Ford Australia

Response to:

REVIEW OF BUSINESS TAXATION

Discussion Paper Two

April 1999

This submission is made by the Ford Motor Company of Australia Ltd (ACN 004 116 223). The Company is referred to as Ford Australia in the submission.

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1.0 EXECUTIVE SUMMARY

1.1 Ford Australia launched the AU Falcon in September 1998. In automotive terms, this launch represented a major commitment to skillfully engineer a truly world class vehicle, yet one uniquely Australian in styling and performance. In investment terms, this single business decision taken in 1995, committed funding and resources of approximately $1 billion.

1.2 This investment decision was not only predicated on the Falcon's ability to compete globally on quality, cost and delivery but also on the investment environment which had to be competitive relative to other countries. Each investment decision is now made in a global context, with investment funds both scarce and mobile.

1.3 With regard to forward and on-going model and facilities investment decisions, we approach aspects of the debate on the future of business tax reform with concern. We believe the debate currently taking place which pits a seductive 30% corporate tax rate against the removal of business tax concessions as inappropriate.

1.4 Tax concessions have been a legitimate and accepted policy delivery tool for successive Governments. It is important that the rationale for their existence be thoroughly understood and not overlooked. The R&D tax concession and the Accelerated Depreciation Allowance are both important to Ford Australia. The consequences of quickly unloading these concessions will have wide ramifications.

1.5 A number of proposals with regards to the taxing of Business Entities will not enhance our return to shareholders. If they were to be adopted, they would act as disincentive for non-residents to invest in Australia.

1.6 Of greater concern to Ford Australia are the proposed changes to FBT provisions concerning the valuation of motor vehicles. If these poorly researched proposals were adopted, we believe the proposed changes would significantly reshape the Australian new car market at the expense of Australian manufactured cars. This would seriously alter the parameters by which future investment decisions will be made by the four automotive manufacturers in Australia.

1.7 Ford Australia has strongly supported reform of indirect taxation in the Federal Government's "A New Tax System", but we do not wish to see the growth opportunities that may be derived from an introduction of a goods and services tax nullified, or wiped out, by an additional impost placed on FBT treatment of cars.

1.8 The fundamental tenant of the review is to provide Australia with a tax system that encourages growth. A lower corporate tax rate at the expense of business tax concessions, and a revenue heist through the tightening of FBT provisions on cars, will certainly not promote growth in the automotive industry or the many reliant industries that are important contributors to the well being of the Australian economy.

2.0 AN APPROACH TO THE CHANGE PROCESS

2.1 Ford Australia's submission aims to provide the review team with additional data, evidence and viewpoints in order to assist finalisation of recommendations to Government.

There is a need for systemic thinking to be applied to change of this nature, with careful consideration of all likely impacts being fully understood and evaluated.

2.2 As in any major change process whether it be at a corporate level or at national level, short and long term consequences of actions can be quite different. In many instances many obvious solutions fail or actually make the situation worse. An individual action in its own right may appear to make sense, but there are often unintended side effects of an action that could prove detrimental or disastrous both short or long term.

2.3 Decisions taken will have multiple consequences, on many time frames. This submission will highlight what we believe are the necessary considerations and potential outcomes of changes foreshadowed in the Review of Business Taxation discussion papers.

Key Message:

Before you make comprehensive change in taxation policy, it is critical that all integrated elements are understood. Reforms of this magnitude should not be limited to a trade-off debate; it is not appropriate when the stakes are so high.

3.0 POORLY RESEARCHED POLICY INITIATIVES

3.1 Automotive manufacturers throughout the world have often borne the brunt of poorly researched policy initiatives. This has contributed to unnecessary harm to the automotive industry or individual manufacturers. Importantly, a lack of prior understanding as to the likely consequences of a policy initiative has also frustrated the achievement of wider policy objectives.

