achieved if they are easily and comprehensively understood and applied. These outcomes may be best achieved if the measures recommended and adopted are, as far as possible, consistent with the current business taxation system.

Achieving integrity through the entity chain

15.27 Of the options proposed by the Review, we prefer Option 3 for the introduction of full imputation, being the taxing of unfranked inter-entity distributions. We believe the following reasons recommend the adoption of this change:

- Option 3 involves the simplest approach to the application of full imputation as there is no conceptual change in the manner in which companies, at least, are subject to entity taxation. In addition, entities such as trusts, which are not presently subject to entity taxation, would be subject to a full imputation system whose fundamental features are already well understood. This would improve the ability of the owners and managers of these entities to understand the full imputation system.

- The adoption of Option 3 means there is no need to introduce new collection and administration procedures in the application of company tax. One of the most significant concerns attending the introduction of a deferred company tax is the associated administrative issues. Equally, a resident dividend withholding tax, while conceptually simple, would involve administrative complexities. Option 3 would not face these difficulties.

- The simple administration of Option 3 would also be of advantage in the management of revenue collection by the Australian Taxation Office ("ATO"). The introduction of a deferred company tax or resident withholding tax obviously creates a wider range of issues which will require management, technical review and audit investigation by the ATO. The minimisation of these issues obviously operates to improve administrative certainty and eliminate the areas of dispute which can arise between the revenue collector and taxpayer.

- As identified in the *Platform*, Option 3 provides an effective treatment for the concerns of foreign investors. It also means that relief through the Non-Resident Investor Tax Credit, which we believe lacks integrity, is not required.

- This approach will not operate to exacerbate the cash flow disadvantages created by full imputation and entity taxation where the investor has carry-forward tax losses or has used interest bearing debt to finance the investment in the entity (refer comments in regard to paragraph 17.74).

- This approach provides a potential mechanism to address the double taxation liability which arises for timing differences for accounting purposes (refer comments regarding paragraph 15.53).

- Option 3 maintains the present conceptual understanding of the application of the taxation system to entity distributions.

  Under Option 3 if an entity has retained profits of $100 which it proposes to distribute to investors, its actual distribution will be $100 in all circumstances. Under deferred company tax or resident dividend withholding tax, it would be necessary for an entity to have either franking credits of $52 or cash resources of $152, or a sufficient mixture of credits and additional cash, if the entity proposed to make a distribution of $100. Although this distinction may seem simplistic, it is significant in the administration of entities and especially the application of full franking to non-cash distributions.

Consider an entity with $100 of assets in the form of cash at bank and no franking credits. If this entity was to make a loan of this amount which was deemed subsequently to be a dividend it would not have sufficient resources to pay the tax liability of $52 which would arise under deferred company tax or resident dividend withholding tax. It may be necessary for the Commissioner of Taxation ("Commissioner") to oblige the liquidation of the entity and the refund of the funds loaned (which are deemed to be a dividend) so that resources can be made available to satisfy the outstanding tax liability. Alternatively, it would be necessary to have some form of ability to transfer a liability for resident dividend withholding tax or deferred company tax to the recipient of the distribution. This would obviously be a technically and administratively complex solution. Under Option 3, this difficulty would not arise because the recipient of the distribution would be the only party with a responsibility to meet the tax liability. Of course, the tax liability would only be calculated at the tax rate of the investor.

- Although this method does not alleviate the problem of dividend streaming, this should not be considered to be a concern. The share capital rules proposed in Chapter 19 will necessitate the retention of all anti-avoidance provisions which deal with dividend streaming and thus the adoption of Option 3 will not create any avoidable complexity (refer comments in regard to Chapter 19).

- Option 3 would mean that the level of cash distributed to investors would not change from its current level. This may be important for listed public companies retaining the confidence of their investors after the introduction of a new business tax system. The adoption of Option 3 will also have no impact on the level of reported profits of entities, especially listed public entities. This clearly makes Option 3 more palatable from a commercial and business perspective (although it is admitted that this distinction is substantially cosmetic).

Addressing the potential for double taxation of distributed tax-preferred income

15.53 None of the options presented by the Review to resolve this issue are satisfactory. Specifically, we disagree with the adoption of Option 1, being the refunding of any franking account surplus on liquidation.

An alternative option which should, however, be considered by the Review is the following proposal. We propose that an entity should be allowed to over-frank a distribution made from retained profits which are subject to a timing difference. The over-franked distribution would give rise to a liability to pay company tax (and not deferred company tax if Option 1 at paragraph 15.28 was adopted) and the payment of company tax would offset the franking debit arising on the over-franked dividend.

The payment of company tax would also be credited against the company tax liability of the company arising when the timing difference reversed.

This approach could be adopted by the making of an election by the entity. That is, the entity would elect to over-frank at its own discretion. It is anticipated that entities would only elect to over-frank and so face an additional payment of company tax where the timing difference was likely to reverse within an identifiable term. Companies which could not foresee the reversal of the timing difference would not over-frank the dividend distribution and so incur a liability for a further amount of company tax. This would mean that there should not be significant record keeping difficulties as the incentive to over-frank in regard to obscure or long term timing differences will not be established.

Refund of excess Imputation Credits

15.80 Due to our preference for the adoption of the taxation of unfranked inter-entity distributions as the vehicle for achieving integrity through the entity chain, we do not agree that under such a regime the entity should be responsible for refundable imputation credits. As a result, we disagree with Option 1 proposed in this regard. We agree with Option 2 and believe that the responsibility should be with the ATO.

OTHER OPTIONS/ISSUES

1. Paragraph 15.35

In the event that resident dividend withholding tax is adopted, we do not support the proposal in **paragraph 15.35** to provide relief to non-resident investors. We note that the observation that this relief is consistent with the current taxation treatment of investors is not uniformly correct. Where an unfranked dividend is paid by a company to another non-wholly-owned private company under the current taxation system, income tax will apply to the unfranked dividend so that a subsequent distribution to a non-resident by the second company will be a fully franked dividend. This is the operation of the present Section 46F. We believe that this taxation treatment should be maintained and applied uniformly.

We recognise that the introduction of resident dividend withholding tax extends this system in circumstances where it did not previously apply. However, it should be appreciated that the only instance where the current taxation treatment will change is the receipt of dividends by resident private companies owned by foreign investors, i.e. it only applies to foreign investors which are not listed public companies. This is likely to be a small population within the tax paying community. Given the likely size of this population of taxpayers, the maintenance of two franking accounts by all companies would create unnecessary complexity to tax management.

2. Additional Comments

We provide the following additional comments to the matters raised in Chapter 15:

- If deferred company tax or resident dividend withholding tax were adopted, we do not believe there is any necessary reason for the company tax rate and the entity distribution tax rate to be the same. For example, the company tax rate could be, say, 36% while the entity distribution tax rate was, say, 30%. The entity distribution tax rate would be the tax rate which applied to an unfranked distribution which was subject to deferred company tax or resident dividend withholding tax. Such an approach would operate to eliminate some of the difficulty which arises for non-resident investors. For resident investors, if this approach were adopted, it would be necessary to know whether a distribution had been subject to company tax or entity distribution tax to determine the attached franking credit. It is recognised that this would create some administrative complexity, however, this complexity may not be significant given the present obligation for an entity to advise the investor of the level of franking credits attached to any distribution paid.

- We believe that many of the concerns raised by the current business taxation system, especially concerns arising in regard to loss cascading, could be addressed by reforming the capital gains tax cost base provisions. We believe that cost base provisions which are based on the earnings and profits of the entity in the manner of the current US cost base provisions would operate to eliminate many of the current difficulties with the entity taxation system. Rather than introducing full imputation to solve what is merely an indirect and associated problem (i.e. loss cascading), a proper reform of cost base rules would operate as a direct and effective solution to both loss cascading and gain duplication problems. We would also suggest that consideration be given to whether proposals of this nature could eliminate the need for the proposals contained in Chapter 19.

CHAPTER 16
AN ALTERNATIVE TREATMENT FOR COLLECTIVE INVESTMENT VEHICLES

Chapter 16 fails to discuss the manner in which equity investments and capital distributions would be treated for collective investment vehicles and their investors by the taxation system. We note, however, that the collective investment vehicle will be a vehicle which is delivering a full flow-through of annual profits. In these circumstances, we do not believe it would be appropriate to apply the "profits first rule" or the "slice" approach discussed in Chapter 19. These methods are only relevant to entities which are able to retain profits for re-investment and thereby enhance their capital base. If such retention is outside the scope of the operation of a collective investment vehicle, the adoption of these methods would appear unnecessary.

Preventing Double Taxation Through the Entity Chain

17.68 Of the options proposed, we believe that the least offensive is the adoption of the inter-entity dividend rebate option (Option 3) as the means of preventing double tax in a full imputation system. We note that we have recommended the taxation of inter-entity distributions in regard to Chapter 15. Accordingly, the adoption of Option 2, being an exemption for distribution between entities is not a viable alternate and has been excluded from our consideration.

Of the options proposed by the Review, the use of the present dividend rebate system fits consistently with an approach of taxing inter-entity distributions and involves the least amount of change from the operation of the current business tax system. Accordingly, this option would create minimum disruption for taxpayers and also minimises the disadvantage to the investor which has made a leveraged investment or which has carry-forward losses.

Despite the less offensive nature of Option 3, we do not believe that it should be adopted above other alternatives which have not been proposed by the Review. One alternative which should also be considered is the availability of a dividend deduction. Under a dividend deduction system similar to that existing in the US, an entity in receipt of a dividend payment would return the dividend as an amount of assessable income, but would then obtain a deduction for an amount equal to the dividend received. This approach would also deal with the problems identified in our comments in regard to paragraph 17.74. In these comments we have also proposed an additional alternate solution which is a refund of excess imputation credits at the entity level.

OTHER OPTIONS/ISSUES

1. Paragraphs 17.74 and 17.75

We believe that the comments provided at paragraphs 17.74 and 17.75 of the *Platform* are, at best, mistaken. The introduction of full imputation will create a significant bias in favour of debt finance as compared to equity finance for investors due to the cash flow leakage which arises for equity investment made by an entity. This is demonstrated by the observations which are made in paragraphs 17.74 and 17.75 although the implications of these observations are not realised.

To provide a demonstration of the problems which will arise, reference should be made to the attached examples (refer Chapter 17, Examples One and Two). These examples show that where an equity investment is made into another entity, the actual cash distribution received by the investor and included in assessable income is \$64. If there is an associated cost on interest bearing debt to finance the investment of \$100, the investor will suffer an immediate cash deficiency of $36. In contrast, a debt investment of the same amount made into the entity will generate cash flow of $100, being interest income and so there will be no cash deficiency to the investor. Accordingly, the investor will prefer a debt investment into the entity.

It should be appreciated that this disadvantage will only apply to entity investors given the proposal to refund franking credits to individuals and complying superannuation funds. In Example One, an individual investor will obtain a refund of its excess franking credits and will be able to use that refund of $36 to meet its interest costs on the debt finance used to undertake the investment.

The cash flow disadvantage will arise where an entity uses leverage to make an investment in another entity. This is demonstrated by Example Two. Accordingly, the taxation system will bias investments on an inter-entity basis so that they are predominantly conducted through debt rather than equity.

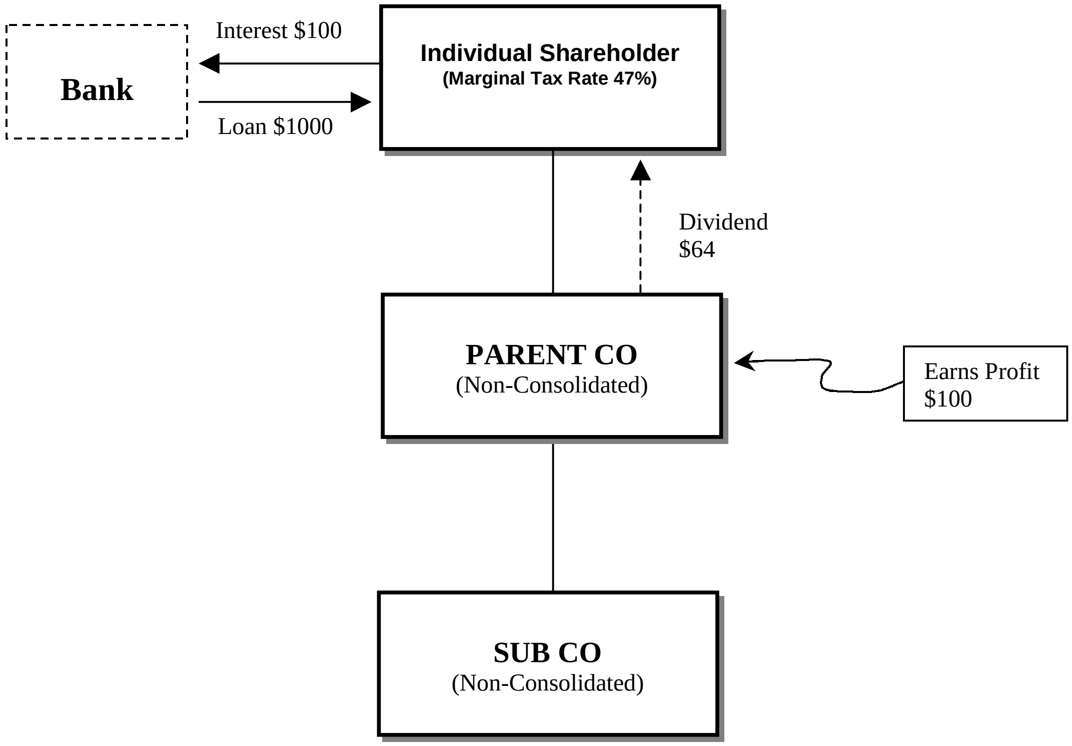
We believe that relief should be provided to ensure that this disincentive does not arise. The mechanism for relief which we prefer is the provision of a refund of any excess imputation credits that arise at the entity level. (An alternate form of relief would be the dividend deduction discussed above.) Thus, in Example Two, the entity with excess imputation credits but no taxable dividend income would be able to obtain a refund of those imputation credits. This would provide a cash flow of $36 which would redress the cash deficiency which arises from the dividend payment. The extent to which any excess imputation credit is refunded would mean a franking debit would arise to the entity which has received the franked distribution.

We note that to some extent this difficulty exists under the present business taxation system. This does not make this difficulty in any way acceptable. However, due to the operation of the current dividend rebate, the cash disadvantage to the entity investor is currently $23 for each $100 of income generated. That is, under the present rebate system, the investor obtains a tax loss of $36 which if offset against other income, generates a cash flow of $13. Hence the cash flow disadvantage is $23, being $36 less $13.

The proposed introduction of full imputation will mean that this disadvantage will increase to $36 if either deferred company tax or resident dividend withholding tax is adopted in combination with gross up and credit or exemption. For this reason we believe that taxing inter-entity distributions and the maintenance of the dividend rebate system is to be preferred as the cash flow disadvantage will remain at $23. However, if individual investors are to be relieved of this disadvantage, neutrality requires the same treatment at the entity level.

Example One: Dividend Distribution to Leveraged Individual Shareholder

Background



- The individual shareholder finances a share subscription in Parent Co with interest bearing debt.
- Parent Co earns a profit of $100 which is subject to $36 of company tax. It pays a dividend of $64.
- All companies and shareholders are Australian residents for tax purposes.
- No consolidation.

Example One: Dividend Distribution to Leveraged Individual Shareholder

Platform Treatment

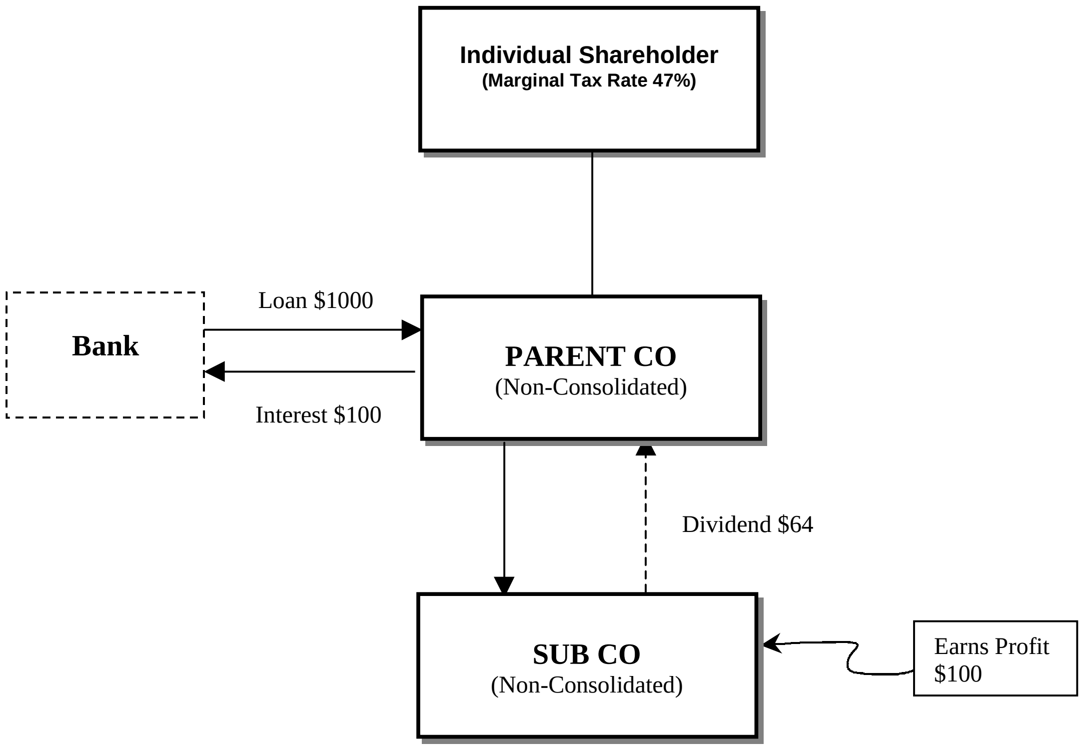
Parent Co	Current	DCT	RDWT	TID
Taxable Income	100	100	100	100
Company Tax	(36)	(36)	(36)	(36)
DCT	-	0	-	-
After Tax Income	64	64	64	64
Distribution	64	64	64	64
RDWT	-	-	0	-
Net Distribution to Shareholder	64	64	64	64

Individual Shareholder (Marginal Tax Rate 47%)	Current	DCT	RDWT	TID
Distribution Received	64	64	64	64
Gross-up	36	36	36	36
Assessable Income	100	100	100	100
Deductions	(100)	(100)	(100)	(100)
Taxable Income	0	0	0	0
Personal Tax	0	0	0	0
Imputation Credit	36	36	36	36
Tax Payable	0	0	0	0
Excess Credits/Refund	36 [1]	36	36	36
After Tax Receipt	0	0	0	0
Cash Deficit	36	0	0	0

Notes: 1. No refund of excess credits under the current system.

