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16 April 1999

Dr Alan Preston
The Secretary
Review of Business Taxation
Department of Treasury
Parkes Place
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Dear Dr Preston

Westpac Banking Corporation
A Platform for Consultation - Submission

Please find attached two hard copies of our submission, together with an electronic copy on disk.

If you or any member of the Review team have any queries in relation to any aspect of our submission, please contact Paul Hooper on (02) 9226 4147, Sue Oh on (02) 9226 3393 or Henry Lam on (02) 9226 3404..

Yours faithfully

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WESTPAC BANKING CORPORATION

REVIEW OF BUSINESS TAXATION

Submission on

A Platform for Consultation

Second Discussion Paper issued by the Review of Business Taxation

16 April 1999

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EXECUTIVE SUMMARY

1. Corporate Tax Rate and Tax Preferences

Westpac Banking Corporation (“WBC”) supports a reduction in the company tax rate from 36% to 30% funded by the removal of accelerated depreciation.

2. Imputation

WBC opposes the introduction of Deferred Company Tax (“DCT”). However, WBC will support the introduction of DCT if the streaming of foreign earnings to foreign shareholders is allowed without any Australian tax impost. In the alternative, WBC supports the a resident dividend withholding tax regime and the retention of the intercorporate dividend (section 46) rebate.

3. Taxation of Entities

WBC supports the concept of taxing most entities as companies with the exception of collective investment vehicles (“CIVs”); superannuation funds, approved deposit funds (“ADFs”) and pooled superannuation trusts (“PSTs”); trusts wholly owned by CIVs and superannuation funds, ADFs and PSTs; life companies; deceased estates, bare trusts and court ordered trusts. In relation to CIVs, the tax treatment of income distributed to beneficiaries should follow the character of the income distributed.

4. Taxation of Life Insurers / Collective Investment Vehicles

WBC suggests that all public offer unit trusts should retain their flow through status. In addition, the immediate annuity and pension businesses should be taxable at the investor level only. We also propose that PSTs and life company superannuation policies should remain tax paid products, and that existing life and superannuation policies should be grandfathered from both the shareholder and policyholder perspective.

5. Taxation of Entity Groups

WBC does not consider that the introduction of a consolidation regime for the taxation of entity groups will provide the benefits cited in the Review especially when compared to the current system. However, in the event that a consolidated regime was to proceed, it is imperative that the regime achieves the benefits cited in the Review. We do not support the abolition of capital gains tax rollover relief for asset transfers when determining the attributable income of Australian Controlled Foreign Companies.

6. International Tax

Whilst WBC supports, in principle, the concept of a foreign income account, for the proposal to operate effectively the current dividend streaming rules will need to be relaxed. In addition, Australia's inefficient tax treaties with respect to dividend withholding tax need to be reviewed. However, WBC does not support the interest allocation rules nor the taxation of branches as separate entities. We also do not support the amendments to the Foreign Investment Fund rules.

7. Taxation of Financial Assets and Liabilities

WBC supports the introduction of the taxation of financial arrangements, subject to the recognition of internal hedging and the inclusion of an option to use foreign currency re-translation.

8. Taxation of Leases

WBC does not support the adoption of a sale and loan approach to leasing. If a decision is made to proceed with a sale and loan approach, it should only apply to finance leases (as defined in the current Australian accounting standard).

However, WBC does support the replacement of section 51AD and Division 16D with a sale and loan approach. We also support a sale and loan approach for leases that involve overseas use of assets, provided Australian residents that have leased assets from lessors overseas are allowed the benefit of depreciation and other capital allowances.

9. Taxation of Rights

WBC supports the reform of the tax treatment of rights. However, we do not support the proposals outlined in the Review. The proposals are complex and will make it difficult for businesses to assess the value of benefits received / foregone from the right granted.

In addition, WBC does not support accounting for prepayment and deferred payment service contracts as implicit loans between the parties. Nor do we support proposals to treat the sale of rights as equivalent to a realisation of an asset.

10. Taxation of Capital Gains

WBC supports the abolition of indexation and averaging provisions provided that a stepped rate for individuals, based on the marginal tax rate of the individual investor, is adopted. WBC also supports the scrip-for-scrip rollover relief to publicly listed companies and corporate deconsolidation, as well as extending similar relief to normal tax provisions where the conditions for capital gains tax relief are satisfied.

The proposals to relax the capital loss quarantine rules and to allow the carry back of capital losses are also supported.

11. Fringe Benefits Tax (“FBT”)

WBC supports returning the liability for FBT to employees. We also support removing entertainment and on-premises car parking from FBT. However, our support does not extend to the alignment of FBT and income tax years.