3.2 Some illustrative examples of poorly researched policy initiatives include:

(a) **United Kingdom**: The UK Budget in early March 1999 included an interim scheme for vehicle excise duty (VED) based on engine capacity and environmental performance. The fact that engine size does not provide an accurate reflection of the fuel efficiency of new cars can be illustrated in the context of the interim scheme's breakpoint of 1100cc. A Ford Ka (1299cc) has a combined miles per gallon figure of 47.9, which is more fuel efficient than the Volkswagon Polo (1043cc) with 40.4 mpg and the Nissan Micra (998cc) with 47.1 mpg. Under the interim scheme, some less fuel efficient, and by implication less environmentally friendly, cars will have a VED rate of £100 compared to a rate of £155 for the Ford Ka. Needless to say, this anomalous treatment will have a distortionary impact on the car market.

(b) **Australia**: For a number of years, primary producers have been able to buy four-wheel-drive utility vehicles free of wholesale sales tax. A factor behind this tax exemption was that particular vehicles are "productive machinery" in a farm context and should be exempt of sales tax just like factory machinery. However an unintended consequence of this selective tax exemption has been to deny Australian-made commercial utility vehicles like Falcon and Commodore sales in regional Australia. This impact is despite the fact these Australian utilities have greater workhorse characteristics like engine torque, towing capability and payload capacity than many tax exempt four-wheel-drive vehicles.

(c) **South Africa**: In July 1997, the South African Government sharply increased the fringe benefit tax liability for motor vehicles. This equated to many car users a theoretical car price increase of more than four per cent and resulted in a significant decline in overall car sales. In addition, the tax hike triggered a down-sizing trend among buyers. Vehicle sales in key segments declined by approximately 10 per cent, with serious viability consequences for vehicle assemblers, suppliers and retailers.

Key Message:

Taxation policy changes can carry significant unintended consequences and distortions. It is therefore important that considerable research be undertaken before comprehensive policy changes are introduced.

4.0 TAXATION REFORM

4.1 Ford Australia recognises the benefits that can be had from comprehensive tax reform and has been an active participant in the reform dialogue that has been taking place.

As a member company, Ford Australia has made contributions to submissions through representative bodies such as the Federal Chamber of Automotive of Industries (FCAI). Ford has actively participated and is supportive of the FCAI submission on business tax reform.

4.2 In addition, Ford has made representations at the Prime Minister and Ministerial level on both broad based taxation reform initiatives and Business tax reforms. In these contributions, the company has sought to balance the objective of comprehensive reform with the commercial reality of doing business in an increasingly competitive environment.

4.3 Ford Australia has elected to submit to the Review of Business Taxation as a separate entity to highlight important considerations for our company and our industry that need to be fully understood before any decisions are taken.

4.4 Taxes on motor vehicles and motor vehicles users are a major source of revenue for Government. According to the Australian Automobile Association, in 1996-97 taxes on road users accounted for 11 percent of total Commonwealth, State and Territory taxation revenue collected in Australia. (AAA Motoring Directions, Summer 1998/99).

4.5 The current wholesale tax system (WST) is levied at 22% on non–luxury motor vehicles, well above comparable goods in the Australian economy and generated over $2,778 million in 1996-97 accounting for 22% of total Commonwealth sales tax revenue. (AAA Motoring Directions, Summer 1998/99).

4.6 The movement to a 'broader-base' collection of tax proposed by a GST is supported by Ford Australia in that it will provide a fairer and more equitable approach to the current system, which has an over reliance on the collection of indirect tax from a 'goods base'.

4.7 In the case of FBT, the Australian Tax Office figures indicated that almost half (47%) of all FBT paid was for motor vehicles and represented $1.47 billion in revenue to Government for the 1995-1996 year.

Key Message:

From these figures alone, the automotive industry in Australia has a legitimate interest in seeking a fairer taxation system as it has a strong bearing on the business environment in which the industry operates. Ford Australia has strongly supported a change to an across-the-board goods and services tax (GST).

5.0 FRINGE BENEFITS TAX (FBT) REFORM

5.1 Ford Australia is strongly opposed to the possible changes to the fringe benefits tax requirements that have been put forward. The changes are likely to be of a piece-meal nature and little, if any, analysis of their wider impacts has been carried out.

