

TRANSURBAN CITY LINK LIMITED
SECOND SUBMISSION TO THE REVIEW OF BUSINESS TAXATION
“A BETTER DESIGN - II”

INTRODUCTION

Transurban City Link Limited (“Transurban”) is pleased to make this further submission in response to the two Discussion Documents released by the Review of Business Taxation (“RBT”), *A Strong Foundation* and *A Platform for Consultation*.

Based on its review of the Discussion Documents, Transurban has concerns about the following aspects of the business taxation reforms under consideration by the RBT:

- The proposal for a regime of uniform entity taxation, in particular the sacrificing of the design principle of transparency for a high degree of uniformity without proper justification; and
- The transition from the current system of business taxation to the reformed system ultimately decided upon by the government.

The bases of our concerns in these areas are set out in the following paragraphs.

THE PROPOSAL FOR UNIFORM ENTITY TAXATION

Tension between Design Principles

As indicated in our earlier submission *A Better Design*, Transurban strongly supports the design principles proposed in *A Strong Foundation*, namely, that business entities should be regarded as extensions of their ultimate owners [paragraph 6.62] and that investment neutrality should exist regardless of the vehicle chosen as the intermediary [paragraph 6.69]

There is, however, the potential for tension between these design principles, and in Transurban’s view, the approach taken in *A Platform for Consultation* to the resolution of this tension is not sufficiently tested or developed and hence is potentially flawed. The approach, which involves a substantial sacrifice of the principle of transparency in order to achieve a high level of perceived consistency, is flawed because transparency will produce real design improvements whereas the justification for consistency is questionable. Moreover, the quest for perceived consistency may have some unintended consequences.

A Strong Foundation and *A Platform for Consultation* do not make clear the bases on which the chosen balance in favour of consistency over transparency has been struck. Paragraph 9 of *A Strong Foundation* states that:

“There are many instances in the current tax law where the tax treatment of income from a particular transaction depends on the nature of the entity undertaking the transaction. This violates the tax Principle that taxpayers in similar positions should be treated

similarly. Taxpayers are also encouraged to adopt ownership structures that maximise their tax advantages rather than the structure best suited to their business circumstances"

Given that this position substantially affects everything that follows in *A Strong Foundation* and *A Platform for Consultation*, it is surprising that so little is offered in the way of its justification.

The statement that "Taxpayers are also encouraged to adopt ownership structures that maximise their tax advantages rather than the structure best suited to their business circumstances" is particularly concerning for the following reasons:

- No insight is provided into either the distinction perceived between "tax advantages" and "business circumstances" or how the implied dysfunction arising from the distinction occurs; and
- No evidence is provided that the perceived "encouragement" is occurring or that it cannot be adequately dealt with by existing anti-avoidance provisions.

The Role of Pricing

The analysis underpinning the statements of paragraph 9 also seems to ignore the role that other mechanisms, in particular pricing, play in removing the potential for arbitrage between particular entity forms.

The RBT's apparent strong preference for a uniform entity taxation system based on a corporation model could be inferred as implying a view that other entity forms are somehow deficient from a revenue collection viewpoint. However, such a view cannot be sustained, as under current taxation law, a wide variety of entity forms is observed. If there was an entity form which universally provided "tax advantages" (in the sense in which this term is used in paragraph 9), this form would be expected to dominate. The reasons for the lack of such dominance are, firstly, that in reality, "tax advantages" do not exist independently of "business circumstances" and secondly, that the price of an investment merely reflects the relevant "business circumstances".

Redressing the Balance between the Design Principles

Transurban considers that the RBT has erred in focussing its design of the reformed business taxation system on the achievement of consistency in the form of uniform entity taxation, rather than on transparency.

The following developments appear to indicate that recognition of the potential adverse consequences of rigorous pursuit of uniform entity taxation is emerging:

- The decision to provide for a regime for the taxation of an entity designated as a Collective Investments Vehicle ("CIV") outside the proposed uniform entity taxation regime; and

- The Treasurer's announcement indicating that cash management trusts and, in principle, certain other widely held public trusts will be taxed as flow through entities.

