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

Dear Sir,

Qantas Airways Limited (Qantas) welcomes the opportunity to make a submission on a number of issues canvassed in the discussion paper entitled "A Platform for Consultation" (the RBT paper) released on 22 February 1999.

The position of Qantas on these issues is summarised below. Further detail is attached to this letter where indicated.

Depreciation and Related Issues

1. The effective life of an asset should be determined by reference to current estimates of future international best practice taking into account the likely development of the most rigid rules in regard to the environment and safety.

2. Accelerated depreciation should be maintained on the basis that:

   (a) it promotes capital intensive industries which gives rise to a more robust and better balanced structure to the Australian economy;

   (b) its removal is likely to discourage more in the way of large project investment than is likely to be attracted to Australia on the basis of a reduction in the company tax rate;

   (c) it maintains the international competitiveness of Australia's capital-intensive industries;

   (d) the promotion of capital intensive industries will improve the balance of payments through additional export dollars or import substitution;

   (e) it promotes the replacement of capital assets with new assets giving rise to additional environmental, safety and other intangible benefits;

(f) it compensates for inflation, obsolescence risks, commercial risks of failure and early financing costs associated with capital-intensive industries;

(g) removal would bias decisions towards expenditure on repairs and maintenance, being deductible up front, rather than on replacement assets; and,

(h) its removal will increase the cost of certain "infrastructure" and similar assets, such as aircraft, reducing the economic viability of more marginal operations, with possible detrimental impacts to regional Australia;

Refer to Attachment 1 for a more detailed argument of the above points.

3. Broadbanding should be abandoned and the loading method introduced on the basis that the loading method is a more equitable method of "accelerating" depreciation.

4. The balancing charge offset should be maintained, but if changed it should not go beyond limiting its application to anything other than the reduction in the depreciable value of replacement assets. The removal of the balancing charge offset election would mean that taxpayers are less likely to update capital equipment, resulting in the continued use of older and less efficient equipment, which may have broader impacts on the economy and environment. Moreover, due to inflation, the cost of replacement assets are continually rising. Hence, unless recognition is given to this, by way of a balancing charge offset (or otherwise), taxable profits on disposal would exceed 'true' profits. Further, the mere replacement of one depreciable asset with a similar asset in the same business does not properly give rise to a true realised gain that should be taxable.

5. The immediate write-off of assets less than $300 should be maintained without a de minimus rule given the very considerable compliance burden that would arise if it was removed. To overcome possible Treasury concerns, the write-off could be limited to circumstances where the assets are not subject to a lease financing arrangement.

6. If it was determined to proceed with the removal of accelerated depreciation and the balancing charge offset, such removal should only apply to assets ordered after and disposed of after 1 July 2000. Assets ordered and disposed of prior to that time should be subject to the current regime.

7. On the grounds of equity, it is supported that where a taxpayer incurs capital expenditure on the acquisition of depreciable assets, a taxpayer should be entitled to tax depreciation even though they are not the legal owner of the asset.

Leasing

8. The leasing regime is extremely complex and any changes thereto requires a detailed and thorough analysis. Therefore, consideration of any such changes should be done after determining the outcome in relation to the potential removal of accelerated depreciation.

9. The current leasing regime should be maintained. In the case of Qantas considerable revenue is obtained (resulting in greater tax payable in Australia) from the cross border leasing of aircraft. To change the rules in such a manner so as to deny the ability to cross border lease large value assets will have a detrimental impact on the Australian tax base and put Australian operators at a competitive disadvantage to other international airlines.

10. However, if the rules are changed in relation to taxation of leasing, existing arrangements should be completely “untouched” by any new rules and the transitional rules should contain sufficient flexibility to ensure appropriate commercial variation and modification can continue to occur without fear of the new rules applying.

11. The proposed mechanism for transferring tax benefits (if tax benefit transfers are allowed) would appear to be unduly complex and the present rules should be maintained.

