# REVIEW OF BUSINESS TAXATION: A PLATFORM FOR CONSULTATION

## SUBMISSION BY THE MOBIL AUSTRALIA GROUP

## 1. INTRODUCTION

1.1 The Mobil Australia Group ("Mobil") wishes to specifically raise for consideration by the Review of Business Taxation ("RBT") Committee a number of issues in relation to *Chapters 1* to *2* and *Chapters 25* to *28* of the discussion paper *"A Platform for Consultation"* (the "*Platform*"). These issues are addressed in the following sections of this submission:



1.2 While Mobil has been an active participant in the formulation of other submissions by bodies such as the Australian Petroleum Production & Exploration Association and the Corporate Tax Association/Business Council of Australia and, generally endorses the views expressed in these submissions, the company is particularly concerned that its view in relation to both the proposed consolidation regime and tax losses be directly brought to the attention of the RBT Committee and the Federal Government.

1.3 In this submission, wherever appropriate, reference has been made in italics to the relevant chapter or paragraphs in the *Platform* in order to assist the RBT Committee in collating the response to this and other submissions.

1.4 In addition, attached as a summary in Appendix B is a completed checklist of relevant issues raised in the *Platform*, cross referenced back to the paragraphs in this submission.

1.5 Mobil would be only too willing at any time to provide further detail in relation to any aspect of this submission, or to meet with representatives of the RBT Committee to further discuss these issues.

## 2. EXECUTIVE SUMMARY

2.1 Mobil is supportive of the vast majority of the proposals raised in the *Platform*, but, it is particularly concerned about: the proposal to remove accelerated capital allowances *(Chapters 1-2)*; some aspects of the proposed consolidation regime *(Chapters 25-27)*; and the apparent conclusions noted in the document in respect of realised and unrealised tax losses *(Chapter 28)*.

### 2.2 Accelerated Depreciation

2.2.1 Mobil is strongly opposed to the wholesale removal of accelerated capital allowances. Adopting the proposal to remove current accelerated capital allowance concessions could have a significant impact on future investment in long term capital intensive projects such as Liquefied Natural Gas (LNG) projects. Mobil is committed to the Gorgon LNG project but the project faces strong international competition. Competing countries provide more significant fiscal incentives to attract LNG investments than are provided in Australia.

2.2.2 Therefore, as detailed in Part 3 of this submission, Mobil believes that in order to ensure the competitiveness of these projects in Australia such that Australia attracts long term capital investment of this nature, this proposal to remove or reduce accelerated capital allowances must be either abandoned, or if adopted, modified to exclude major capital investment projects such as LNG projects.

### 2.3 Consolidation Regime

2.3.1 While Mobil believes that the case for a consolidation regime is somewhat overstated in the *Platform*, it is recognised that some compliance benefits may be realised under this regime. However, Mobil is firmly of the view that these potential benefits would be far outweighed by inequities and, substantial technical and compliance complexities, if the following four issues are not appropriately addressed:

- Consolidation to a non-resident parent entity
- Treatment of tax losses
- Dividend flows from non-wholly-owned companies
- Other transitional aspects

2.3.2 Options for dealing with these four issues that are summarised below are detailed in Part 4 of this submission.

2.3.3 First, Mobil believes that the RBT Committee should abandon the requirement that consolidation must occur to a head Australian parent entity. This requirement would not only disadvantage a large number of foreign owned groups currently operating in Australia, but would also stifle future foreign investment in Australia. Mobil therefore is of the view that **a prerequisite for the introduction of a consolidation regime must be that if necessary, a group can consolidate to a non-resident parent company.**

2.3.4 In relation to consolidating to a non-resident parent entity, there appears to be no reason why this essential facility, if implemented, should not apply on an on-going basis. If this issue were only addressed by way of transitional/grandfathering provisions, then this would further complicate the consolidation regime and could unnecessarily restrict future foreign capital flows into Australia.

2.3.5 Secondly, Mobil believes that of the stated options in the *Platform* for the entry of tax losses into a consolidated group, Option 5 (quarantining of carry-forward losses within a group) is the most equitable option and the option which most closely mirrors the current grouping regime. However, Option 5 would require some modification to increase its effectiveness. In particular, it would be necessary to expand Option 5 to encompass loss sub-groups.

2.3.6 Despite Mobil's preference for a modified Option 5 as a means of bringing tax losses into a consolidated group, in the event that Option 5 was found to be overly complex to both legislate and administer, Mobil believes that Option 6 (also with some modifications) would be an acceptable compromise between equity and simplicity. Again in the context of Option 6, modifications would be necessary encompassing issues such as loss sub-groups, post-acquisition losses and an ability to elect to enter the consolidated group.

2.3.7 Thirdly, the consolidation regime blue print in *Chapter 26* does not address the significant anomalies that could arise as a result of the single entity concept, if external dividends received by the consolidated group could erode the group's tax loss pool. This issue must be addressed.

2.3.8 Fourthly, Mobil believes that the formulation of transitional rules that are equitable and practical is essential in ensuring the acceptance of a consolidation regime by corporates. Sufficient detail has yet to be provided in the *Platform* regarding transition aspects and consequently, Mobil reserves its right to comment in this area when this detail is made available.

## 2.4 Tax Losses — Same Business Test

2.4.1 In *Chapter 28* of the *Platform*, it is proposed that the "same business test" relief, by which tax losses can be carried forward by an entity, be repealed. The potential commercial implications of this proposal cannot be overstated, and therefore, it is disappointing that the full range of issues associated with this proposal are not discussed or even acknowledged in the *Platform*.

2.4.2 Mobil believes that to repeal the "same business test" relief is unwarranted and unnecessary, and would in effect create "gain duplication" problems, which other sections of the *Platform* recognise as inequitable. In contrast to the position adopted in the *Platform*, Mobil believes that there is in fact justification for further broadening and updating the "same business test" relief mechanism.

## 3. TAXATION OF LIQUEFIED NATURAL GAS PROJECTS

***Liquefied Natural Gas ("LNG") liquefied projects are major long life developments which generate substantial export income and taxation revenue. Specific taxation treatment should be adopted to enhance the competitiveness of Australian LNG projects in regional markets.***

### 3.1 Background

3.1.1 The objective of the RBT Committee is to make recommendations on Australia's tax system which will lead to more robust investment decisions, improved competitiveness, greater productivity, higher GDP growth and more jobs.

3.1.2 The information paper issued by the RBT, *An International Perspective* addresses these issues in the international context:

> ***"To redesign a tax system which does not take sufficient account of international factors would be to risk a declining revenue base, poorer economic outcomes, inadequate foreign investment in Australia and a poorer competitive position for Australian enterprises."***

3.1.3 These observations are acutely relevant to the international LNG industry, which is highly competitive and features a small number of highly capital intensive projects chasing new markets. Mobil is a participant in the Gorgon Project which aims to win contracts to supply LNG to Asian markets around the middle of the next decade, with a plateau export capacity of 8 million tonnes/annum (8 MMTA).

### 3.2 Overview of the International LNG Industry

3.2.1 Current and prospective LNG consumers in the wider Asian region comprise the relatively mature markets of Japan and Korea, and emerging markets in China, Taiwan and India. Australia currently supplies over 10% of the current LNG demand in this region, which amounts to 65-70 MMTA. Regional demand is expected to grow by 20-30 MMTA by 2010. Australia should target securing a substantial proportion of this new demand.

3.2.2 During 1998, projects in the Middle East secured future supply commitments for India amounting to 10 MMTA. China is expected to call for tenders late in 1999 for supply of 3 MMTA as from 2005, its first LNG imports forming the foundation for larger scale imports. Taiwan will call tenders for 2 MMTA this year. Both of these opportunities will be the subject of intense international competition. In around 2000-2001, Korea is also expected to seek additional supplies post 2005.

3.2.3 Direct competitors to Australia for long term contracts for Asian markets include the existing suppliers in Abu Dhabi, Qatar and Oman in the Middle East, Malaysia, Brunei and Indonesia. Potential new sources of supply exist in Yemen, Russia and Alaska (Algeria, Trinidad and Nigeria are also significant LNG producers, although have only a peripheral effect on Asian markets). Each of these countries has a history, of aggressively supporting LNG projects through government policy (taxation), and provision of infrastructure and investment incentives. *An International Perspective* did not examine any of these countries in detail, but did address Malaysia as a Group 2 country.

3.2.4 The LNG industry is maturing from one with few buyers and sellers, where security of supply dominated negotiations, to one where price is becoming the key determinant. This is evidenced by use of tendering in recent deals, rather than drawn out negotiations with one or two preferred suppliers.

## 3.3 Characteristics of LNG Projects

3.3.1 LNG projects are high cost with long lead times, relatively low returns, of long duration and long payback periods. Once built and commissioned, the projects will generate employment, export income and taxation revenue for over 20 years or more.

3.3.2 The key dimensions of an indicative greenfield LNG project in Australia, such as Gorgon are:

- initial investment of $6 billion (1999 dollars) rising to $8-9 billion (1999 dollars) over project life;
- four or five year lead time from start of project to first production. This follows a lag of 10 to 20 years from initial investment in exploration for the resource;
- payback period 10 to 15 years;
- increase in GDP of around 1.5% on current levels;
- project life of 20 years from start of production;
- generates substantial company tax revenue, >$10 billion (1999 dollars) or>$20 billion (dollars of the day) over project life; and
- Project cannot be relocated offshore unlike many transaction processing based enterprises.