1. COMPANY TAX RATE AND TAX PREFERENCES

1.1 Corporate Tax Rate

Westpac Banking Corporation (“WBC”) supports a reduction in the company tax rate from 36% to 30% funded by the removal of accelerated depreciation.

1.2 Wasting Assets

Business should be consulted on the definition of “wasting assets” prior to any legislative enactment. For example, recent legislation on software expenditure which was intended to avoid blackholes in fact created blackhole expenditures that arguably did not exist previously.

1.2.1 Blackhole Expenditures

WBC supports the elimination of blackhole expenditures and their consistent treatment with other wasting assets. However, any proposal to list blackhole expenditures risks a replication of the existing problem.

1.3 Deduction for Wasting Assets

WBC supports the availability of tax deductions to the taxpayer that incurs the economic loss, provided the asset is used to derive assessable income and the taxpayer has an economic interest in the asset.

1.3.1 Effective Life

WBC supports the use of the effective life of an asset as a measure of the period of write off for tax depreciation. However, taxpayers should have the option of adopting published rates determined by the Australian Taxation Office (“ATO”) or to self assess if they have a reasonably arguable position in relation to the effective life.

1.3.2 Cost Base

The cost base of a wasting asset should be based on its cost to the taxpayer (or its market value where the asset has been gifted to the taxpayer). However, expected disposal receipts should not reduce the cost base.

1.3.3 Commencement Date

WBC supports maintaining the status quo for the commencement of depreciation write off.

1.3.4 *Balancing Charge*

WBC does not support the removal of balancing charge offsets.

1.4 *Items of a value less than \$300*

Capping the aggregate of immediate write-offs for assets less than \$300 to \$10,000 is biased against larger taxpayers.

1.5 *Goodwill*

WBC supports the depreciation of acquired goodwill, with a balancing adjustment upon further sale of the business. In this regard, the rate of write off should be consistent with that which is available to foreign competitors in offshore jurisdictions (for example, the US).

2. IMPUTATION

2.1 Deferred Company Tax (“DCT”)

WBC opposes the introduction of DCT. However, WBC will support the introduction of DCT if, and only if, the streaming of foreign earnings to foreign shareholders is allowed without any Australian tax impost. In this regard, foreign earnings should encompass foreign dividend, offshore branch income and OBU income.

2.2 Resident Dividend Withholding Tax

If there is no relaxation of the dividend streaming provisions, WBC supports the adoption of a resident dividend withholding tax regime and the retention of the intercorporate dividend (section 46) rebate.

2.3 Refund of Excess Imputation Credits

WBC supports the refund of excess imputation credits.

3. TAXATION OF ENTITIES

3.1 Entity Taxation

WBC supports the concept of taxing most entities as companies with the exception of collective investment vehicles (“CIVs”); superannuation funds, approved deposit funds (“ADFs”) and pooled superannuation trusts (“PSTs”); trusts wholly owned by CIVs and superannuation funds, ADFs and PSTs; life companies and other trust estates such as deceased estates, bare trusts and court ordered trusts.

3.2 Collective Investment Vehicles (“CIVs”)

The tax treatment of income distributed by CIVs to their beneficiaries should follow the character of the income distributed. Also refer to Section 4 of our submission (“Taxation of Life Insurers / Collective Investment Vehicles”) below.

3.3 Definition of Dividend

WBC does not support the application of a broad definition for public companies or widely held entities. The separation of management and control, as well as corporate governance rules, should prevent disguised dividends being paid to shareholders.

3.4 Buy-Backs, Redemptions and Liquidations

WBC supports initiatives that prevent double taxation.

3.5 Profits First Rule and Slice Approach

WBC supports a profits first rule for dividends paid in the ordinary course of business. However, we do not support the profits first rule or the slice approach where the transaction is a termination of the shareholder’s economic interest (for example, selective share buy-backs; on market buy-backs; company liquidations). In those cases, there is a sale by the relevant shareholder and the current capital treatment should apply equally to both shareholder and company. Should the slice approach apply to share buy-backs, WBC considers that the capital gains treatment, as set out in the Review, be adopted, particularly for on-market buy-backs. This approach is supported by paragraph 20.39 of the Review.

3.6 Transitional Arrangements

WBC supports transitional rules that preserve the existing tax treatment of amounts derived by trusts prior to the commencement of the new entity tax system.