12. If the sale and loan treatment of leases is adopted, principles in the Australian Accounting Standards should be adopted to determine if the lease is to be treated as a sale and loan (ie, distinction between a finance lease as against an operating lease). This could be subject to a general anti-avoidance provision to prevent abuses. A significant advantage of adopting the accounting treatment is that it is relatively flexible and can accommodate future changes by the Accounting Standards Boards.

13. Section 51AD and Division 16D should be abolished if leases are converted into sale and loan transactions for tax purposes. Refer Attachment 2.

14. If the current treatment of leases was to be maintained, Section 51AD should be amended to:

    (a) limit the denial of deductions only to the extent that the deductions are proportionately referable to the derivation of non-assessable income.

    (b) provide a discretion to the Commissioner not to apply Section 51AD in circumstances where there is no tax avoidance. Refer Attachment 2.

15. The application of any anti-avoidance provisions by press release (including the proposals in relation to lease assignments) should be clear and concise and the proposed legislative rule should accompany the press release. This would provide greater certainty and minimise the risk of innocent transactions being caught by widely drafted legislation.

Consolidation

16. A principal purpose of the proposed consolidation regime is to quash the ability to create artificial losses by cascading losses through the company chain and by shifting assets around the company group at values lower or higher than their market values. We refute this repeated proposition and do not believe that consolidation is the remedy to these problems. Refer Attachment 3.

17. Given that consolidation is not the answer, the problems associated with exploitation of intra-group transactions (loss duplication, value shifting and full franking) should be remedied through other statutory reform measures. To this end, we support the adoption of an ‘entity-based model’ over the ‘asset based model’. The latter, requiring valuation of assets of the acquired entity, the separate identification of goodwill, awkward transitional provisions and problems with incremental acquisitions, is administratively more cumbersome and less objective than the entity-based model.

18. International experience suggests that the consolidation of entities for tax purposes tends to increase rather than reduce the tax compliance burden (from the point of view of the taxpayer). Attachment 4 provides arguments why we believe the compliance burden would actually increase. As easing compliance appears to be the only remaining argument for consolidation, the proposal should not be pursued. Rather, the tax law should allow the transfer from one group company to another of certain tax benefits which currently are unable to be transferred. These are franking credits and foreign losses.

19. In a tax environment such as ours with many grey areas, the law should be modified to give full flexibility to taxpayers to adjust transfer notices in circumstances where there is an adjustment to the tax position of one taxpayer in the group. We further submit that TR98/12 should be withdrawn as application thereof in its current format is inequitable. It unreasonably denies group companies the ability to freely adjust loss transfers when adjustments to their tax position arise. If consolidation aims to undo this injustice, and the consolidation regime is not implemented, this fault should nonetheless be remedied.

Full Franking

20. The introduction of Deferred Company Tax (DCT) as proposed is opposed given that it presents significant disadvantages to corporate Australia (given that the DCT tax cost is expensed in the company's profit and loss statement). It contains no significant structural advantage over the resident dividend withholding tax either from the revenue or taxpayer perspective. Refer Attachment 5.

21. The mechanism adopted for the refund of excess imputation credits to individuals and superannuation funds should not involve the company paying the dividend. This presents an undue compliance burden and liability on the company. The ATO should be responsible for administering the refund of excess imputation credits.

22. The Non-Resident Investor Tax Credit proposal is supported on the basis that it makes Australian equities more attractive for certain foreign shareholders.

Capital Gains Tax Changes

23. The ambit of the Australian capital gains tax provisions should not be widened to cover the taxation of disposals by non-resident companies of interests in other non-resident companies which hold a greater than 10% interest in an Australian resident company. Such provisions extend well beyond the normal boundaries of the capital gains tax rules of other OECD countries. Furthermore, the proposed extension of the capital gains tax rules in this manner provide non-residents with further disincentive to invest in Australia as the potential for double taxation arises.

24. The proposal for rollover relief for script for script share exchanges (ie, where one public company acquires another for an exchange of shares alone including mergers and deconsolidations) is supported. Such a modification would be in line with most capital gains tax regimes internationally and may contribute to a more efficient domestic capital market and deal with the problem of taxing unrealised gains.

