Pioneer International Limited

Comments on the Review of Business Taxation Discussion Papers - "A Platform For Consultation"

Introduction

In response to the Review's invitation, Pioneer International Ltd is providing its comments on the Second Discussion Paper and also on related issues which have emerged in debate following the Paper's release.

Summary

In summary:

1. We strongly oppose the introduction of the proposed deferred company tax regime.

2. We strongly support amendments to the capital gains tax regime to allow scrip for scrip rollover relief in both domestic and international mergers, as well as for divisional spin offs involving assets already owned by shareholders.

3. We would like to see amendments to Australia's controlled foreign corporation provisions to ensure Australia remains internationally competitive.

4. We naturally support any reduction of the corporate tax rate. However, it is difficult to view this benefit in isolation from other proposed changes to the business tax climate.

Deferred Company Tax

The Review of Business Taxation document, "A Platform For Consultation" provides three mechanisms for changing the current imputation system:

(a) Deferred company tax;
(b) Resident withholding tax;
(c) Taxing and franked inter-entity distribution

In addition, the introductory remarks (paragraph 240 and following) raise the possibility of a return to a classical system under which an entity is taxed and the members of the entity taxed on their distributions received from the entity without any credit for tax paid by the entity.

In our initial submission we were supportive of any changes to the imputation system on the following basis:

(a) The new system is a method for collecting, up to the corporate tax rate, the tax payable by domestic individual shareholders.

(b) Domestic individual resident shareholders are entitled to a refund of the tax paid to the extent their tax liability on the dividend is not 36%, and the excess is not able to be utilised against their tax liability on other income.

(c) Domestic superannuation funds, which are taxed at the rate of 15%, are entitled to a refund of excess franking credits if the funds are unable to use the additional tax to offset their tax liability on other income.

(d) The tax needs to be designed and referred to as a withholding tax in order to enable foreign shareholders to claim a credit in their domestic jurisdiction and obtain treaty relief where applicable.

(e) The accounting treatment is such that the tax amount does not result in a charge to the profit and loss statement at the corporate level.

Having reviewed the proposals contained in "A Platform For Consultation", it is clear that the deferred company tax proposal does not meet all these objectives. Specifically we are concerned that in cases such as ours (which is not an isolated example) where there is a significant mix of foreign and domestic income the proposal will result in additional tax, reduced profit or a reduced dividend payout. In turn there is a potential flow on effect causing share prices to decline and ultimately hampering Australian based multi-nationals ability to raise capital in foreign markets.

On the face of it, it appears the deferred company tax proposal has been designed without recognition of Australia's multi-nationals and of the fact that they derive a significant portion (in our case approximately 65-70%) of their income from activity conducted in foreign jurisdictions.

The same proposal also fails to adequately address the fact that Australia's multi-nationals such as ours have a significant portion of foreign shareholders. The level of foreign shareholding is more difficult to estimate given the propensity of nominee shareholdings. However, in our case we estimate the number of foreign shareholders to be in the vicinity of 40%. We are not comfortable that foreign jurisdictions will accept the increased dividend withholding tax and allow additional credit.

As such, we are strongly opposed to the introduction of a deferred company tax regime.

Resident Dividend Withholding Tax

If there is to be a change to the proposals put forward we favour the introduction of a resident dividend withholding tax, on the basis it has the least distortionary effect on dividend pay out ratios and capital markets.

Obviously there will be cashflow and administrative matters to deal with which will increase the burden on Australian corporates. However, we are prepared to undertake a collection mechanism in order to ensure the Government obtains its proper share of revenue from dividends.

Streaming Foreign Income to Foreign Shareholders

There has been mounting speculation that in order to deal more equitably with Australian multi-nationals and foreign shareholders, dividend streaming of foreign income to foreign shareholders could be allowed as part of the introduction of a deferred company tax. Conceptual neatness aside (in that Australian taxable income goes to Australian shareholders and foreign income flows to foreign shareholders), such an idea is fraught with difficulties, both in terms of its implementation and in terms of mix of shareholders and income.

Pioneer earns approximately 65-70% of its income offshore and has approximately 35-40% offshore shareholders. In such a situation foreign streaming will create a build up of foreign income which cannot be distributed to shareholders without adverse tax consequences. We can see that it is a conceptual improvement on the introduction of a pure deferred company tax regime, however, it is still detrimental to many Australian multi-nationals when compared to the existing system.