Example Two: Dividend Distribution to Leveraged Company Shareholder

Background



- Parent Co finances the share subscription in Sub Co with interest bearing debt.
- Sub Co earns a profit of $100 which is subject to $36 of company tax. Sub Co pays a dividend of $64.
- All companies and shareholders are Australian residents for tax purposes.
- No consolidation.

Example Two: Dividend Distribution to Leveraged Company Shareholder

Platform Treatment

SUB CO	Current	DCT	RDWT	TID
Taxable Income	100	100	100	100
Company Tax	(36)	(36)	(36)	(36)
DCT	-	0	-	-
After Tax Income	64	64	64	64
Distribution	64	64	64	64
RDWT	-	-	0	-
Net Distribution to Parent Co	64	64	64	64

PARENT CO Gross-up and Credit	Current (Rebate)	DCT	RDWT	TID
Distribution Received	64	64	64	64
Gross-up	-	36	36	36
Assessable Income	64	100	100	100
Deductions	(100)	(100)	(100)	(100)
Taxable Income/cfd Tax Loss	(36)	0	0	0
Company Tax	0	0	0	0
Imputation Credit	-	0	0	0
Intercompany Rebate	0	-	-	-
Tax Payable	0	0	0	0
Franking Credits	36	36	36	36
Cash Deficit	$23 [2]	$36	$36	$36

Notes:

1. All franking accounts are on a "tax paid" basis.

2. $23 cash deficit is calculated as $36 outlaid to save $13 of future tax.

Treatment of Created Ownership Rights

18.85 We support the proposal for a dividend treatment for non pro-rata bonus issues of shares. We believe the current taxation treatment is flawed as it fails to represent or reflect the true nature of the transaction.

CHAPTER 19
DISTINGUISHING PROFIT AND CAPITAL DISTRIBUTIONS

Overview

In summary, our submissions in regard to the proposed changes to the taxation of capital distributions are, as follows:

- The proposals will realise an asymmetric taxation treatment of capital contributions and capital returns. This asymmetric treatment will necessarily create tax arbitrage opportunities and will lead to transactions designed to stream capital benefits and franking credit benefits.

- To deal with the likely leakage from taxation, it will be necessary to retain detailed anti-avoidance provisions in the form of the current Sections 45A, 45B and 160AQCBA. These provisions will avert possible anti-avoidance activity. The retention of these provisions will mean that the benefits identified at paragraphs 19.4 and 19.5 will not be achieved.

- The reform proposals will create excessive and unnecessary administrative and disclosure obligations on taxpayers, especially widely held entities (such as listed public companies).

- The share capital rules will inhibit the operation of the capital markets and will create a bias towards debt funding.

- The proposed share capital rules will influence economic decisions and impede the management of corporations and businesses.

We provide further explanation of these comments below. It should be understood that our comments are made in the context of distributions of capital (in various forms) made by a company to its shareholders. We have not sought to consider the impact of the proposed changes for trusts and their beneficiaries.

The Review would be aware that the proposals contained in Chapter 19 were previously contained in the 1996 Discussion Paper issued by Treasury and the ATO in regard to Corporate Law Simplification. Following a period of consultation, these proposals were abandoned in favour of the proposals contained in Taxation Laws Amendment (Company Law Review) Act 1998. Apparently, it is now intended to abandon this legislation. To understand the reasons why the proposals previously made in 1996 and now contained in the *Platform* were previously considered defective or inappropriate, the Review should refer to submissions made at that time, e.g. the submission of the Corporate Tax Association to Dr Ken Henry dated 19 August 1996.

The observations made in these earlier submissions, although supported, are not repeated in this submission. We request that you refer to these earlier submissions.

This submission proposes to merely focus on the consequences which will arise from the proposals made in this chapter. Where possible, recommendations are made to avoid the disadvantages which attend these consequences.

The *Platform* proposes at **paragraph 19.4** that the slice approach and profits first rule will be simpler, better structured, will reduce complexity and will eliminate the reliance on anti-avoidance provisions. We consider these claims to be matters of conjecture. The critical question is whether the *Platform* can provide proof of these conjectures. In our opinion, that proof has yet to be established.

Although a common set of rules for all entities as proposed in **paragraph 19.5** is an apparently sensible goal, it is not an essential nor necessary outcome for the effective operation of the business tax system. If the system of taxing corporate distributions is unnecessarily complicated by the need to incorporate trust and company distributions into the same system, separate systems should be considered. It would appear that concern with the ability of trusts, especially discretionary trusts, to distribute amounts of capital tax free has had an inappropriate impact on the proposals made regarding distributions by companies.

19.9 In our opinion, the consequences of the slice approach have been misunderstood in the *Platform*. The fundamental basis of the slice approach is that contributions to capital and returns of capital are characterised differently. Contributions of capital made to an entity will continue to be characterised as amounts of capital, i.e. they will be included in the share capital account or contributed capital account of the entity (this treatment will arise even if Option 2 at paragraph 19.21 is adopted). For example, an amount paid on the subscription for shares of a company would be treated as capital in the hands of the company for tax purposes. In contrast, returns of capital made by an entity would be re-characterised under the slice approach as amounts of capital and taxed as untaxed profits.

This asymmetrical taxation treatment will create arbitrage opportunities which will be driven by the tax circumstances of individual investors, e.g. high cost base in shares, exempt ownership interests for non-residents, capital losses and the ability to use additional franking credits. These circumstances create the risk that streaming transactions will occur which seek to take advantage of these arbitrage opportunities. To prevent these streaming transactions occurring, it will be necessary to maintain and possibly expand the existing anti-avoidance provisions. Hence, we do not foresee any possibility for the repeal of sections such as Sections 45, 45A, 45B or 160AQCBA.

These conclusions are demonstrated by the attached Examples 1 & 2.

Operation of a "Profits First" Rule

19.12 The *Platform* fails to indicate whether the operation of the profits first rule or the definition of distributable profits will be qualified where there are prohibitions on the ability of the entity to distribute profits to certain investors or where the relevant ownership interests have limited or no profit entitlement rights. It would be inappropriate to apply the profits first rule to a return of capital or off-market buy-back for a shareholder whose shares provide no rights to a dividend distribution, e.g. if the shares are partly paid and dividend distributions can only be made on fully paid shares.

It is also unclear how the application of a profits first rule can operate consistently with the existing tax rules which rely upon the share capital account to determine the level of contributed capital in a company (Option One at paragraph 19.18). The difficulty created if this option is adopted is demonstrated by the following situation:

> Suppose that a company has net assets of $300 and a share capital account of $200. The company makes a $100 capital distribution which it debits to its share capital account so that net assets are reduced to $200 and share capital is now $100. This distribution is subject to the profits first rule. Distributable profits are $100 and so the entire distribution is deemed to be a dividend in the hands of the shareholders.
>
> The company subsequently makes a further capital return of $100. At this time net assets are $200 and its share capital account is $100. The company would again have distributable profits of $100 and the profits first rule would again apply to deem the distribution to be a dividend. Thus, although the total distributable profits of the company are only ever $100, there would be taxable dividends of $200. These taxable dividends would exist because the share capital account was reduced for legal purposes but should not have been for tax purposes by the first capital distribution. Clearly this duplication or double taxation would be inappropriate. This outcome suggests that Option 1 at paragraph 19.18 is not viable if the profits first rule is to be adopted.

19.13 It is our opinion that the comments made in this paragraph underestimate the issues that the proposed definition of distribution profits will create. For example, any entity which has trading losses so that it has negative retained earnings for book purposes, but has capital assets such as land which have appreciated in value, may have a distributable profit. Difficulties will also arise if distributable profits are determined by reference to the value of assets solely on the day the distribution occurs. For example, an entity which has a portfolio of assets such as listed securities may, on the day of a particular distribution have distributable profits due to a rise in the price of those securities on that particular day. In the subsequent days or week, a decline in the price of those listed securities may mean that the entity no longer has distributable profits or that the amount of distributable profits has declined. It would be inappropriate for such fickle movements in market value to determine the taxation treatment of distributions. It is considered, therefore, that some means should be provided to allow the market value of an asset to be determined upon its average value over a period of time prior to the distribution. This would eliminate unfortunate tax consequences which could arise from the volatility in the value of certain assets.

It should be further appreciated that adoption of a profits first rule effectively means that, to some extent, the business tax system will operate as a comprehensive income tax system. Consider the following example:

Facts

- Individual Shareholder A establishes and subscribes for $200 of share capital in Company A.
- Company A invests the $200 of subscribed capital in an asset.
- The asset increases in value to $300.
- Company A proposes to refinance with a mixture of debt and equity by obtaining a loan of $100 and making a return of capital of $100.

Consequences

If the return of capital to Shareholder A is subject to the profits first rule, it will be deemed to be a dividend of the same amount. This is due to the existence of distributable profits at the time of the return of $100. The application of either deferred company tax or resident withholding tax will mean that this distribution was subject to tax of $36 before receipt by the shareholder. The shareholder may be subject to further tax or obtain a refund of some portion of the franking credits attached to this deemed dividend.

At a later date the value of the asset falls to $200, the asset is disposed of and the company is wound-up. The distribution to Shareholder A is $100 after the repayment of the debt.

For tax purposes, Shareholder A has share capital in the company of $200 which has a cost base of $200 and so realises a capital loss of $100 when the company is wound-up. There is no further deemed dividend.

In this circumstance, $36 of company tax has been paid when no gain has ultimately been realised by the shareholder. Effectively, the shareholder has been subject to a form of comprehensive income taxation. That is, the shareholder has been taxed on the appreciation in the value of the asset and has been allowed a loss, *albeit* a capital loss, for the loss of value which subsequently occurs. This outcome would arise under the present business tax system but only if the asset was revalued and the company sought to distribute that revaluation. However, whether this treatment is presently appropriate is also debateable.

Our concern is whether this outcome is consistent with the observations made by the Review in the Overview. At Overview paragraph 26, the Review states that it is not proposed to establish an undiluted comprehensive income tax base. In the example above, if the individual investor undertook the asset acquisition directly, a comprehensive income tax outcome would not arise. That is, according to the proposals outlined at Overview paragraphs 26-31 the investor would only be assessed on the accretion in value if the asset fell within a class of assets for which that comprehensive income taxation treatment was expressly imposed. In contrast, as a result of the acquisition of the asset by an entity, a comprehensive income tax treatment applies irrespective of the nature of the investment. This outcome would appear to be inconsistent with the policy proposals contained in *A Strong Foundation* and outlined in the *Platform*.

These are merely a range of issues that arise from the use of a profits first rule. We envisage that other issues will arise which create further difficulties for this proposal.

Determining Contributed Capital

19.17 Our comments made in regard to paragraph 19.12 explain why we believe Option 1 to the determination of share capital is unviable.

19.22 In our opinion, the adoption of a separate contributed capital account will involve significant reporting and information obligations for companies. We expand on these comments below:

- As identified in this paragraph, companies would have the additional administrative obligation of maintaining a contributed capital account.

- Many companies including listed public companies would be obliged to report the balance of its contributed capital account as part of its Annual Report. Presumably, the balance of the contributed capital account would be included in the tax note of companies' statutory accounts. There may also be necessary amendments to the listing rules for listed public companies maintained by the Australian Stock Exchange to ensure that this information is made available to shareholders.

- The information disclosed on the statutory balance sheet of a company, and especially a listed public company, would not accurately reflect the share capital of the company available for distribution for taxation purposes and so would be of limited value to shareholders. Where listed public companies entered into transactions such as selective off-market buy-backs, it would be necessary to report the current balance of the contributed capital account (and taxed profits) to shareholders so that they would be able to determine their taxation treatment.

Reference should also be made to the comments made in regard to paragraph 19.29 at Other Option/Issue 1 below.

19.25 We believe that companies should be allowed to remove the tainted amount from their share capital account at any time so that the account would then be considered to be untainted.

Calculating the Components of the Slice Approach

19.67 The attached examples demonstrate that the methodology proposed to calculate the contributed capital component and taxed profit component is flawed. We believe this methodology will lead to enormous commercial and management problems for entities, especially widely held entities. As the attached examples demonstrate, the slice approach means that capital contributed by a shareholder to a company may be returned as contributed capital, taxed profits and untaxed profits. This would happen in circumstances where the same dollar amount has been subscribed by the shareholder and returned by the company. This outcome creates a bias for investors to provide debt funds rather than equity, given that a repayment of debt will attract the same characterisation as the original advance.

This problem is created by the proposed manner of dividing contributed capital amongst shareholders. This methodology assumes that all shareholders have contributed the same amount of capital to obtain the same equity interest. This is not a uniform occurrence and indeed the operation of the existing value shifting provisions in the capital gains tax legislation means this occurrence does not commonly occur. Once capital contributions are non-uniform, the means to allocate contributed capital becomes arbitrary and operates to render the treatment of contributed capital asymmetrical.

(One solution to this problem would be to apply the slice approach to all debt repayments and funds advanced by shareholders on all loans, irrespective of whether the loan is provided on arm's length terms or not. Another option would be to apply the slice approach to all capital contributions. That is, capital contributed to a company would be deemed to be capital, taxed and untaxed profits. These solutions are obviously not viable.)

This outcome may place limitations on the ability of listed public companies to obtain capital contributions through new share subscriptions and rights issues. It could be necessary for listed public companies to disclose in a prospectus for a rights issue of shares, the contributed capital component of any capital subscribed. Shareholders may be reluctant to subscribe for new shares when they discover the contributed capital component of those shares will be less than the actual subscription made. It is also unclear whether the existing shareholders would be able to take any action against directors if they undertook any transaction, including an on-market buy-back or share issue, which operated to dilute the contributed capital component of the existing shareholders.

A further issue not explored by RBT is the operation of the profits first rule and the slice approach to consolidated groups. Is it envisaged that the slice approach would apply on the basis of the contributed capital and profits of the head entity of a consolidated group or by reference to the profits of all group members? How would the contributed capital account of a consolidated group be calculated where a member of the consolidated group was a discretionary trust which had been separately settled? What relationship would exist between profits for the purposes of the slice method and the level of available franking credits?

If the franking credits of a consolidated entity are considered to effectively be held by the parent entity, it would seem inappropriate to only take into account the actual profits of the parent entity. If the only profits of the parent entity were considered, the ratio of taxed profits to untaxed profits could be skewed. Equally, if the profits of only the parent entity were considered there would be an incentive to ensure that untaxed profits were derived by entities other than the head entity.

If an aggregation of all profits of the members of a consolidated group is proposed to apply to the slice rule and profits first rule, it would be necessary to ensure that any measurement of taxed or untaxed profits excluded any intra-group transactions. Equally, any determination of the amount of distributable profits of a consolidated group for the purposes of the profits first rule would need to exclude the value of any intra-group asset. There would obviously be substantial complexity in developing legislation of this type and in administering and ensuring its effective application to consolidated groups.

19.68 The *Platform* provides insufficient detail to the methodology to calculate the taxed profit component.

Although we broadly agree that an entity's franking account balance should be used to measure retained taxed profit, it would appear from paragraph C19 (in Appendix C of Chapter 19) that the taxed profit component would merely be calculated on the franking account balance **at the time** a capital distribution is made to shareholders. This would appear to create further opportunities to stream taxed profits to certain shareholders. It would also create an inequity where a return of capital was made to a shareholder and the slice approach applied if at that time there were no taxed profits, but taxed profits would exist once subsequent or anticipated tax instalments were paid or income tax returns lodged.

We believe it would be necessary to include provisions to allow for the taxed profit component to be calculated by reference to possibly the franking year of the distribution (although this would still mean that distortions exist, e.g. between different franking years). We also believe that anti-avoidance provisions would be necessary to ensure that capital transactions were not timed to bias the distribution of the taxed profit component to certain shareholders and not others.

OTHER OPTIONS/ISSUES

1. Contributed Capital Account

We are concerned that accounting difficulties may arise from the contributed capital account which have not been identified by the *Platform* in the context of their comments at **paragraph 19.29**. For example, where distributable profits exceeded book profits for an entity, would it be necessary for the entity to take an income tax expense to its accounts in regard to this difference under the deferred company tax regime? If the full imputation regime adopted is taxing inter-entity distributions and a company makes a capital distribution, what notification will be required to be provided to shareholders so that they can identify the amount of the capital distribution which is taxed and untaxed profits. How will companies advise shareholders that resident withholding tax has been held on capital distributions if the profits first rule applies?

We strongly object to the comment made at the conclusion of **paragraph 19.30** that consideration should be given to changes in the corporations law to achieve closer alignment. Given that the corporations law has been simplified under Government policy, it seems perverse to introduce new restrictions to the Corporations Law to deal with tax complexity.

2. Slice Approach and Proportionate Distributions

In **paragraph 19.64**, it is proposed that the profits first rule could apply, at least, where there is any proportionate distribution of contributed capital. It would appear that this will occur even if the proportionate capital distribution is due to an entity realising, and having available for return to its investors, a significant amount of the originally contributed capital. This approach contrasts to both the 1996 Discussion Paper and the current Section 45B (as explained in the relevant explanatory memorandum) where it is identified that proportionate distributions made in these circumstances would not be subject to a "profits first type treatment". It is unclear why this particular proposal has been abandoned.

EXAMPLES

Example 1

Background

- Company B has $2 of contributed capital and untaxed retained profits of $98. It has one shareholder being Shareholder B which acquired its one share for $2.

- Shareholder C now subscribes for one share in Company B for an amount of $100. After this subscription, Company B has assets of $200, contributed capital of $102 and untaxed retained profits of $98. It has issued two shares which have the same rights.

- What consequences arise if Shareholder C then has its share cancelled.

Consequences

- The contributed capital for the share held by Shareholder C is $51 (i.e. $102 divided by 2 shares). Accordingly, the cancellation of the share held by Shareholder C will mean, under the slice approach, a return of contributed capital of $51 and untaxed profits of $49.