25. The proposal for removal of indexation on the disposal of capital assets is opposed. It is appropriate to recognise the inflationary impact on market values of capital assets and to tax the true economic gain on realisation such assets.

Fringe Benefits Tax Changes

26. Significant industrial relations issues may arise if the liability for the taxation of fringe benefits is moved from the employer to the employee. There will also be issues in relation to retired employees. For example, a retired employee would be required to pay tax on existing travel entitlements under the proposal. The retired employee, may not be able to afford the trip unless the retired employee was to receive cash compensation from Qantas for the tax liability payable on the travel benefit. This in itself raises a substantial number of issues and administrative complexities.

27. If the proposal is to be accepted, then employers should be given the option of being able to opt out of the employee taxation method (and retain the employer approach) in circumstances where the employee taxation method gives rise to substantial administrative burdens or other problems.

28. If changes are to be made to statutory formula for the taxation of motor vehicles, it is preferable that the method adopted involves a fixed percentage of the vehicle price no matter the kilometres travelled. This method would reduce the compliance burden.

29. Qantas supports the proposals to treat entertainment as not subject to FBT (but non-deductible) and to treat carparking benefits as not subject to FBT (but deductible).

Taxation of Financial Arrangements

30. Provisions should be available to enable a taxpayer to tax gains or losses on a particular hedge derivative in the same manner as the taxation treatment adopted for the underlying item being hedged (eg. an AUD-USD forward contract designed to cover the purchase of an aircraft in USD). Such measures may assist in ensuring that there is no adverse mismatch for taxation purposes in circumstances where a position is perfectly hedged for accounting and economic purposes.

31. In many cases taxation on a realisation basis may give rise to a mismatch between the accounting and taxation treatment. Companies should be able to elect to adopt the accounting treatment for taxation purposes, provided the accounting treatment satisfies generally accepted accounting standards and is adopted consistently for income and expense items.

Interest Allocation Rules

32. Qantas opposes the introduction of interest allocation rules on the grounds that they are likely to give rise to very considerable administrative complexity without giving rise to any significant benefit to the revenue.

Thin Capitalisation

33. The level of shareholding that should give rise to a foreign controller for thin capitalisation purposes should be 50% (or 40% if there is no other controller) in line with the Controlled Foreign Corporation provisions.

CFC Rules

34. The current CFC regime is restrictive and burdensome from a compliance perspective. The current global market is one which drives mergers and joint ventures in order to maintain international competitiveness. In this climate, Australian multinationals are restricted from undertaking such behaviour due to the barriers imposed in complying with CFC rules. As these activities are, however, allowed in other jurisdictions (eg US and most European countries) without an immediate tax cost, incentives exist to maintain or relocate residency offshore. The RBT Paper downplays the shortcomings of the CFC rules and foreshadows that the few existing rollover provisions to restructure foreign operations may be removed. Qantas opposes the removal of such rollover provisions and supports a general review of the CFC rules, such that Australia's tax regime is comparable to competitive tax jurisdictions in their treatment of foreign investments.

Please do not hesitate to contact Mr Wardell-Johnson if you require clarification of the above positions.

Yours sincerely

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Chief Executive

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Attachment 1

Arguments for accelerated depreciation

Accelerated depreciation should be maintained on the basis that:

(a) <u>it promotes capital intensive industries which gives rise to a more robust and better balanced structure to the Australian economy;</u>

Removal of accelerated depreciation rates increases the effective corporate tax rate on domestic long-lived investment in Australia, thereby favouring service-based industries which provide short-term returns, but do not build an enduring framework for the Australian economy.

Service-based industries will benefit from the lower corporate tax rate but will not be impacted by the removal of accelerated depreciation. This apparent inequity between capital intensive and non-capital intensive industries appears inconsistent given Australia's rich resource base. Incentives should be provided to those activities that add value to both capital intensive and non-capital intensive industries. These include food, fibre and mineral processing, as well as pulp, paper, waste and environmental management technology, scientific and medical equipment, transport, communications and computer technology. Development of these activities that result in Australia's economic independence rather than dependence, should be encouraged rather than stifled.