## 3.4 Taxation Regimes in other LNG Producing Nations

3.4.1 In *An International Perspective* the statement is made that:

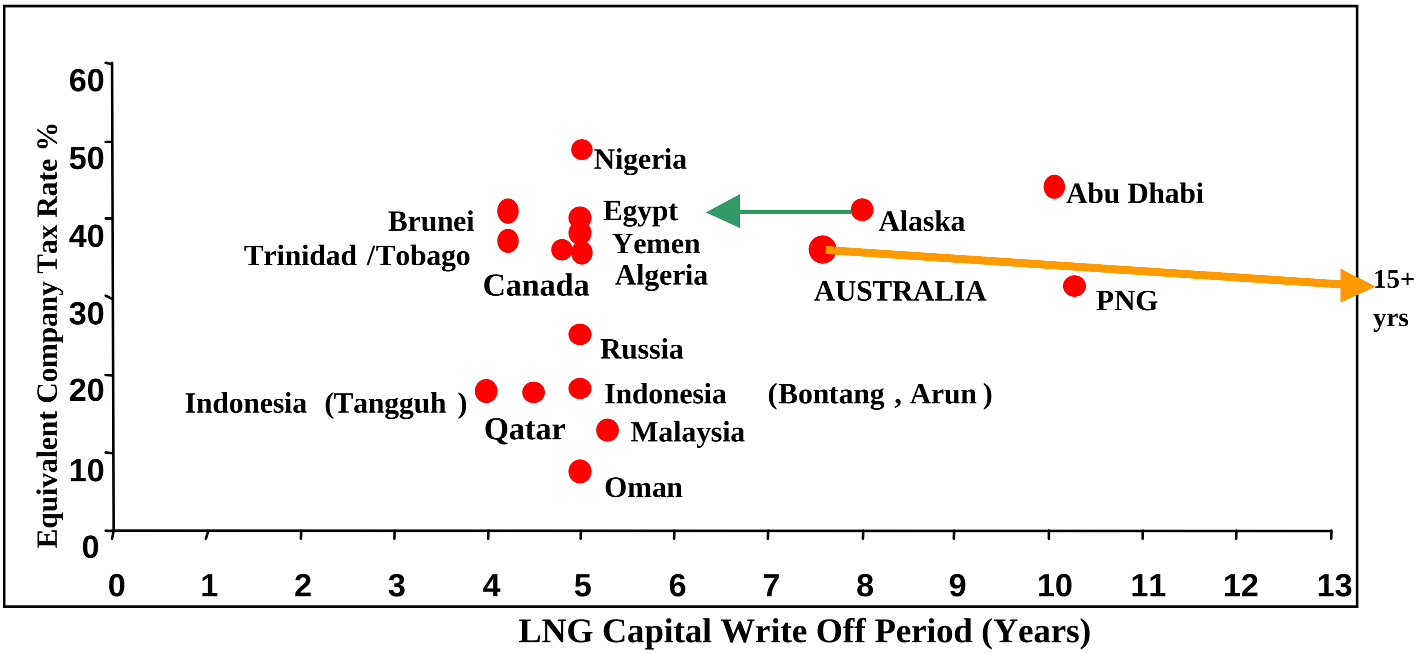
> ***"Australia provides more generous depreciation allowances compared to most other countries for assets with longer economic lives. This tends to arise because of the broad banding approach to fixing the rates as well as the underlying concessional element that is built into the rates."***

3.4.2 This is not the case with LNG projects, since other LNG producing nations have adopted a variety of measures to improve competitiveness of their projects, including:

- accelerated depreciation – write-off periods as low as 2 to 5 years (Brunei, Oman, Qatar, Nigeria);
- tax holidays – 10 to 12 years (eg Qatar, Oman, Trinidad, Nigeria); and

- competitive company tax rates.

3.4.3 Australia's tax and depreciation rates are contrasted with competing LNG producing nations in the graph below (prepared by Woodside Energy Limited and disclosed in LNG Action Agenda materials). Malaysia, Indonesia, Oman and Qatar all have more favourable rates than Australia. The plot shows equivalent tax rates after allowing for tax holidays in several countries. The changes envisaged by the RBT Committee would significantly worsen Australia's position as a location for investment in LNG projects, as illustrated by the line associated with Australia.




## 3.5 Impact of Reduced Corporate Tax rate and Slower Depreciation

3.5.1 The *Platform* proposes a reduced corporate tax rate and amendments to tax depreciation rates to reflect the effective lives of assets. The combined effect of these changes of an LNG project, which is by its very nature long term, would have a negative impact on the project. Since returns are low, this would need to be passed onto the customer and would add about US$0.05/MMBTU to the FOB price. (Based on current oil prices, a competitive FOB price is in the range US$1.75-US$2.00/MMBTU.) Australia's competitive fiscal position would be improved with the further acceleration of depreciation allowances (for example, 10% straight line depreciation on an incurred basis, in line with allowable capital expenditure: Sub-division 330-C of the Income Tax Assessment Act 1997 ("the 1997 Act")). This would allow price reductions of about US$0.09/MMBTU to be offered to customers. Price variations of this amount are likely to determine success from failure in winning new LNG sales contracts.

## 3.6 Impact on Foreign Investors

3.6.1 Mobil is a US owned entity, as are two other participants in the Gorgon project. The fourth participant is also ultimately foreign controlled. Given that tax is ultimately paid in the country of ownership, the benefit of a reduction in the Australian tax rate may be reduced significantly, as the Australian tax position cannot be considered in isolation. The US tax rate is currently 35% and it is possible that the profits taxed at 30% in Australia will face a further US tax liability when distributed.

3.6.2 We have calculated that the overlay of US taxation could require the breakeven price to increase by up to a further US$0.05/ MMBTU.

3.6.3 From a foreign investors perspective significant further downside could also result from proposed changes to the thin capitalisation provisions as detailed in section 33 of the *Platform*.

## 3.7 Conclusion

3.7.1 A reduced corporate tax rate of 30% with removal of accelerated depreciation would have negative impact on the Gorgon project, which is in competition with international sources of supply.

3.7.2 Positive changes to the Australian taxation system arising from the Review of Business Taxation have the potential to significantly enhance the competitiveness of the Australian LNG industry and lead to substantial investment occurring in Australia. We believe the challenge to focus on is ensuring the taxation revenues are generated from Gorgon LNG, through its success in the marketplace, rather than the concept of maintaining revenue neutrality for a project which may not be successful if it cannot compete.

3.7.3 We believe that this view is in line with the RBT Committee's object to increase Australian competitiveness, as enunciated in the extract from *An International Perspective* quoted above.

> ***"Withdrawal of accelerated depreciation provisions will adversely affect Australia's LNG industry. A special case must be made within the Australian taxation system to ensure the industry is internationally competitive."***

## 4. THE CONSOLIDATION REGIME: GENERAL COMMENTS

### 4.1 General Acceptability *(Chapter 25)*

1.1.1 *Chapter 25* of the *Platform* states the case for adopting a consolidation regime in relation to the taxation of corporate groups and, in this regard, *paragraph 25.3* lists seven "problems" that are intended to be rectified by the introduction of this regime. Of these seven factors, two are anticipated to be to the benefit of corporate groups in reducing compliance costs and minimising complexity The other five factors are intended to address stated tax avoidance aspects and generally enhance the "integrity" of corporate taxation.

1.1.2 Mobil does not believe that the analysis in *Chapter 25* of itself proves the case for the need for the Australian tax system to adopt a consolidation regime and to repeal the existing group relief mechanisms. In fact, the discussion in *Chapter 25* fails to identify a number of fundamental difficulties with the consolidation proposal, that unless addressed, would render the proposal totally inequitable, inappropriate and unacceptable to the broader corporate community.

1.1.3 In relation to the factors raised in *Chapter 25* of the *Platform* in support of a consultation regime, the following points are noted:

***(i) Tax as an Impediment to Business Reorganisation***

4.1.4 It is accepted that in certain circumstances, income tax can be an impediment to intra-group reorganisations, but in the vast majority of cases, the existing group relief mechanisms enable transactions of this nature to proceed on a tax neutral basis.

4.1.5 However, the single most significant impediment to intra-group reorganisations is invariably stamp duty. Until stamp duty is repealed (including stamp duty on real property transactions), many corporate groups will have to persist with inefficient and unnecessary corporate structures. Unfortunately, it appears that this stamp duty problem will not be addressed by the consolidation proposal.

***(ii) High Compliance Costs***

4.1.6 It is true that tax compliance costs will be reduced to some extent under a consolidation regime, but corporate groups will still have to generate separate data to prepare a consolidated tax return. This is due to the fact that the proposed tax consolidation regime will not include non-wholly-owned subsidiaries and foreign subsidiaries, that are otherwise included in a group's consolidated financial statements.

### *(iii) Tax Avoidance/Loss Cascading/Gain Duplication/Value Shifting*

4.1.7 These issues and concerns regarding tax avoidance/loss cascading/gain duplication/value shifting are not unique to wholly-owned groups and other chapters of the *Platform* identify alternative mechanisms by which these issues can be addressed. Therefore, assuming these issues will be separately addressed outside the consolidation regime, they cease to be a compelling argument for the introduction of a consolidation process.