- Effectively, Shareholder C has not had any increase in net wealth but due to the operation of the slice approach, will suffer taxation when its share is cancelled and the amount paid on subscription is returned by the company. This taxation liability arises from the flawed approach used to calculate contributed capital. If contributed capital is based upon the number of shares issued, each issue and redemption of shares can create a transfer of contributed capital and accordingly taxed and untaxed profits from one shareholder to another, i.e. a type of dividend stripping without the need to pay the dividend. In the present circumstances, this apparently operates to the disadvantage of Shareholder C. However, simple circumstances can be envisaged in which such an outcome could operate to the advantage of Shareholder C.

- In contrast to the treatment of Shareholder C, Shareholder B may be advantaged by the transactions discussed above. On the liquidation of Company B, it could obtain a return which comprises contributed capital of $51 and untaxed profits of $49. The contributed capital would be consideration on disposal of its $2 share for capital gains tax purposes. However, if Shareholder B had available tax losses or was a non-resident with treaty relief, it could effectively avoid the implication of capital gains tax on its share held in Company B. The amount of dividend received by Shareholder B would also be reduced and would suffer a smaller tax impost.

Example 2

Background

- X Company has one shareholder, X Shareholder who acquired one issued share for $100.

- X Company invests the $100 in an income producing business and makes a profit of $50. The value of X Company is now $150.

- X Shareholder invites Y to become a shareholder in X Company. Prior to the issue of shares to Y, X Company splits the shares held by X Shareholder into 3 ordinary shares.

- Y Shareholder is issued 2 shares for the subscription amount of $100. X Company now has a value of $250. It has issued 5 shares, each with a value of $50.

- X Company now makes a further profit of $100 so that the value of the company is $350.

- Z decides to become a shareholder in the company and be issued 2 shares in return for a subscription of $100. Prior to the issue of shares to Z Shareholder, the 3 ordinary shares of X Shareholder are split into 4 ordinary shares and the 2 ordinary shares of Y Shareholder are split into 3 ordinary shares.

- After the capital subscription by Z Shareholder, the company has a value of $450. The company then makes a further profit of $150.

- No amount of profit has been taxed.

- After the production of all profits, the company has share capital of $300, untaxed profits of $300 at a total value of $600. The company has issued the following shares:

X Shareholder	:	4 shares
Y Shareholder	:	3 shares
Z Shareholder	:	2 shares

- The shareholders decide to wind up X Company. On winding up, each shareholder receives the following capital distribution:

X Shareholder	:	$266
Y Shareholder	:	$200
Z Shareholder	:	$134

Consequences

- The components of contributed capital and untaxed profit return to each shareholder are as follows:

Shareholder	Return	Contributed Capital	Untaxed Profit
X	$ 266	$ 133	$ 133
Y	$ 200	$ 100	$ 100
Z	$ 134	$ 67	$ 67

- X Shareholder has only contributed $100 of capital to X Company. Nevertheless, when contributed capital is calculated the contributed capital of X Shareholder is increased to $133. This amount of contributed capital is effectively taken from Z Shareholder which contributes capital of $100, but only has contributed capital of $67. Further, Z Shareholder has only been a shareholder in the company while profits of $150 have been generated and in issuing shares to Z Company the share split made by the existing shareholders was such that Z Company obtained no right to the existing profits generated by the company. Nevertheless, the share issued to Z Shareholder has effectively transferred some of the untaxed profit to that shareholder in exchange for capital contributed by that shareholder.

- It is acknowledged that pro rata capital distributions to shareholders under the current business tax system could realise the outcomes discussed above. However, the distinction with the current system is that it allows a company to specify the capital paid to a shareholder. For example, an off-market share buy-back of X Shareholder could be undertaken from share capital as to $100 and untaxed profits as to $166. Further, existing anti-avoidance provisions could operate if an alternate application of capital occurred.

CHAPTER 20
PREVENTING DOUBLE TAXATION OF BUY-BACKS, REDEMPTIONS AND LIQUIDATIONS

Overview

In our comments in regard to Chapter 19 we have expressed our concerns with the operation of the slice approach. The proposed treatment of share buy-backs is, in essence, an application of that slice approach. Accordingly, the concerns previously expressed in regard to the slice approach apply to the proposed treatment of share buy-backs and other forms of capital return.

Notwithstanding these comments, we support the proposed capital gains treatment of on-market buy-backs.

OTHER OPTIONS/ISSUES

1. Example 20.1: potential for double taxation

We wish to make the following comments about Example 20.1 and the underlying principle that arises. While we accept the theory which underlies this example, we have two fundamental concerns with its presumption that there will be no double tax on dividends in all situations. These are:

- The example assumes that all taxpayers are subject to the same tax rate. This of course is not a valid assumption and means that circumstances would exists where there is double taxation. It could also mean circumstances of under taxation exists;

- The example assumes that a capital loss has the same value as a revenue loss. As capital losses can only be set off against capital gains the benefit of the capital loss may not be immediately, or even at all, realised.

EXECUTIVE SUMMARY

A Consolidation Regime

While we believe that Chapters 25-27 of the *Platform* overstate the case for the introduction of a consolidation regime accompanied by the repeal of existing group relief mechanisms, we recognise that some compliance benefits could be achieved.

However, we are particularly concerned that some specific issues must be addressed that are not considered or reviewed in any detail in the *Platform*. Unless these following three issues are appropriately dealt with, a large number of corporate groups would be significantly disadvantaged under the proposed consolidation regime, to the extent that the regime would not be equitable or viable. This would then lead to the continuation of the existing group relief mechanisms.

The three specific concerns relate to:

1. Allowing Consolidation to a Non-Resident Parent Entity

This is an extremely important issue for a number of foreign owned Australian groups, which in practice will be unable to restructure to form a common Australian holding company.

We believe that allowing consolidation to a non-resident parent entity should not prejudice the "integrity" of a consolidation regime and we raise for consideration some practical proposals in this regard. However, we appreciate that further work is required in relation to this issue.

We also believe it would be unnecessarily restrictive to only allow consolidation to a non-resident parent as a transition/grandfathering measure as this would adversely impact on future international mergers and capital flows into Australia.

2. Dividends Received from Non-Consolidated Group Entities

Specific attention needs to be given to the interaction of the proposed consolidation regime and the treatment of inter-entity dividend flows. Unless this issue is appropriately addressed, then the majority of publicly listed Australian groups (particularly those involved in the resources sector) will be required to restructure to either deconsolidate particular subsidiaries that may generate tax losses, or to dispose of external equity investments in respect of which the group cannot control the receipt of dividends.

3. Pre-Consolidation Losses

The *Platform* raises various options for the treatment of pre-consolidation losses. Of these options, we believe that only two are viable, the other options substantially prejudicing the utilisation of *bona fide* tax losses.

Other important technical and compliance issues are also discussed in this submission.

Finally, we wish to share with the Review our significant concerns that it will not be possible to design a policy framework and draft legislation for a comprehensive consolidation regime (particularly a consolidation regime encompassing trusts) by 30 June 1999. These proposed changes go to the very core of the business tax system, such that any inadvertent arbitrage or anomaly that arises could cost the Government or business millions (or possible billions) of dollars. Therefore, we believe that more resources and more time must be committed to developing a consolidation regime.

CHAPTER 25
A CASE FOR CONSOLIDATION

In this chapter of the *Platform*, the Review provides a list of the benefits of implementing a consolidation regime. These benefits include:

- simplifying the tax system and reducing compliance costs;
- promoting economic growth by reducing impediments to group restructuring; and
- promoting equity by improving the integrity of the tax system.

The portrayal of these benefits in such a positive light by the Review, in our opinion, fails to recognise that there is a much finer balance between having a consolidation regime and retaining the status quo for entity groups. Indeed, if the consolidation regime as currently proposed in Chapter 26 is adopted, the introduction of consolidation will not be a benefit to entity groups. To truly benefit taxpayers, the Review must first resolve a number of key issues of concern to entity groups. These are discussed below under the heading "How can real benefits be achieved?" and also where appropriate in our comments in relation to Chapter 26.

Suggested benefits of a consolidation regime

As can be seen above and at paragraph 25.7 of the *Platform,* the Review cites a number of benefits of introducing a consolidation regime.

First, the Review advocates that consolidation will simplify the tax system and reduce compliance costs for entities. We do not believe that the Review has provided sufficient evidence to support the validity of this statement. For example, the Review states in relation to consolidation that all inter-entity transactions will be ignored and this, therefore, should result in reduced compliance obligations. This is true to the extent that consolidated groups can rely on their consolidated statutory accounts to prepare their income tax return. However, consolidated statutory accounts cannot be relied upon without significant amendment.

First, consolidated statutory accounts consolidate less than 100% subsidiaries. However, transactions involving less than 100% subsidiaries will require exclusion for the purposes of preparing a consolidated income tax return.

Secondly, consolidated statutory accounts also include foreign subsidiaries which will also need to be excluded for the purposes of preparing a consolidated income tax return.

Further compliance issues will arise where foreign owned Australian groups prepare their consolidated statutory accounts based on overseas consolidation principles such as US or UK GAAP. In these circumstances, greater compliance costs may be incurred in preparing Australian consolidated income tax returns.

Whether inter-entity transactions can be ignored, even under a consolidation regime is a questionable proposition in itself, given the various other measures proposed by the Review in the *Platform*. For example, if the entity-based model of calculating gains and losses on the disposal of consolidated group members is adopted, this will require inter-entity asset transfers to be tracked in many cases, regardless of the consolidation principle. Furthermore, the suggested value shifting options contained in Chapter 29 may also require the tracking of certain inter-entity asset transactions. The existence of these factors may, therefore, further reduce the compliance savings otherwise suggested under consolidation.

It terms of simplifying the taxation system, examples need only be sought from the United States ("US"). The US consolidation regime is extremely complex and the legislation is voluminous. The blue print for consolidation provided in Chapter 26 of the *Platform* appears to adopt a number of the US style consolidation principles. Therefore, it would appear likely that once the operational and legislative details of consolidation begin to be fleshed out, a "simple" regime will be impossible to achieve.

The second stated benefit of the consolidation regime concerns group restructuring. It is true that ignoring transactions within a consolidated group (this is of course qualified by our comments above) will make restructuring easier from an income tax perspective. In this sense there is a benefit to consolidation. However, whether this benefit is significant enough to justify the introduction of the regime is again questionable and stamp duty will still remain a significant cost to group restructuring even after consolidation is introduced. Many corporates would argue that at present stamp duty, rather than income tax, is a greater cost and impediment to group restructures.

The third stated benefit of a consolidation regime is an enhancement to the integrity of the tax system. This integrity is enhanced for entity groups through the proposed consolidation regime and for other entities, by the measures outlined in Chapters 28 and 29. Given that the resolution of these integrity issues can and will be achieved regardless of consolidation, this benefit really potentially adds little to the credibility of introducing a consolidation regime. Indeed, given the precariousness of the arguments in favour of consolidation outlined by the Review, we believe that the achievement of integrity enhancement without consolidation, is a strong argument in favour of implementing such reforms without the introduction of this additional level of compliance obligation.

How can real benefits be achieved?

If the introduction of a consolidated regime is to produce real benefit to taxpayers, not only must it be able to achieve the various benefits listed above, but it must also address the following three key issues:

Issue 1 Consolidation to a non-resident parent entity;
Issue 2 Dividends received from non-consolidated group entities; and
Issue 3 Pre-consolidation Losses.

Issue 1: Non-Resident Parent Entity

In respect of Issue 1, we strongly believe that to develop a consolidation regime in Australia which does not encompass the ability to consolidate to a **non-resident** parent would not only result in little compliance benefit for many entity groups, but would substantially disadvantage a large number of corporate groups. At paragraph 26.3 of our submission, we discuss this issue in detail, as well as provide suggested resolutions to some of the Review's concerns about consolidating to a non-resident parent entity,.

Issue 2: Non-Consolidated Group Dividends

Issue 2 relates to the position under the consolidation regime as currently proposed, whereby dividends received from shareholdings **external** to the consolidated group could erode the consolidated group's revenue losses.

At present, many corporate groups are structured such that external (non-group) dividends are received direct by the group's ultimate holding company. The ultimate holding company therefore acts as a dividend conduit to shareholders and will rarely have active trading businesses capable of generating losses. Losses may be generated in other active trading companies within the group and, therefore, by way of this structure these trading losses need not restrict the flows of external dividends to the group's ultimate shareholders. In this way, losses can in effect be quarantined and can be used by the group to be offset against trading profit, not dividends received.

By way of contrast, however, under the consolidation regime as currently proposed, the "single entity" concept will result in an erosion of losses generated by members of the consolidated on the group's receipt of external dividends. This is due to the fact that trading losses cannot be isolated within such trading entities as at present. Consequently, unless this issue is resolved such that receipts of dividends by a consolidated group do not erode the group's loss pool, consolidated groups will be forced to de-consolidate companies/entities that could potentially fall into a tax loss position. Alternatively, consolidated groups could be forced to sell off less than 100% subsidiaries and other minority equity investments in respect of which they cannot control the flow of dividends into the consolidated group.

Unless this issue is dealt with in relation to externally generated dividend flows, it would inevitably result in tax becoming a major impediment to a group's investment decisions. At paragraphs 17.68 and Other Option/Issue 1 in Chapter 17 of our submission, we have discussed this issue in the context of the introduction to a full franking regime. We refer you to this discussion and the possible options we propose in that regard, which should also resolve this issue.

Issue 3: Pre-Consolidation Losses

The third key issue which must be addressed in developing a consolidation system that will maintain an equitable position, while providing compliance benefits to taxpayers, relates to the treatment of pre-consolidation losses. The Review outlines six options in Chapter 26 to deal with pre-consolidation losses. We provide our views on the preferred options in our discussion in relation to paragraph 26.86 of the *Platform*.

* * * * *

In summary we believe that in order for the move towards a consolidation regime to provide positive benefits to entity groups, the Review must ensure that it can at least resolve the three key issues raised above positively in favour of entity groups. If this cannot be achieved, the system as it currently stands should be maintained, given that other measures will be introduced to achieve the promotion of greater "integrity" as per Chapters 28 and 29.

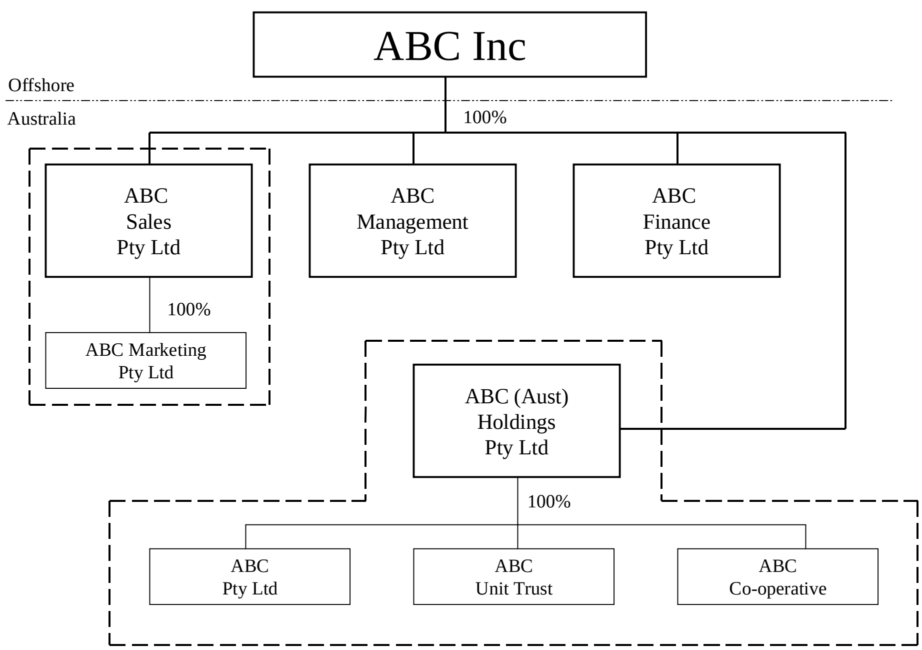
Principle 1: Consolidation Optional and to include all Australian wholly-owned entities in group.

26.3 "Head Australian Holding Entity"

We strongly disagree with the requirement for a head **Australian holding company** in order for consolidation to be available to a wholly-owned group of entities. Consolidation to a **non-resident holding entity** should be available, provided, of course, all other requirements are satisfied.

Given the variety of organisational structures currently in existence in Australia, requiring a "head Australian holding entity" under consolidation would be contrary to the aims of equity, efficiency and simplicity. It would result in fragmented and smaller consolidated groups and the wasting of tax attributes that should be able to be utilised in a larger group context as is the case at present.

The requirement for a "head Australian holding entity" may also result in some foreign owned wholly-owned Australian groups preparing numerous consolidated tax returns as a result of what, in effect, would be the fragmenting of existing groups. Worse still, some entities in a wholly-owned group may fall out of consolidation altogether by virtue of being owned directly from overseas. These groups would be in a far worse tax position under consolidation than at present. The diagram below illustrates these points:



As can be seen from the diagram, despite all entities being wholly-owned by a common parent, the requirement that a "head Australian holding entity" exist results in two distinct consolidated groups. Moreover, two entities, which under the current regime could benefit from group relief measures, would be isolated for tax purposes. Creating such fragmented groups under consolidation would certainly not be beneficial to a large number of entity groups.

The Review, to some extent, recognises these difficulties and raises at paragraph 26.32 the possibility of extending transitional CGT roll-over relief to allow groups to install a "head Australian holding entity" to facilitate consolidation. Such transitional relief would be particularly useful for both trusts and foreign-owned companies. However, this is not enough. Additional costs would still be incurred, for example:

(i) *Foreign Tax Costs*

From a foreign held group's perspective, interposing a "head Australian holding entity" to facilitate consolidation of its entire Australian wholly-owned group could trigger substantial foreign tax liabilities. Reorganisations of this nature would require a disposal of assets such as shares, units etc to the "head Australian holding entity". The Federal Government would be unlikely to have any influence in encouraging foreign transitional relief in such a case, nor is it likely to provide domestic tax relief for such foreign taxes. As far as foreign-owned groups are concerned, therefore, their need to incur such costs could seriously damage Australia's attractiveness as an investment destination in the future.