4. TAXATION OF LIFE INSURERS / COLLECTIVE INVESTMENT VEHICLES

WBC, on behalf of Westpac Financial Services, recommends the following in respect of the taxation of funds managers:

- All public offer unit trusts (retail, wholesale and listed) should retain their flow-through status, including the ability to distribute tax preferences.
- PSTs and life company superannuation should remain tax-paid products, taxed at 15%.
- Immediate annuity and pension business should remain taxable at investor level only.
- Grandfathering of existing life / super policies, from both the shareholder and policyholder perspective, should be granted.
- The commencement date of the new regime must be no earlier than 1 July 2001, and must be at least one year after the passage of the enacting legislation.

A detailed submission of the taxation of superannuation funds, life insurers and collective investment vehicles is attached as Appendix A.

5. TAXATION OF ENTITY GROUPS

WBC does not consider that the introduction of a consolidation regime for the taxation of entity groups will provide the benefits cited in the Review especially when compared to the current system. However, in the event that a consolidated regime was to proceed, it is imperative that the regime achieves the following benefits cited in the Review:

- Reduction of compliance costs.
- Reduction of impediments to group restructuring.
- Promoting greater equity.

In addition, the following specific issues arising from the proposal must be addressed.

5.1 Tax Losses on Entry

WBC would prefer the use of a combination of options 1 and 5 or 6, with modifications, to ensure an equitable transfer of losses into the consolidated group. Option 1 should be used as a transitional measure to achieve an equitable treatment for pre-consolidation losses.

5.2 Inter-Company Dividends

The issue of dividend rebate wastage needs to be resolved. Possible solutions are to allow the carry forward of unused dividend rebates or to allow a deduction equal to the amount of dividend income received.

5.3 Optional Consolidation

WBC suggests that the choice to consolidate should be truly optional. However, once a group elects to consolidate, the election should be irrevocable.

5.4 Transitional Measures

Transitional measures are required to adequately deal with the impact of current anti-avoidance measures, such as Division 19A, where the cost base of shares do not reflect the underlying value of assets held.

5.5 Joint and Several Liability

WBC recommends that joint and several liability should cease at the time an entity leaves a consolidated group.

5.6 Characterisation of Transactions

WBC prefers the characterisation of transactions in a consolidated group to be determined based on the character of the transactions at the individual entity level, and not in the hands of the group.

5.7 Allocation of Expenses

Clear but equitable rules are required for the allocation of expenses in a consolidated group.

5.8 Cost Base of Equity

WBC considers that the asset-based model is a more appropriate means of determining the cost base of equity in consolidated group members on their disposal.

5.9 Entry and Exit Times

The timing of entry and exit should equate to the timing of the acquisition or disposal of a 100% interest in an entity. Such timing rules will allow groups to absorb the part year income of entities acquired and ignore the income / transactions of members exiting the group from the date of disposal.

5.10 Capital Gains Tax Rollover Relief for Controlled Foreign Companies

WBC does not support the abolition of capital gains tax rollover relief for asset transfers when determining the attributable income of Australian Controlled Foreign Companies (“CFCs”). The abolition of rollover relief will limit the ability of Australian companies to restructure their offshore operations in a tax effective manner, even if the restructure can be executed tax effectively overseas. This necessarily imposes a tax impost on Australian companies regardless of whether any tax cost is incurred in the relevant jurisdiction.

On the contrary, WBC supports the expansion of the current rollover provisions.

6. INTERNATIONAL TAX

6.1 Dividend Withholding Tax

There needs to be a review of Australia's inefficient tax treaties with respect to dividend withholding tax. For example, most countries enjoy more favourable rates of dividend withholding than the 15% dividend withholding tax under the current Australia / US Double Tax Agreement.

6.2 Collective Investment Vehicles ("CIVs")

WBC supports a flow through treatment for income derived by CIVs and the flow through of tax preferences in accordance with the character of the income derived by the CIVs. In the alternative, WBC also supports a flow through treatment for Non-Resident Investment Funds.

6.3 Investment by Residents through Non-Residents in Australian Entities

Whilst WBC supports, in principle, the proposition to allow the passing through of franking credits to the ultimate Australian resident investors, we do not support the proposal outlined in the Review due the administrative difficulties that will be encountered in its implementation.

6.4 Foreign Income Account ("FIA")

WBC supports, in principle, the concept of a FIA and its inclusion of other types of foreign income. However, for the proposal to be operate effectively, the current dividend streaming rules will need to be relaxed.

6.5 Anti-Deferral Rules

WBC does not support the overhaul of the anti-deferral rules and does not accept that the provisions governing Foreign Investment Funds ("FIFs") need further tightening through the removal of the active business income exemption. The FIF provisions already place onerous compliance obligations on business.