4.1.8 However, as noted above, there are at least some compliance benefits that could flow from a consolidation regime, but Mobil could only support this initiative if certain major anomalies and inequities are corrected. These major anomalies and potential inequities are outlined below under the following headings:

- Consolidation to a Non-Resident Parent Entity (4.2 below)
- Treatment of Tax Losses (4.3 below)
- Dividend Flows from Non-Wholly-Owned Companies (4.4 below)
- Other transitional aspects (4.5 below)

## 4.2 Consolidation to a Non-Resident Parent Entity

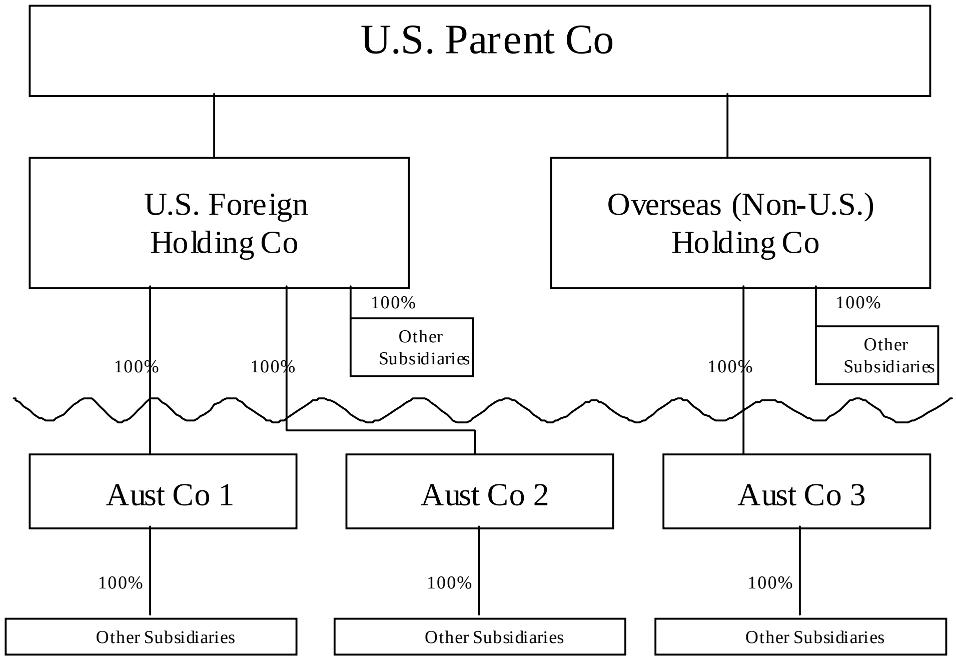
4.2.1 *Paragraph 26.3* of the *Platform* states that:

> *"groups choosing to enter the consolidation regime would be required to have a resident holding company at the head of the group in order to give practical meaning to the concept of a single Australian taxpayer".*

No justification or explanation is provided for the adoption of such a narrow eligibility requirement, particularly as it varies so significantly from the current eligibility criteria for group loss transfers and CGT roll-over relief.

4.2.2 Therefore, unless this *paragraph 26.3* proposal is substantially modified to allow consolidation by reference to a common resident **or non-resident** parent entity, a large number of significant foreign owned groups will not only be unable to elect to utilise the consolidation regime, but will also be precluded from continuing to utilise the existing group relief mechanisms. This is due to the fact that many foreign owned groups, including Mobil, have a number of subsidiaries in Australia that do not have a common Australian interposed parent company. Rather, separate subsidiaries, or chains of subsidiaries, are individually owned direct by one or more non-resident group entities.

4.2.3 A not uncommon example in this regard, although not illustrative of Mobil's precise structure, is as follows:




4.2.4 A corporate structure such as that illustrated above involving multiple chains of subsidiaries into Australia can arise for a number of reasons, including:

- Satisfying management objectives of having totally separate and independent operating groups in Australia;
- Acquisitions via a foreign merger (eg. Overseas (non US) Holding Co and Aust Co 3 in the above example);
- The need to retain distinct lines of business separately in the event of a global disposition of one of the lines of business; and
- Providing the flexibility of being able to separately stream dividends from different subsidiaries/sources of income to the foreign parent can in some circumstances have foreign tax advantages.

4.2.5 For the same reasons that have lead to the existence of separate chains of subsidiaries into Australia, it may well be totally inappropriate to now seek to restructure groups so that a common Australian parent company is inserted into a structure. In addition, in many instances, substantial tax costs would be incurred in one or more foreign jurisdictions if Australian subsidiaries were to be transferred to a common Australian parent company. Stamp duty may also be payable on transactions of this nature, depending on the precise group relief mechanism in the relevant state or territory.

4.2.6 **For these reasons, a prerequisite for the introduction of a consolidation regime must be that if necessary, a group can consolidate to a non-resident parent company.**

4.2.7 Appendix A of this submission discusses the concerns of the RBT Executive that we understand led to the initial proposal regarding the requirement to consolidate to a resident parent company. In this appendix, alternative ways of dealing with these concerns are noted.

4.2.8 While it is also acknowledged that this requirement for a head resident entity exists in the US consolidation regime, the US economy's strength and dominance is vastly different to Australia's. Indeed, the US is a significant capital exporter, whereas Australia is a significant capital importing nation. Therefore, attracting and retaining foreign investment is obviously of greater significant to Australia.

4.2.9 On the basis that an appropriate way of facilitating consolidations to a non-resident parent company can be devised, then it is further submitted that consolidation to this non-resident level should continue to apply on a **prospective basis** and not be limited to a transitional exemption for structures in place as at 1 July 2000.

4.2.10 To attempt to limit the non-resident parent consolidation facility to simply be a transitional measure would create the following unnecessary complications and compliance costs:

- Attempting to formulate a restrictive transitional measure, without otherwise constraining the development and evolution of these existing groups, would require complex legislative provisions. For example, if a further company or companies were established or acquired by an existing group utilising this transitional relief, would these new subsidiaries also be able to access this transitional relief and hence form part of the consolidated group?;

- The circumstances that have led to existing structures utlising a non-resident parent company will invariably also arise in the future and there would appear to be no substantial reason for excluding future structures of this nature from consolidation relief. This is particularly the case, given that the RBT reforms are wherever possible intended to increase Australia's international competitiveness and flexibility in attracting international capital flows; and

- To preclude consolidating to a foreign parent could significantly diminish the integrity of the "one-in-all-in" concept outlined in *paragraph 26.4*. For example, foreign owned groups could simply circumvent this one-in-all-in requirement, while maintaining a 100% equity ownership interest in a subsidiary, by establishing or acquiring the subsidiary by way of a direct ownership from a non-resident group company rather than via a resident group company.

## 4.3 Treatment of Tax Losses

4.3.1 Mobil is also of the view that the equitable treatment of tax losses is another essential pre-requisite to the establishment of a consolidation regime. In this regard, some of the stated options noted in *Chapter 26* of the *Platform* for the treatment of tax losses are far from being practical and/or equitable. In particular, Mobil has significant concerns in relation to the following stated options:

*Option 1:* To not allow losses into a consolidated group (*paragraph 26.90)*

*Option 2:* Allow carry-forward losses to be brought into a consolidated group subject to a modified SBT *(paragraph 26.92-26.95)*

*Option 3:* To reduce revenue cost, add a further test to Option 2 *(paragraph 26.96)*

*Option 4:* Allow a specific portion of the loss to be brought into the consolidated group *(paragraph 26.97)*

4.3.2 Of the stated options in the *Platform* for the entry of tax losses into a consolidated group, Option 5 (quarantining of carry-forward losses within a group) is the most equitable option and the option which most closely mirrors the current grouping regime. Option 5 would require some modification to increase it effectiveness, however, in particular it would be necessary to expand Option 5 to encompass loss sub-groups. Loss sub-groups are discussed in more detail below at 4.3.5. Although Mobil prefers the adoption of such a modified Option 5, it is accepted that this option will be one of the most complex to both legislate and administer, in that it would simultaneously treat such a loss entity as both a member of the consolidated group and as a separate non-group entity. These complications are evident in the U.S. consolidation regime, which broadly seeks to treat acquired loss entities in this manner.

4.3.3 Therefore, despite our preference for a modified Option 5, Option 6 (leaving entities outside the group) is regarded by Mobil as being an acceptable compromise between equity and simplicity.

4.3.4 However, the following important points of detail are noted in relation to this Option 6 proposal:

### *(i) Loss Sub-Groups*

4.3.5 While *paragraph 26.99* refers to a loss “entity” remaining outside a group, it is understood that this term is intended to encompass a loss “consolidated group” that is itself acquired by another single entity or consolidated group. In these circumstances, the loss consolidated group would remain outside the purchaser group until such time as it had utilised its pre-acquisition losses, or these pre-acquisition losses had otherwise been extinguished (refer (iii) below);

***(ii) Post-Acquisition Losses***

4.3.6 This restriction on losses being utilised by the purchaser group should only apply in respect of **pre-acquisition** losses of the purchased entity. **Post-acquisition** losses of the entity should ultimately be able to be utilised by the purchaser group when the loss entity finally enters the group, ie when its pre-acquisition losses have been utilised by the entity itself or have otherwise been extinguished (refer (iii) below). In association with this approach, consideration should then be given to introducing modified loss carry-back rules to apply in such cases so that ultimately, the post-acquisition losses can be applied back to the tax years to which they relate within the consolidated group. Alternatively, post-acquisition losses could be group-transferred into the consolidated group; and

***(iii) Electing to Extinguish Pre-Acquisition Losses***

4.3.7 The purchaser group should have the right to at any time, elect to bring the purchased entity into the consolidated group, *albeit* that at that time pre-acquisition losses may not have been fully utilised. In such circumstances, the remaining balance of **pre-acquisition** losses would be extinguished. As per (ii) above, post-acquisition losses of the relevant entity would not be extinguished and could then be accessed by the purchaser group.

