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Thakral Holdings Limited

Submission to the Review of Business Taxation

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1 Executive summary of submissions

1 After introduction of entity taxation, the types of entities that are grouped for the purposes of income tax and other taxes [including the proposed Goods and Services Tax ("GST")] should comprise both companies and fixed trusts.

2 Fixed trusts that are part of a consolidated group should be able to bring (or transfer) income tax losses into the consolidated group at 30 June 2000, if the relevant fixed trust satisfies the requirements of the trust loss regime in relation to these losses during the period to 30 June 2000.

3 Stamp duty on transfer or conveyances of business property, should, as outlined in "A New Tax System", be scrapped as soon as possible.

4 As an interim step, relief from State stamp duty should be available for transfers of assets between fixed trusts, and fixed trusts and companies, that are part of a 100% owned group, especially where such restructuring is required due to the implementation of the entity taxation proposals.

5 Listed stapled security groups, in which units in a unit trust and shares in a company are stapled together and jointly listed on the Australian Stock Exchange, should be able to elect for the listed company and listed trust and all 100% subsidiary entities to be treated as part of one consolidated group.

6 Roll over relief should be available for transfers of assets between fixed trusts, and also between fixed trusts and companies, that are part of a 100% owned group:

- as a transitional measure to facilitate the restructuring of groups of companies and trusts prior to the implementation of the entity taxation proposals; and
- after 1 July 2000 so that consistent rules apply to companies and trusts, where no consolidated group election is made.

7 The definition of CIV, as proposed in paragraph 16.16, of APFC should not include any requirement that a fixed property trust be 'widely held'.

8 A fixed trust or company that is listed on a Australian Stock Exchange or is a wholly owned subsidiary of such listed trust or listed company, should be deemed to be widely held for the purposes of the proposed CIV rules and classification of entities (refer to chapter 21 of APFC) <u>if</u> a "widely held" test is adopted.

9 A fixed trust that is considered to be a CIV by virtue of the fact that it is a subsidiary trust of a CIV, should be able to elect not to be treated as a CIV for taxation purposes.

10 Income and the value of capital deductions (such as depreciation and Division 43 building amortisation allowances) should continue to flow through CIVs in the same way they currently do as taxable, tax deferred and tax free distributions.

11 Where entities establish a joint venture through a fixed trust, the joint venturers should be able to irrevocably elect for the fixed trust to be treated as a partnership for income tax purposes.

12 Of the three proposed methods of implementing a full franking system, we submit that:

- the deferred company tax option (refer to paragraphs 15.28 to 15.31 of APFC) should not be adopted; and

- under resident dividend withholding tax, the Section 46 inter-corporate dividend rebate should continue to be available for dividends paid by entities (being companies and fixed trusts) to entity shareholders

2 Consolidated taxation regime

2.1 Consistent determination of "Groups"

Submission:	After introduction of entity taxation, the types of entities that are grouped for the purposes of income tax and other taxes [including the proposed Goods and Services Tax ("GST")] should comprise both companies and fixed trusts.

Entity taxation intends to treat trusts and companies in a consistent manner for tax purposes. The consolidated tax regime is proposed to apply to groups that consist of a holding entity and its wholly owned subsidiary companies and trusts. However, paragraph 26.6 of APFC contemplates that there may be departures from this principle in certain circumstances.

The concept of the type of entities that constitute a group should be applied consistently for taxation purposes, including the proposed GST. This will ease the administrative burden for groups that may otherwise need to monitor different groupings of companies and trusts, depending on the particular taxation regime in question.

For example, the draft GST legislation currently only contemplates that companies may be grouped. This is different from the consolidated tax regime outlined in Chapter 26 of APFC. Such differences could give rise to significant administrative difficulties for groups that comprise of companies and trusts.

2.2 Carrying forward losses into a consolidated group

Submission:	Fixed trusts that are part of a consolidated group should be able to bring (or transfer) income tax losses into the consolidated group at 30 June 2000, if the relevant fixed trust satisfies the requirements of the trust loss regime in relation to these losses during the period to 30 June 2000.