(ii) *Domestic Tax Costs*

A significant cost of establishing a "head Australian holding entity" would be the stamp duty imposts on the transfer of shares, units, property, etc required to achieve such a structure. Although stamp duty on marketable securities will be phased out with the introduction of the GST, this phase-out will be gradual and will not extend to real property transfers. This is recognised at paragraphs 26.33 and 26.34 of the *Platform* where the Review makes mention of stamp duty. We believe that unless some firm commitment can be obtained from all State and Territory Governments that, transitional relief will be provided in respect of stamp duty incurred for the purposes of reorganising to become entitled to consolidation, the introduction of the regime will be an expensive burden to entities currently operating in Australia.

Alternative: Consolidating to a "Head Foreign Holding Entity"

It is not uncommon for a number of head Australian entities to exist within the same foreign owned Australian group. Requiring such groups to have a further "head Australian holding entity" may result in Australia being an unattractive business destination from a risk management and foreign tax planning perspective. We acknowledge that this requirement for a "head resident entity" exists in the US consolidation regime, but point out that the US economy's strength and dominance is vastly different to Australia's. Indeed, the US is a capital exporter whereas Australia is a capital importing nation. Attracting foreign investment is obviously of greater significance to Australia.

Given that one of the aims of the Review is to foster Australia's international competitiveness by ensuring that the business tax system does not influence business decisions unnecessarily, to impose such a requirement would discriminate against such foreign investment into Australia. Therefore, we are strongly of the view that the Review should **abandon the requirement for a "head Australian holding entity"** particularly for foreign owned groups operating in Australia**.**

We understand that the Review has several concerns about allowing consolidation to a non-resident parent, but we believe that these concerns can be addressed and we have sought to do so below:

1. Integrity/Tracing

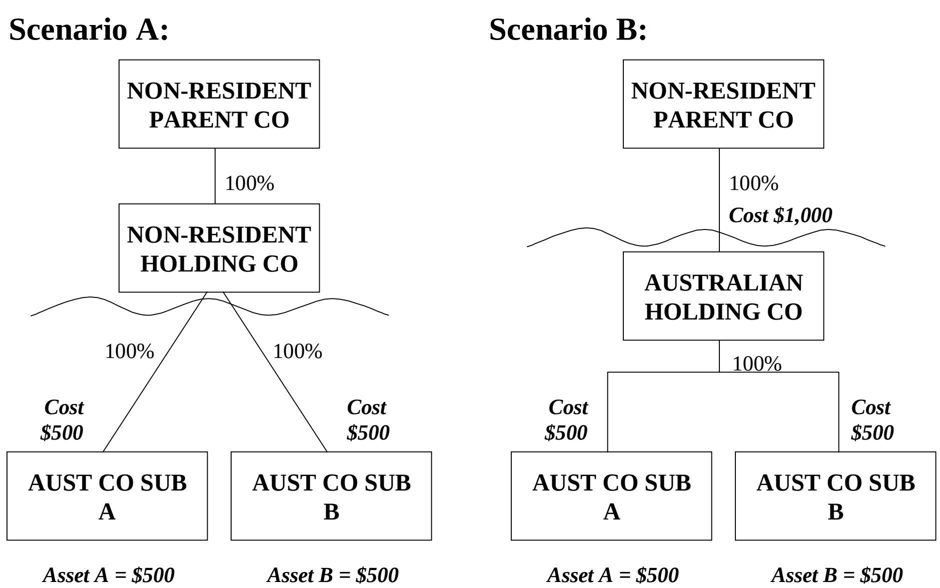
The Review is apparently concerned that if consolidation to a head foreign holding entity is allowed, it will be unable to control the integrity of the consolidation regime. For example, integrity would be jeopardised if external shareholders held interests in interposed foreign entities that could not be identified or traced by the Australian authorities.

In response, it is noted that this same integrity issue in relation to a wholly-owned foreign group currently exists under the CGT roll-over and revenue and CGT loss transfer regimes. However, we are not aware that this aspect is regarded as a significant problem under the current regime nor has the ATO publicly expressed concerns regarding integrity in the context of allowing such asset and loss transfers.

In any event, it is submitted that one practical approach to this issue would be to require a declaration by consolidated groups that the 100% common ownership requirement has been satisfied throughout the entire year. This declaration could, for example, be included specifically as part of the consolidated group income tax return form, which would have to be signed by the group's financial officer prior to lodgement. Penalties would apply where this declaration was falsely made and where insufficient documentary evidence exists to support that statement.

2. Achieving Equitable Exit Models

It is understood that a major concern for the Review regarding consolidation to a head foreign holding entity is the method which should be used to calculate the taxable gain or loss to the foreign parent if and when it disposes of its Australian subsidiaries. This issue can be illustrated by the following example, which contrasts the calculation of the taxable gain on disposal where a head Australian entity exists as compared to where consolidation occurs to a head foreign holding entity:



Scenario A and B are identical except that Scenario A consolidates two sister companies to a non-resident parent, while Scenario B involves consolidation to a head Australian entity.

The following events are assumed to occur under each scenario:

Event 1. Asset A appreciates in value to $1,000 and is then sold by Aust Co Sub A, with the proceeds being reinvested by the company; and

Event 2. Non-Resident Parent Co then sells its interest in the Australian consolidated group.

The occurrence of Event 1 would trigger the same effects under both Scenario A and B. Under either the asset-based model or entity-based model discussed in Chapter 27 of the *Platform*, the consolidated group's cost base in Aust Co Sub A would increase from $500 to $1,000 to reflect the reinvestment of the realised profit of $500.

It is acknowledged that the occurrence of Event 2 could **potentially** have a different tax impact under each scenario. Under Scenario A, Non-Resident Parent Co would sell the Australian consolidated group by way of Non-Resident Holding Co selling its shareholding in each of Aust Co Sub A and Aust Co Sub B. If market value consideration of $1,500 was received, no CGT gain would be triggered for Non-Resident Holding Co because its combined CGT cost base in the two subsidiaries after Event 1 would be $1,500.

By way of contrast, under Scenario B, in order to dispose of its interest in the Australian consolidated group, Non-Resident Parent Co could sell its shareholding in Australian Holding Co. Based on capital proceeds of $1,500 and a CGT cost base in the Australian Holding Co shares of $1,000 (assuming no Chapter 28 value adjustment - refer below), Non-Resident Parent Co would realise a $500 capital gain.

Importantly, this difference in the CGT gain under Scenario A and Scenario B need not, and should not, arise in practice, however, for the following reasons:

1. *Generalised Application of Asset-Based/Cost-Base Models*

   Chapter 28 of the *Platform* (paragraphs 28.40-28.46), propose measures which directly address the gain duplication otherwise occurring under Scenario B. If these proposed general rules applied to readjust Non-Resident Parent Co's CGT cost base in Australian Holding Co to $1,500 a CGT gain would also not have been triggered under Scenario B.

2. *Other Relevant Factors*

   Even if the proposals in Chapter 28 of the *Platform* are not implemented, the difference between the market value of the group's underlying assets and its cost base, to the extent that they represent taxed profits would, in Scenario B most likely be paid up to the ultimate holding company as a dividend prior to disposal.

   For example, under Scenario B, if the disposal of Asset A resulted in $500 of profit on which tax was paid, that profit could have been paid up through the entity chain to Non-Resident Parent Co as a franked dividend free of any further Australian taxation. This distribution in turn would result in the market value of Aust Co Sub A remaining at $500, with the capital proceeds on disposal of the shares in Australian Holding Co being $1,000 such that no CGT gain would arise.

Therefore, it may only be in the case of untaxed profits (i.e. tax preferences) that a different CGT gain could arise under Scenarios A and B. In this regard, we note that, the majority of tax preferences that could result in untaxed profits will, in fact, already be appropriately dealt with under either of the valuation models discussed in Chapter 27. Depreciation and other capital allowance deductions which create tax preferences will result, under the valuation models, in a write-down of the groups CGT cost base in the particular subsidiary which will be effectively assessed to Australian tax on the disposal of that subsidiary. Consequently, the treatment of these tax preference should not be of great concern to the Review.

Although the aforementioned tax preferences do, in a sense, "wash-out" on disposal, we do recognise that some form of separate CGT cost base adjustment may be required for certain other tax preferences that do not result in a write-down of the cost base of an investment in a subsidiary. By way of example, research and development deductions and pre-CGT exempt asset gains would not adjust CGT cost base under either valuation model. In relation to such tax preferences, further consideration must be given to precisely how such tax preference adjustments should be made.

Therefore, given that the tax consequences of exiting a consolidated group should ultimately be the same whether or not a "head Australian holding entity" exists, this concern does not sufficiently justify precluding consolidation to a head foreign holding entity.

3. Retaining Tax Attributes in Consolidated Group

On the basis that consolidation to a head foreign holding entity will be possible, the issue arises as to where tax attributes generated by the consolidated group should reside.

The most appropriate option in this regard would appear to be for the consolidated group's tax attributes to be deemed to be held in the last group company remaining in Australia. In particular, a model similar to that adopted by New Zealand in sFD6 of the Income Tax Act 1994 could be applied whereby the group nominates an entity which acts as the notional head of the consolidated group, and in a sense, repository for its tax attributes. If this nominated head entity was sold out of the group, as is the case in New Zealand, it would transfer its nominated status to another remaining Australian member of the group.

For example, in the context of Scenario A above, if Aust Sub Co A was the nominated head entity and was sold, it would be required or would be deemed to transfer its nominated status to Aust Sub Co B and, therefore, the consolidated group's tax attributes would remain in tact in Aust Sub Co B.

4. Allow consolidation to a non-resident transitionally.

We understand that the Review has given some consideration to the provision of grandfathering or transitional type relief to entity groups, whereby:

(a) existing foreign owned groups could access transitional relief, to consolidate to their head foreign holding entity for a specified period of time; or

(b) **only existing foreign owned groups** could consolidate to head foreign holding entity on a go-forward basis. This would in effect provide grandfather relief to existing foreign owned groups and would not be available to future foreign owned groups.

We do not believe that either of these transitional/grandfathering propositions would be appropriate.

In relation to the transitional relief mechanism, all that this would do would be to push the problem out to later years. Once the transition period expired, the issues currently being debated and of concern would again resurface and need to be resolved.

As to a grandfathering measure, if the issues raised above can be appropriately resolved whereby consolidation can be achieved to a head foreign holding entity, then this should apply on a "go-forward" basis to all foreign owned groups. A grandfathering piecemeal approach would lack integrity and would create its own problems. For example, how would such a regime handle the acquisition of new companies into the consolidated group?

In summary, we are strongly of the view that the issue of consolidating to a head foreign holding entity must be resolved and must be resolved in the affirmative if Australia is to have an internationally competitive, efficient and equitable consolidation regime.

26.6 The existence of minor shareholdings resulting from employee share ownership and non-voting financing shares should not preclude an entity's ability to form part of a consolidated group.

Promoting employee ownership of enterprises is seen as a positive enhancement to business productivity. Its promotion should, therefore, not detriment entities from a taxation perspective.

Finance shares, particularly when they are temporary in nature and non-voting should also not preclude consolidation. Where such shareholdings are utilised also as merely a financing tool and in no way affect the group's control over the entity, they should be ignored for the purposes of consolidation.

Disregarding such minor shareholdings would also strengthen the integrity of the proposed consolidation regime. Allowing such minor shareholdings to trigger the deconsolidation of an entity would enable groups to readily take specific companies outside the consolidated group if they so chose. It could, therefore, lead to abuse and hence the need for complex anti-avoidance rules. To simply "carve out" these minor shareholdings would be a more appropriate solution.

Principle 2: Consolidated groups to be treated as a single entity.

26.43 We agree that a member of a consolidated group should loose their separate tax identity on entry into the consolidation regime, subject to resolution of the treatment of pre-consolidation losses under Principle 4, and the issue of external dividends and the impact on the groups losses. This issue was addressed in our discussion of Chapter 25.

With regard to pre-consolidation issues, if Option 6 is adopted, members with pre-consolidation losses should not loose their separate tax identity with respect to pre-consolidation losses **but** should loose their separate tax identity with respect to losses generated while wholly-owned entity by the consolidated group. This issue will be discussed in more detail at paragraph 26.86.

26.48 As previously discussed, we are strongly of the view that if resident entities with non-resident parents are unable to take advantage of the consolidation system, then a regime of CGT grouping and tax loss grouping must exist outside consolidation.

Principle 4:
Bringing losses and franking account balances into consolidated groups.

26.86 None of six options proposed by the *Platform* on their own can achieve an equitable and efficient transition of pre-consolidation losses into a consolidated group.

However, the combination of options, particularly Option 1 as a transitional measure, in addition to either Option 5 or Option 6 on a go-forward basis, could provide adequate relief to entity groups. Each of Options 1, 5 and 6 do, however, require some refinement. Our comments regarding these options and proposed modifications are noted below:

Option 1: Do not allow losses into group apart from two limited transitional cases.

Regardless of whichever other option was introduced, as a transitional measure we believe it is necessary that Option 1 be adopted. However, Option 1 will require some refinement to make it an efficient transitional measure for non-corporate entities, i.e. trusts.

The proposed requirement of loss transferability outlined in Option 1 will mean that any losses in existence in trusts which are to form part of a consolidated group will be lost on entry because, currently, trusts are unable to transfer losses. If the Review is proposing to, in effect, tax trusts like companies and to allow related trusts to be part of any proposed consolidation regime, then transitional rules will be required to deal with pre-existing trust losses. These trust related rules could either be part of a modified Option 1 or an additional trust focussed transitional measure.

Option 5: Quarantine losses within the loss entity for use while in the consolidated group.

On a go forward basis, after Option 1 achieves transition into consolidation, we believe that Option 5 is the more equitable of the remaining options prepared by the *Platform*. No mention, however is made of how Option 5 would deal with loss sub-groups. This issue is dealt with by the US Treasury regulation 1-1502, as the US applies a modified version of Option 5 which allows loss-subgroups to utilise pre-consolidation losses against income earned by that subgroup during consolidation. This is effectively a system of consolidated loss sub-groups existing within the broader consolidated group.

If Option 5 were to be adopted, it would be essential that the subgroup issue be dealt with and included within the framework of quarantining losses. We recognise that this may cause complexity, in the sense of having to prepare "mock" consolidated returns for subgroups, but, this would have to be done in any event to track intra-group transactions. Therefore, it should not cause unnecessary compliance work.

It is assumed in respect of Option 5 that although past losses will be quarantined, any losses incurred by the quarantined member entity **while a member of the consolidated group** would automatically flow into the consolidate groups loss pool. This would be consistent with the philosophy of the regime and would ensure loss subgroups remained in existence only as long as necessary to absorb **past losses**. If this were not a feature of Option 5, and indeed also Option 6 discussed below, both options would prove inefficient and inequitable from a consolidated group's perspective.

Option 6: Leave loss entities outside group.

Option 6 also appears to be one of the more equitable options proposed by the *Platform* and would be a preferred option if, as discussed in the context of Option 5, any post-acquisition losses incurred by loss entities left outside the consolidated group ultimately formed part of the consolidated group's loss pool.

Ensuring Option 6 operates in this way would be essential to the efficient use of tax attributes by consolidated groups. Any new losses incurred by a loss entity while a wholly-owned entity but left outside the consolidated group because of pre-consolidation losses, should fall into the consolidated group's loss pool. These new losses could enter the consolidated group either when incurred or when the loss entity enters the group as a result of absorbing all pre-consolidation losses.

On additional refinement to Option 6 would involve providing entities left outside a consolidated group with the ability to elect to forego all pre-consolidation losses as a means of entering the consolidated group. In this way, groups could choose whether it was efficient to exclude entities from consolidation on the basis of their pre-consolidation losses.

OTHER OPTIONS/ISSUES

1. Entry and exit times for consolidated group members

No mention is made in Chapter 26 of the *Platform* of the timing of an entity's entry or exit from a consolidated group.

We believe it would be appropriate that the timing of entry and exit equates to the timing of the acquisition or disposal of a 100% interest in an entity. Our preference would, therefore, be to adopt the US approach as outlined in Section 1501 of the Internal Revenue Code.

By basing the timing of entry and exit on the acquisition/disposal date, consolidated groups would absorb the part year income of entities acquired and ignore the income/transactions of members exiting from the date of disposal.

2. Joint and several liability of entities existing the consolidated group

The *Platform* does not address the issue of what level of tax liability individual entities will retain if they ultimately exit a consolidated group.

The resolution of this issue will be significant for a number of reasons:

- Whether a previous consolidated group member entity remains exposed to tax liabilities incurred while a member of that group will impact on the value placed by external parties on such an entity; and

- This valuation issue is compounded by the fact that entities exiting the group leave behind all franking credits, foreign tax credits, revenue and capital losses generated while members of the group.

We are strongly of the view that entities leaving a consolidated group should cease, at that time, to be joint and severally liable for the groups tax liabilities. If this is not proposed as a general rule, it should at least be applicable in situations where entities are sold outside the group on arm's length terms at full value. In this case, the asset value of the entity is still retained in the group in the form of cash proceeds from its disposal and, therefore, the group's ability to pay its tax liabilities is maintained.

3. Changing nature of assets within a consolidated group

An important issue requiring resolution in the context of a single entity for consolidation purposes is how to treat assets that may change their nature as they are transferred between entities within a consolidated group.

The *Platform* proposes two possible approaches to this issue in **paragraph 26.46**:

Proposal 1: Adoption of the generalised unified treatment for investment assets; or

Proposal 2: That the asset's character be determined according to the character of the relevant transaction in regard to the group as a whole.

We do not believe that either of these proposed solutions is adequate. First, Proposal 1 is unlikely to be adopted as it would essentially eliminate the corporate tax status of capital gains.

We believe that the adoption of Proposal 2 would both provide a distorted view of transactions and result in unnecessary re-characterisation of transactions.

The preferred approach, in keeping with the principle of ignoring intra-group transactions, would be to look at the character of the asset in the hands of the individual member entity actually disposing of the asset outside the group. It should be the character of the asset in that entity's hands which should finally determine its nature for assessment purposes. That is the approach broadly adopted in the US under US Treasury regulation 1502-13.

27.5 Of the two options proposed, on balance we believe that the asset-based model is more appropriate as a means of determining the cost base of consolidated group members on their disposal.