4.3.8. In relation to transitional issues involving **existing losses** within corporate groups, as noted in 5.3 below, the two proposals outlined in *paragraph 26.91* appear to be both equitable and essential from a practical perspective, if the introduction of the consolidation regime is to be undertaken in a relatively straight forward manner.

## 4.4 Dividend Flows from Non-Wholly-Owned Companies

4.4.1 A further significant issue to be resolved if a consolidation regime is to be introduced relates to the position whereby dividends are received on shareholdings external to the consolidated group in circumstances where the group has current year or carried forward tax losses.

4.4.2 At present, many corporate groups are structured such that external (non-group) dividends are received direct by the group's ultimate holding company. The ultimate holding company therefore acts as a dividend conduit to shareholders. Therefore, losses that may be generated in other group subsidiaries presently need not restrict the flow of external dividends to a group's ultimate shareholders. In this way, tax losses can in effect be quarantined and can be used by the group to offset against trading profits, rather than being required to be offset against franked dividends from non-group companies.

4.4.3 However, under the consolidation regime which is currently proposed, the "single entity" concept will result in the erosion of tax losses generated by members of a consolidated group on the group's receipt of external dividends. This is due to the fact that trading losses will not be able to be isolated within separate subsidiaries as at present.

4.4.4 Therefore, unless this issue is resolved so that receipts of dividends by a consolidated group do not erode the group's tax loss pool, consolidated groups will be forced to deconsolidate companies that could potentially fall into a tax loss position. Alternatively, a consolidated group could be forced to sell its less than 100% subsidiaries and other minority equity investments in respect of which dividend flows into the consolidated group cannot be controlled.

4.4.5 It is understood the joint submission by the Corporate Tax Association and The Business Council of Australia also identifies this potential problem and raises various solutions, including quarantining tax losses of a consolidated group from external dividends received. Mobil fully supports suggestions of this nature to address what could otherwise be a very significant problem.

## 4.5 Other Transitional Aspects

4.5.1 While paragraphs 27.31 to 27.39 of the *Platform* provides some detail in relation to the proposals to deal with transitional issues on the commencement of the consolidation regime, Mobil believes that the formulation of an equitable and practical transitional framework will be critical to the viability of the total proposal.

4.5.2 Mobil must therefore reserves its view on these transitional issues until further information is made available. However, it is noted that any approach which at the commencement of the regime sought to re-calculate the cost base of assets held in a subsidiary from the asset's initial cost, to an amount calculated by reference to a holding company's initial equity investment in the subsidiary, is likely to be regarded by the corporate community as inequitable and inappropriate.

## 4.6 Summary

4.6.1 Subject to these four critical aspects of: consolidation to a non-resident parent entity; the treatment of tax losses; dividend flows from non-wholly-owned companies; and other transitional aspects being appropriately addressed, Mobil would generally support the consolidation concept. However, if any one of these four aspects is not appropriately dealt with, Mobil would strenuously oppose the introduction of consolidation and support the retention of the current group relief mechanisms.

## 5. <u>THE CONSOLIDATION REGIME – OTHER SPECIFIC ISSUES RAISED IN THE *PLATFORM*</u>

### 5.1 Repeal of Current Grouping Provisions *(Paragraphs 26.68 – 26.70)*

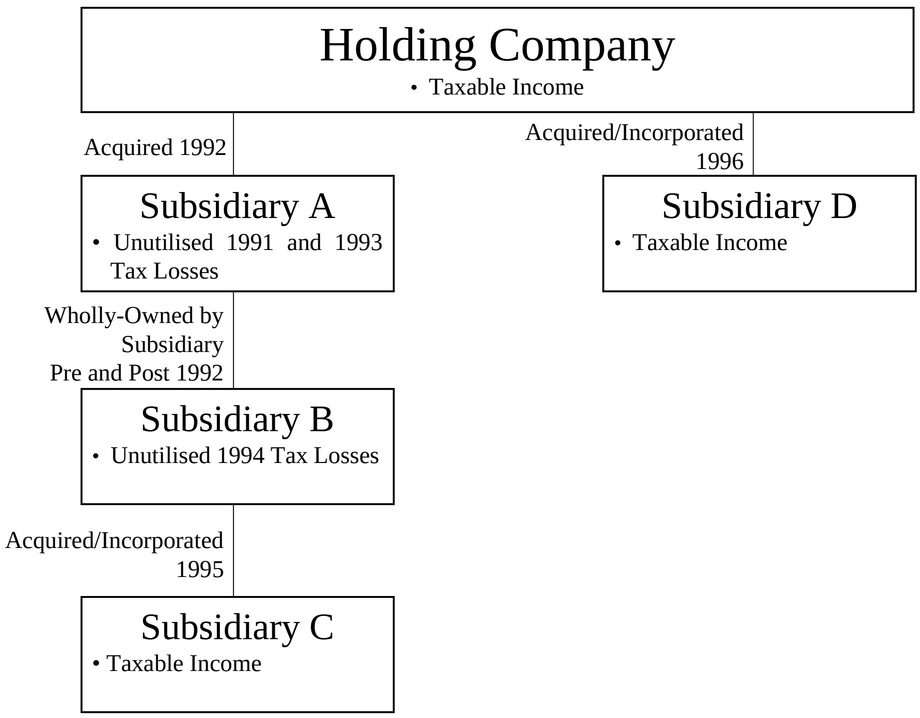
5.1.1 It is Mobil's firm view that unless the current consolidation proposal is modified to allow consolidation to a non-resident parent then it will be necessary to retain the current group relief provisions, *albeit* that they may have restricted application. In particular, the current group provisions in relation to losses, CGT roll-overs and foreign tax credits, would at least have to continue to apply in respect of existing wholly-owned group companies that could not otherwise elect to consolidate due to the resident parent company requirement.

5.1.2 So that these wholly-owned group companies that could not consolidate were not unduly disadvantaged, the existing group relief provisions would also have to be extended to encompass group transfers of franking credits.

### 5.2 Treatment of Existing Tax Losses *(Paragraph 26.91)*

5.2.1 Obviously, tax losses that were eligible to be grouped under the existing legislative provisions should be available to a consolidated group on the commencement of the consolidation regime.

5.2.2 Similarly, as a transitional measure, it will be essential that other losses of wholly-owned entities, that for whatever reason are currently restricted from full grouping should also be available to a consolidated group on the commencement of the consolidation regime. To do otherwise would be to significantly fragment and complicate the introduction of the consolidation system, as illustrated in the following general example:



5.2.3 In the above example, the following restrictions apply under the **current legislative provisions** in relation to the grouping of tax losses:

| **Potential Recipient of Tax Loss Transfers** | **Tax Losses** | | |
|---|---|---|---|
| | **Subsidiary A** | | **Subsidiary B** |
| | **1991 Losses** | **1993 Losses** | **1994 Losses** |
| Holding Company | Not Transferable | Transferable | Transferable |
| Subsidiary A | Not Applicable | Not Applicable | Transferable |
| Subsidiary B | Transferable | Transferable | Not Applicable |
| Subsidiary C | Not Transferable | Not Transferable | Not Transferable |
| Subsidiary D | Not Transferable | Not Transferable | Not Transferable |

5.2.4 To attempt to build these limitations into transitional arrangements for the introduction of the consolidation regime would be totally impractical and would add enormous complexity. It would also invariably lead to inequitable outcomes. For example, as illustrated in the above table, the following issues would arise in a number of circumstances if, as a transitional measure, an attempt was made to defer the full entry of subsidiaries into the consolidated group until the losses of those subsidiaries were fully groupable with all other group companies under the existing provisions:

5.2.5 (i) An intermediate subsidiary that has ungroupable losses (Subsidiary A) may have direct subsidiaries that do have groupable losses (eg. Subsidiary B). To excise Subsidiary A from the group, but not its direct subsidiaries (eg. Subsidiary B), would create other significant difficulties;

5.2.6 (ii) A subsidiary may have some losses which are currently ungroupable, while also holding a balance of groupable losses (eg. Subsidiary A); and

5.2.7 (iii) The ability for carry-forward losses to be groupable with **all** group companies is not only impacted by when the loss company joined the group (eg. Subsidiary A and Subsidiary B), but is equally dependent upon when the particular **gain subsidiaries** joined the group (eg. Subsidiary C and Subsidiary D). Because of this existing restriction, there would be few if any large corporate groups with accumulated losses that could group these losses with every single subsidiary in their group.

5.2.8 For these reasons, Mobil concurs with the transitional proposal in *paragraph 26.91*, being that: *"if a group has a wholly-owned entity (say at the date of announcement) with carry-forward losses that cannot be transferred because they arose prior to 100% ownership, those losses can be brought into a consolidated group".*

## 5.3 Tax Attribute Balances Remaining with the Consolidated Group

5.3.1 Mobil concurs with the proposal in *paragraph 26.103 and 26.104*, that for practical reasons, it would be necessary for tax attributes such as carry-forward losses and franking credits, to remain with the consolidated group on the exit of a subsidiary. The method by which this would be achieved in the context of a consolidated group with a non-resident parent company is discussed in Appendix A to this submission (paragraphs A.19 to A.21).

## 5.4 Determining the Cost Base of an Entity on its Exit from a Group

5.4.1 As per the discussion in *Chapter 27* of the *Platform*, Mobil fully appreciates the inevitable difficulties in formulating an appropriate method by which to calculate the taxable gain or loss that may arise on the disposal of a consolidated group's interest in a subsidiary.