In support of this submission, we make the following comments:

- The proposed transitional rules concerning entities bringing prior year losses into a consolidated group, as outlined at paragraphs 26.89 to 26.99 of APFC, do not properly reflect the differing tests to be satisfied for utilisation of carry forward losses of trusts and companies and are therefore unduly restrictive.

- Whilst trust losses cannot, technically, be transferred within a group in the way company group losses can be transferred, trust losses may be effectively used within a group due to the "flow through" nature of trusts.

For example, the losses of a holding trust may be effectively used to offset against the taxable income distributed by a subsidiary trust. The trust loss regime contains an anti-avoidance provision, being the income injection test, to prevent any schemes to take advantage of trust losses.

- Any requirement for there to be 'transferability' of losses before such losses are able to be transferred into a consolidated group, could never be satisfied by trusts (refer to option 1, paragraph 26.90, and option 5, paragraph 26.98 of APFC). This clearly discriminates against business operations that have been established in fixed trusts, where income tax losses are being carried forward by the fixed trust as at 30 June 2000.

- Any income tax losses incurred by fixed trusts, other than listed widely held trusts, are only able to be carried forward if a continuity of ownership test is satisfied. These fixed trusts do not have the benefit of the same business test as that test is only available to listed widely held trusts.

  The losses of fixed trusts which satisfy the trust loss regime during the period to 30 June 2000 should be able to be transferred to the consolidated regime as such losses, effectively, represent continuity of ownership losses.

- The trust loss regime allows losses incurred by fixed trusts before 9 May 1995, which were not incurred whilst the fixed trust was within the 100% owned group, to be carried forward and utilised where a continuity of ownership test (the 50% stake test) is satisfied from 9 May 1995.

  It is therefore inappropriate for the transition rules (refer to option 4, paragraph 26.97 of APFC) to only allow losses of fixed trusts to be transferred to the consolidated group where the losses were incurred whilst the fixed trust was part of the 100% owned group.

2.3 Stapled securities

Submission:	Listed stapled securities groups, in which units in a unit trust and shares in a company are stapled together and jointly listed on the Australian Stock Exchange, should be able to elect for the listed company and listed trust and all 100% subsidiary entities to be treated as part of one consolidated group.

Listed stapled securities do not comprise part of the one consolidated group under the proposed consolidated tax regime as there are, effectively two holding entities. However as the listed company and listed trust that comprise the stapled security generally have 100% common beneficial ownership, such entities and their 100% subsidiary entities should be able to elect to form part of the one consolidated group.

3 Roll over relief

3.1 General taxation relief

Submission:	Roll over relief should be extended so that it is available for transfers of assets between fixed trusts, and also between fixed trusts and companies, that are part of a 100% owned group: ■ as a transitional measure to facilitate the restructuring of groups of companies and trusts prior to the implementation of the entity taxation proposals; and ■ after 1 July 2000 so that consistent rules apply to companies and trusts, where no consolidated group election is made.

In support of this submission, we make the following comments:

- Transitional provisions are required to allow roll over relief for the transfer of assets between fixed trusts and fixed trusts and companies that are part of the same wholly owned group. The review of business taxation proposes wide-ranging and fundamental changes to the taxation treatment of business entities, in particular fixed trusts which, if introduced, are likely to facilitate substantial restructuring and rationalisation of groups including trusts and companies. The rationalising of groups would reduce complexity and be more efficient.

- Roll over relief is currently available for transfer of assets within wholly owned groups of companies. In keeping with the proposed entity taxation regime, the same rollover relief which is available to transfers of assets between companies with 100% common ownership should also be available for asset transfers between entities that comprise both trusts and companies.

- The above roll over relief should be available for transfers of assets between entities within a group of companies and trusts under the new legislative regime, if no consolidated group election is made.

3.2 Stamp duty

3.2.1 Abolish stamp duty on commercial property

Submission:	Stamp duty on transfer or conveyances of business property, should, as outlined in "A New Tax System", be scrapped as soon as possible.