Efficient transport and communications sectors are essential to minimise the cost impact of Australia's geographical isolation, of the location of our natural resources and of the dispersion of our major cities. Due to these reasons, efficient infrastructure is imperative, and therefore should not be further strained by the removal of accelerated depreciation rates.

Accelerated rates are aimed at revitalising industry generally and strengthening Australia's competitive position internationally. They particularly strengthen the investment performance of capital-intensive industries, such as construction, heavy manufacturing and transport. It is postulated that the revenue lost from the provision of accelerated depreciation rates is recouped through resultant increases in business activity and investment.

(b) <u>its removal is likely to discourage more in the way of large project investment than is likely to be attracted to Australia on the basis of a reduction in the company tax rate;</u>

In the absence of accelerated depreciation measures, the economic cost of financing large projects increases. The result would be required rates of return being higher for investment in capital-intensive industry which is likely to lead to reduced overall investment in these activities. Further, if required ‘hurdle rates’ for particular projects would not be met at the onset of a project, the project would not proceed at all.

Alternatively, the projects will be undertaken in a jurisdiction offering a more competitive tax regime for capital-intensive projects. Tax incentives associated with accelerated depreciation improves the investment climate for capital-intensive industries in Australia and, without which, such industries may be encouraged to locate operations offshore.

In addition, foreign operations will not be encouraged to develop their investments in Australia. Most major industrialised nations give their industries - especially the export-oriented businesses - competitive depreciation and tax allowances. So do a number of South-East Asian countries that aggressively seek to encourage industry development. To maintain competitiveness in attracting foreign investment and developing our export industries, such allowances should also be provided to Australian industries.

The need for such competitiveness was recognised in Canada in its Finance and Economic Affairs Committee Report on Tax Reform (16 November 1987). The Committee recognised the importance of the depreciation system in maintaining a competitive position for Canada as an attractive location for new plants. Under the proposed system it was thought that a multi-national firm, having the option of investing in either country, would choose the US over Canada, due to the significant cost element of depreciation and the fact that the proposed rates would fall short of similar manufacturing depreciation rates in the US.

(c) <u>it maintains the international competitiveness of Australia's capital-intensive industries</u>

Accelerated depreciation provides some compensation for the more expensive processes required by capital intensive industries to adhere to environmental standards and labour conditions required in Australia. Other countries do not necessarily insist that their industries maintain ecologically sound processes nor do they enforce minimum rates of pay. Australia does maintain these standards, which results in its industries incurring additional compliance costs. As environmental considerations are clearly extremely important, to maintain international competitiveness, an allowance such as accelerated depreciation is required to balance the scales.

To this end it should be acknowledged that the aim of 'international' competitiveness does not necessarily correlate with any aim of 'domestic' competitiveness. That is, to maintain an international 'even playing field' for capital intensive industries, such industries may need to be provided with tax incentives that effectively reallocate resources away from other domestic industries.

(d) <u>the promotion of capital intensive industries will improve the balance of payments through additional export dollars or import substitution;</u>

Any incentives should be aimed at increasing national wealth and should therefore be directed at export promotion and import substitution industries. It follows from the above arguments that the provision of appropriate incentives to capital-intensive industries should in this way improve Australia's balance of payments.

(e) <u>it promotes the replacement of capital assets with new assets giving rise to additional environmental, safety and other intangible benefits;</u>

Plant and equipment needs to be depreciated for tax at rates which provide the necessary incentive to invest in latest technology and match best international practice.

Without the appropriate incentives or required rates of return, replacement and upgrade of property is delayed, giving rise to environmental and safety risks.

(f) <u>it compensates for inflation, obsolescence risks, commercial risks of failure and early financing costs associated with capital-intensive industries;</u>

<u>(i) inflation</u>: A company's physical capital must eventually be replaced and in times of inflation the cost of replacement is continually rising. Further, inflation leads to the erosion of real capital and company earnings. There is an ongoing need to provide for funds/retain profits to assist in the financing of higher costs of replacing fixed assets. The pressure on business to finance replacement assets could be alleviated through accelerated depreciation measures. This brings taxable income closer to 'true' profits.