5.4.2 In broad terms, Mobil considers the asset-based model to be the most appropriate of the two models proposed. This is due to the fact that this model directly addresses both potential gain duplication problems and will streamline group reorganisations that may otherwise require complex value shifting computations.

5.4.3 However, there is considerable concern that this model and the associated valuations that must be undertaken on the acquisition of a subsidiary, do not become unnecessarily complicated when the associated operational framework and legislative provisions are formulated. Therefore, Mobil reserves the right to reassess its support for the asset-based model when this vitally important additional detail has been made available.

5.4.4 Mobil also believe that a significant issue arises, both under the asset-based model and the equity-based model, in relation to the calculation of a group's cost base in a subsidiary, where the subsidiary owns assets in respect of which depreciation or capital allowances have been claimed. Unfortunately, this specific issue has not been referred to in the *Platform*.

5.4.5 In particular, it is understood that it is intended that a group's cost base in an existing subsidiary will be eroded by annual depreciation and capital allowance deductions that have been claimed in respect of the assets that are owned by the subsidiary on exit. Therefore, these deductions could effectively be subject to an assessable balancing charge (*albeit* via a CGT gain) on the sale of the relevant subsidiary. This then raises the following issues:

5.4.6 (i) If a purchaser of a subsidiary is not itself a consolidated group then it will not obtain a "step-up" in the depreciable value/capital allowance value of the underlying assets, notwithstanding that the vendor group has paid tax based on this amount. This would be inequitable and would distort commercial decision making in favour of structuring transactions as asset transfers rather than entity transfers; and

5.4.7 (ii) In the case of capital allowances such as exploration expenditure, etc, while deductions previously claimed by the vendor may in effect be clawed-back by way of a CGT gain on the degrouping of the subsidiary, it is far from clear that the purchaser (be they a consolidated group or otherwise) would then be eligible to claim capital allowances based on this clawed-back amount. An important example in this regard would be petroleum and mining exploration expenditure allowances.

5.4.8 These aspects must be addressed to ensure that the cost base model that is ultimately legislated (ie. the asset-based model or the entity-based model), operates in an efficient and equitable manner and does not distort commercial decision making.

# 6. CARRY-FORWARD TAX LOSSES

## 6.1 Proposal to Repeal the Same Business Test Relief

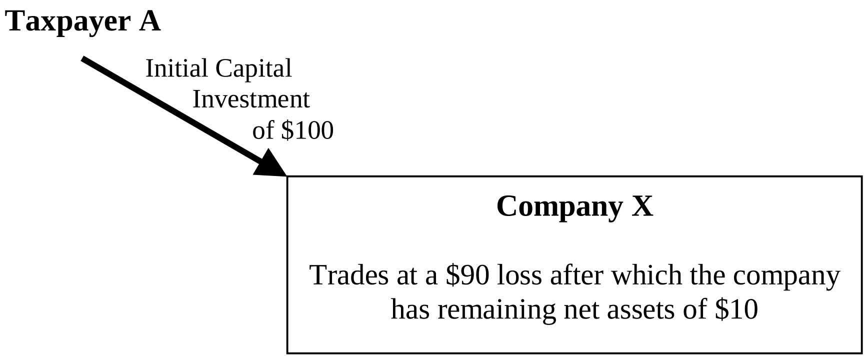
6.1.1 *Chapter 28* of the *Platform* deals with a number of extremely important issues of relevance to the carrying forward of realised and unrealised tax losses. In particular, *paragraph 28.22* contains the following definitive statement:

> *“The continuity of ownership test allows access to realised but unrecouped losses incurred by an entity during the tenure of an owner by allowing that owner a tax loss on the disposal of equity. To prevent duplication, the entity being sold should be denied the ability to carry-forward its tax losses if it fails the continuity of ownership test (discussed in chapter 26). Thus, the same business test needs to be removed to prevent the duplication.”*

6.1.2 The potential commercial implications of this proposal cannot be overstated, and therefore, it is disappointing that the full range of issues associated with this proposal are not discussed, or even acknowledged, in the *Platform*.

6.1.3 Mobil understand that the principle rationale for the proposed abolition of the “same business test” can be summarised in the following “base case” example:

**“BASE CASE” EXAMPLE**




Taxpayer A then realises a CGT loss of $90 on the disposal of their shares in Company X to Taxpayer B for $10. Company X eventually commences to trade profitably (while continuing to satisfy the same business test) and therefore progressively utilises the deduction for the $90 of carry-forward losses.

6.1.4 It is understood that the proposition inherent in the *paragraph 28.22* proposal is that as per the above example, by virtue of the same business test, there is a duplication of the tax benefits in respect of the one economic loss of $90 (ie. a $90 CGT loss claim by Taxpayer A and the $90 loss deduction ultimately claimable by Company X). However, this proposition is not valid or appropriate for the reasons outlined in 6.2 below.

6.1.5 The substantial arguments against the repeal of the "same business test" (and in fact for its updating and broadening) are outlined under the following headings:

- The "Loss Duplication" Proposition (6.2 below)
- Practical and Equitable Issues (6.3 below)
- Tax Loss Trafficking (6.4 below)
- Interaction With Other Provisions (6.5 below)

6.1.6 More generally, in reviewing the proposed repeal of the same business test it is also appropriate to consider the legislative background to the initial introduction of these provisions.

6.1.7 The same business test, as initially contained in Section 80E of the Income Tax Assessment Act 1936, was introduced by the Income Tax Assessment Act 1965, the year following the introduction of the continuity of ownership test in Section 80A. The rational for the introduction of these "same business test" provisions was summarised in the associated second reading speech:

> *"One amendment proposed will ensure that a major, or even a total, change in the shareholdings of a company will not operate to disturb a deduction for a prior year loss incurred by the company if, at all times in the year of income in which the deduction may be claimed, the company is carrying on the same business as it carried on immediately prior to the change in the shareholdings. For this purpose, a company is not to be treated as qualifying for the deduction if, after the change in its shareholdings occurred, it begins to carry on a business, or enters into transactions, of a kind that it did not carry on or enter into before the change occurred. The Government considers that this amendment will satisfactorily meet cases of mergers and takeovers of companies that are carried out for sound economic purposes and with which there is not associated any transfer of profitable business from one company to another so that income which would otherwise be taxed is directed free of tax."*

6.1.7 The need for the "same business test" relief provisions so that *"mergers and takeovers of companies that are carried out for sound economic purposes"* are not inappropriately distorted or prejudiced are as relevant today as they were in 1965 when it was seen as essential to introduce such provisions

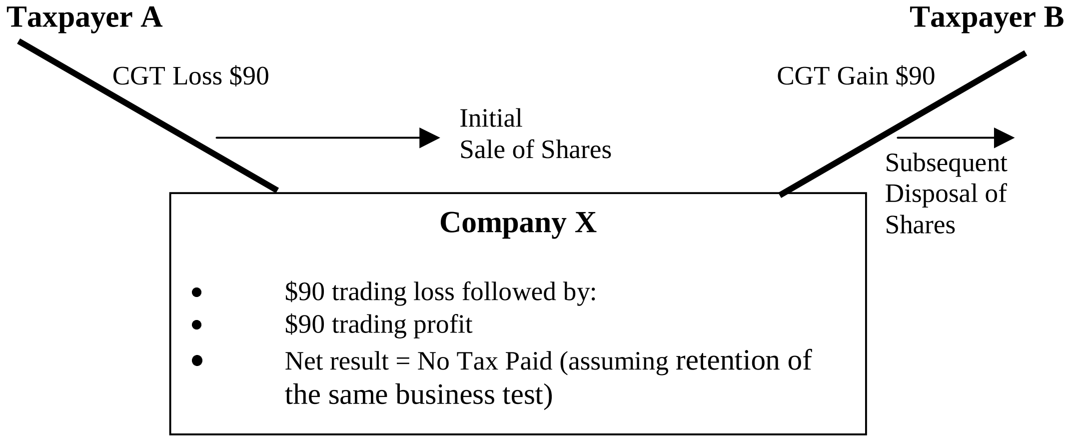
## 6.2 The "Loss Duplication" Proposition

### *(i) Broadening the Analysis*

6.2.1 The above "base case" example underpinning the proposal to repeal the "same business test" is selective in that it does not broaden the analysis to consider the total implications, by also encompassing the position of the purchaser of the relevant company.

6.2.2 For example, if the purchaser (Taxpayer B) was to sell its shareholding in Company X after the company had recouped the $90 trading and tax loss, that taxpayer would realise a CGT gain of $90. Therefore, the **total position** can be summarised as follows:

### "COMPREHENSIVE" EXAMPLE




SUMMARY:

| | |
|---|---|
| Taxpayer A: CGT Loss | ($90) |
| Taxpayer B: CGT Gain | $90 |
| Net CGT Gain/Loss | Nil |
| Net Tax Payable by Company X | Nil |
| Net Economic Gain/Loss | Nil |

6.2.3 This result summarised in the "comprehensive" example above is the equitable outcome given that in total economic terms, there has been no net overall gain or loss.

6.2.4 Repealing the "same business test" would significantly distort this balanced position, with the result being that net tax on at least $90 would be imposed on Company X and/or Taxpayer B, *albeit* there has been no net economic gain.

6.2.5 Undertaking a comprehensive analysis of this nature, whereby the ultimate tax impact on the purchaser is also considered, is clearly appropriate and is in fact consistent with the analysis adopted in the *Platform* in relation to addressing gain duplication issues in *paragraphs 28.37 - 28.39*. Therefore, only having regard to the tax position of the vendor of the loss entity in proposing the abolition of the "same business test" would be totally inconsistent with the basis for the model proposed in the *Platform* for addressing gain duplication inequities.