Thakral supports the abolition of stamp duty on transfers or conveyances of business property as soon as possible, for a number of reasons, including the following:

- Stamp duty on real property in the States and Territories in Australia is "discriminatory" in the sense that as a class of assets, real property bears a significant higher rate of duty compared to other types of assets, particularly shares. Thus stamp duty lacks the critical characteristics of tax neutrality. The long term result is that the lack of tax neutrality will distort decision making and investment capital flows to the real property market;

- Stamp duty is a transaction tax that creates market place inefficiencies by distorting the behavior patterns of property owners by the so-called "lock-in" effect. That is, the amount of stamp duty payable is a significant factor in the decisions of the owners of real property to acquire or dispose of an existing property;

- Stamp duty in Australia is imposed at significantly higher levels and in a vastly more complex manner than in comparable jurisdictions;

- The lack of harmony existing in relation to the various stamp duty regimes has lead to distortions between the respective States and Territories in Australia which can (and do) impede capital movements. This imposes significant compliance costs, particularly for those businesses that operate in more than one jurisdiction. These differences also create opportunities to avoid taxes, encouraging taxpayers and businesses to locate themselves, or conduct their activities, in States with lower stamp duties; and

- The commonwealth of the Managed Investments Act will, in the absence of adequate stamp duty rollovers, impose an additional unfair burden on the property industry.

3.2.2 Group relief

Submission:	As an interim step, relief from State stamp duty should be available for transfers of assets between fixed trusts, and fixed trusts and companies, that are part of a 100% owned group, especially where such restructuring is required due to the implementation of the entity taxation proposals.

As noted at 3.1 above, the review of business taxation proposes wide-ranging and fundamental changes to the taxation treatment of business entities, in particular fixed trusts, that are likely to necessitate substantial restructuring of trust groups. In this context, relief from State transaction taxes, such as stamp duty, should also be available.

4 Collective Investment Vehicles ("CIVs")

4.1 'Widely held' requirement of CIVs

Submission:	The definition of CIV, as proposed in paragraph 16.16 of APFC, should not include any requirement that a fixed property trust be 'widely held'.

We submit that the concept of 'widely held' should not be applied in determining whether a fixed property trust is a CIV as:

- There will be a significant on going administrative burden for fixed property trusts in tracing their unitholders to ascertain whether the 'widely held' test is satisfied, especially for listed trusts. The administrative difficulties are compounded by the fact that a number of shareholdings in listed trusts and companies are held through nominee entities.

- Fixed property trusts are investment vehicles that are used to allow small investors to invest in property, and receive the returns associated with such investments, without a prohibitive capital outlay.

- It is important that investors in these trusts are able to receive the same tax benefits as investors who invest directly in such investment properties. Any change to this may fundamentally and adversely impact the viability of this type of property investment, the value of these properties and the returns able to be realised by investors.

- Large corporate groups are increasingly deciding that they do not wish to bear the property risk associated with owning any property required for their business operations. Their property needs, for the time being, are being increasingly met through leasing properties.

- Fixed property trusts are typically used to invest in such properties as they:

  - represents an effective way of raising capital to finance the acquisition of property; and

  - provides liquidity in relation to property investment by allowing investors to realise their investment by selling units in the fixed property trust rather than a direct interest in the property.

4.2 Classification of entities

Submission:	A fixed trust or company that is listed on a Stock Exchange or is a wholly owned subsidiary of such listed trust or listed company, should be deemed to be widely held for the purposes of the proposed CIV rules and classification of entities (refer to chapter 21 of APFC) <u>if</u> a "widely held" test is adopted.

All fixed subsidiaries of trusts and companies that are listed on the Australian Stock Exchange ("ASX") or a wholly owned subsidiary of a listed trust or company should be deemed to be widely held for the purposes of the CIV rules and classification of entities as the listing rules of the ASX require a minimum spread of investors before such entities may be listed

4.3 Election to reject CIV status

Submission:	A fixed trust that is considered to be a CIV by virtue of the fact that it is a subsidiary trust of a CIV, should be able to elect not to be treated as a CIV for taxation purposes.

Under current income tax legislation, the status of subsidiary entities is determined by the status of the ultimate holding entity. For example:

- Under the trust loss regime, the status of a subsidiary of a fixed trust may be determined by the status of its ultimate holding trust (refer to Section 272-127 in Schedule 2F of the Income Tax Assessment Act 1936).

- A subsidiary of a public company is also deemed to be a public company for income tax purposes.