In addition, WBC will support further revisions to the CFC regime to reduce unnecessary complexity and avoid inequitable outcomes.

6.6 Interest Allocation Rules

WBC does not support the interest allocation rules outlined in the Review. The proposal would impede an entity's ability to finance its offshore operations in the most appropriate manner and fails to take into account the effects of foreign regulations. In any event, Australia's imputation system provides a strong incentive for Australian companies to pay Australian tax. As such, it is submitted that the proposal is not warranted.

6.7 Sources of Income

WBC supports the codification of source rules that are currently found in a variety of places. However, we do not support the approaches outlined in the Review which are likely to create uncertainty. Nevertheless, it may be appropriate to adopt a combination of:

- retaining the overall concept of source as being determined on a case by case basis, with emphasis on substance over form; and
- in respect of certain types of income, develop black letter law source rules that need not be based on treaty concepts.

6.8 Taxation of Branches

WBC does not support the taxation of branches as separate entities. In addition, we do not support the imposition of withholding tax on intra-group interest:

- In most jurisdictions, only a resident entity is entitled to foreign tax credit relief. As such, the foreign branch may not be entitled to foreign tax credit relief for withholding tax imposed on intra-entity interest. It will increase the cost of intra-group transactions.
- The imposition of such a withholding tax will prohibit intra-group transactions. The proposal ignores commercial considerations for intra-group dealings (for example, risk rating issues; efficiencies from centralised management of currencies).

6.9 Transfer Pricing

WBC supports the clarification of the transfer pricing rules to provide clarity and increase certainty. However, the codification of the current administrative practice will not achieve those objectives and is likely to lead to excessive legislative amendments. To this end, the tax rulings and tax determinations issued by the ATO should be rewritten to provide simplicity and clarity.

For completeness, franking credits should not be denied where transfer pricing adjustments are made to Australian based multi-nationals. In most cases, foreign profits will ultimately be remitted to Australia and the denial of franking credits is likely to result in double taxation.

6.10 Record Keeping

WBC does not support the proposal outlined in the Review. The proposals are onerous and will increase the administrative burden on Australian entities.

7. TAXATION OF FINANCIAL ASSETS AND LIABILITIES

WBC supports the introduction of the proposed regime for the taxation of financial arrangements, subject to the recognition of internal hedging and the inclusion of an option to use foreign currency re-translation.

In this regard, we support the comments made in the joint submission by the Australian Bankers' Association, the International Banks and Securities Association of Australia and the Australian Financial Markets Association.

8. TAXATION OF LEASES

8.1 Sale and Loan Approach

WBC does not support the adoption of a sale and loan approach to leasing. The removal of accelerated depreciation and a 30% corporate rate of tax will reduce the scope of any arbitrage.

If a decision is made to proceed with a sale and loan approach, it should only apply to finance leases. The distinction between finance leases and operating leases should be based on the current Australian accounting standard.

8.2 Tax Exempt Entities

WBC supports the removal of section 51AD and Division 16D and their replacement by a sale and loan approach. However, where a tax exempt entity pays tax equivalents, these entities should be excluded from the leasing regime as tax equivalent remains an impost on business (albeit payable to State Governments).

8.3 Overseas Use of Assets

If a sale and lease approach is to apply to Australian lessors leasing assets to non-residents overseas, then in the reverse situation where Australian residents have leased assets from lessors overseas, the Australian lessee should be allowed the benefit of depreciation and other capital allowances (where the assets are used to produce income that is assessable in Australia).

8.4 Lease Assignments

Any leasing regime will impact on lease assignments. Specific issues that need to be addressed include:

- royalty withholding tax - its impact on Australia's international competitiveness and how it would be affected by a sale and loan approach to the leasing of assets overseas;
- interest withholding tax; and
- defeasance arrangements - how they will be affected by a sale and loan approach.

8.5 Transitional Arrangements

If a sale and loan approach to leasing is to be adopted in respect of finance leases, any existing finance lease arrangements should be allowed to run their full term and subject to tax under the current regime.

9. TAXATION OF RIGHTS

WBC supports the reform of the tax treatment of rights such that there is consistency, symmetry and certainty. However, we do not support the proposals outlined in the Review. The proposals are complex and will make it difficult for businesses to assess the value of benefits received / foregone from the right granted.