#### *(ii) Tax Losses May Not Represent Economic Losses*

6.2.6 The "base case" example used to justify the proposed abolition of the "same business test" on the basis of loss duplication, also fails to recognise that in many cases, tax losses in a company will not in any way be representative of an economic loss. This is particularly the case in relation to tax losses resulting from accelerated deprecation and capital allowance deductions, including exploration deductions.

6.2.7 In such cases, these accelerated deductions and allowances can drive a company into a tax loss position when in commercial reality the company may have traded profitably and/or its value may have increased substantially. Particularly, in the case of exploration deductions and other capital improvements, capital expenditure of this nature may in fact have substantially increased the market value of the company, notwithstanding that the tax concessions have placed the company in a tax loss position.

6.2.8 To further jeopardise tax losses that have arisen in such circumstances by the repeal of the "same business test" would be totally inequitable and could, in fact, significantly disadvantage companies that had embarked on major capital projects based on such "incentive" type deductions.

6.2.9 A similar situation can arise where trading losses are accrued in the earlier years of a developing business, notwithstanding that the value of the business and its goodwill may have increased substantially.

6.2.10 In both of the situations outlined above, a CGT loss (or reduced CGT gain) will not arise on the sale of the shares in the tax loss entity and therefore, even on the "base case" analysis summarised at 6.1.3 above, there is no justification for the repeal of the "same business test".

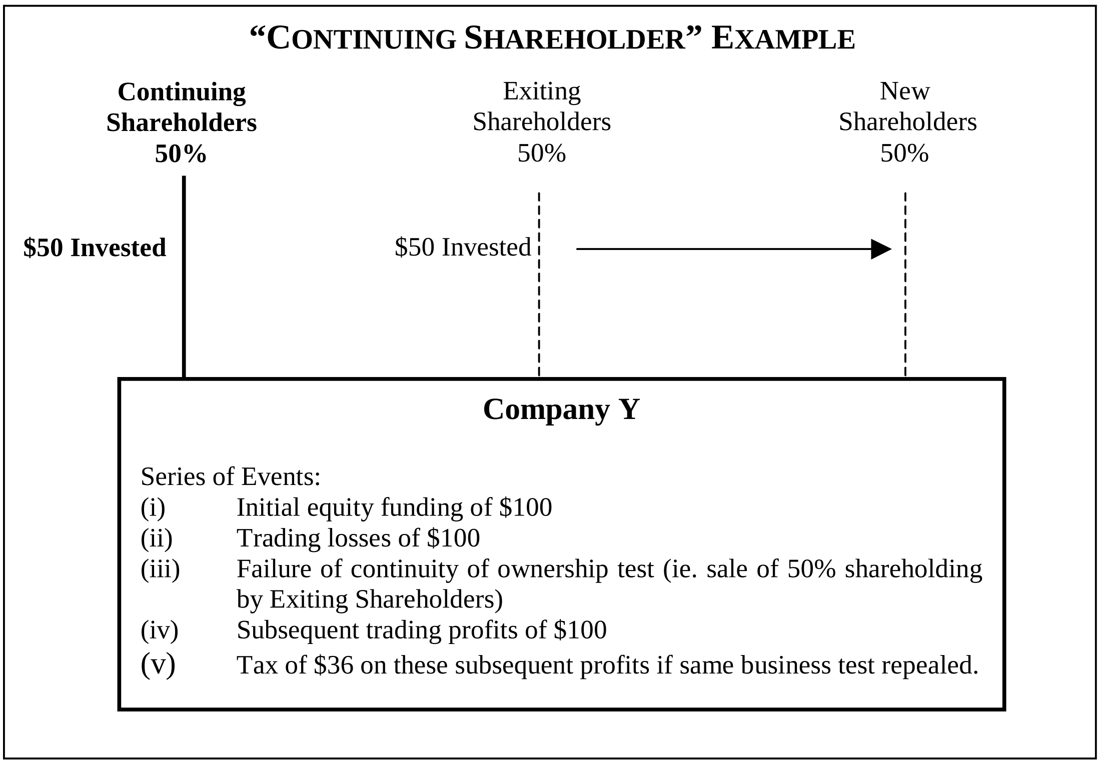
#### *(iii) CGT Losses May Not Arise or May Not Be Able to be Utilised*

6.2.11 It is also noted that in many cases, the vendor of a tax loss entity will not be eligible to claim a CGT loss in respect of the sale of the relevant shares. This may arise because the ultimate vendor is a non-resident without any direct ownership of Australian assets (ie. an ultimate non-resident parent company), or the shares in the tax loss entity may have a pre-CGT exempt status. Even where a CGT loss is triggered by the vendor it may be a number of years before a tax benefit in respect of these losses can be realised, given the restriction placed on the utilisation of CGT losses.

## 6.3 Practical and Equitable Issues

#### *(i) Continuing Shareholders*

6.3.1 Notwithstanding that the continuity of beneficial ownership test may be failed in respect of a tax loss company, there may be continuity of up to 50% of the shareholders in the company. These continuing shareholders would have held an interest in the company when it originally incurred the relevant tax losses and as they will be continuing to hold their shares in the company, they will not realise a CGT loss in respect of the underlying losses incurred by the company. As illustrated in the following example, the repeal of the same business test would be particularly inappropriate and inequitable in respect of these continuing shareholders.




6.3.2 As illustrated in the above example, the repeal of the “same business test” can lead to a position where a continuing shareholder is substantially disadvantaged, notwithstanding that there is ultimately no net economic gain derived in the underlying company.

6.3.3 In this example, the company has only returned to a “break-even” position but the continuing shareholders are indirectly exposed to an $18 tax cost (50% of $36). The company would also not have any trading profits by which it could return the capital invested by shareholders as a franked dividend.

### *(ii) Widely Held Public Companies*

6.3.4 If the same business test was repealed, then the tax position of widely held public companies and their wholly-owned subsidiaries could be dramatically altered, depending upon progressive change in their underlying shareholder base. This could occur even though none of the numerous share transactions that ultimately lead to the failure of the continuity of ownership test may have in any way been influenced by tax losses that may have accrued to the public company or any of its individual underlying shareholders.

## 6.4 Tax Loss Trafficking

6.4.1 It is generally accepted that the "same business test" in Section 165-210 of the 1997 Act (and its predecessor, Section 80E of the 1936 Act) are already extremely rigid provisions that, in effect, preclude tax loss trafficking transactions. This is evidenced in the extensive and comprehensive discussion of the application of the "same business test" as contained in Taxation Ruling TR95/31. Similarly, rigid provisions also now apply in relation to tax losses incurred and carried forward by trusts.

6.4.2 Therefore, there could be no justification for repealing the "same business test" as a "tax avoidance" measure.

## 6.5 Interaction With Other Provisions

6.5.1 Simply repealing the "same business test" without introducing a host of complex corresponding legislative amendments would create further significant inequities.

6.5.2 For example, where a company has effectively funded the tax losses incurred by way of loans from related and unrelated parties, the termination of these tax losses on a change of the company's ownership followed by the subsequent application of the current debt forgiveness provisions (Division 240 of the 1936 Act) or the debt forgiveness proposals contained in the *Platform* (*paragraph 6.105 - 6.115)* would immediately create a double tax impost.

6.5.3 Other similar double tax anomalies could arise. For example, an assessable balancing adjustment could be triggered on the sale of a depreciable asset, *albeit* that the related depreciation deductions of earlier years were included in tax losses extinguished on the change of ownership of the company.

6.5.4 To the extent that the application of the "same business test" reduces the incidents of tax losses being extinguished, it also reduces the likelihood of these double tax anomalies arising.

## 6.6 Summary

6.6.1 The paragraph 28.22 proposal to repeal the same business test is not soundly based and would be extremely inequitable and create significant distortions and anomalies. In fact, as part of the RBT process, it is submitted that consideration should be given to updating the "same business test" as it is generally accepted that as presently drafted, it is unduly restrictive. The test would also have to be broadened to also operate within the proposed consolidation regime.

*** * * * ***

KS/cs:140499 Amended Mobil RBT Sub Memorandum_Current.doc: Mobil

# CONSOLIDATION TO A NON-RESIDENT PARENT ENTITY: ADDRESSING POTENTIAL RBT CONCERNS

A.1 As has been stated a number of times in this submission, Mobil will not support the introduction of a consolidation regime unless the RBT Committee **abandons the requirement for a head Australian holding entity**, particularly for foreign owned groups operating in Australia.

A.2 Mobil understands that the RBT Committee has several concerns about allowing consolidation to a non-resident parent entity, but Mobil believes that these concerns can be addressed in the manner outlined below:

## 1. Integrity/Tracing

A.3 The RBT Committee is apparently concerned that if consolidation to a head foreign holding entity is allowed, it will be unable to control the integrity of the consolidation regime. For example, integrity would be jeopardised if external shareholders held interests in interposed foreign entities that could not be identified or traced by the Australian authorities.