The major disadvantage cited with respect to the asset-based model is that it requires market valuations of assets at the time an entity joins a consolidated group. Given that some form of valuation would still be required to determine the price to be offered for entities being acquired by consolidated groups, we believe that this issue could be managed in advance. Practically, therefore, valuation may not be a major impediment, or cost, in adopting the asset based model over the entity-based model.

In any event, market valuations would still be required under the entity-based model in order to track value shifting movements when entities transfer assets within a consolidated group. Given that such valuations would be necessary, by adopting the asset-based model, all valuations could be done at the outset when an entity is acquired, thereby removing the compliance costs of tracking subsequent shifts in value as would be required under the entity based model.

CHAPTERS 30 TO 33
TAXATION OF INTERNATIONAL INCOME

EXECUTIVE SUMMARY

Our observations of these chapters suggest that they are somewhat subordinated to the more pressing issues of tax rate, entity taxation and the treatment of "tax-preferred" income. Consequently, they do not address a number of fundamental international tax issues, such as company residency determination, tax treaty policy and the complicated division of the rest of the world into three parts (two parts "listed"; and one part "unlisted"). Given that one of the principle purposes of the tax reform process is to become more internationally tax competitive, we think that the international aspects of the *Platform* are somewhat "underdone".

Nevertheless, we are heartened by a number of the ideas promoted in the *Platform*. For example, we are excited and encouraged by the sensible analysis leading to the suggestion that Australian companies should receive Australian franking credits for overseas withholding taxes on foreign dividend income. We were also pleased to note the suggestion that the Foreign Dividend Account should be expanded to embrace other types of foreign income, and that conduit income should be encouraged, by preserving a flow-through concept for certain Collective Investment Vehicles.

On the negative side, we think that the proposed Non-Resident Investor Tax Credit ("NRITC") lacks integrity and should certainly not be endorsed. It is a demeaning little "trick" which, in our view, has the capacity to create more harm than good. It will certainly not win Australia any great respect in the international arena.

The international aspects of Australian Capital Gains Tax have been approached from the wrong perspective. In our view, there is a substantial opportunity to enhance Australia's competitiveness by reducing the list of assets which have the "necessary connection with Australia". Instead, the issue is being addressed as a tax avoidance "hole". This is an example of a "fortress Australia" mindset, which we consider to be retrograde.

Finally, on the difficult topic of interest expense allocation, we call for more detailed consultation and recommend strongly against the sudden introduction of a new regime which may prove to be no more efficient than that which applies at present. We also note that it may prove to be unnecessary to make any change in this area, if other anticipated reforms are implemented.

CHAPTER 30
INVESTMENT IN AUSTRALIA BY NON-RESIDENTS

Levying Australian Tax On Non-Residents Investing In Australian Entities

As a general comment, we are of the view that the DCT model should not be adopted as the preferred method of taxing entity distributions. We have discussed this in detail in the context of Chapter 15.

Not adopting the DCT model also makes sense from an international taxation perspective. Under either of the RDWT or inter-entity distribution tax, the operation of tax rules regarding non-residents is much simpler and less contrived. Indeed, the Review has conceded this point in paragraph 30.12 where it says:

> *"If, instead of deferred company tax, resident dividend withholding tax (RDWT) were introduced or unfranked inter-entity distributions were taxed, the need would be reduced for tax neutral treatment of branches given that they are not currently taxed on their tax-preferred (unfranked) income. There would also be less need for the DWT/entity tax rate switch — though the option could still be considered in order to give more favourable treatment than currently to non-resident investors at no cost to revenue."*

Although we are not in favour of the adoption of the DCT model, in responding to the issues raised in the *Platform* in relation to international taxation, we respond where appropriate on the basis that DCT is adopted. This in no way indicates our approval for the DCT model.

30.14 We agree that if the DCT model were adopted, it would be necessary to ensure that no further dividend withholding tax ("DWT") was imposed on dividends paid to non-resident investors. We do note, as mentioned above, that if the RDWT were adopted, non-residents would not be subject to the corporate rate of tax on tax-preferred/unfranked distributions, resulting in the current DWT rates applying to such distributions.

30.16 Although the operation of a DCT model would result in non-residents paying a higher rate of tax on tax-preferred/unfranked income distributed to them as a dividend than at present, we strongly disagree with the proposal to alleviate the non-creditability of this in their home country by way of a Non-Resident Investor Tax Credit ("NRITC"). Indeed, we strongly disagree with the introduction of a NRITC even in respect of normal, franked distributions.

The NRITC lacks integrity. It attempts to re-characterise tax paid at the entity level, and encourages the prevalence of form over substance, the exact antithesis of the principle which the Review hopes to engender in our business tax system throughout the *Platform*.

In addition to being a misleading way of providing foreign tax credits to non-resident investors, the NRITC is unlikely to affect a large enough proportion of investors to warrant either its introduction or the additional complexity it will bring to the

Australian tax system. Non-portfolio investors would mostly not be affected by the NRITC; they would likely be entitled to a credit for the underlying tax in their home country by virtue of their shareholding size and the fact that they will generally not be individuals. The NRITC is, therefore, targeted at portfolio investors.

In the context of portfolio investors, their decision on whether to invest in Australian entities would be insignificantly influenced by the way Australia imposes tax on dividends. Other factors, including gross yields, PE ratios and exchange risks will be far weightier decision factors. Furthermore, the biggest portfolio investors in the Australian market are generally US pension funds and other such superannuation/prudential institutions, which are commonly exempt from tax in their home country.

As a result, we believe that the introduction of a NRITC would be of little benefit in making Australia a more attractive investment prospect for non-residents. Its lack of integrity also risks potential foreign relation issues which we consider would tend to discredit Australia's aspirations as a serious participant in international trade and investment.

Taxing Profits Remitted By Foreign Branches

30.50 We disagree with the proposal that branch remittances of "unfranked" income should be subject to DCT. In this era of sophisticated electronic fund transfers, to apply DCT on the movement of unfranked funds is inefficient and unnecessary.

Although we have no sophisticated evidence on the subject, from our practical experience as taxation advisers it does not appear that the use of branches as an investment vehicle into Australia is prolific. This is notwithstanding that this "discrepancy" between branch and subsidiary structures, has been in place for almost 12 years.

If change is necessary or desirous, however, we would suggest alternatives to the remittance tax proposal which would prove easier to administer from a compliance perspective. These are:

1. Apply a branch level/premium tax on branches profits earned in Australia; or

2. Deny certain tax preference to foreign branches operating in Australia.

In the context of the "discrepancy" at which the *Platform* is directed, the second of these alternatives offers a more equitable solution than the first.

Taxation Of Non-Resident Indirect Asset Transfers

30.75 If the RBT is serious about improving and reforming the business tax system to enhance Australia's international competitiveness, this proposal is one which we consider should be abandoned.

The Australian assets which presumably form the basis for the value of shares sold will remain within the Australian tax system notwithstanding the indirect share sale, and will attract tax when they are sold outside the Australian entity. To tax the foreign shareholding as well as recover the tax on the underlying assets when sold in Australia would, therefore, amount to double taxing the same gain. Given that the *Platform* goes to some length in previous chapters to ensure that the double taxation of gains is avoided, the introduction of such a tax on indirect transfers would be inconsistent.

Furthermore, it would seem that a non-resident could easily mount an argument that Australia has no right to tax such a gain because its source is not Australia. It is arguable that the source of the profit on the sale of the shares is outside Australia given that the incentive for gain, contracts, etc., would most likely arise outside of Australia. We understand that a similar provision has been introduced in Israel, with little success. The jurisdictional difficulties have tended to discredit the provision.

Rather than seeking to prevent the avoidance of Australian CGT on direct transfers (by non-residents) of shares in Australian companies, we recommend that such "avoidance" should be endorsed by an explicit exemption from Australian CGT, except where the Australian company is "land rich". This would align our system with that of USA and would likely have a noticeably positive influence on foreign investment in Australia (including foreign investment in private, venture capital, companies). Arguably, Australia could even abandon a "land-rich" provision, as in the U.K.

30.77 Despite our opposition to the introduction of such an indirect transfer tax, if for some reason it is adopted, we would agree that it should be limited to situations where the actual disposed asset derives a "substantial proportion" of its value from underlying Australian assets.

Providing Conduit Treatment For CIV's Investing For Non-Residents

31.14 We agree with the suggested proposal that the general "flow-through" approach which currently applies to trusts should be adopted for all non-residents investing outside Australia through Australian Collective Investment Vehicles ("CIV") or conduits. In this regard, it would equally be necessary that no Australian level of tax be applied to such income and, therefore, that DCT and RDWT be specifically exempted from applying to such income.

Taxing Conduit Income Derived By Non-Residents

31.22 We strongly agree with the proposal that the current Foreign Dividend Account ("FDA") concept be extended to absorb other foreign income. The account would, therefore, operate as a Foreign Income Account ("FIA") in respect of conduit income.

Creating such a FIA would provide incentive for entities to base operations in Australia without the risk of such conduit income being subject to double taxation.

31.23 &
31.24 In order for the FIA proposal to have a truly positive tax impact for foreign investment, it is desirable that **all foreign income** passing to non-resident investors should be exempt from tax in Australia in the hands of the resident conduit entity. Australia has no real basis on which to tax such income where it simply flows through to non-residents as none of its resources are absorbed in any way in the income's derivation, nor does the income ultimately belong to an Australian resident to justify its taxation here.

If the conduit is to operate as a true flow through for such income, then to impose additional tax would be a significant disincentive to locating businesses which may involve some element of flow through in Australia.

Given that Australia is no worse off by not collecting tax on such income from the point of view of efficient resource use, more would be gained by providing this concession if it would result in conduits locating in Australia. The gain would come from their investment in Australian sourced business/and employment as well as foreign conduit income, this Australian income then being subject to tax.

Operation Of Foreign Investment Account

31.25 We are strongly of the view that **all** foreign income which is creditable to a FIA should be credited, irrespective of the degree of foreign ownership of the resident conduit entity at the time of derivation. The FIA should operate, therefore, in the same way that the franking account operates for domestic tax paid income.

A FIA which operates on the same basis as a franking account provides a simple and efficient mechanism for tracking foreign income through resident entities. Furthermore, the measurement of proportionality of ownership will still occur even though all foreign income is credited to the FIA. The requirement that exists in both the current franking and FDA regimes (that FDA credits be spread across all shareholders), if retained in a FIA system, will achieve the passage of FIA credits to non-resident shareholders based on their proportion of ownership.

To allow the spreading effect of FIA credits across all shareholders while crediting all foreign income to the FIA will, therefore, achieve the aim of allowing non-residents only that proportion of credits based on their ownership.

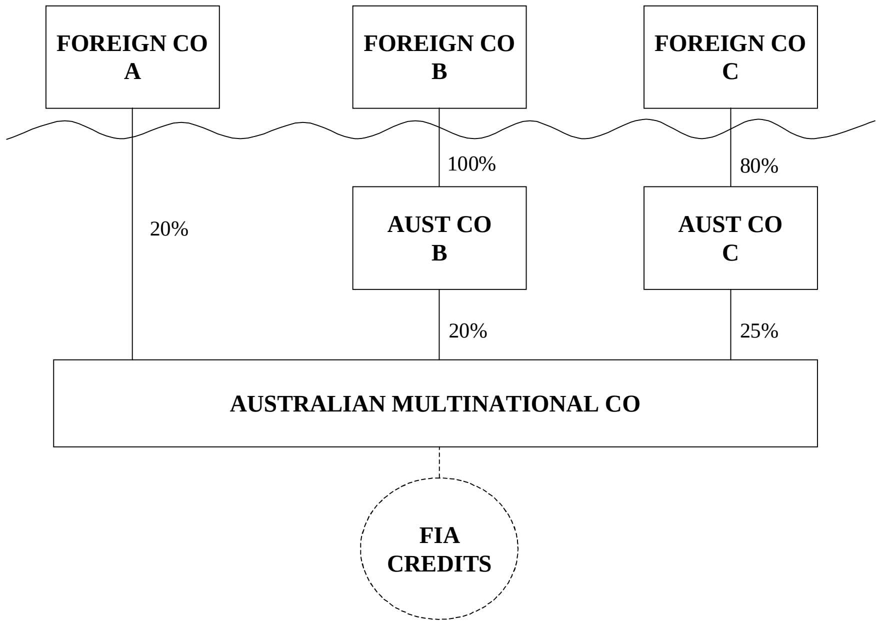
Furthermore, having such a system is much simpler to legislate and then administer on a go-forward basis by taxpaying entities as it will mirror the franking account systems they will have in place. Given that it will not result in a leakage of revenue for the government, we believe that this simpler system should be adopted.

31.27 For the reasons outlined above, to introduce a system in which the credit to the FIA is limited to the proportionate share of the resident conduit entity which is owned by non-residents at the time of derivation would be inconsistent with the aims of simplicity and efficiency. It would be an unreasonably onerous exercise for entities to be required to track ownership changes and apply them to the FIA each time foreign income was derived. When a simpler system is available, such as that described at paragraph 31.25, it should, in our view, be adopted.

31.28 Consistent with the aim of simplicity and indeed to be consistent with the franking account already operated by entities, the FIA should be operated on a tax paid basis.

31.33 If a minimum percentage ownership is required, we would agree with the "at least 10% foreign ownership" option proposed by the Review.

We strongly disagree, however, with any notion of requiring 100% ownership before FIA credits can pass through multiple layers of owners. Indeed, the difficulty of requiring 100% ownership before FIA credits can pass to non-resident owners can be illustrated by the following example:



As can bee seen from the above example, if the minimum 10% foreign ownership requirements was imposed, foreign shareholder Foreign Co A would be eligible to benefit from the FIA account credits. Logically, Foreign Co B and Foreign Co C should also be entitled to benefit from the FIA credits given that they too have a 20% beneficial interest in Australian Multinational Co, *albeit* indirectly. However, if the additional requirement proposed requiring 100% ownership of the interposed entity(s) by the foreign shareholder is introduced, despite the fact that Foreign Co B and Foreign Co C have the same percentage ownership interest, Foreign Co C would be denied the FIA credits.

The result depicted above lacks logical foundation and should not be condoned as an option if the Review is serious about making Australia’s taxation system internationally competitive.

CHAPTER 32
FOREIGN SOURCE INCOME OF RESIDENTS

Overview

Unfortunately, with the important exception of paragraph 32.35, Chapter 32 does not seek bold strategies for reforming the taxation of foreign source income derived by residents. Rather than providing options for reforming the complex rules which currently exist to tax foreign sourced income, the *Platform* in Chapter 32 tends to address detailed anti-avoidance measures and their potential technical "correction". Overall, we think that Chapter 32 is a disappointment: it is too narrowly focussed.

However, we applaud the proposal in **paragraph 32.35** to allow franking credits to Australian resident companies in respect of overseas withholding tax on dividend income. This is a genuine and sensible reform which receives our unreserved support.

How could active business exemption problems be addressed?

32.45 We disagree with the suggestion that in order to tighten the anti-deferral purpose of the measures, the foreign investment fund ("FIF") measure should apply to all FIF's and therefore the active business exemption be removed. In our view, this proposal lacks an understanding of the purpose behind the introduction of the FIF measure and the active business exemption.

> The FIF measures were introduced by Income Tax Assessment Amendment (Foreign Investment) Bill 1992 (Act No.9 of 1992) as the third instalment in developing a comprehensive system for taxing foreign sourced income. An integral part of these FIF measures was the active business exemption.

The inclusion of the active income exemption reflects the aim of the then Federal Government that the FIF measures tax passive investments held through FIF's, rather than tax investments in going concerns. The active business exception was explained on page 4 of the Explanatory Memorandum in the following terms:

> *"The active business test ensures there is no tax hindrance to portfolio diversification or joint venture participation by Australians who wish to invest directly into a foreign company that is principally engaged in active business. A direct investment in a foreign company which is principally engaged in one of the designated active businesses will not attract FIF taxation."*

Unless, therefore, a major policy shift has occurred regarding the operation of the FIF provisions, this option should not be pursued.

32.47 Although we are not in favour of the replacement of the FIF active business exemption, if the RBT chose to recommend its replacement, we would prefer, of all the options listed, that it be replaced with a listed country FIF exemption for portfolio investors.

How could anti-deferral rules for foreign trusts be improved?

32.55 -
32.59 As stated above, the reform measures proposed in relation to foreign trusts are more in the nature of technical corrections than proposals for reforming the taxation of foreign trust income. As such, we have limited comments on the proposals other than as indicated in the checklist.

How should the transferor trust measures be improved?

32.66 We strongly disagree with the proposal to remove the exemptions stated in relation to transferor trusts, as not only are the proposals unfair to taxpayers for the reasons mentioned in paragraph 33.69, but also no evidence has been provided that they are being abused by taxpayers. The opinion of the Commissioner of Taxation that they are "likely to be abused" is not sufficient to warrant change from the status quo.

Hidden Trusts

32.70 We are indifferent to whether stringent rules are adopted for hidden trusts, because we cannot see how such rules would make any difference. Trusts are presumably hidden for tax **evasion** purposes. If a "taxpayer" has already made a choice to "cheat", it is unlikely that he or she will be respectful of rules requiring them to provide more information. The armoury of rules faced by compliant taxpayers is already overwhelming. As we see it, the problem of hidden trusts is essentially the same as the problem of the "black economy": it is a problem which requires strong policing, not tax reform.

CHAPTER 33
ALLOCATING WORLDWIDE TAXABLE INCOME BETWEEN COUNTRIES

Should legislative source rules be enacted?

33.7 In creating a set of comprehensive source rules for tax purposes, we believe that instead of creating these rules based on either Option 1 or Option 2 in the *Platform*, they should be created based on a mixture of both options, depending on the type of income concerned.

Determining the source of income is a difficult issue to resolve. Source is very often dependent on the type of income involved and, therefore, it would be impossible to develop a comprehensive set of black letter law source rules that applied equitably across the board in all factual circumstances. That is not to say that black letter law is not useful in certain circumstances.

Our recommendation, therefore, in reforming the source rules would be to adopt the following approach:

1. The overall concept of source should be retained as "fuzzy" law, stressing substance over form; and

2. In respect of certain types of income, black letter law source rules should be developed based on concepts which are independent of tax treaty concepts. One example of income for which black letter law source rules would be of great advantage is personal services income. So much uncertainty currently surrounds the source of personal services income that black letter law rules would be a significant enhancement.