A fixed trust that is part of a group should have the ability to elect not to be treated as a CIV. This would enable the fixed trust to be consolidated with other entities in the group (including companies and trusts) in the consolidated tax return.

4.4 CIV flow through

Submission:	Income and the value of capital deductions (such as depreciation and Division 43 building amortisation allowances) should continue to flow through CIVs in the same way they currently do as taxable, tax deferred and tax free distributions.

Thakral endorses the comments of the Property Council of Australia in its submission concerning this point. In particular, allowing distributions of tax preferred income by property trusts to continue flowing through to property trust investors as non-assessable income would:

- Ensure competitive neutrality between wealthy individual investors and smaller investors;
- Avert a shift from the Australian property trust sector by investors, making it difficult for a sector to finance capital requirements;
- Be consistent with international practice and maintain the international competitiveness of the property trust industry;
- Avoid a reduction in the income distributions of property trusts, which would affect the incomes of many small investors; and
- Avoid further increase in the complexity associated with the business income tax system.

Moreover, it is submitted that there would be little addition to taxation revenue if such tax preferences were neutralised on distribution.

4.5 Grandfathering

Submission:	If, as a general rule, it is decided that tax preferences are not to flow through CIVs, there should be appropriate grandfathering provisions to ensure that investors in a CIV which owns a building can continue to access the tax preferences (such as depreciation and building allowances) over the remaining life of the assets and building.

Such a measure is necessary to ensure fairness to those investors who made investments decisions in anticipation of such tax preferred income distributions. Moreover, a sudden change in the method of taxing such distributions could have an immediate negative impact on the value of small investors investments: again, this would be unfair.

Accordingly, such grandfathering would assist in causing there to be an overall fair and orderly transition to the new regime.

5 Joint Ventures

Submission:	Where entities establish a joint venture through a fixed trust, the joint venturers should be able to irrevocably elect for the fixed trust to be treated as a partnership for income tax purposes.

There are currently various ways for independent parties to structure a joint investment, including:

- legal joint ventures;
- partnerships; and
- fixed trusts.

Under the current law, a joint venture fixed trust structure, broadly, results in the same flow through taxation consequences as if a partnership had been formed (except that tax losses do not currently flow through trusts). It is proposed that the current tax treatment of partnerships will be maintained.

Joint investments structured through a fixed trust may be disadvantaged if a similar flow through is no longer allowed where a fixed trust is used as a joint venture vehicle. For this reason, where entities establish a joint venture through a fixed trust, the joint venturers should be able to irrevocably elect for the fixed trust to be treated as a partnership for income tax purposes. This would mean that a unitholder (ie. quasi-partners) would be assessed on its share of the trust's taxable income or be entitled to a share of any tax loss suffered by the trust.

6 Deferred Company Tax

Submission:	Of the three proposed methods of implementing a full franking system: ■ the deferred company tax option (refer to paragraphs 15.28 to 15.31 of APFC) should not be adopted; and ■ under resident dividend withholding tax, the Section 46 inter-corporate dividend rebate should continue to be available for dividends paid by entities (being companies and fixed trusts) to entity shareholders.

The option for a Deferred Company Tax ("DCT") should not be adopted as:

- Any tax preferred distributions of an entity would be subject to a DCT. As this is to be a tax on the company rather than the shareholder, the proposed DCT would act as a disincentive for foreign investment in Australia where the return to investors is at least partially in the form of tax preferred distributions. Such distributions would have an effective tax rate equal to the corporate tax rate, of 30% rather than 15% as currently applies to unfranked dividends paid to investors resident in listed countries.

  Further, foreign shareholders may have difficulty in claiming a foreign tax credit for any additional Australian tax in respect of these distributions.

- The DCT proposal results in a significant acceleration in the payment of tax on distributed profits within a corporate group. This will adversely impact investors, especially investors entitled to a refund of any tax overpaid.

The Resident Dividend Withholding Tax ("RDWT") is preferred provided the current Section 46 inter-corporate dividend rebate is retained for dividends paid by entities (being companies and fixed trusts) to entity shareholders. If the inter-corporate dividend rebate is unavailable, tax preferred (or unfranked) dividends to entity shareholders will be effectively taxed in the hands of entity shareholders. This would remove the ability to flow through distributions of tax preferred income untaxed.