<u>(ii) obsolescence:</u> Even ignoring the effect of inflation, assets' values do not decline at constant rates and concern has often been expressed that an effective-life system cannot adequately reflect the influence of rapid technological change on assets' effective working lives. The Commissioner's rates (even if they were regularly updated) will generally only pick up gradual and persistent technological change. A rapid drop in value of a particular asset through technological change will not be immediately accounted for in the scheduled rate. Loading or acceleration of rates in this way takes into account obsolescence resulting from technological change and is expected to encourage modernisation.

These effects can be somewhat eliminated via self-assessment of effective life. Although due to the considerable compliance burden placed on the taxpayer to substantiate rates used that differ to the Commissioner's rates, it is often the most efficient solution to simply resort to the Commissioner's (understated) rates.

<u>(iii) commercial risk/cost of finance:</u> Industries, such as mining, have vast developmental expenditures at the beginning of a project before peak profit levels have been obtained. Measures such as accelerated depreciation assists in alleviating the related cash flow problems at this developmental stage of a project and thereby assist in repayment of borrowings and also in quicker expansion and development of the relevant activities. In the absence of such measures, the required rates of return for investment in this type of industry would increase which is

likely to lead to reduced overall investment in these activities. Further, if required 'hurdle rates' for particular projects would not be met at the onset of a project, the project would not proceed at all.

(g) <u>removal would bias decisions towards expenditure on repairs and maintenance rather than on replacement assets;</u>

Repairs and maintenance, which attract immediate write-off, bias decisions towards this type of expenditure in relation to existing equipment rather than the purchase of new plant. Accelerated rates would to some degree help reduce this bias.

(h) <u>its removal will increase the cost of certain "infrastructure" and similar assets, such as aircraft, reducing the economic viability of more marginal operations, with possible detrimental impacts to regional Australia.</u>

Removal of accelerated depreciation effectively increases the operating costs of capital intensive industries. Operations or projects that are currently only providing minimal returns may no longer be profitable and may therefore be terminated. For example, in the airline industry, flight paths to certain destinations in regional Australia may no longer be viable as such routes would cease to be profitable. It is thought that the detrimental consequences to the Australian economy, of cessation of certain means of transport to those regional areas, may be significant.

Attachment 2

Section 51AD

Background

In the 1970's and early 1980's, Australian tax benefits were used to lower the cost of funding of property used otherwise than to produce income subject to Australian tax. Broadly, an Australian investor would acquire the relevant asset and lease it to the (exempt) end user or the (exempt) end user would use or control the use of the property. The Australian investor would claim the normal tax deductions associated with ownership, principally, tax depreciation and interest. In a 46% tax rate environment, the tax timing benefits were significant and enabled the offshore or exempt end user to access cheaper finance.

Typically, the end user of the equipment was an off-shore party with no connection with Australia, the equipment was used outside Australia and the only connection with Australia was the use of the Australian tax benefits, or the end user was a tax exempt body in Australia (e.g. a government instrumentality).

To prevent this perceived abuse of the Australian Revenue, the Government enacted Section 51AD of the Income Tax Assessment Act 1936.

Section 51AD denies the tax owner of equipment tax deductions for <u>all</u> the usual costs associated with ownership (e.g., tax depreciation, interest, repair costs, etc.) whilst at the same time, leaving the Australian owner fully subject to tax on the income derived from leasing out the equipment. It is a very widely drafted provision with draconian consequences. Section 51AD applies where both of the following threshold conditions are satisfied:

- the acquisition of the equipment is financed predominantly by way of non-recourse debt; and

- a party not subject to Australian tax (e.g., a foreign resident or an Australian tax exempt entity) leases or uses or controls the use of the equipment or a (normally) taxable person uses the asset for the purpose of producing exempt income.