5.2 Ford Australia submits that changes to the statutory valuation formula for passenger cars, if implemented, would have wide-ranging implications for the continued viability of a core manufacturing industry.

5.3 Fringe benefits tax was first introduced in 1986. It sought to bring into the income tax net the increasing number and variety of non-monetary non-taxable benefits that were being paid to employees.

5.4 The tax has since become a significant government revenue source with annual receipts now exceeding $3 billion. Motor vehicles account for 47 per cent of the tax receipts. Fringe benefits tax is paid on 550,000 vehicles annually.

5.5 In introducing the fringe benefits tax, the government of the day was mindful of the practical, and political, complexities of the issue at hand. As a result, it sought to balance the traditional principles of a fair tax – equity, efficiency and simplicity – with the demands of pragmatic decision-making.

5.6 The outcome was a complex and somewhat unique tax. For example, the responsibility for paying the tax rested with the employer rather than employee. Furthermore, the need for administrative reality, a recognition of the historical importance of the "company car" and industry policy consideration saw the introduction of a statutory formula for the purposes of valuing car benefits.

5.7 The statutory valuation formula was designed to be user friendly. It should therefore be of no surprise that it has become widely used with some 85 per cent of motor vehicles being taxed under this methodology in preference to the complexities of the log book method. Nor should this popularity indicate an opportunity for an increased revenue source.

5.8 Three key suggestions of the Review of Business Taxation discussion paper involve a transfer of FBT liability from the employers to employee, an alignment of the flat rate with marginal tax rates, and an upwards revision of the statutory valuation formula.

5.9 Federal Treasurer Peter Costello has already indicated a Government rejection of a liability transfer ensuring that any changes to fringe benefits tax will be of a piece-meal rather than comprehensive nature.

5.10 Ford Australia supports the submission by the Federal Chamber of Automotive Industries concerning the merit in changing FBT liability with individual marginal tax rates. This approach is consistent with equity considerations of a fair tax.

5.11 Ford Australia strongly advocates a rejection of the suggestion concerning the statutory valuation formula. To date, the company is unaware of any comprehensive impact study concerning this suggestion. In fact, the discussion paper acknowledges this by saying (page 774) it has not addressed the issue of the explicit stimulus to the vehicle industry.

5.12 Ford Australia submits, it is a highly undesirable to advocate a particular policy position without open regard to the likely "whole of community" costs of the Government adopting that position. Close industry consultation would be desirable as part of any assessment.

5.13 In chapters 6.0, 7.0 and 8.0, Ford Australia seeks to provide a broad understanding of the structures of the Australian vehicle fleet and the Australian vehicle manufacturing industry. An understanding of these issues highlights the complexities and likely impact of significant changes to fringe benefits tax requirements.

Key Message:

The FBT suggestions are complex with far-reaching implications. They should not be further advocated without a detailed public analysis as to their likely impact.

6.0 FBT – AUTOMOTIVE INDUSTRY IMPACTS

6.1 Ford Australia strongly objects to the various fringe benefits tax statutory valuation car formula options put forward in the discussion paper. The canvassed options represent a considerable tax hike for motor vehicle users, will significantly reduce the benefits of a goods and services tax and will have serious flow-on affects for the motor vehicle manufacturing industry.

6.2 Ford Australia has carried out a range of calculations to demonstrate the impact of the various FBT options. The calculations show that the FBT cost of providing a fully maintained family car could increase by more than a half, or more than $3,000 annually.

6.3 The following tables illustrate the potential cost impact of introducing alternative statutory formulas outlined in Table B-3 page 788 of the discussion paper.