We would not support the development of black letter law source rules based on treaty concepts. Treaty concepts operate on the basis of determining what income each country wishes to tax and then deeming that income to be sourced in the particular country. Source rules based on these concepts would not be based on solid foundations.

33.19 We disagree with the proposal that a country taxing current income from an asset should also have the right to tax profits accruing from the realisation of the asset. In the interests of international tax competitiveness, the source rules applicable to capital gains should be capable of being different to the source rules which apply to the income from such capital assets. This issue was also discussed in relation to paragraph 30.76.

Deductibility of interest for offshore investments

33.28 It might be conceded that the current, tracing basis of allocating interest expense, tends to influence taxpayer behaviour. That is, Australian taxpayers have an incentive to use borrowed funds to acquire assets which produce assessable income, and not to use borrowed funds to acquire other assets.

However, we do not believe that it has yet been established that this necessarily operates to the overall detriment of the Australian Revenue, although we understand that an attempt has been made to prove this point by a strategic unit within the Australian Taxation Office. It appears to us that what appears to be of concern here is that taxpayers are in a position to control their contribution to Australian Revenue, provided they make tax-prudent use of borrowed funds. The alternatives which have been presented appear to favour rules which are less subject taxpayer control, with the **assumption** that they will operate more fairly.

Bearing in mind that offshore non-portfolio investment normally bears a very high rate of global taxation (because of overseas withholding taxes and the non-franked status of foreign-taxed income), most taxpayers would actually seek to control their global taxation by aligning borrowings directly with overseas investments. That is, the greater incentive is to borrow in the local, overseas country wherever possible.

The impact of this issue on Australian Revenue has the prospect of being reduced further: not only as a result of a possible drop in the company tax rate, but also in the context of the proposal to introduce consolidated tax returns for company groups.

We think that this topic requires more detailed open consultation without it being necessary to implement a sudden shift of policy. Many taxpayers could be unreasonably affected, and a change-of-rule on this point requires careful and sensitive introduction. If a change-of-rule is recommended to the Government, we consider that it should be accompanied by grandfathering or phase-in transitional rules, which will give companies an opportunity to adjust to a new regime without undue impost, and without forcing these companies to reconsider their nexus with Australia.

Improvements to record-keeping and substantiation

33.60 We strongly disagree with the adoption of US style record-keeping rules in Australia. They are extraordinarily onerous for taxpayers and are unlikely to enhance compliance to a sufficient degree to warrant their introduction. Many taxpayers find the current transfer pricing record-keeping and substantiation rules difficult to comply with. The level of detail existing in the US IRC s 6038A rules would make this compliance burden even more onerous.

33.61 We strongly disagree with the statement that an Australian taxpayer be denied a "reasonably arguable position" if insufficient documentation exists. Whether a "reasonably arguable position" exists is a matter of fact and degree. Each case should be judged on its merits. Indeed, it is arguable that if insufficient documentation exists to prove a "reasonably arguable position" then conversely, insufficient documentation exists to disprove it.

Such a rule in any event is contrary to the principles of self-assessment.

S&S Response to A Platform for Consultation.doc: TRW

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 15: A FAIRER AND MORE CONSISTENT TREATMENT OF ENTITY DISTRIBUTIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
15.16	**The redesigned company tax arrangements should be extended to apply to trusts, limited partnerships, co-operatives and life insurers.**	☐	☐	☐	☐	☒	☐	**4**
	Achieving integrity through the entity chain							
15.27	**Integrity through the entity chain can be achieved by the following means, while minimising the impact on non-residents:**							
	Option 1: **Deferred Company Tax (DCT) (para 15.28-31)**	☐	☐	☐	☐	☒	☐	**4-6**
	Option 2: **Resident Dividend Withholding Tax (RDWT) (para 15.32-35)**	☐	☐	☐	☒	☐	☐	**4-6**
	Option 3: **Tax unfranked inter-company distributions (para 15.36-37)**	☐	☒	☐	☐	☐	☐	**4-6**
	Addressing the potential for double taxation of distributed tax-preferred income							
15.53	**The potential for double taxation as a result of temporary timing difference can be addressed as follows:**							
	Option 1: **Refund franking account surplus on liquidation (para 15.54-55)**	☐	☐	☐	☒	☐	☐	**6-7**
	Option 2: **Credit double tax against future company tax (para 15.56-61)**	☐	☐	☒	☐	☐	☐	**6-7**
	Option 3: **Allow pre-payment of tax on temporary tax preferences (para 15.62)**	☐	☐	☒	☐	☐	☐	**6-7**
	Option 4: **Adjust cost base of "funding" asset upon distribution from unrealised gains (para 15.63)**	☐	☐	☒	☐	☐	☐	**6-7**
	Refund of Excess Imputation Credits							
15.64	**Both resident individual taxpayers and complying superannuation funds would be eligible for refunds of excess imputation credits where they exceed total tax payable.**	☒	☐	☐	☐	☐	☐	
15.72	**Refunds of excess imputation credits for tax paid at the trust level should be allowed to registered charities on 'donations' made to them by way of trust distributions.**	☐	☐	☒	☐	☐	☐	
15.73	**Refunds should not be allowed for imputation credits attached to distributions made to non-resident charities.**	☐	☐	☒	☐	☐	☐	
15.80	**Which of the following approaches regarding the timing of refundable imputation credits is preferable:**							
	Option 1: **Refund at entity level so that distributions to eligible beneficiaries are gross of company tax (para 15.81-88)**	☐	☐	☐	☒	☐	☐	**7**
	Option 2: **Allow refundable credits to be claimed through instalments during the course of the income year (para 15.89-92)**	☐	☒	☐	☐	☐	☐	**7**
15.81	**Under Option 1 above, the refund could be provided by:**							
	- treating the distribution as though no tax was paid at the entity level	☐	☒	☐	☐	☐	☐	
	- assume a standard rate of tax for each distribution	☐	☐	☐	☒	☐	☐	
15.83	**The obligation should be on eligible taxpayer to notify the entity of refund status.**	☐	☐	☐	☒	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 15: A FAIRER AND MORE CONSISTENT TREATMENT OF ENTITY DISTRIBUTIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
15.91	**Under Option 2 above, the availability of refunds by instalments should be subject to specific conditions.**	☐	☐	☒	☐	☐	☐	
	Other Options/Issues:							
1.	**In paragraph 15.35, the Review raises the proposal that if the RDWT is adopted, relief will be provided to non-resident investors by refunding the RDWT and applying DWT to the dividend gross of refund.**							**7**
2.	**Additional general comments regarding Chapter 15.**							**8**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 16: AN ALTERNATIVE TREATMENT FOR COLLECTIVE INVESTMENT VEHICLES	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
16.13	**CIV's would be defined as widely held vehicles undertaking investments delivering a full flow-through of annual profits to participants.**	☐	☒	☐	☐	☐	☐	**10**
16.18	**Two options are proposed for dealing with tax-preferred income distributed from CIV's in member's hands:**							
	Option 1: **Not taxing the tax-preferred income (para 16.19-20)**	☐	☒	☐	☐	☐	☐	
	Option 2: **Taxing the tax-preferred income (para 16.21-22)**	☐	☐	☐	☒	☐	☐	
16.25	**If Option 1 is adopted, US style rules governing investment diversity and ensuring genuinely passive non-controlling interest investment would be required.**	☐	☐	☒	☐	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 17: HOW A REDESIGNED IMPUTATION SYSTEM WOULD APPLY TO ENTITIES	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Calculating Deferred Company Tax							
17.3	**Determining when DCT should be levied could be done using the franking account system.**	☒	☐	☐	☐	☐	☐	
17.8	**For entities which would be subject to imputation for the first time, as a transitional issue, all transactions which affect the franking account but which relate to a period before 1 July 2000 should not be reflected in the franking account.**	☐	☐	☒	☐	☐	☐	
17.9	**The franking account should operate:**							
	Option 1: **Taxed-income basis (para 17.9)**	☐	☐	☐	☐	☒	☐	
	Option 2: **Tax paid basis (para 17.10)**	☒	☐	☐	☐	☐	☐	
17.22	**The "balancing day" for determining liability to pay DCT on distributions should be:**							
	Option 1: **Align franking year and income year, making the "balancing day" the end of the income year (para 17.23-27)**	☐	☒	☐	☐	☐	☐	
	Option 2: **Align franking year and income year and exclude current year instalments with the "balancing day" being the end of the income year (para 17.28-29)**	☐	☐	☐	☐	☒	☐	
	Option 3: **Align franking year to payment year, making the "balancing day" the day on which the final tax payment is due (para 17.30-31)**	☒	☐	☐	☐	☐	☐	
	Option 4: **The "balancing day" would be the time of each distribution (para 17.32-33)**	☐	☐	☐	☐	☒	☐	
17.34	**DCT would not be creditable against future income tax liability of entity.**	☒	☐	☐	☐	☐	☐	
17.34	**Tax rebates and credits would only be available to reduce income tax not DCT.**	☐	☒	☐	☐	☐	☐	
	Collecting Deferred Company Tax							
17.39	**The following options are proposed for collecting DCT:**							
	Option 1a: **Build DCT payments into the PAYG turnover ratio (para 17.40-43)**	☐	☐	☐	☒	☐	☐	
	Option 1b: **Base instalments on previous years liability to DCT (para 17.44)**	☐	☐	☐	☒	☐	☐	
	Option 1c: **Require instalments at the time of distribution (para 17.45-46)**	☐	☐	☐	☒	☐	☐	
	Option 2: **Collect on assessment (para 17.47-48)**	☐	☒	☐	☐	☐	☐	
17.42	**If Option 1a were adopted, as a transitional measure in the first year of operation, the prior years value of unfranked dividends could be used to determine the liability for DCT and feed into the ratio.**	☐	☒	☐	☐	☐	☐	
17.44	**Under Option 1b, the first years instalments could be based on immediate prior year's unfranked distributions.**	☐	☒	☐	☐	☐	☐	
17.50	**The current system for liquidators tax liabilities could continue under DCT.**	☐	☐	☒	☐	☐	☐	
	Calculating Resident Dividend Withholding Tax							
		☐	☒	☐	☐	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 17: HOW A REDESIGNED IMPUTATION SYSTEM WOULD APPLY TO ENTITIES	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
17.53	**The franking account system would be used to determine the amount of unfranked distributions.**							
	Collecting Resident Dividend Withholding Tax							
17.59	**RDWT could be collected in the same way as existing dividend withholding tax is currently collected.**	☐	☒	☐	☐	☐	☐	
	Preventing Double Taxation Through the Entity Chain							
17.68	**The following options have been presented as a means of preventing double taxation of dividends through the entity chain:**							
	Option 1: **Gross-up and credit (para 17.69-75)**	☐	☐	☐	☐	☒	☐	**13**
	Option 2: **Exempt distributions between entities (para 17.76)**	☐	☐	☐	☐	☒	☐	**13**
	Option 3: **Provide an inter-entity dividend rebate (para 17.77)**	☐	☐	☐	☒	☐	☐	**13**
	Transitional Issues: Substituted Accounting Periods							
17.86	**The following arrangements have been proposed for introducing entity taxation and accommodating entities with substituted accounting periods:**							
	Option 1: **Apply the new entity tax system to all entities from their 2000-01 income year (para 17.86)**	☐	☐	☐	☒	☐	☐	
	Option 2: **Apply the new entity tax system to all entities from 1 July 2000 (para 17.87)**	☒	☐	☐	☐	☐	☐	
	Option 3: **Apply the new entity tax system to early balancers from the beginning of their 2001-02 income year**	☐	☐	☐	☒	☐	☐	
17.89	**If Option 2 were not adopted, would problems be caused as a result of entities subject to different regimes transacting with each other.**	☐	☐	☒	☐	☐	☐	
	Other Options/Issues:							
1.	**The comments raised by the Review in paragraphs 17.74 and 17.75 are mistaken.**							**13-18**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 18: DEFINING "DISTRIBUTION" IN AN ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Reform the Definition of Distribution							
18.6	**The following definitions of "distribution" have been proposed:**							
	Option 1: **Broad definition covering all benefits provided by an entity to its members**	☐	☐	☒	☐	☐	☐	
	Option 2: **Broad definition, but exclude certain benefits provided by widely held entities**	☐	☐	☒	☐	☐	☐	
	Option 3: **Adopt Option 1 or Option 2 but tax certain benefits under Fringe Benefits Tax**	☐	☐	☒	☐	☐	☐	
	Option 1: Broad Definition							
18.9	**The definition of "distribution" for tax purposes should apply the accounting principle of distribution — "when value has been passed from the entity to the members".**	☐	☐	☒	☐	☐	☐	
18.12	**"Member" should include a person with an interest in either the income or capital of the entity.**	☐	☐	☒	☐	☐	☐	
18.12	**"Member" should specifically include the objects of discretionary trusts.**	☐	☐	☒	☐	☐	☐	
18.16	**"Services" should be defined to include the use of an entity's property or property that is controlled by the entity (with some exclusion for principal residence).**	☐	☐	☒	☐	☐	☐	
18.17	**Beneficiaries should be assessed on distributions made to them, not present entitlements.**	☐	☐	☒	☐	☐	☐	
18.19	**The forgiveness by an entity of a debt owed by a member should be a distribution as should offsetting liabilities.**	☐	☐	☒	☐	☐	☐	
18.20	**Non-commercial loans and finance to members should be distributions.**	☐	☐	☒	☐	☐	☐	
18.21	**Benefits provided by an associate of an entity on less than fair terms to members should be a distribution.**	☐	☐	☒	☐	☐	☐	
18.22	**Excess consideration over fair value given by an entity for goods and services provided to it by a member should be a distribution.**	☐	☐	☒	☐	☐	☐	
18.26	**The cost of providing a benefit which is treated as a distribution should not be deductible to the entity.**	☐	☐	☒	☐	☐	☐	
18.35	**In applying Option 1 to limited partnerships, a distribution would constitute the partner's total drawings for the year less any repayments of overdrawn amounts made during the year.**	☐	☐	☒	☐	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 18: DEFINING "DISTRIBUTION" IN AN ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Option 2: Broad Definition — Widely Held Entity Exclusions							
18.41	**Under this option, loans from closely held entities to members could be treated as follows:**							
	Option 1: **Extend current Division 7A treatment to cover all entities (para 18.41-43)**	☐	☐	☒	☐	☐	☐	
	Option 2: **Impose a Commercial loan exclusion (para 18.44-56)**	☐	☐	☒	☐	☐	☐	
	Option 3: Option 1 or Option 2 and FBT Mix							
18.65	**Where a member is not also an employee, the income tax provisions would take precedence over FBT provisions.**	☐	☐	☒	☐	☐	☐	
18.71	**Where a member is also an employee, apply current Division 7A methodology to determine whether income tax or FBT applies.**	☐	☐	☒	☐	☐	☐	
18.73	**Where the benefits provided are the use of an entity's assets, FBT only should apply to an employee and/or member.**	☐	☐	☒	☐	☐	☐	
	Treatment of Created Ownership Rights							
18.81	**A consistent treatment of shareholders should treat new shares received, as well as cash payments, as distributions.**	☐	☐	☐	☒	☐	☐	
18.85	**Where shareholders have a choice between a bonus share and a dividend, the bonus shares should be taxed as a distribution as for dividend reinvestment plans.**	☐	☒	☐	☐	☐	☐	**21**
18.86	**Valuation of ownership interests provided could be based on fair market value at the time of distribution.**	☐	☐	☐	☒	☐	☐	
18.86	**Alternatively, if choice between bonus share and dividend is given by a widely held entity, the value of the ownership interest would be the value of the profit distribution used.**	☐	☒	☐	☐	☐	☐	
18.87	**The extent of any assessable distribution arising from the creation or provision of ownership interests will depend on the entity's distributable profits.**	☐	☐	☐	☒	☐	☐	
18.90	**The rules above should not apply to traditional pro-rata bonus issues of shares.**	☐	☐	☐	☒	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph	CHAPTER 19: DISTINGUISHING PROFIT AND CAPITAL DISTRIBUTIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
19.6	**A "profits first" rule should apply in determining the source of funds distributed by an entity (other than distributions associated with the extinguishment of an ownership interest).**	☐	☐	☐	☐	☒	☐	**24-25**
19.9	**A "slice" rule should apply in determining the source of funds distributed by an entity upon the extinguishment of an ownership interest.**	☐	☐	☐	☐	☒	☐	**24-25, 32-34**
	Operation of a "Profits First" Rule							
19.12	**In determining the components of the "profits first" rule, an entity's "distributed profits" should be defined as the market value of its net assets less contributed capital at the time of distribution.**	☐	☐	☐	☐	☒	☐	**26**
19.13	**Most entities would be able to rely on book values in calculating distributable profits.**	☐	☐	☐	☐	☒	☐	**26-28**
	Determining Contributed Capital							
19.17	**Should the "contributed capital" of companies be determined by:**							
	Option 1: **Reference to existing tax laws that apply to share capital accounts (para 19.18-20)**	☐	☐	☐	☐	☒	☐	**28**
	Option 2: **The maintenance of a separate contributed capital account for tax purposes (para 19.21-26)**	☐	☐	☐	☐	☒	☐	**28**
19.22	**If Option 2 is adopted, do you agree with the suggested components of "contributed capital" for:**							
	- a company (para 19.22)	☐	☒	☐	☐	☐	☐	**28-29**
	- a non-testamentary trust established on/after the commencement date (para 19.35)	☐	☐	☒	☐	☐	☐	**28-29**
	- a testamentary trust established on/after the commencement date (para 19.37)	☐	☐	☒	☐	☐	☐	**28-29**
	- an existing trust (para 19.43)	☐	☒	☐	☐	☐	☐	**28-29**
	- a limited partnership established on/after date of commencement (para 19.52)	☐	☐	☒	☐	☐	☐	**28-29**
	- an existing limited partnership (para 19.54)	☐	☐	☒	☐	☐	☐	**28-29**
19.25	**In determining the contributed capital of a company, a three year grace period should be available to untaint the share capital account.**	☐	☒	☐	☐	☐	☐	**29**
19.48	**Where an existing trust has prior taxed income which will form part of contributed capital, the following options have been proposed:**							
	- include amount as contributed capital but separately identify	☐	☒	☐	☐	☐	☐	
	- allow that amount to be distributed as an exemption to the "profits first" rule within five years of commencement	☐	☐	☐	☒	☐	☐	
	- if not distributed within five years, lose its separate identity — increase relevant cost base	☐	☐	☐	☐	☒	☐	