However, given the relatively limited relief which these decisions provide and the unsatisfactory nature of the regime itself (see below), Transurban considers there is still a strong need to further redress the balance between the key design principles in favour of transparency. As previously indicated, this could readily be achieved by providing for an election for entities undertaking certain types of activity to be treated as flow through entities in relation to those activities. This would be a more general application of the narrowly focussed exemptions from the uniform entity taxation regime already being considered.

Improving the Uniform Entity Taxation Regime

While Transurban considers for the reasons outlined in the preceding paragraphs, there is considerable scope for a more flexible approach to the issue of the degree of uniformity of entity taxation, the approach to the taxation of the RBT's "benchmark" entity form, the company, also needs further consideration, particularly with regard to the impact of the approach on "non-benchmark" entities.

Paragraph 15.6 of *A Platform for Consultation* refers to the need to address the presently perceived complexities of the imputation system, but the initiatives proposed for this purpose have their own deficiencies, particularly when applied to non-benchmark entities.

A Platform for Consultation proposes three different methods for the taxation of distributions of untaxed income. All appear to simply move the point of taxation to an earlier stage in the distribution chain. If this were the only consequence of the proposed changes they would be of little concern. Critically, however, in the case of non-benchmark entities which are not otherwise exempt from the uniform entity taxation regime, they create the potential for a material adverse change in the entity's "tax advantages" (which are recognised and promoted by the existing tax law) and hence, its "business circumstances".

Transurban suggests that projects which are presently being undertaken through non-benchmark entities are being undertaken in this way because, taking into account the particular circumstances of the project, the chosen entity form provides the most favorable "business circumstances" for undertaking the project. Clearly, because (as stated earlier) one aspect of "business circumstances" is "tax advantages", if the effect of the application of the benchmark entity taxation regime to a non-benchmark entity is to reduce its "tax advantages", it is clear that its "business circumstances" and hence, the value of an investment in the entity (i.e. its price) will be adversely affected.

It is Transurban's clear preference that this problem be avoided by a more flexible approach to the taxation of non-benchmark entities involving a greater reliance on transparency. Specifically, it is Transurban's view that widely held non-benchmark entities engaged in infrastructure provision should be included in the proposed regime for Collective Investment Vehicles.

A “second best” approach would be to redesign the regime applicable to the benchmark entity to remove some of the negative consequences for non-benchmark entities of the currently proposed approaches. In this regard, it is disappointing that *A Platform for Consultation* does not appear to have considered the Canadian system of imputation. Under this system, a shareholder is automatically entitled to receive a credit for imputed corporate tax attaching to a dividend, irrespective of whether or not tax has been paid on the underlying corporate profit. The credit is provided without any corresponding provision for equalisation tax or deferred company tax because the cost to revenue of the incentive represented by the credit has taken into account the lack of any clawback. In other words, the incentive provided is smaller than it would otherwise have been because it is received by shareholders as untaxed income. Such a system is considered to have the potential to deliver the benefit of a simplified imputation system at no cost to revenue, by appropriately adjusting the amount of the incentive. The system would also have fewer adverse consequences for non-benchmark entities.

TRANSITIONAL CONSIDERATIONS

Transurban is particularly concerned about the potential negative effects of the application of a uniform entity taxation regime based on a particular benchmark to non-benchmark entities. It is Transurban’s strong view that appropriate “safe harbours” need to be provided as part of the transition to the reformed system of business taxation. The process of transition, if not handled correctly, has the potential to eliminate the benefit of all the assistance previously delivered to entities and projects through the business taxation system.

Of particular concern to Transurban in this regard is the impact of the Deferred Company Tax proposals on one of the most significant assets of the Melbourne City Link project, the ability to carry forward the tax losses which typically arise in the early phases of an infrastructure project.

To the extent that such transitional impacts can not be avoided by the design of the reformed business taxation system, any provisions of the system which would have a material adverse effect on the quantum or timing of the tax payments of an existing project, particularly if the project is the subject of arrangements which have been previously approved by the taxation authorities, should not apply to such projects. Alternatively, such projects should be given the opportunity to adopt a different corporate structure without being subject to the negative tax consequences which would otherwise arise from such a reorganisation.

12 April 1999