FALCON – RRP $32,000 at 20,000 Kms. fully maintained

		Present	Proposed – Ralph Report	
Statutory fraction		20%	25%	30%
Value of Benefit per vehicle		$6,400	$8,000	$9,600
Employee Contribution		$ -	$ -	$ -
Taxable Value per Vehicle		$6,400	$8,000	$9,600
Fringe Benefits Tax (@ 48.5%) per Vehicle		$6,027	$7,534	$9,041

Tax Payable at Marginal Tax Rates

Taxable Value per Vehicle		$6,400	$8,000	$9,600
Current Tax Scale				
Tax Payable per Vehicle @ Tax rate + Medicare levy	21.5%	$1,753	$2,191	$2,629
	35.5%	$3,522	$4,403	$5,284
	44.5%	$5,142	$6,414	$7,697
	48.5%	$6,027	$7,534	$9,041
New Tax Scale				
Tax Payable per Vehicle @ Tax rate + Medicare levy	18.5%	$1,453	$1,816	$2,179
	31.5%	$2,943	$3,679	$4,415
	41.5%	$4,540	$5,675	$6,810
	48.5%	$6,027	$7,534	$9,041

6.4 As illustrated above, the alternative formulas will have a significant impact on people earning more than $50,000 annually. These are the key income groups where a family sedan motor vehicle is most likely to form part of a salary package.

6.5 The discussion paper acknowledges (page 782) that the canvassed options for reforming the statutory formula could impact both the composition and size of the new car market.

6.6 Ford Australia submits that the abovementioned acknowledgement has been followed by no detailed impact assessment.

6.7 Ford Australia disagrees with the inferred proposition that the negative impact could be offset by a positive response from people on lower incomes:

- these people will generally take most of their package as cash as opposed to a combination of cash/benefits).
- their motor vehicle choice, if any, will inevitable be in smaller vehicles as opposed to Australian-manufactured family cars.

Key Message:

Ford Australia strongly opposes options that could increase the fringe benefits tax payable on a family car by more than 50 per cent. Such a move, in the absence of a detailed impact assessment, would be draconian.

7.0 THE AUSTRALIAN VEHICLE FLEET

7.1 There are more than 10.94 million motor vehicles in Australia. Passenger vehicles account for 80% of the vehicle fleet.

7.2 Modern new vehicles and large volumes of relatively low mileage used cars (generally ex-business fleet and government) play a critical role in the diffusion of new safety, environmental and security standards into the national vehicle fleet.

7.3 The Australian Automobile Association says modern cars are safer, greener and more fuel-efficient than vehicles built in the 1970s and 1980s. They are also less prone to theft and are generally cheaper to maintain and operate. (AAA Motoring Directions, Spring 1998).

7.4 A worrying characteristic of the vehicle fleet in recent years has been its ageing. The 1995 ABS Motor Vehicle Census reports on average age of all vehicles of 10.6 years, a near 75 per cent deterioration since 1971. (ABS, 1997). This is one of the oldest fleets in the developed world.

7.5 The ageing of the vehicle parc, which results from a flat demand for new vehicles and low scrappage rate, severely restricts the rate of economic and environmental improvement.

7.6 For example, vehicles on Australian roads which pre-date 1975 have virtually no emission control systems and high fuel consumption. They do not necessarily use unleaded petrol and neither do they have catalytic converters as do new technology engines and vehicles

7.7 The environmental impact of the ageing fleet and a lack of maintenance and uniform inspection requirements was highlighted by a National In-service Emission study published in early 1996 by the Federal Office of Road Safety. The study found:

- a well maintained passenger car fleet could reduce pollution to between nine per cent and 25 per cent below existing levels;
- these reductions would be accompanied by substantial greenhouse gas reductions and fuel savings of around $200 million per annum;
- the average cost of servicing, repairing and adjusting a car to achieve the above results is around $200 at typical 1996 motor vehicle repair industry rates.

Key Message:

The diffusion of new environmental and safety standards into an ageing national vehicle parc is heavily dependent on a ready supply of modern used cars. Tax law changes, which reduce this ready supply, will have a negative impact in achieving higher community standards.

8.0 THE AUSTRALIAN VEHICLE INDUSTRY

8.1 Australia's car industry, is a core manufacturing activity with extensive local and global linkages in what is increasingly becoming a borderless industry.