The following example assumes a company that has distributable profits is not prepared to suffer a deferred company tax impost.

By way of a simple numerical example, assume pre Australian tax earnings of 100 of which 30 are domestic and carry tax at 36%. The Australian tax paid will give rise to a franking credit of 19.2. Under the existing system the gross dividend would be paid out at 19.2 franked.

Under a deferred company tax proposal the dividend to domestic shareholders would be required to be 100% franked, therefore only 19 could be paid out as a dividend if no deferred company tax was to be paid.

Under the deferred company tax with foreign streaming a 19 fully franked dividend would be paid to domestic shareholders and 8 paid to the foreign shareholders. As such, the dividend pay out has been reduced to 27. The excess, representing the surplus foreign earnings, can only be distributed on payment of additional Australian tax (deferred company tax).

	Existing		DCT		DCT with Streaming	
Dividend	80		19.2		27.43	
Shareholders						
• Domestic	56		13.44		19.2	
• Foreign		24		5.76		8.23
Franking Credits	19.2	-	13.44	-	19.2	-
Withholding Tax	-		-	-	-	-
Net Dividend	80		19.2		27.43	

Assumptions:

100 of profit
70% foreign income
30% Australian income - fully taxed
Distributions between 70% and 90% of profit
100 Shareholders
70 Domestic
30 Foreign

In a situation such as ours, where foreign earnings are increasing at a greater rate than domestic earnings, such a regime, would provide a positive incentive to have fewer and fewer Australian shareholders. It is our view that the Government would not intend disincentivising Australian multi-nationals from having Australian shareholders.

Such a regime would also become a driver of corporate dividend policy, which we would regard as a totally undesirable and unacceptable consequence. We are strongly of the view that decisions in relation to dividends and pay out ratios should be unfettered by tax policy. The dividend decision at a corporate level is a matter of fundamental bearing on a corporation’s market value and ability to grow, in the interests of all its shareholders. Inadvertent or premeditated incidence of a tax policy (aimed at purifying imputation or avoiding manipulation of the imputation regime) on the dividend policy decision would be a tragic result for Australia and Australian multi-nationals’ international competitiveness.

At a time when global markets encourage the free flow of funds Australia should not be introducing tax regimes which will dictate how multi-nationals determine their dividend policies, or be incentivising them to increase their mix of foreign shareholders.

The practical difficulties that arise include:

(a) The inability to track foreign shareholders, particularly on the basis that many invest via nominees in Australia.

(b) The mechanics of tracking and allocating foreign income to foreign shareholders. If foreign income is pooled via Australia, which is administratively easier, the potential benefits to foreign shareholders may not be delivered, and there may be further incidence of foreign withholding tax.

Conclusion

We are strongly of the view that a deferred company tax regime should not be introduced into Australia. Furthermore, any coupling of a foreign income to foreign shareholders streaming mechanism to alleviate the foreign problem of such a regime does not, at a practical level, provide the compensation or benefits necessary to justify the introduction of a deferred company tax regime.

Capital Gains Tax

The income tax provisions need to be reviewed and amended to ensure they provide appropriate relief for corporate reorganisations and mergers. In particular, there needs to be relief for scrip for scrip transactions for both domestic and international mergers as well as for divisional spin offs involving assets effectively already owned by shareholders. The imposition or potential imposition of tax should not be used as a reason against a merger of companies which provides enhance value to shareholders and the economy in general.

We are of the view that indexation should be maintained. However, it should be consistent for all taxpayers which means that it should be able to be passed through corporations to shareholders and be treated as tax free in their hands.

CFC Provisions

We are of the view that the CFC provisions need to be reviewed and amended. It is our view that they are currently overly complex. They require significant internal administrative effort, both domestically and offshore, which does not necessarily result in any additional revenue for the Australian Government.

In addition, they make it very difficult and sometimes impossible to undertake any form of internal reorganisation without triggering an Australian income tax liability. Even internal reorganisation which would not be subject to tax in Australia if it took place in Australia is potentially taxable under the CFC provisions. Such a position needs to be remedied.

We trust these comments are useful in providing insight into tax reform from the point of view of one of Australia’s most international companies.

14 April 1999