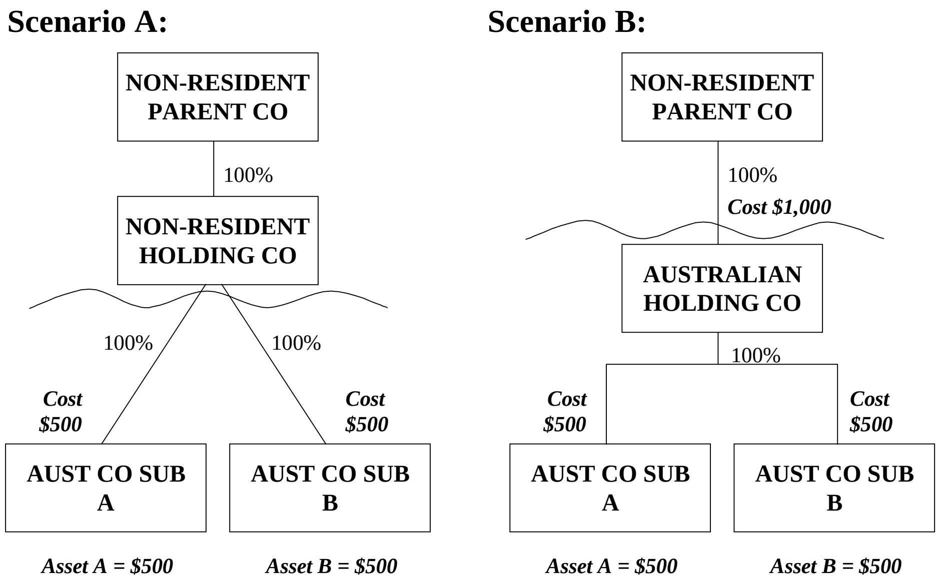
A.4 In response, it is noted that this same integrity issue in relation to a wholly-owned foreign group currently exists under the CGT roll-over and revenue and CGT loss transfer regimes. However, Mobil is not aware that this aspect is regarded as a significant problem under the current regime nor has the ATO publicly expressed concerns regarding integrity in the context of allowing such asset and loss transfers.

A.5 In any event, it is submitted that one practical approach to this issue would be to require a declaration by consolidated groups that the 100% common ownership requirement has been satisfied throughout the entire year. This declaration could, for example, be included specifically as part of the consolidated group income tax return form, which would have to be signed by the group's financial officer prior to lodgement. Penalties would apply where this declaration was falsely made and where insufficient documentary evidence exists to support that statement.

## 2. Achieving Equitable Exit Models

A.6 It is understood that a major concern for the RBT Committee regarding consolidation to a head foreign holding entity is the method which should be used to calculate the taxable gain or loss to the foreign parent if and when it disposes of its Australian subsidiaries.

This issue can be illustrated by the following example, which contrasts the calculation of the taxable gain on disposal where a head Australian entity exists as compared to where consolidation occurs to a head foreign holding entity:




A.7 Scenario A and B are identical except that Scenario A consolidates two sister companies to a non-resident parent, while Scenario B involves consolidation to a head Australian entity.

A.8 The following events are assumed to occur under each scenario:

Event 1. Asset A appreciates in value to $1,000 and is then sold by Aust Co Sub A, with the proceeds being reinvested by the company; and

Event 2. Non-Resident Parent Co then sells its interest in the Australian consolidated group.

A.9 The occurrence of Event 1 would trigger the same effects under both Scenario A and B. Under either the asset-based model or entity-based model discussed in Chapter 27 of the *Platform*, the consolidated group's cost base in Aust Co Sub A would increase from $500 to $1,000 to reflect the reinvestment of the realised profit of $500.

A.10 It is acknowledged that the occurrence of Event 2 could **potentially** have a different tax impact under each scenario. Under Scenario A, Non-Resident Parent Co would sell the Australian consolidated group by way of Non-Resident Holding Co selling its shareholding in each of Aust Co Sub A and Aust Co Sub B. If market value consideration of $1,500 was received, no CGT gain would be triggered for Non-Resident Holding Co because its combined CGT cost base in the two subsidiaries after Event 1 would be $1,500.

A.11 By way of contrast, under Scenario B, in order to dispose of its interest in the Australian consolidated group, Non-Resident Parent Co could sell its shareholding in Australian Holding Co. Based on capital proceeds of $1,500 and a CGT cost base in the Australian Holding Co shares of $1,000 (assuming no Chapter 28 value adjustment - refer below), Non-Resident Parent Co would realise a $500 capital gain.

A.12 Importantly, this difference in the CGT gain under Scenario A and Scenario B need not, and should not, arise in practice, for the following reasons:

### *1. Generalised Application of Asset-Based/Cost-Base Models*

A.13 Chapter 28 of the *Platform* (paragraphs 28.40-28.46), proposes measures which directly address the gain duplication otherwise occurring under Scenario B. If these proposed general rules applied to readjust Non-Resident Parent Co's CGT cost base in Australian Holding Co to $1,500, a CGT gain would also not have been triggered under Scenario B.

### *2. Other Relevant Factors*

A.14 Even if the proposals in Chapter 28 of the *Platform* are not implemented, the difference between the market value of the group's underlying assets and its cost base, to the extent that they represent taxed profits would in Scenario B most likely be paid up to the ultimate holding company as a dividend prior to disposal.

A.15 For example, under Scenario B, if the disposal of Asset A resulted in $500 of profit on which tax was paid, that profit could have been passed up through the entity chain to Non-Resident Parent Co as a franked dividend free of any further Australian taxation. This distribution in turn would result in the market value of Aust Co Sub A remaining at $500, with the capital proceeds on disposal of the shares in Australian Holding Co being $1,000 such that no CGT gain would arise.

A.16 Therefore, it may only be in the case of untaxed profits (i.e. tax preferences) that a different CGT gain could arise under Scenarios A and B. In this regard, we note that, the majority of tax preferences that could result in untaxed profits will, in fact, already be appropriately dealt with under either of the valuation models discussed in Chapter 27. Under both valuation models, depreciation and other capital allowance deductions which create tax preferences will result in a write-down of the group's CGT cost base in the particular subsidiary, which will be effectively assessed to Australian tax on the disposal of that subsidiary. Consequently, the treatment of these tax preference should not be of great concern to the RBT Committee.

A.17 Although the aforementioned tax preferences do, in a sense, "wash-out" on disposal, Mobil recognises that some form of separate CGT cost base adjustment may be required for certain other tax preferences that do not result in a write-down of the cost base of an investment in a subsidiary. By way of example, research and development deductions and pre-CGT exempt asset gains would not adjust CGT cost base under either valuation model. In relation to such tax preferences, further consideration must be given to precisely how such tax preference adjustments should be made.

A.18 Therefore, given that the tax consequences of exiting a consolidated group should ultimately be the same whether or not a "head Australian holding entity" exists, this concern does not justify precluding consolidation to a head foreign holding entity.

## 3. Retaining Tax Attributes in Consolidated Group

A.19 On the basis that consolidation to a head foreign holding entity will be possible, the issue arises as to where tax attributes generated by the consolidated group should reside.

A.20 The most appropriate option in this regard would appear to be for the consolidated group's tax attributes to be deemed to be held in the last group company remaining in Australia. In particular, a model similar to that adopted by New Zealand in sFD6 of the Income Tax Act 1994 could be applied whereby the group nominates an entity which acts as the notional head of the consolidated group, and in a sense, repository for its tax attributes. If this nominated head entity was sold out of the group, as is the case in New Zealand, it would transfer its nominated status to another remaining Australian member of the group.

A.21 For example, in the context of Scenario A above, if Aust Sub Co A was the nominated head entity and was sold, it would be required or would be deemed to transfer its nominated status to Aust Sub Co B and, therefore, the consolidated group's tax attributes would remain in tact in Aust Sub Co B.

In summary, Mobil are strongly of the view that the issue of consolidating to a head foreign holding entity must be resolved and must be resolved in the affirmative if Australia is to have an internationally competitive, efficient and equitable consolidation regime.

* * * * *

**Appendix B**

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| CHAPTER 1 | | | | | | | | |
| | **Entitlement to Deductions** | | | | | | | |
| 1.15 | The taxpayer who will be entitled to deductions in respect of wasting assets should be: | | | | | | | |
| | ***Option 1:*** Whoever incurs the expenditure to produce assessable income and has an economic interest in the asset (para 1.15-17) | | ✓ | | | | | |
| | ***Option 2:*** Whoever qualifies under the accounting principle: AASB 1021 (para 1.18-20) | | | | ✓ | | | |
| | **Cost Base for Deductions** | | | | | | | |
| 1.23 | The cost base of a wasting asset for depreciation purposes should be based upon the cost of the asset to the relevant taxpayer. | ✓ | | | | | | |
| 1.26 | The cost base of an asset for depreciation purposes should be reduced, where appropriate, by expected disposal receipts. | | | | | ✓ | | |
| 1.27 | The cost base of an asset for depreciation purposes should be reduced by the amount of bounty or subsidy received in respect of that asset. | | ✓ | | | | | |
| | **Commencing Deductions** | | | | | | | |
| 1.37 | The timing of commencement of depreciation deductions for wasting assets should be: | | | | | | | |
| | ***Option 1:*** Write-off the asset from the time the asset is installed and ready for use (para 1.37) | ✓ | | | | | | |
| | ***Option 2:*** Allow a standard write-off in the year in which the asset is installed (para 1.38) | | | | ✓ | | | |
| | **Period of Write-Off** | | | | | | | |
| 1.41 | Assets should be required to be written off over their effective life — no concessions. | | | | | ✓ | | 3.4-3.7 |
| 1.48 | The effective life of an asset could be assessed by: | | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| | ***Option 1:*** Retaining the existing system (para 1.48) | ✓ | | | | | | |
| | ***Option 2:*** Use of effective life schedules prepared by ATO with option for taxpayer variation (para 1.49-52) | | | | ✓ | | | |