8.2 It comprises four car manufacturers (Ford, General Motors-Holden, Mitsubishi and Toyota) and more than 150 key automotive component producers supplying domestic and export markets. Five car models (Falcon, Commodore, Magna, Camry and Vectra) are currently in production. They are produced in a highly competitive marketplace, which has one of the largest model/brand/source varieties of any world market. The Australian market takes 45 different brands with 540 models and derivatives from 15 source countries.

8.3 Though small by world standards, accounting for less than one per cent of world production, the industry has the rare capability outside of the major industrial countries of being able to take an automotive design from concept to finished product state while maintaining a high level of local content.

8.4 Significant restructuring of the industry has occurred in recent years consistent with the Federal Government's Car Plan objectives of boosting the industry's competitiveness by enhancing its export profile and by exposing it to greater import competition. Locally produced models have reduced from 13 to 5 as tariffs on imported cars and components have been cut by more than two-thirds since 1984 to their present level of 17.5 per cent. By 2000 they will have been reduced by 75 per cent to 15 per cent.

8.5 In line with the reductions in tariffs, the local industry's share of the domestic car market has declined from 75 per cent in 1990 to 48 per cent in 1998. This has occurred in a largely mature domestic market placing significant pressure on the viability of domestic manufacturers.

8.6 A major customer source for Australian manufactured cars are business fleet buyers. Sixty per cent of vehicles sold in Australia by domestic manufacturers are bought by business fleet and governments, with sales for key model lines like Falcon and Commodore exceeding 70 percent.

8.7 The domestic industry's dependence on fleet customers has been widely recognised.

- "Fleets have long been the major underpinning of upper medium cars sales …." (Dept. of Industry, 1997)
- "Fleet sales are an important source of sales for domestic motor vehicle producers …." (Industry Commission, 1997)

8.8 In 1997, the four car manufacturers and the leading 150 component producers employed 45,000 people. The employment of many thousands more service providers was also dependent on the industry. The value of car production in Australia in 1997 was nearly $8 billion with local manufacturers having total dependence on medium to larger cars.

8.9 This dependence on medium to larger cars reflects strong market preference, particularly among dominate business fleet and government buyers, and a concentration by a low volume industry on the type of vehicle it can economically produce. This focus is consistent with the Government's objective of improved economic efficiency across all sectors.

8.10 It is extremely doubtful, given the domestic market size, international competition and the present and proposed levels of Car Plan assistance, that the Australian industry could be viable producing only smaller cars.

8.11 In parallel, with a strong export thrust involving cars and componentry, the Australian industry has continued to make significant capital investments in product and manufacturing facilities, quality enhancements and productivity improvements. This response reflects a key competitive challenge of the Government's Car Plan.

8.12 Since 1990, automotive exports have increased from $1.03 billion to nearly $3 billion. In the same period, investment expenditure by the four car manufacturers has exceeded $3.7 billion with R&D expenditure by the car makers of $1.3 billion.

8.13 The industry's quality performance has improved to world-class levels with gains of more than 50 per cent. Australian made cars had a faults per car range of 1.4 – 2.1 in 1999 compared to 1.1 – 1.8 by imported cars.

8.14 A similarly impressive productivity story exists. Since 1990, local car manufacturers have reported a 40 per cent improvement in cars produced per employee.

Key Message:

Australia's automotive industry is a core manufacturing activity with extensive linkages. It is small by world standards and dependent on medium to larger cars, which are critically dependent on business fleet and government buyers. It has made significant product feature, productivity and quality gains in recent years.

9.0 AUSTRALIAN AUTOMOTIVE RESEARCH & DEVELOPMENT

9.1 Research and development investment in new products and processes is fundamental to the future competitiveness of the Australian automotive manufacturing industry. It plays a critical role in securing new opportunities in both domestic and export markets.

9.2 The Australian automotive manufacturing industry has recongised the importance of research and development, and is a major investor. Two vehicle manufacturers (Ford and General Motors-Holden) were among Australia's top six business investors in research and development in 1997 (Scoreboard '97), while total industry research and development in the five years to 1997 exceeded $960 million (ISR, 1998).