Submitted By: Shaddick & Spence

Paragraph	CHAPTER 19: DISTINGUISHING PROFIT AND CAPITAL DISTRIBUTIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
19.50	**As an alternative to the treatment proposed in para 19.48, the prior taxed income could immediately be applied to adjust cost base.**	☐	☐	☒	☐	☐	☐	
19.57	**Should an exemption from the "profits first" rule operate for certain gains on pre-commencement trusts assets?**	☐	☒	☐	☐	☐	☐	
	Calculating the Components of the Slice Approach							
19.67	**The contributed capital component should be calculated by reference to the contributed capital of the entity attributable to the ownership interest that is extinguished.**	☐	☐	☐	☒	☐	☐	**29-30**
19.68	**An entity's franking account balance should be used to measure retained taxed profit.**	☐	☒	☐	☐	☐	☐	**30-31**
19.71	**The untaxed component of a distribution should be calculated as the residual of the distribution after determining the taxed profit and contributed capital components.**	☐	☒	☐	☐	☐	☐	
	Other Options/Issues:							
1.	**Additional difficulties created by the adoption of a separate tax "contributed capital account" (paragraphs 19.29-30).**							**31**
2.	**Application of the "slice approach" to a proportionate distribution of contributed capital (paragraphs 19.64-65).**							**31**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 20: PREVENTING DOUBLE TAXATION OF BUY-BACKS, REDEMPTIONS AND LIQUIDATIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Share Buy-Backs							
20.23	**Should *on-market share buy-backs* or equivalent distributions be taxed under:**							
	Option 1: **"Dividend treatment" (para 20.26-28)**	☐	☐	☐	☒	☐	☐	**37**
	Option 2: **"Capital gains tax treatment" (para 20.29-30)**	☐	☒	☐	☐	☐	☐	**37**
20.23	**Should *off-market share buy-backs* or equivalent distributions be taxed under:**							
	Option 1: **"Dividend treatment"**	☐	☒	☐	☐	☐	☐	**37**
	Option 2: **"Capital gains tax treatment"**	☐	☐	☐	☒	☐	☐	**37**
	Taxing the Untaxed Profit Component							
20.31	**Under either of the above options, the untaxed profit component of the distribution should be treated as:**							
	Option 1: **An unfranked profit distribution (para 20.31-33)**	☐	☒	☐	☐	☐	☐	
	Option 2: **A different capital gains tax treatment (para 20.34-37)**	☐	☐	☐	☒	☐	☐	
	Application of Dividend and CGT Treatment							
20.38	**The capital gains tax treatment (Option 2) would only be available to listed entities.**	☐	☒	☐	☐	☐	☐	
	Market Value Rule							
20.41	**Should a market value rule apply to off-market share buy-backs?**	☐	☒	☐	☐	☐	☐	
	Liquidations							
20.44	**Should liquidation or equivalent distributions be taxed under:**							
	- the "dividend treatment" option (para 20.44)	☐	☐	☐	☒	☐	☐	
	- the "modified slice" option (para 20.45-47)	☐	☒	☐	☐	☐	☐	
20.48	**The non-assessability of profits distributed by a liquidator which are sourced from pre-CGT assets in pre-CGT companies can be achieved for companies by treating them as consideration for the disposal of pre-CGT shares.**	☐	☐	☒	☐	☐	☐	
	Interim Distributions							
20.51	**Should interim dividend distributions be treated under:**							
	Option 1: **The "profits first" rule**	☐	☒	☐	☐	☐	☐	
	Option 2: **The modified "slice" approach**	☐	☐	☐	☒	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 20: PREVENTING DOUBLE TAXATION OF BUY-BACKS, REDEMPTIONS AND LIQUIDATIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
20.53	**Where an interim distribution consists in whole or part of contributed capital should be treated as:**							
	- consideration	☐	☐	☐	☒	☐	☐	
	- cost base reduction	☐	☒	☐	☐	☐	☐	
20.54	**An alternative to para 20-53 is to treat all contributed capital distributions made in the same income tax year as the dissolution of the company as disposal consideration and, contributed capital distributions made in prior income tax years as resulting in a cost base reduction.**	☐	☒	☐	☐	☐	☐	
20.58	**Should the appointment of a liquidator/receiver be treated as creating a trust for tax purposes?**	☐	☐	☒	☐	☐	☐	
20.58	**Should the liquidator/receiver be responsible for:**							
	- lodgement of the company (in liquidation) tax return	☐	☒	☐	☐	☐	☐	
	- payment of tax	☐	☒	☐	☐	☐	☐	
20.58	**Should two tax returns be lodged on behalf of a company in the year in which it is placed into liquidation (one by the directors up to the date of appointment of the liquidator for the balance of the year).**	☐	☐	☐	☒	☐	☐	
	Other Options/Issues:							
1.	**Comments in relation to example 20.1: potential for double taxation.**							**37**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 21: CONSISTENT TREATMENT OF ENTITY INCOME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
21.4	**Should all entities covered by the new entity tax system (ie. companies, trusts, limited partnerships, co-operatives, life insurers) be taxed in a manner consistent with companies?**	☐	☐	☐	☒	☐	☐	
21.5	**Should unincorporated associations continue to be treated as companies for taxation purposes?**	☐	☐	☒	☐	☐	☐	
	Aligning the Treatment of Losses							
21.8	**The taxation rules in relation to losses held in trusts and companies should be aligned towards the current company rules (ie. continuity of ownership and same business test).**	☐	☒	☐	☐	☐	☐	
21.12	**Common loss measures should apply to all closely held or widely held entities subject to the new entity tax system.**	☐	☐	☒	☐	☐	☐	
21.15	**As a transitional arrangement, the new loss measures should apply to all prior year losses existing from the start date of the new regime, regardless of when incurred.**	☐	☒	☐	☐	☐	☐	
	Concessions							
21.16	**Should entities subject to the entity tax system have equal access to tax concessions?**	☐	☒	☐	☐	☐	☐	
21.16	**Should specific entity tax concessions be available?**	☐	☐	☐	☒	☐	☐	
	Classifying Entities for Tax Purposes							
21.20	**For taxation purposes, entities should be classified using the following distinction:**							
	Option 1: **Public/private distinction (para 21.24-25)**	☐	☐	☐	☒	☐	☐	
	Option 2: **Closely held/widely held distinction (para 21.26-30)**	☐	☒	☐	☐	☐	☐	
	Option 3: **Corporations law distinctions (para 21.31-34)**	☐	☐	☐	☒	☐	☐	
21.25	**Should all limited partnership be treated as private companies?**	☐	☐	☒	☐	☐	☐	
21.30	**If classification Option 2 were adopted, widely held status should be extended to certain entities (eg. subsidiaries of a widely held entity) which would otherwise be treated as closely held.**	☒	☐	☐	☐	☐	☐	
21.30	**Non-profit entities should be treated as widely held.**	☐	☒	☐	☐	☐	☐	
	Liability Issues							
21.37	**Should all parties to an arrangement which resulted in an entity's inability to pay tax be liable?**	☐	☒	☐	☐	☐	☐	
21.42	**Beneficiaries and trustees should be able to determine which assets should bear the economic burden of tax paid by the trustee in accordance with trust law.**	☐	☒	☐	☐	☐	☐	
	What rules should apply when an entity moves between different taxation regimes? [Added Question]	☐	☐	☐	☐	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 21: CONSISTENT TREATMENT OF ENTITY INCOME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 22: BRINGING TRUSTS INTO THE NEW ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
22.2	**The following types of trusts should be excluded from the new entity taxation regime:** **- trusts which have been created or settled only as a legal requirement or subject to a legal test or sanction ("excluded trusts")**	☒	☐	☐	☐	☐	☐	
	- trusts where beneficiaries are "absolutely entitled" to the trust property and trustee has no interest or duty in relation to that property (para 22.3)	☒	☐	☐	☐	☐	☐	
	- constructive trusts (para 22.3)	☒	☐	☐	☐	☐	☐	
22.4	**Excluded trusts should be taxed under a modified Division 6 regime.**	☐	☒	☐	☐	☐	☐	
22.8	**The trust relationship should be ignored in relation to trusts where the beneficiaries are absolutely entitled to the income and capital from the creation of the trusts.**	☒	☐	☐	☐	☐	☐	
22.13	**Entity taxation should apply to a trust arising from a stakeholder relationship.**	☐	☐	☐	☒	☐	☐	
22.14	**If entity taxation is applied to a trust arising from a stakeholder relationship, it should only apply if the relationship extends beyond a specified period of time.**	☐	☐	☐	☒	☐	☐	
22.20	**Constructive trusts should be taxed on the basis of a "look-through" to the trustee.**	☒	☐	☐	☐	☐	☐	
	Trust Distributions to Minors							
22.25	**Should Division 6AA continue to apply to trust distributions to minors?**	☐	☐	☒	☐	☐	☐	
22.29	**Should child maintenance trust be subject to the entity tax regime?**	☐	☐	☒	☐	☐	☐	
	Some Specific Trust Issues							
22.32	**Multiple purpose trusts should be split into components for taxation purposes.**	☐	☐	☐	☒	☐	☐	
22.34	**The current trust loss definitions of fixed trusts and non-fixed trust should be adopted for the new entity taxation system.**	☐	☐	☐	☒	☐	☐	
22.38	**A rebuttable presumption should exist that subsequent settlements of trusts are intended to be additions to existing trusts rather than the creation of a new trust.**	☐	☒	☐	☐	☐	☐	
	Entitlements to Unpaid Income or Capital							
22.40	**A beneficiary's entitlement to unpaid income or capital of a trust should be treated as:** *Option 1:* **A rebuttable presumption that money (or property) that represents the unpaid distribution would remain an asset of the original trust (para 22.41-42)**	☐	☒	☐	☐	☐	☐	
	Option 2: **A distribution and loan back (para 22.43-44)**	☐	☐	☐	☒	☐	☐	
	Creation or Winding-Up of a Trust							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 22: BRINGING TRUSTS INTO THE NEW ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
22.51	**In determining the timing of a resettlement of a trust for taxation purposes, should the approach be:**							
	Option 1: **Define the concept of resettlement for taxation purposes (ie. when there has been a substantial alteration in the interest of exiting or potential beneficiaries) (para 22.51-53)**	☐	☒	☐	☐	☐	☐	
	Option 2: **Ignore the resettlement and apply value shifting rules (para 22.54-55)**	☐	☐	☐	☒	☐	☐	
	Primary Producer Arrangements							
22.58	**Distributions from existing and future trusts should continue to attract:**							
	- the primary producer averaging provisions	☐	☐	☒	☐	☐	☐	
	- the farm management deposit arrangements	☐	☐	☒	☐	☐	☐	
	Cost Base Issues							
22.69	**An in-kind distribution from a trust to a beneficiary should be treated in the same way as an in-kind distribution by a company to a shareholder.**	☐	☒	☐	☐	☐	☐	
22.73	**Under the proposed entity taxation regime, an interest in a trust would be treated in the same way as an interest in a company.**	☐	☒	☐	☐	☐	☐	
22.74	**Under the new entity taxation system, a person who is the beneficiary of a discretionary trust would have a nil cost base in respect of their interest.**	☐	☐	☐	☒	☐	☐	
	Deceased Estates and Testamentary Trusts							
22.87	**The transfer of an asset by a LPR (previously owned by a deceased person) directly to a beneficiary that is not a natural person should constitute a realisation of that asset for taxation purposes, with the beneficiary deemed to acquire the asset for market value.**	☐	☐	☒	☐	☐	☐	
22.87	**An exception to this rule above would arise in relation to the transfer of an asset to a trust established by the will of the deceased person, provided the property is held on trust for the benefit of a natural person.**	☐	☐	☒	☐	☐	☐	
22.89	**The following options have been proposed for the transfer of assets by testamentary trusts to beneficiaries:**							
	Option 1: **The transfer be treated as a realisation (para 28.90-91)**	☐	☐	☒	☐	☐	☐	
	Option 2: **The transfer be treated in the same way as distributions by a LPR (para 22.92-93)**	☐	☐	☒	☐	☐	☐	
22.99	**In the context of the transfer of a deceased persons principle residence by an LPR to a testamentary trust, CGT relief should be available when the residence is ultimately transferred to a beneficiary under:**							
	Option 1: **Adopt the LPR rules (para 22.99)**	☐	☐	☒	☐	☐	☐	
	Option 2: **Give a higher cost base to the trustee (para 22.100)**	☐	☐	☒	☐	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 22: BRINGING TRUSTS INTO THE NEW ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 23: BRINGING ALL CO-OPERATIVES INTO THE NEW ENTITY REGIME	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
23.9	**All co-operatives should be taxed like companies under the new entity regime.**	☐	☐	☒	☐	☐	☐	
23.20	**If rebates or bonuses are provided by a co-operative solely due to capacity as a member/shareholder, rather than by reference to business activities, amount would be treated as a distribution of profits.**	☐	☐	☒	☐	☐	☐	
23.22	**If the rebate or bonus is calculated by reference to the members actual activities with the tax co-operative and is on a "commercial basis", amount would not be treated as a distribution of profits.**	☐	☐	☒	☐	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 24: ANTI-AVOIDANCE PROVISIONS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
24.24	**Are specific anti-avoidance provisions required in the following circumstances, despite the existence of a "robust general anti-avoidance" rule?**							
	- decisions to invest in debt/equity	☐	☐	☐	☐	☒	☐	
	- non-arm's length asset transfers	☐	☐	☐	☒	☐	☐	
	- transfer of entity losses	☐	☒	☐	☐	☐	☐	
	- unfranked dividend streaming, assumed deferred company tax is not adopted	☐	☒	☐	☐	☐	☐	
	- franking credit trading	☐	☒	☐	☐	☐	☐	
	- dividend stripping	☐	☒	☐	☐	☐	☐	
	- dividend substitution	☐	☒	☐	☐	☐	☐	
	- capital streaming	☐	☒	☐	☐	☐	☐	
	- capitalisation of profits	☐	☒	☐	☐	☐	☐	
	- substituting interest for dividends on redeemable preference shares	☐	☒	☐	☐	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 25: A CASE FOR CONSOLIDATION	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	A consolidated tax regime should be introduced in Australia. [Added Question] Other Options/Issues:	☐	☒	☐	☐	☐	☐	**48-51**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 26: A FRAMEWORK FOR CONSOLIDATION	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Principle 1: Consolidation Optional and to include all Australian wholly-owned entities in group							
26.3	**Consolidation should be optional.**	☒	☐	☐	☐	☐	☐	
26.3	**A head Australian holding company should be a requirement for consolidation.**	☐	☐	☐	☐	☒	☐	**55-61**
26.6	**Minor shareholdings on the following grounds should preclude consolidation:**							
	- employee share ownership	☐	☐	☐	☐	☒	☐	**62**
	- special purpose finance shares	☐	☐	☐	☒	☐	☐	**62**
	- non-voting preference shares	☐	☐	☐	☒	☐	☐	**62**
	Application of Principle 1 to Trusts:							
26.8 - 26.9	**Where the only objects of a discretionary or hybrid trust are members of a consolidated group, the trust should be included on this basis.**	☐	☒	☐	☐	☐	☐	
26.11	**If a member of a consolidated group is an object of a discretionary trust and the consolidated group controls the trust, the trust should be included in the consolidating group.**	☐	☒	☐	☐	☐	☐	
26.13	**A hybrid trust should be included in a consolidated group if the group members hold all fixed entitlements and, at least one member is discretionary object of hybrid trust and the group controls the trust.**	☐	☒	☐	☐	☐	☐	
26.14	**The following "tiebreaker rule" would be preferable in case of discretionary trusts:**							
	- share of distributions	☐	☐	☐	☒	☐	☐	
	- election	☒	☐	☐	☐	☐	☐	
26.17	**If a discretionary or hybrid trust heads a consolidated group, should distributions by any other trust within the group to a non-group member be subject to penalty tax?**	☐	☐	☐	☒	☐	☐	
26.20	**In order to preserve the tax free status of goodwill exempt profits in a consolidated group that comprises trusts and companies, companies pre-consolidation goodwill assets should be tagged to prevent tax free status applying.**	☐	☐	☒	☐	☐	☐	
26.22	**Groups of family trusts and companies should be consolidated:**							
	- under general regime	☐	☐	☐	☒	☐	☐	
	- under a special optional regime	☒	☐	☐	☐	☐	☐	
26.38	**Once a group elects to consolidate, the election is irrevocable.**	☐	☒	☐	☐	☐	☐	
26.43	**Members of a consolidated group should lose their separate tax identity on entry to the consolidation regime.**	☒	☐	☐	☐	☐	☐	**62**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 26: A FRAMEWORK FOR CONSOLIDATION	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
26.48	**A regime of capital gains tax grouping provisions should exist outside consolidation:**							
	- resident entities	☐	☐	☐	☒	☐	☐	**62**
	- non-resident entities	☒	☐	☐	☐	☐	☐	**62**
	- resident entities with non-resident parent	☒	☐	☐	☐	☐	☐	**62**
26.48	**A regime of loss grouping provisions should exist outside consolidation:**							
	- resident entities	☐	☐	☐	☒	☐	☐	**62**
	- non-resident entities	☒	☐	☐	☐	☐	☐	**62**
	- resident entities with non-resident parent	☒	☐	☐	☐	☐	☐	**62**
26.52	**Should CGT roll-over relief continue to be available to controlled foreign companies?**	☒	☐	☐	☐	☐	☐	
	Principle 3: Repeal of Current Grouping Provisions							
26.68	**Once the consolidation regime commences, the current grouping provisions would be repealed, excepting non-concessional elements.**	☐	☒	☐	☐	☐	☐	
	Principle 4: Bringing losses and franking account balances into consolidated group.							
26.86	**The following options have been proposed regarding pre-consolidation losses:**							
	Option 1: **Do not allow losses into group apart from 2 limited transitional cases (para 26.90-91)**	☐	☒	☐	☐	☐	☐	**62-64**
	Option 2: **Allow carry-forward losses in subject to a modified same business test (para 26.92-95)**	☐	☐	☐	☐	☒	☐	
	Option 3: **Option 2 test with additional time usage limitation (para 26.96)**	☐	☐	☐	☐	☒	☐	
	Option 4: **Allow a specific proportion of loss to be brought into consolidated group(para 26.97)**	☐	☐	☐	☐	☒	☐	
	Option 5: **Quarantine losses within the loss entity for use while in consolidated group (para 26.98)**	☒	☐	☐	☐	☐	☐	**62-64**
	Option 6: **Leave loss entities outside group (para 26.99)**	☐	☒	☐	☐	☐	☐	**62-64**
	Principle 5: Losses and franking credits on exit							
26.103 - 104	**Should entities leaving a consolidated group be entitled to take with them:**							
	- Pre-consolidation losses	☐	☐	☒	☐	☐	☐	
	- Pre-consolidation franking credits	☐	☐	☒	☐	☐	☐	
	- Pre-consolidation foreign tax credits	☐	☐	☒	☐	☐	☐	
	- Pre-consolidation foreign dividend account credits	☐	☐	☒	☐	☐	☐	