Relevance to Qantas

Throughout the 1980's and early 1990's, leveraged leases offered an effective means for Qantas to finance the acquisition of its aircraft fleet. Integral to such leveraged leases is the use of non-recourse finance. Therefore, if the use or the control of the use of any aircraft financed in this manner passes at any stage to an entity not subject to Australian tax (eg., a foreign airline, or a tax exempt body such as the Department of Defence), Section 51AD is brought into play.

The tax owner of the Section 51AD affected aircraft will suffer the denial of the tax deductions as long as the offensive use continues. Under all relevant leveraged leases, the tax owner of the aircraft is entitled to require Qantas to pay additional rentals to compensate the tax owner for the loss of the tax deductions. This can be a very substantial cost.

Transactions Affected

Any form of lease (dry or wet), or charter with a tax exempt or non-resident institution (utilising a Qantas aircraft) will potentially attract the operation of Section 51AD. Leasing of engines which were originally fitted to a Section 51AD affected aircraft are also potentially caught by Section 51AD even though they may no longer be fitted to that particular aircraft.

Qantas is also prevented from flying Section 51AD effected aircraft to jurisdictions from which it derives exempt income (eg, the Philippines). This gives rise to a significant issue in the effective and flexible scheduling of aircraft.

Opportunities involving leasing or chartering to non-resident airlines or tax exempt bodies by Qantas are frustrated by the restrictions imposed by Section 51AD. Revenue derived from such activities would be fully subject to Australian tax and there would be no additional tax deductions generated for any party. In other words, there can only be a net benefit to the Australian Revenue.

Section 51AD frustrates efforts by Qantas to earn significant export revenue. It also puts Qantas at a distinct competitive disadvantage to other airlines who are readily able to take up opportunities otherwise available to Qantas.

Remedy Required

If the general proposals in relation to leasing involving the conversion of a lease into a sale and loan are pursued, Section 51AD should be able to be abolished completely without any threat to the Revenue.

If such proposals are not pursued (as is recommended in this submission), then Section 51AD must be limited in such a manner to prevent its operation where there is no detriment to the Australian tax base. The Commissioner's discretions within Section 51AD should be broadened so that the Commissioner can determine that Section 51AD has no application where there is no detriment to the Australian tax revenue.

Also the operation of the section should be limited to deny deductions only to the extent (on a proportional basis) that income is derived from the use of property in a manner which contravenes Section 51AD. This would address one difficulty under the current law that the derivation of $1 of exempt income through the use of a Section 51AD effected aircraft, could give rise to a denial of all deductions in respect of that aircraft.

At present, the Commissioner has limited discretions in respect of Section 51AD and the Commissioner is generally reluctant to exercise these discretions in any event. Thus, it would be necessary for the Section to be amended so as to provide the Commissioner with more flexibility and commerciality in this regard.

Attachment 3

Consolidations - Artificial Loss Creation

The stated primary purpose of the regime is to quash the ability to create artificial losses by cascading losses through the company chain and by shifting assets around the company group at values lower or higher than their market values. We refute this repeated proposition based on the following arguments.

The problems of artificial loss creation and value-shifting arise primarily because of the dual layers of capital gains cost bases that currently apply - that is, one layer applying to the assets held by a company and the other applying to the equity of the company itself. The operation of capital gains tax generally only applies to one layer at the time of realisation and hence the cost bases of assets and of equity are often out of balance.

Although it is agreed that the current grouping provisions for rollovers and loss transfers allow loss duplication and cascading to occur, we do not believe that consolidation is the remedy to these problems.

The opportunity to duplicate losses is realised, not on the disposal of the underlying assets, but rather on the subsequent disposal of the equity in the relevant subsidiary. Therefore, it follows that the solution is in the adjustment of the relevant subsidiary's equity cost base on disposal. This adjustment is independent of the consolidation process. These adjustments to an exiting entity's equity cost base could be made regardless of consolidation and, therefore, the argument that consolidation is the answer to the existing problems of loss duplication and value shifting seems to be lacking the appropriate causal connection. More simply, the fact that the entity was once consolidated becomes irrelevant.