9.3 Ford is an industry leading research and development investor, directly and indirectly, through its extensive product development activities based on the Ford Falcon. In addition to the company's in-house developments, Australian supplier industry research and development has seen major contributions to transmission (BTR), security systems (Bosch) and air-bags (Autoliv).

9.4 Supplier industry research and development not only supports vehicle development in Australia (i.e. Falcon and Commodore) but also allows suppliers to become significant exporters in their own right.

9.5 The skill base that supports research and development activities is an important factor in the automotive industry's ability to attract talented employees and overseas contracts, and to ensure the on-going development of contemporary products in the face of increased global competition.

9.6 An important factor in enhancing the research and development competitiveness of the Australian automotive industry is the 125 per cent tax concession. In fact, Ford believes a strong case can be made for an increased concession.

9.7 Ford believes the automotive sector is a significant contributor to Australia's total R&D capability for the following reasons:

- Automotive research is focused at specific outcomes – it rarely becomes shelf data;
- Automotive has the critical mass to be a major driver of R&D;
- Automotive R&D is driven into the suppliers to enhance their capability to meet systems supply requirements;
- Automotive development drives the research – ie. It is very cost effective.

Key Message:

Automotive research and development is critical to the growth of the Australian automotive industry. The 125 per cent research and development tax concession is an important contributor to fostering research and development activity. It should not be reduced as part of any business tax reform package.

10.0 THE IMPORTANCE OF ACCELERATED DEPRECIATION TO THE AUTOMOTIVE INDUSTRY

10.1 Motor vehicle manufacturing is a highly capital intensive industry. It is a major user of complex state-of-the-art tooling, advanced robotics and comprehensive environmentally friendly painting equipment.

10.2 Australian motor vehicle manufacturers are significant investors. In the three years to 1997, they invested more than $2.2 billion. Much of this investment was of a capital nature covering model-specific tooling and production machinery and equipment.

10.3 In the case of Ford Australia, capital investments for the production of its recently launched AU Falcon model range exceeded $750 million.

10.4 The nature of the motor vehicle industry generally ties capital to vehicle model cycles. This means a manufacturer's investment will be unevenly distributed in that the vast majority of expenditures will be concentrated in the short period prior to the launch of a new model. For example, this expenditure will inevitably cover new tooling for body panels and equipment for new production processes and quality enhancements.

10.5 The motor industry's product model cycles – (i.e. EL Falcon followed by an AU Falcon) means it is not possible for the industry to evenly spread its capital investments on a year-by-year basis.

10.6 Following the introduction to public sale of a new model, a manufacturer will be looking to amortise capital investments over the model life. In the meantime, however, a manufacturer will incur considerable cash flow distortions in that significant capital investments have been required prior to even the first dollar of revenue being received.

10.7 The industry's ability to access accelerated depreciation allowances, and sometimes prevailing investment allowances, is an important contributor to ameliorating the adverse impact of these cash outflows, particularly given the domestic industry's recent investments in the face of a declining volume base.

10.8 Any move to further restrict accelerated depreciation allowances will have a negative impact on the attractiveness of new model investment programs in Australia, relative to overseas programs where a larger volume base is inevitably an attractive feature.

10.9 It is therefore important to retain this incentive to maintain international competitiveness.

Key Message:

The motor industry is highly capital intensive. Its focus on model cycles means its investment patterns are not evenly distributed. The accessibility of accelerated depreciation allowances provides a valuable, though only partial, offset to the cash flow distortions of this investment pattern. No changes should be made.

11.0 ENTITY DISTRIBUTIONS

11.1 The assertion that there is considerable complexity in the present dividend imputation system caused by dividends being either franked or unfranked has no foundation. The present imputation system has worked effectively for the last 13 years without a significant administrative burden to business. The rules are not unduly complex, particularly when compared with other provisions of the Income Tax Assessment Act such as the Controlled Foreign Corporation Rules. The DCT system will not result in simplification as suggested in the Report, it will in fact, impose complexity and administrative burden as it actually builds on the present system.