CHAPTER 1 … cont'd

| Paragraph Number | | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| | **Special Treatment for Buildings and Structures** | | | | | | | |
| 1.55 | The depreciation of buildings and structures should be treated as follows: | | | | | | | |
| | ***Option 1:*** Retain existing system (para 1.55) | ✓ | | | | | | |
| | ***Option 2:*** Include buildings and structures in the general depreciation regime for all physical assets (para 1.56-59) | | | | | ✓ | | |
| | ***Option 3:*** Reduce the rate of depreciation (para 1.60) | | | | | ✓ | | |
| 1.62 | If the treatment of buildings and structures were to change, the following transitional measures should apply: | | | | | | | |
| | ***Option 1:*** Apply new arrangements to all new buildings and structures for which construction contracts are entered into after the date the new measures take effect (para 1.63-64) | | ✓ | | | | | |
| | ***Option 2:*** Apply new arrangements to all buildings and structures acquired after the date the new measures take effect | | ✓ | | | | | |
| | **Special Rules for Resources Sector** | | | | | | | |
| 1.69 | No special rules should apply to the resources sector. | | | | | ✓ | | 3.1-3.7 |
| | **Immediate Write-Off for Small Items** | | | | | | | |
| 1.74 | The provisions allowing for the immediate write-off of small items should be amended to: | | | | | | | |
| | ***Option 1:*** Limit deductions to a specified number of items of the same class each costing less than the *de minimus* threshold (para 1.74-76) | | | | | ✓ | | |
| | ***Option 2:*** Place an annual dollar limit for immediate write-off of *de minimus* items (para 1.77-78) | | | | | ✓ | | |
| 1.79 | Where items fall below the *de minimus* threshold as a result of depreciation, the item should be fully written-off in that year. | ✓ | | | | | | |
| | **Write-Off Methods** | | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| 1.80 | The two methods of write-off should remain prime-cost and diminishing value. | | ✓ | | | | | |
| | **Taxing the Disposal of Assets** | | | | | | | |
| 1.91 | The current balancing charge offset applying on the disposal of wasting assets should be removed. | | | | | ✓ | | |
| | **Blackhole Expenditure** | | | | | | | |
| 1.96 | Blackhole expenditure should be treated consistently with other expenditure — immediately deductible or written-off over time. | | ✓ | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **CHAPTER 2** | | | | | | | | |
| 2.19 | If accelerated depreciation were not available or was made less generous in regard to long-life assets, significant prospective investments may be located in other countries in preference to Australia. | ✓ | | | | | | 3.1-3.7 |
| 2.28 | Should accelerated depreciation or some form of it remain? | ✓ | | | | | | 3.1-3.7 |
| 2.30 | If accelerated depreciation is removed, it should be replaced: | | | | | | | |
| | ***Option 1:*** With an effective life regime for all wasting assets (para 2.30-31) | | | | | ✓ | | |
| | ***Option 2:*** With an effective life regime with a fixed percentage loading (para 2.32-35) | | ✓ | | | | | |
| **CHAPTER 25** | | | | | | | | |
| | *A consolidated tax regime should be introduced in Australia. [Added Question]* **** Subject to Significant Qualifications*** | | ✓* | | | | | 4.1 |
| **CHAPTER 26** | | | | | | | | |
| | **Principle 1: Consolidation Optional and to include all** | | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| | **Australian wholly-owned entities in group** | | | | | | | |
| 26.3 | Consolidation should be optional. | ✓ | | | | | | |
| 26.3 | A head Australian holding company should be a requirement for consolidation. | | | | | ✓ | | 4.2 |
| 26.6 | Minor shareholdings on the following grounds should preclude consolidation: | | | | | | | |
| | - employee share ownership | | | | | ✓ | | |
| | - special purpose finance shares | | | | ✓ | | | |
| | - non-voting preference shares | | | | ✓ | | | |
| 26.48 | A regime of capital gains tax grouping provisions should exist outside consolidation: | | | | | | | |
| | - resident entities | | | | ✓ | | | 5.1 |
| | - non-resident entities | ✓ | | | | | | |
| | - resident entities with non-resident parent | ✓ | | | | | | 5.2 |

| CHAPTER 26 … cont'd | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 26.48 | A regime of loss grouping provisions should exist outside consolidation: | | | | | | | |
| | - resident entities | | | | ✓ | | | 5.1/5.2 |
| | - non-resident entities | ✓ | | | | | | |
| | - resident entities with non-resident parent | ✓ | | | | | | 4.3/5.2 |
| 26.52 | Should CGT roll-over relief continue to be available to controlled foreign companies? | ✓ | | | | | | |
| | **Principle 3: Repeal of Current Grouping Provisions** | | | | | | | |
| 26.68 | Once the consolidation regime commences, the current grouping provisions would be repealed, excepting non-concessional elements. | | ✓ | | | | | 5.1/5.2 |
| | **Principle 4: Bringing losses and franking account balances into consolidated group.** | | | | | | | |
| 26.8 | The following options have been proposed regarding pre- | | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| 6 | consolidation losses: | | | | | | | |
| | ***Option 1***: Do not allow losses into group apart from 2 limited transitional cases (para 26.90-91) | | | | | | | |
| | ***+ Agreement only in relation to para. 26.91 transitional issues*** | ✓+ | | | | | | |
| | ***Option 2***: Allow carry-forward losses in subject to a modified same business test (para 26.92-95) | | | | | ✓ | | 4.3.1 |
| | ***Option 3***: Option 2 test with additional time usage limitation (para 26.96) | | | | | ✓ | | 4.3.1 |
| | ***Option 4***: Allow a specific proportion of loss to be brought into consolidated group( para 26.97) | | | | | ✓ | | 4.3.1 |
| | ***Option 5***: Quarantine losses within the loss entity for use while in consolidated group (para 26.98) | ✓ | | | | | | 4.3.2 |
| | ***Option 6***: Leave loss entities outside group (para 26.99) | | ✓ | | | | | 4.3.3 |
| | **Principle 5: Losses and franking credits on exit** | | | | | | | |
| 26.103 - 104 | Entities leaving a consolidated group should not be entitled to take with them: | | | | | | | |
| | - Pre-consolidation losses | | ✓ | | | | | 5.3 |
| | - Pre-consolidation franking credits | | ✓ | | | | | 5.3 |
| | - Pre-consolidation foreign tax credits | | ✓ | | | | | 5.3 |
| | - Pre-consolidation foreign dividend account credits | | ✓ | | | | | 5.3 |
| CHAPTER 26 … cont'd | | | | | | | | |
| | **Other Options/Issues:** | | | | | | | |
| 1. | Entry and exit times for consolidated group members. Timing of entry and exit of a subsidiary to a consolidated group: | | | | | | | |
| | - Beginning of a tax year of entry | | | | ✓ | | | |
| | - Beginning of next tax year | | | | ✓ | | | |
| | - At time of acquisition/disposal | | ✓ | | | | | |
| 2. | There is a need to address anomalies that could otherwise arise where a consolidated group with current or carried-forward tax losses receives a dividend from a non-group entity. | ✓ | | | | | | 4.4 |
| CHAPTER 27 | | | | | | | | |
| 27.5 | The following two methods have been proposed to determine the cost base for disposal of equity: | | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| | - entity based model | | | | ✓ | | | 5.4 |
| | - asset based model | | ✓ | | | | | 5.4 |
| **CHAPTER 28** | | | | | | | | |
| | **Preventing loss cascading** | | | | | | | |
| 28.19 | The current compulsory CGT roll-over rules should be extended to cover asset disposals within the same majority-owned group of entities. | | | | | ✓ | | |
| | **Preventing realised loss duplication** | | | | | | | |
| 28.21 | The continuity of ownership test should be amended to require each owner existing at the relevant loss recoupment and loss incurrence time to hold more than 50% ownership. | | ✓ | | | | | |
| 28.22 | The same business test should be removed to prevent carry-forward of realised tax losses when entity is sold. | | | | | ✓ | | 6.1-6.6 |
| | **Preventing unrealised loss duplication** | | | | | | | |
| 28.24 | Measures are necessary to prevent the duplication of unrealised capital losses on a majority change in ownership. | | | | | ✓ | | |
| 28.28 | If anti-capital loss duplication measures are introduced, the <u>Canadian</u>-based approach should be adopted. | | ✓ | | | | | |
| **CHAPTER 28 … cont'd** | | | | | | | | |
| 28.33 | If anti-capital loss duplication measures are introduced, the <u>United Kingdom</u> approach should be adopted. | | | | | ✓ | | |
| | **Preventing the duplication of unrealised and realised gains** | | | | | | | |
| 28.37 | A capital loss should be allowed to new equity owners resulting from the distribution of realised and unrealised gains in order to prevent the duplication of unrealised and realised gains. | ✓ | | | | | | |

## SUBMITTED BY: THE MOBIL AUSTRALIA GROUP

| Paragraph Number | A CASE FOR CONSOLIDATION | Strongly Agree | Agree | Indifferent | Disagree | Strongly Disagree | Costed in Chapter 39 | Submission Paragraph Ref. |
|---|---|---|---|---|---|---|---|---|
| | **Realised loss/gain duplication: Majority Ownership** | | | | | | | |
| 28.40 | The following models would be preferable in preventing the duplication of realised gains and losses in majority ownership changes: | | | | | | | |
| | - asset based model | | ✓ | | | | | |
| | - entity based model | | | | ✓ | | | |