9.1 Valuation Approaches

9.1.1 Implicit Benefits Approach

This approach assumes that the benefits can be determined. However, this is not commercially realistic:

- It may not be possible to determine the benefit derived from a right or it may not be possible to determine that value until some time after the end of the year of income.
- Cashflows and benefits fluctuate from year to year and may occur more than once each year. Calculating the value of the resulting benefit and any changes is likely to be difficult.
- There is no guarantee that the grantor and the grantee of the right will value the benefits in the same way or adopt the same implicit interest rate.

9.1.2 Deemed Benefits Approach

Whilst the deemed benefits approach overcomes the problem with valuing the benefits derived from a right, a straight line amortisation methodology poses its own issues:

- The present value of payments made to acquire a right will not necessarily be equal to the present value of benefits derived from that right.
- There is no guarantee that the grantor and the grantee of the right will value the benefits in the same way or adopt the same implicit interest rate.
- An assumption that benefits from a right will arise on a straight line basis in each year of income does not reflect economic reality.

9.2 Prepayments and Deferred Payments

WBC does not support accounting for prepayment and deferred payment service contracts as implicit loans between the parties. This will add unnecessary complexity and increase compliance costs to businesses. In any event, prepayments and deferred payment service contracts are not tax avoidance devices where the parties to the contract deliberately seek to defer tax.

9.3 Sale of Rights as a Realisation of Assets

WBC does not support the proposal to treat the sale of rights as equivalent to a realisation of an asset:

- The proposals do not take into account the difficulties that will be experienced where the assets are intangible assets (for example, granting a right to acquire an option, or conferring a right of subrogation on a third party).
- The granting of a right to an asset (for example an option) does not necessarily equate to the realisation of that asset.
- It may be practically impossible to determine whether there is partial realisation. A similar problem will be experienced with a threshold realisation approach.

10. TAXATION OF CAPITAL GAINS

10.1 Rate of Tax on Capital Gains

WBC supports the abolition of indexation and averaging provisions provided that a stepped rate for individuals, based on the marginal tax rate of the individual investor, is adopted. WBC supports the adoption of rates of 30%, 25% and 12 % as set out in Table 39.2 of the Review. WBC also recommends the adoption of a 9% flat rate for capital gains derived by superannuation funds.

10.2 Scrip-for-Scrip Rollover

WBC supports the scrip-for-scrip rollover relief to publicly listed companies and corporate deconsolidation. In addition, the relief should be extended to:

- revenue assets where the gains and losses on investment are on revenue account (for example, for taxpayers such as banks and insurance companies where their investments are on revenue account); and
- non-listed public companies, public companies, units in publicly listed trusts, units in public offer funds, interests in superannuation funds and exchanges of life insurance policies to encourage growth and efficiencies that come with economies of scale.

(**CONFIDENTIAL** - set out in Appendix B is an example of the difficulties faced by WBC in its acquisition of the Bank of Melbourne Limited that highlights the difficulties companies and their shareholders face in corporate acquisitions and why scrip-for-scrip rollover relief is necessary).

10.3 Goodwill

WBC supports, in principle, the replacement of the current goodwill exemption with a generalised exemption (20% of all capital gains derived on the disposal of a small business with net assets of less than \$5 million). However, further details are required.

10.4 Capital Losses

WBC supports a relaxation of the capital loss quarantine rules and in particular, the carry back of capital losses against prior capital gains.

10.5 Partnerships

WBC supports an entity approach to partnerships that would achieve the objectives of the Review whilst having the advantages of simplicity.

11. FRINGE BENEFITS TAX (“FBT”)

11.1 Taxing Fringe Benefits in the Hands of Employees

WBC supports returning the liability for FBT to employees.

11.2 Specific Inclusion Approach

WBC supports a positive inclusion approach to the taxation of fringe benefits. This should improve compliance and address issues of equity by only including remuneration type benefits on the “list”.

11.3 Entertainment and On-Premises Parking

WBC supports removing entertainment from FBT coverage and reverting the treatment of entertainment to its pre-1995 non-deductible status. In this regard, all forms of entertainment should be included in this proposal.

WBC also supports the removal of on-premises car parking from FBT and to retain its deductible status.

11.4 Alignment of FBT and Income Tax Years

WBC does not support the alignment of FBT and income tax years. The group certificate reporting requirements are complex and the alignment of year ends will create administrative complexities.

11.6 Statutory Formula for Cars

WBC supports the proposal to align the valuation of car fringe benefits to commercial values only where the liability for FBT is returned to employees and provided that such measures constrain compliance and administration costs. From the options proposed, the Scale 2 alternative under the second option would result in the most equitable method of limiting distortive behaviour and constrain compliance costs.

In addition, any existing arrangements should be allowed to run its full term and subject to FBT / income tax under the current regime.