11.2 Ford Australia opposes the imposition of a Deferred Company Tax "DCT" System for the following reasons:

11.3 It will impose an additional tax at the entity level, thereby reducing Retained Earnings and Shareholder Net Worth. Consequently, distributions to non-resident shareholders will diminish commensurately.

11.4 Ford Australia challenges the statement made on Page 353 of the Discussion Paper that "Countries operating foreign tax credit systems should allow credit for deferred company tax." As DCT will not be a "tax on income", a non-resident parent company may not be entitled to a foreign tax credit in respect of DCT paid. This is a concern as it may result in double taxation and therefore, a much lower "after tax rate of return".

11.5 The "lower after tax rate of return" associated with the DCT regime will adversely influence future equity investments into Australia, (which at present is a Net Capital Importer).

11.6 The four general options listed on pages 359 and 360 of the Discussion Paper for dealing with the very real issue of double taxation, not only create additional problems, but lack commercial reality. For instance, placing a company into liquidation in order to access a Franking Account Surplus makes little commercial sense.

11.7 The DCT will inhibit Australia's international competitiveness and will in fact act as a major disincentive for multi nationals to invest in Australia.

11.8 The DCT goes against the trend in other jurisdictions such as the UK, which has recently abolished Advanced Corporation Tax.

11.9 The DCT system fails to distinguish between income distributions, which are unfranked due to "timing adjustments" (these will reverse out in a subsequent period) and those which relate to "permanent differences". This mismatch will result in surplus unusable franking credits accumulating in later years when the tax is paid, but no corresponding accounting income is derived. (Refer to Attachment 1 for an illustration of the ramifications).

11.10 As there are no imputation credits attaching to dividends paid from pre 1 July 1987 profits, the DCT system will result in double taxation of these profits, even though they have been subject to full company tax.

11.11 The combined effect of the DCT system and the proposed changes to the Thin Capitalisation rules will result in a lower return to non-resident shareholders and accordingly, a higher cost of capital. (This is illustrated in Attachment 1). The ramifications of this will be that Australian companies will experience real difficulties in raising capital offshore from related parties and accordingly, this will limit growth potential.

Key Message:

Australia is a net importer of capital. The combined effect of the DCT system and amendments to the Thin Capitalisation rules will act as a major disincentive for non-residents to invest in this country.

12.0 CONSOLIDATION OF COMPANY GROUPS

12.1 The Consolidation Proposals contain a major impediment, which will ensure that some multi- national groups will be adversely affected when compared with the present system which contains relieving provisions for "wholly owned groups".

12.2 As the proposals require a single Australian holding company, most of the subsidiaries of Ford Motor Company resident in Australia will not be permitted to form part of the consolidated group for tax purposes without major restructuring of shareholding.

12.3 This is not feasible due to the adverse financial impact of Canadian Capital Gains Tax on the disposal of its Australian subsidiary companies to the Australian Holding Company.

12.4 Further, as Ford Motor Credit Company of Australia is a Financial Institution, there are additional reporting requirements that preclude it being part of a manufacturing company group for statutory consolidation purposes.

12.5 Although Consolidation is not mandatory (i.e. companies will elect to form part of a consolidated group), all "Relieving Provisions" in the Income Tax Assessment Act dealing with corporate groups such as loss transfers, asset rollovers etc., are to be abolished. Therefore, there will no longer be any group tax relief available for those Australian subsidiaries of Ford Motor Company, which will be ineligible to form part of the consolidated group.

12.6 The administration of tax consolidated accounts will require significant additional resources as each inter company transaction will need to be identified and reversed out for tax purposes. Furthermore, there will be no "added value" in the exercise as Consolidation will not lower the overall tax burden but will merely increase the complexity associated with compliance. Therefore, the object of simplifying the tax system will not be achieved.

Key Message:

The requirement to have an Australian holding company, is a major impediment to companies being able to elect to form part of a Consolidated Group. Therefore, in order that these companies are not adversely affected, " Relieving Provisions" of the Income Tax Assessment Act such as loss grouping provisions, should not be abolished.