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 26: A FRAMEWORK FOR CONSOLIDATION	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Other Options/Issues:							
1.	**The timing of entry into and exit from the consolidated group.**							**64**
2.	**Joint and several liabilities of entities exiting the consolidated group.**							**64-65**
3.	**Changing nature of assets transferred within a consolidated group.**							**65**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 27: DETERMINING THE COST BASE FOR DISPOSAL OF EQITY	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
27.5	**The following two methods have been proposed to determine the cost base for disposal of equity:**							
	- entity based model	☐	☐	☐	☒	☐	☐	**67**
	- asset based model	☐	☒	☐	☐	☐	☐	**67**
27.32	**If the asset based model is adopted the following, which transitional valuation methodology would be preferable:**							
	- reasonable alignment	☐	☒	☐	☐	☐	☐	
	- entity based methodology	☐	☐	☐	☒	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 28: TOWARDS SINGLE RECOGNITION OF LOSSES AND GAINS (OUTSIDE CONSOLIDATION)	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Preventing loss cascading							
28.19	**The current compulsory CGT roll-over rules should be extended to cover asset disposals within the same majority-owned group of entities.**	☐	☐	☐	☐	☒	☐	
	Preventing realised loss duplication							
28.21	**The continuity of ownership test should be amended to require each owner existing at the relevant loss recoupment and loss incurrence time to hold more than 50% ownership.**	☐	☒	☐	☐	☐	☐	
28.22	**The same business test should be removed to prevent carry-forward of realised tax losses when entity is sold.**	☐	☐	☐	☐	☒	☐	
	Preventing unrealised loss duplication							
28.24	**Measures are necessary to prevent the duplication of unrealised capital losses on a majority change in ownership.**	☐	☐	☐	☐	☒	☐	
28.28	**If anti-capital loss duplication measures are introduced, the <u>Canadian</u>-based approach should be adopted.**	☐	☒	☐	☐	☐	☐	
28.33	**If anti-capital loss duplication measures are introduced, the <u>United Kingdom</u> approach should be adopted.**	☐	☐	☐	☐	☒	☐	
	Preventing the duplication of unrealised and realised gains							
28.37	**A capital loss should be allowed to new equity owners resulting from the distribution of realised and unrealised gains in order to prevent the duplication of unrealised and realised gains.**	☐	☒	☐	☐	☐	☐	
	Realised loss/gain duplication: Majority Ownership							
28.40	**The following models would be preferable in preventing the duplication of realised gains and losses in majority ownership changes:**							
	- asset based model	☐	☒	☐	☐	☐	☐	
	- entity based model	☐	☐	☐	☒	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 29: TOWARDS A SYNTHETIC SOLUTION TO CGT VALUE SHIFTING (OUTSIDE CONSOLIDATION)	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
29.23	**The conceptual objective for value-shifting measures is to treat the transfer of value from one asset to another as if the transfer had not occurred, but without a taxing point.**	☐	☐	☒	☐	☐	☐	
	Generalised CGT value shifting rules							
29.26	**"Control" is an appropriate level of connection for the purposes of proposed generalised value shifting rules.**	☒	☐	☐	☐	☐	☐	
29.27	**It is appropriate to exclude non-associated minority interests where value is shifted, even if they have participated/consented.**	☐	☒	☐	☐	☐	☐	
	Value shifting at the direct (asset) level							
29.41	**Value shifting should be addressed at the indirect (interest in entity) level as follows:**							
	Option 1: **Achieve conceptual objective (para 29.42)**	☐	☐	☐	☐	☐	☐	
	Option 2: **Proportional adjustment approach (para 29.43)**	☐	☐	☐	☐	☐	☐	
	Option 3: **Loss-focused approach (para 29.44-46)**	☐	☐	☐	☐	☐	☐	
	Other Options/Issues:							
1.	**29.33 - Bases should be adjusted where value is shifted from post to pre '85 assets.**							
2.	**29.33 - Special adjustment rules should apply where value is shifted from loss assets.**							
3.	**29.51 - "Market value" criteria should not require "greater benchmarking".**							
4.								
5.	**29.53 - "Safeharbour" exemptions should be included.**							
6.	**29.54 - Realistic de-minimus exemptions are required.**							
	29.55 - We broadly agree with the proposed "Generalised" value shifting model.							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 30: INVESTMENT IN AUSTRALIA BY NON-RESIDENTS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Levying Australian tax on non-residents investing in Australian entities							
30.14	*Option 1:* **Under Deferred Company Tax model, all dividends should be franked and therefore no withholding tax required.**	☐	☒	☐	☐	☐	☐	**73**
30.16	*Option 2:* **Adopt switch by refunding some company tax (NRITC) and simultaneously impose an identical amount of withholding tax.**	☐	☐	☐	☐	☒	☐	**73-74**
	Taxing non-residents investing in Australian CIV's							
30.38	*Option 1:* **Permit Non-Resident Investment Funds (NRIF's) to operate as flow-through Collective Investment Vehicles (CIV's) (like existing unit trusts) solely for non-resident investors.**	☐	☐	☒	☐	☐	☐	
30.44	*Option 2:* **Permit all widely-held CIV's to operate on a flow-through basis.**	☐	☒	☐	☐	☐	☐	
	Taxing profits remitted by foreign branches							
30.50	**Should branch remittances of "unfranked" income be subject to deferred company tax?**	☐	☐	☐	☒	☐	☐	**74**
30.55	**If the Resident Dividend Withholding Tax (RDWT) model is chosen in preference to Deferred Company Tax, equivalence would require the imposition of non-resident Dividend Withholding Tax on "unfranked" <u>branch</u> profits.**	☐	☐	☐	☒	☐	☐	
	What tax rate should apply to non-residents?							
30.61	**Non-resident individuals should be subject to a flat rate of Australian tax, not progressive rates.**	☐	☒	☐	☐	☐	☐	
30.61	**If a flat rate is adopted, it should not apply to personal services income which should continue to be subject to progressive rates.**	☐	☐	☐	☒	☐	☐	
30.62	**If a flat rate is adopted it should be:**							
	- Corporate rate applied to <u>net</u> Australian income?	☐	☒	☐	☐	☐	☐	
	- A lower rate applied to <u>gross</u> Australian income?	☐	☐	☐	☒	☐	☐	
	How should non-residents tax be collected?							
30.67	**Extend withholding tax system to (e.g.) rents, gains and service income.**	☐	☐	☐	☒	☐	☐	
	Taxation of non-resident indirect asset transfers							
30.75	**Deem realisation by immediate offshore entity of gain based on market value of Australian asset, proportionate to level of controller interest disposed.**	☐	☐	☐	☐	☒	☐	**75**

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 30: INVESTMENT IN AUSTRALIA BY NON-RESIDENTS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
30.77	**For indirect transfers of underlying Australian assets, deem rule proposed in 30.75, if adopted, should be limited to situations where the actual disposed asset derives a "substantial proportion" of its value from underlying Australian assets.**	☐	☒	☐	☐	☐	☐	**75**
30.78	**Collection of tax would be from immediate offshore entity unless the actual disposer consents to be assessed and provides security for payment.**	☐	☐	☐	☒	☐	☐	
	Other Options/Issues:							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 31: CONDUIT INVESTMENT THROUGH AUSTRALIA	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Providing conduit treatment for CIV's investing for non residents							
31.14	**A general "flow-through" approach should be taken for all Collective Investment Vehicles (like current unit trusts).**	☐	☒	☐	☐	☐	☐	**78**
31.17	**A special Non-Resident Investment Fund (NRIF) status should be established exclusively for non-resident investors with "flow through" approach.**	☐	☐	☒	☐	☐	☐	
31.18	**OBU Offshore Investment Trusts would become a subset of NRIF with management income taxed at 10% (provided Australian investments are less than 10% of the fund assets).**	☐	☐	☒	☐	☐	☐	
	Taxing conduit income derived by residents							
31.22	**The current Foreign Dividend Account (FDA) concept should be extended to other foreign income ("FIA").**	☒	☐	☐	☐	☐	☐	**78**
31.23	**All foreign income passing to non-resident investors should be exempt from Australian tax in the hands of resident conduit entity.**	☐	☒	☐	☐	☐	☐	**78**
31.23	**All foreign income which has been subject to tax in a "listed" foreign country should be exempt from Australian tax in the hands of a resident conduit entity.**	☐	☒	☐	☐	☐	☐	**78**
31.24	**Foreign income which has not been subject to tax in a "listed" foreign country should be subject to "top up" tax in the hands of a resident conduit entity.**	☐	☐	☐	☒	☐	☐	**78**
	Operation of Foreign Investment Account							
31.25	**All foreign income which is creditable to an FIA should be credited, irrespective of the degree of foreign ownership of the resident conduit entity at the time of derivation.**	☒	☐	☐	☐	☐	☐	**79**
31.27	**The credit to the FIA account should be limited to the proportionate share of resident conduit entity which is owned by non-residents at the time of derivation.**	☐	☐	☐	☐	☒	☐	**79**
31.28	**The FIA account should be maintained on an equivalent basis to a franking account, i.e. on a tax-paid basis.**							
	- Deemed Australian tax paid (para. 31.29)	☐	☒	☐	☐	☐	☐	**79**
	- Foreign tax paid (para 31.30 - 31.31)	☐	☐	☐	☒	☐	☐	**79**
31.32	**A single FIA should be maintained for each consolidated company group.**	☐	☒	☐	☐	☐	☐	
31.33	**FIA credits should be able to pass to other resident companies even where less than 100% ownership of the foreign income recipient is held:**							
	- Provided at least 10% of foreign income recipient is held	☐	☒	☐	☐	☐	☐	**79-80**
	- Provided the other resident company is wholly-owned by a single non-resident shareholder	☐	☐	☐	☐	☒	☐	**79-80**
	Treatment of Franking Credits for residents investing in Australia through a non-resident							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 31: CONDUIT INVESTMENT THROUGH AUSTRALIA	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
31.36	**The administrative and legislative burden of providing franking credits to Australian residents having interests in Australian companies <u>via overseas companies</u> is too great to justify such relief.**	☐	☐	☒	☐	☐	☐	
31.37	**Under a full franking regime, relief should be offered by providing Australian shareholders with franking credits equal to combined proportion of both the Australian income and the distributable profits of the overseas company and the extent of the Australian resident's interest in the overseas company. This would be done by direct certification from the Australian subsidiary to its (indirect) Australian owners.**	☐	☐	☒	☐	☐	☐	
31.40	**Relief addressed under 31.37 should be considered as negotiable tax treaty material.**	☐	☐	☒	☐	☐	☐	
	Other Options/Issues:							
1.	**As an additional note to paragraph 31.23, thought should be given to allowing the streaming of foreign dividends direct to foreign shareholders as recommended in the Industries Commission Report.**							

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 32: FOREIGN SOURCE INCOME OF RESIDENTS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Should foreign tax credits flow through entities to resident taxpayers?							
32.34	*Option 1:* **Collective Investment Vehicles (CIV's) should be excluded from entity taxation and current flow through treatment preserved:**							
	- Resident CIV's only	☐	☐	☐	☒	☐	☐	
	- Resident and foreign CIV's (para 32.45)	☐	☒	☐	☐	☐	☐	
32.35	*Option 2:* **Franking credits should be available for overseas withholding tax on dividends received from foreign countries by resident entities:**							
	- Generally	☒	☐	☐	☐	☐	☐	83
	- Only from Treaty Countries	☐	☐	☐	☒	☐	☐	83
	- Full refund to shareholders (para 32.39)	☒	☐	☐	☐	☐	☐	83
	- Including exempt foreign dividends (para 32.44)	☒	☐	☐	☐	☐	☐	83
	How could active business exemption problems be addressed?							
32.45	*Option 1:* **Extend Foreign Investment Fund (FIF) measures to all FIF's by removing exemption for "eligible activities" (active business).**	☐	☐	☐	☐	☒	☐	83
32.47	*Option 2:* **Replace the FIF active business exception with:**							
	- A CFC-type active income exemption for non-portfolio investors	☐	☐	☐	☐	☒	☐	83
	- A listed country FIF exemption for portfolio investors	☒	☐	☐	☐	☐	☐	83
	- A listed entity FIF exemption for portfolio investors, restricted to listed countries with effective anti-tax-deferral regimes	☐	☐	☐	☐	☒	☐	83
	- A Listed country FIF exemption for portfolio investors for any FIF "carrying on business" in a listed country	☐	☐	☐	☐	☒	☐	83
	How could anti-deferral rules for foreign trusts be improved?							
32.55	**Retain the FIF active business exemption and extend its application to widely-held trusts that are FIFs.**	☐	☒	☐	☐	☐	☐	84
32.47	**Retain 5% Balanced Portfolio exemption from FIF regime and consider increasing de minimus threshold to more than 5%.**	☐	☒	☐	☐	☐	☐	84
32.54	**Remove deemed present entitlement rules for foreign trusts (Section 96B); and (para 32.58) extend FIF rules to interests in closely held fixed trusts.**	☐	☐	☐	☒	☐	☐	84
32.59	**Remove "market value" method for trust FIFs other than widely-held fixed trusts.**	☐	☒	☐	☐	☐	☐	84

	How should the transferor trust measures be improved?							
32.66	**Remove exemptions from the transferor trust measures.**	☐	☐	☐	☐	☒	☐	84
32.70	**Adopt stringent rules for hidden foreign trusts.**	☐	☐	☒	☐	☐	☐	84

Submitted By: Shaddick & Spence

Paragraph Number	CHAPTER 32: FOREIGN SOURCE INCOME OF RESIDENTS	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Other Options/Issues:							
1.	**The FIF rules should be amended so that attributed income which does not subsequently materialise is treated as an allowable deduction when the FIF interest is disposed, not as a reduction of capital gain nor as an increase in capital loss.**							

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Paragraph Number	CHAPTER 33: ALLOCATING WORLDWIDE INCOME BETWEEN COUNTRIES	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
	Should legislative Source Rules be enacted?							
33.7	**Legislative source rules should be enacted.**							
	- As "fuzzy" law, stressing substance over form (para 33.12)	☐	☒	☐	☐	☐	☐	**87**
	- As black law:							
	based on treaty concepts (para 33.15)	☐	☐	☐	☒	☐	☐	**87**
	independent of treaty concepts (para 33.16)	☐	☒	☐	☐	☐	☐	**87**
33.19	**If a country taxes current income from an asset, it would also be expected that the country should also have the right to tax profits accruing from realisation of the asset (source rule proposed for capital gains).**	☐	☐	☐	☒	☐	☐	**87**
	Deductibility of Interest for offshore investments							
33.28	**Interest expense of residents should be allocated to non-portfolio foreign investments on a basis other than tracing, e.g.**							
	- A fixed gearing ratio (para 33.28)	☐	☐	☐	☐	☒	☐	**88**
	- A group-wide gearing ratio (para 33.29)	☐	☐	☐	☒	☐	☐	**88**
	- An arm's length test (para 33.29)	☐	☐	☐	☒	☐	☐	**88**
33.36	*Option 1:* **Australia's 2:1 Thin Capitalisation ratio should be replaced with a ratio equal to the international group's gearing ratio, subject to arm's length considerations.**	☐	☐	☐	☒	☐	☐	
33.37	*Option 2:* **Australia should retain a fixed gearing ratio for thin capitalisation purposes as a "safe harbour" rule, with possible extra relief up to the international group's gearing ratio.**	☐	☒	☐	☐	☐	☐	
33.38	**As part of Option 2 above, the 15% "foreign controller" threshold should be increased, and the debt creation rules should be removed.**	☐	☒	☐	☐	☐	☐	
33.39	**The Thin Capitalisation rules (for inbound investment) and the interest allocation rules (for outbound investment) should be generally consistent.**	☐	☐	☒	☐	☐	☐	
	Improvements to transfer pricing rules							
33.44	**Incorporate the transfer pricing rules into the self-assessment regime.**	☐	☒	☐	☐	☐	☐	
33.45	**Additional transfer pricing rules for:**							
	- arm's length details	☐	☐	☐	☒	☐	☐	
	- overlap removal	☐	☒	☐	☐	☐	☐	
	- penalty streamlining	☐	☒	☐	☐	☐	☐	
	- documentation and record keeping	☐	☐	☐	☒	☐	☐	

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Paragraph Number	CHAPTER 33: ALLOCATING WORLDWIDE INCOME BETWEEN COUNTRIES	Strongly Agree	Agree	Indifferent	Disagree	Strongly Disagree	Costed in Chapter 39	Submission Page Ref.
33.46	**Corresponding relief rules (see transfer pricing adjustments) need to be made more comprehensive.**	☐	☒	☐	☐	☐	☐	
33.46	**Transfer pricing dispute resolution processes should be improved.**	☐	☐	☐	☒	☐	☐	
	How should branches taxable income be determined?							
33.53	**Should the taxable income of a branch be calculated as if it were a separate entity?**	☐	☒	☐	☐	☐	☐	
33.56	**Should separate entity treatment of branches include withholding taxes?**	☐	☐	☐	☒	☐	☐	
	Improvements to record-keeping & substantiation							
33.60	**Should Australia adopt U.S. style record keeping requirements (IRC s 6038A)?**	☐	☐	☐	☐	☒	☐	**88**
33.61	**Should an Australian taxpayer who has inadequate documentation be denied a "reasonably arguable position"?**	☐	☐	☐	☐	☒	☐	**89**
33.63	**Should payments to tax havens be non-deductible if certain information is not made available to the Australian Taxation Office?**	☐	☐	☐	☐	☒	☐	
	Other Options/Issues:							

Checklist of Options Chpts 15-24 : TRW