Given that consolidation is not the answer, the problems associated with exploitation of intra-group transactions (loss duplication, value shifting and full franking) should be remedied through other systemic statutory reform measures.

Attachment 4

Consolidations - Reduction in Compliance Burden

Alleged reduction to compliance under the consolidation regime is doubtful for the following reasons:

- The computation of tax returns on an entity by entity basis will be necessary to achieve the consolidated final product.

- The requirements for 100% and wholly Australian ownership to consolidate for tax purposes differs to the 'control' tests required to consolidate for accounting purposes. If consolidated accounting figures cannot be used, a separate consolidation purely for tax purposes will be required. This is clearly not a reduction in the compliance burden.

- It is thought that complexities will arise in relation to interest allocation rules (and determining the non-deductible component thereof) relating to the derivation of exempt (including presumably intra-group) dividends. Previously, the non-deductible component would have been limited to the interest expense of the entity holding the investment giving rise to such dividends, whereas it is possible the ATO may insist that the allocation of related interest expense or any other deduction should now be done on a group basis. Such an approach gives rise to additional compliance complexities.

- Attribution accounts pertaining to Controlled Foreign Corporations (CFC) and Foreign Investment Fund (FIF) interests should follow the relevant entity on exit from the group, as such accounts are meaningless without the entity itself. This divergence from a pure consolidation system raises further questions regarding the ability of a the proposed consolidation regime to decrease compliance.

- Carry-forward losses of an entity would be able to be brought into the group on consolidation. It is unclear how the consolidation of losses will blend with existing tax law governing a company's ability to carry forward tax losses (namely the continuity of ownership and same business tests). Options need to be developed to ensure that carry-forward losses which would otherwise have been available to be carried forward under existing tax laws will not be lost simply by virtue of the mechanics of the proposed consolidation regime. Failing this, business decisions will be unnecessarily influenced by tax considerations, resulting in unnecessary, and presumably unintended, burdens on the taxpayer.

Attachment 5

Deferred Company Tax

A number of countries' corporate tax systems have some feature which could be considered similar to the DCT currently proposed. However, from the discussion in "A New Tax System" none appear identical and most involve lower effective rates of tax.

Furthermore, "*An International Perspective*" indicates that such "top up" tax approaches are not an emerging trend and are largely confined to capital exporting countries.

Conclusions as to the potential inadequacies of such systems may therefore be drawn from the fact that both the UK and Ireland are terminating their Advanced Corporations Tax in April this year, having identified that their systems had adverse impacts on international competitiveness sighting concerns relating to international capital mobility.

In light of this, one needs to consider resultant capital outflow and the potential impact on share prices from non-resident shareholders, who are not taxable in their local jurisdiction, ie, US and UK pension funds, as a result of incurring a tax impost of 36% having previously been taxed exempt in Australia.

The RBT paper also acknowledges that DCT will have an adverse impact on corporate profits as a result of the incidence of tax liability of a shareholder being effectively imposed on the corporate's profit and loss (refer Table 15.2 of the RBT paper). This may be further impacted by corporates being potentially required to fund DCT via instalment effectively reducing existing earnings capacity. Any resulting reduction in yields must have an impact on demand for Australian stocks.

Therefore, given Australia's position of relative weakness in the global capital market, it would appear unrealistic to expect international markets and shareholders to "appreciate the impact of the change on those listed companies deriving significant tax preferred income" (15.38 at 353) as investors, are likely to consider after-tax yields when benchmarking all existing and prospective investments.

Furthermore, the proposition that dividend policies should be influenced by tax considerations can only lead to further market inefficiencies and distortions.

Further consideration also needs to be given to the possible adverse impacts of the proposed DCT system on employee share acquisition schemes and trusts which may be rendered ineffective as a result of the introduction of DCT resulting in the current congruence of economic interests between employee and employer being eroded.

The introduction of Deferred Company Tax (DCT) as proposed is opposed given that it presents significant disadvantages to corporate Australia (given that the DCT tax cost is expensed in the company's profit and loss statement). It contains no significant structural advantage over the resident dividend withholding tax either from the revenue or taxpayer perspective.