13.0 THIN CAPITALISATION PROPOSALS

13.1 The statement that Foreign Controlled Groups often have the flexibility to allocate a disproportionate share of debt to Australia is without foundation. Furthermore, it overlooks the commercial aspects and generally accepted accounting conventions associated with debt versus equity considerations in relation to operating cash flow requirements both long term and short term

13.2 The proposals will restrict the flexibility of Australian subsidiaries to obtain ready access to relatively low cost borrowings from non –resident related parties, and as a consequence, hinder integration into the wider global business community, and international competitiveness.

13.3 The proposal that provision could be made for allowing the full interest deduction if the group could demonstrate that the Australian gearing was not out of line with the gearing of the group's global operations should not supported, as it overlooks the fact that different entities have varying funding requirements and/ or risk profiles

13.4 Furthermore, as Australia is a net Capital importer, the proposal is unrealistic. For example, an Australian subsidiary requiring additional funds in a start-up or expansionary phase would be required to constantly monitor and compare gearing levels with its Parent company and continuously be seeking additional share capital.

13.5 There will be reluctance by a non-resident parent to provide this additional share capital, particularly, if the Deferred Company Tax proposal is implemented. The ramifications of this will be to limit investment outlays and future growth.

Key Message:

The Thin Capitalization amendments will discourage non-resident shareholders from providing loan funds to Australian subsidiaries. This will restrict future growth.

ATTACHMENT 1

AGGREGATED IMPACT ON RETAINED EARNINGS AND SHAREHOLDER NET WORTH OF DEFERRED COMPANY TAX PROPOSAL AND THIN CAPITALIZATION AMENDMENTS

	Present System	Proposed System
	$	$
YEAR 1		
Accounting Net Profit Before Tax	1,000	1,000
Income Tax Expense	(360)	(360)
Adjusted for interest expense of $100 not allowable under world - wide gearing ratio for Thin Capitalization	0	(36)
Net Profit After Tax Available For Distribution	640	604
Franking Credits Available (Refer Attachment 1A)	512	576
Dividend Declaration	640	604
Less		
Non Resident Withholding Tax 15%	(19)	
Deferred Company Tax		(10)
Net Dividend Paid	621	594
YEAR 2		
Accounting Net Profit Before Tax	800	800
Income Tax Expense	(288)	(288)
Adjusted for interest expense of $100 not allowable under world - wide gearing ratio for Thin Capitalization		(36)
Adjusted for Deferred Company Tax paid during Year		(10)
Net Profit After Tax Available for distribution	512	466
Franking Credits Available (Refer Attachment 1A)	640	704
Dividend Declaration (100% Of Retained Earnings)	512	466
Less		
Non Resident Withholding Tax 15%	0	0
Deferred Company Tax	0	0
Net Dividend Paid	512	466
TOTAL RETURNS TO SHAREHOLDER	**1,133**	**1,060**
SURPLUS FRANKING CREDITS THAT MAY NEVER BE UTILISED	**(128)**	**(238)**

ATTACHMENT 1A

CALCULATION OF TAXABLE INCOME TAX PAYABLE AND FRANKING CREDITS

	Present System $	Proposed System $
YEAR 1		
Accounting Net Profit Before Tax	1,000	1,000
Adjusted for tax as follows:		
Accelerated depreciation claim	(200)	(200)
Deduction for interest denied		100
Taxable Income	800	900
Tax payable @ 36%	288	324
Fanking Credit Available (Refer Note 1)	512	576
YEAR 2		
Accounting Net Profit Before Tax	800	800
Adjusted for tax as follows:		
Accelerated depreciation claim reversal	200	200
Deduction for interest denied		100
Taxable Income	1,000	1,100
Tax payable @ 36%	360	396
Franking Credit Available (Refer Note 1)	640	704

Note 1
Franking credits arise once income tax has been paid.
The amount of the credit is based on the applicable tax rate.