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The Chase Manhattan Bank
A.R.B.N. 074 112 011
AAP Centre
259 George Street
Sydney NSW 2000
Telephone: (02) 9250 4111
Facsimile: (02) 9250 4554

Friday, April 16, 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
Canberra ACT 2600

Dear Sir,

Review of Business Taxation

I refer to the meeting on April 12, 1999 between Messrs John Ralph, Alan Preston, and Bruce Paine from the Review of Business Taxation ("RBT"), Mr Stephen Gottlieb from KPMG, and Messrs Peter St George, Robert Webster, Dr David Lynch, and Jonathan Harrex from the International Banks and Securities Association of Australia. The discussions at that meeting were of considerable assistance in clarifying the issues before the RBT, which are of primary concern to international banks.

The Chase Manhattan Bank ("Chase") carries on substantial wholesale banking operations in Australia through a branch of the New York Bank with gross assets in excess of $5 billion attributable to the branch operations. In addition, Australian subsidiaries of the bank are leading providers in the Australian marketplace of custodial and capital markets services.

Chase is keen to be part of the RBT process to work towards the development of a first class Australian business tax environment, which is both regionally competitive and facilitates a proper integration with home country tax systems. We believe that through the RBT process government can achieve this, and that targeted consultation on the details is essential. In this regard, we have identified below key issues, which in our view require further consideration.

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1. The proposed consolidation regime has advantages of local simplicity, however the overlay of home country CFC and FTC regimes, seems at best uncertain as these require foreign (ie Australian) income and tax payable to be determined on a separate entity basis. Foreign owned companies could be forced to opt out of consolidation simply to achieve home country tax compliance. Perhaps key elements of the existing system, such as group tax loss transfers and CGT assets roll-overs could be retained to minimise the most harmful aspects to foreign owned companies.

2. Currently local branches of foreign banks may group tax losses and transfer CGT assets with local subsidiaries, however the proposed design of the consolidation regime appears to exclude local branches from the ambit of the consolidated entity. Some mechanism should be derived to ensure that these critical features are retained or the integrity of branch banking will be seriously compromised.

3. Option 2 Resident Dividend Withholding Tax is preferable to the Deferred Company Tax regime, however its application to local branches of foreign banks should permit branches to control their repatriation policy with the same degree of certainty enjoyed by a local subsidiary without a deeming rule[1].

4. The potential application of revised thin capitalisation rules to branch banks is problematic. The current notional equity requirement in Part IIIB represents a negotiated position on the capitalisation of foreign banks, and should be taken as a frame of reference for further refinement.

5. Consistent with government policy to develop Australia as a regional financial centre in direct competition with both Singapore and Hong Kong, the Offshore Banking Unit ("OBU") regime should be retained. Business booked in an OBU currently benefits from a local tax rate of 10% without which the activity and employment would be re-located offshore. Further the opportunity should be taken to recognise the competitive disadvantage of an Australian OBU compared to a Singaporean ACU, which arises when a dividend is paid from profits taxed at the concessional rate.

[1] Apparently contemplated in para 30.50 of RBT

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6. The fresh proposals in relation to the taxation of financial arrangements, on balance, represent a positive step towards a workable regime; however the comments suggesting that internal hedges (also called inter-desk dealing) "continue to [be] ignored"[2] "consistent with accounting standards"[3] are, misinformed. Further, the comments that "recognising internal hedge transactions would involve complex rules and raise the possibility of tax avoidance"[4] are completely misguided. The development of workable rules for recognition of internal deals, consistent with financial accounting rules, is absolutely essential to a proper TOFA regime.

7. The proposed timing adjustment methodology for foreign currency based on forward rates[5] seems at best strange. Non-traded on-balance sheet foreign currency denominated assets and liabilities are properly accounted for on a re-translation basis. References to a similar regime having been implemented in New Zealand[6] should not overlook the elective nature of that regime and the ability of financial institutions to adopt re-translation[7].

We have endeavoured to keep our comments focussed on the key issues, which are of major concern to us, rather than to attempt a chapter by chapter analysis. Thus, numerous subsidiary issues dealt with in submissions by various industry bodies are not replicated here. In addition, our comments are by design brief. We would be happy meet with representatives of the RBT process to more fully explain our comments to assist governments' task in building a first class Australian business tax environment.

Yours sincerely,

Jonathan Harrex
Senior Taxation Manager

[2] paragraph 6.72 of RBT
[3] paragraph 6.72 of RBT
[4] paragraph 6.73
[5] paragraph 6.47 etc
[6] paragraph 6.48 of RBT
[7] Determination G9A