



AUSTRALIAN BANKERS' ASSOCIATION

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The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Sir

A Platform for Consultation

The Australian Bankers' Association continues to support the reform of Australia's taxation system, including the reform of business taxation. We would like to take this opportunity to provide some initial comments on the review's second discussion paper "*A Platform for Consultation*". We will provide more detailed views in a subsequent submission.

As was acknowledged in the first discussion paper "*A Strong Foundation*", the overriding objective of the review must be to position Australia to compete internationally in the next century. This objective has two components. The first is to provide a taxation system that allows Australian business to compete internationally. The second is to provide a taxation regime that allows Australia to attract business and investment from offshore. These points are particularly relevant to the development of Australia as a regional financial centre.

The ABA supports the following options from those presented in *A Platform for Consultation*. However, it is important to note the linkages between the various options. If the review takes a different course on major issues, ABA's support for the package of measures below should not be viewed as support for individual components.

Reduction in the Corporate Tax Rate

A reduction in the corporate tax rate from 36% to 30% funded by the removal of accelerated depreciation is supported. We do not believe that the case for the retention of accelerated depreciation has been made. Accelerated depreciation clearly favours



capital intensive industries over service industries. These same capital intensive industries have been big beneficiaries from the reform of indirect taxes and the introduction of a GST. The service sector will be subject to a significant increase in tax following the introduction of a GST which will result in higher consumer prices and, consequently, reduced demand; Econtech has projected long run decreases in production for sectors such as Accommodation, Cafes & Restaurants, Cultural & Recreational Services, Personal & Other Services. Some re-balancing is necessary via the trade-off between accelerated depreciation and the corporate tax rate. The reform of business taxation cannot be considered in isolation from the broader tax reform package; it is one component of the broader package.

A reduction in the corporate tax rate will assist the Australian service sector to compete internationally and is also extremely important in attracting offshore businesses to Australia that are seeking to establish a presence in our region. A low corporate tax rate is particularly important to achieving Australia's aim of developing as a regional financial centre. Australia's headline tax rate needs to be competitive with our neighbours and in particular with Singapore and Hong Kong, which are direct competitors for financial centre business.

Deferred Company Tax and Taxation of International Income

The introduction of Deferred Company Tax (DCT) is supported if, and only if, there is a significant improvement in the treatment of foreign earnings flowing to foreign shareholders. Conceptually, DCT would be 'ring fencing' Australian source and resident income and then subjecting it all to a consistent entity tax rate of 30%, which is then fully creditable in Australian shareholders' hands – and possibly also partly, if not fully, creditable offshore for non-residents. However, streaming of foreign earnings to foreign shareholders in comparably taxed countries should be allowed without any Australian tax consequences. The only relevant tax impacts on these earnings would be dictated by the various overseas tax regimes internal dividend rules and bilateral dividend rules. This approach is entirely consistent with that set out in *A New Tax System* and *A Platform for Consultation* and indeed puts meaning into paragraph 31.10 on page 654 of the latter.

In this environment DCT could achieve its intended purpose of taxing preferences and all other non-taxed income earned in Australia and received by Australian residents. At the same time the unintentional consequence (also partly prevalent under the existing imputation system) of double taxing and penalising foreign earnings paid to foreign investors would be overcome. If confined to comparably taxed countries, it provides a simple, certain and transparent method to remove the unintended penalty on foreign expansion of earnings and investors, without any major Australian revenue threat.

Within this context the definition of foreign source income is important and the industry supports the inclusion of the earnings of both offshore branches and offshore banking units within this definition.

However, if arrangements for streaming foreign source income to not resident shareholders are not accepted, ABA opposes deferred company tax and would prefer to see either of the alternative options of imposing a Resident Dividend Withholding Tax



or taxing unfranked inter-entity distributions be adopted.

We support the proposal that resident shareholders should be entitled to a refund of excess imputation credits.

Taxation of Financial Assets and Liabilities

The introduction of the taxation of financial arrangements is supported subject to the recognition of internal hedging and the inclusion of an option to use foreign currency retranslation. These two issues were included in the 1996 issues paper “*Taxation of Financial Arrangements*” issued by the Australian Tax Office and Federal Treasury. There has been no adequate explanation by the Review of Business Tax Secretariat of the reason for the exclusion of these issues in *A Platform for Consultation*. We are extremely concerned by their exclusion and would be pleased to continue discussions to resolve these issues. We are also concerned by the numerous and complex anti-avoidance measures which permeate the proposals. The proposal to quarantine losses on financial arrangements is also opposed. The introduction of a taxation system that adequately addresses the difficulties with taxing financial arrangements is another component of developing Australia as a regional financial centre.

Taxation of Leases

The proposals in respect of the taxation of leases are not supported. These measures are primarily directed at controlling the transfer of tax preferences, which can be delivered through leasing. The vast majority of leases are provided as a simple, easily understood method for small businesses to finance their asset purchases; it has nothing to do with the transfer of tax preferences. The leasing proposals included in *A Platform for Consultation* would add significant complexity to both small business and financiers. Most significantly, the proposals are largely unnecessary if accelerated depreciation is removed and deferred company tax is introduced. The leasing proposals will not simplify the tax system.

Taxation of Entities

The proposal to tax a broader range of entities similar to companies is supported subject to differential treatment of collective investment vehicles where we support the concept of ‘flow through’. The definition of collective investment vehicle needs to cover all public unit trusts. Whilst a wide distribution test is satisfactory, the definition also needs to cover wholesale trusts which have only public unit trusts as beneficiaries; ie. the definition needs to look through the particular trust to determine the distribution of the ultimate beneficiaries. Our views on the appropriate methods of treating distributions will be included in our more detailed submission.

Taxation of Entity Groups

We believe the consolidation regime should be truly optional; ie. the current arrangements should remain in place and entity groups should have the capacity to opt into a consolidation regime. The potential compliance costs of a consolidation regime will only become apparent once the options set out in *A Platform for Consultation* are



converted into a coherent policy and legislation. Given the U.S. experience with consolidated tax returns, there is a real danger of a consolidation regime significantly increasing compliance costs. If a consolidation regime is recommended, then appropriate transitional arrangements must be put in place.

Taxation of capital gains

The proposal to provide scrip for scrip rollover relief is supported. The current rules create a bias against scrip for scrip purchases in favour of cash purchases, as shareholders often require cash to pay their resultant capital gains tax liabilities. Scrip for scrip purchases are an efficient method of effecting takeovers as they alleviate the need to raise large amounts of cash via a separate issue and should not be subject to such a disadvantage. We will provide comment on the other aspects of capital gains in our detailed submission.

Taxation of Fringe Benefits

We support the proposals to return to the pre-1995 treatment of entertainment and exempt on premise car parking from the fringe benefits tax regime. These measures would significantly reduce compliance costs. Any revenue loss from these measures could be funded for changes to the statutory formula used to assess car fringe benefits.

Implementation

The other significant issue of which we have serious concerns is the timing of implementation of any changes. Government must recognise that all industries are currently grappling with the Year 2000 problem and the introduction of the GST. The Review of Business Tax will potentially require further significant changes to systems. Some serious consideration needs to be given by the review to the prioritisation of and timing of the various initiatives.

Please call if you wish to discuss these issues. We shall forward our more detailed submission shortly.

Yours sincerely

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