16 April 1999

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

Dear Sir

Re: **Review of Business Taxation**

The Australian Institute of Petroleum (AIP) is pleased to respond to request from the Review of Business Taxation for comments on the proposals and options as canvassed in the *Platform for Consultation* of February 1999. These comments provided by AIP are supplementary to the submission lodged by AIP in December 1998 in response to *A Strong Foundation,* and are supplied on behalf of the refiner-marketer members of AIP, as follows:

- BP Australia Limited
- Caltex Australia Limited
- Mobil Oil Australia Limited
- Shell Company of Australia.

AIP is a member of the Business Coalition for Tax Reform (BCTR). AIP supports the submission of the BCTR on the Review of Business Taxation. The comments contained in this submission are designed to cover those areas of the reform of business taxation that could have a particular impact on the businesses of the AIP refiner-marketer oil companies.

The Trade-off between a Lower Company Rate and Tax Concessions

The four AIP refiner-marketer companies are major investors in Australia. Net capital expenditure in the period 1992-97 totalled $2.4 billion. The products of the companies' refineries compete with imported petroleum products, leading to a major benefit to the balance of payments. The four refiner-marketers are affiliates or

…/2

subsidiaries of overseas corporations. Capital expenditure plans of the four companies must compete for scarce corporate resources with capital expenditure opportunities in Australia, as well as in other countries. It is crucial, therefore, to AIP member companies that the Australian business tax regime is efficient and internationally competitive.

Central to the issue of an internationally competitive tax regime is the overall tax rate and the treatment of capital expenditure. Given the options outlined in the *Platform for Consultation*, AIP member companies have carefully assessed the issue of the trade-off between a lower tax rate and a broader tax base.

It is clear from the options outlined that for a significant reduction to be achieved in the corporate tax rate, there would need to be significant reductions in the accelerated depreciation provisions. Any reduction in the latter will have a negative impact on the attractiveness of capital investment in Australia, compared to investment in other countries.

The impact between the proposed trade-off is not uniform on the AIP companies. While some would benefit, others would be adversely affected. Nevertheless, most of the AIP companies believe that it is more important to align the basic corporate tax rate with those of other countries, including countries which supply investment capital and those which offer competing investment opportunities. Therefore, AIP would support a reduction in the corporate tax rate to 30 percent, financed in part by a reduction in accelerated depreciation provisions. However two caveats must be made:

- existing investments have been committed on the basis of accelerated depreciation regimes in existence at the time of the investment decision. It would be most inequitable if such investments were disadvantaged by a retrospective loss of the depreciation treatment on which the investment had been justified. AIP urges therefore that existing investments and committed projects do not have a loss of accelerated depreciation provisions imposed on them
- the loss of accelerated depreciation will make it harder to justify investment and will lead to losses in investment. AIP urges, therefore, that any trade-off of accelerated depreciation necessary to reach the 30 percent corporate tax rate be kept as low as possible.

AIP Recommendation

The corporate tax rate be reduced to 30 percent to align closer with rates in other key countries. Any trade-offs of accelerated depreciation necessary to achieve this should be kept to a minimum and not be applied retrospectively to existing and committed investments.

…/3

Deferred Company Tax

In *The Platform for Consultation,* the Review has noted a need to achieve integrity through the entity chain, and canvassed three options to achieve this: the imposition of a deferred company tax (DCT); the application of a resident dividend withholding tax (RDWT); or the taxation of unfranked inter-entity distributions.

AIP companies have concerns over the deferred company tax option:

- as a point of principle, tax should be imposed on profits, not the movement of capital. The deferred company tax route seems to impose a tax akin to a 'capital movement' tax on tax-preferred income
- the DCT would impact directly on company profits
- in practice, AIP companies have grave doubts that a deferred company tax would be creditable in the home countries of overseas investors. There is no guarantee that the company tax/dividend withholding tax switch suggested in *The Platform for Consultation* would be allowed in the overseas countries.

In the previous section, AIP stressed the need for international competitiveness in the business tax regime to attract and retain internationally mobile investment. While AIP companies generally supported the reduction in the corporate tax rate, supported by a trade-off in accelerated depreciation, AIP noted that it would make investment in Australia harder to justify. It is particularly important therefore to ensure that other parts of the business tax review do not provide further disincentives to investment.

There would be no point in providing concessions in the tax on profits, if the positives from such a move are outweighed by negatives from changes to the taxation on remissions. If there has to be tax on remissions, AIP would prefer the retention of the withholding tax system.

A RDWT would have the advantages that:

- it would not impact on company profits as significantly as a DCT
- it would ensure that all distributions through the entity chain are subject to full corporate tax and that distributions to individuals are taxed at source

AIP Recommendation

There should be no imposition of a deferred company tax. If overseas remissions are to be taxed, this should be through the RDWT tax system

Consolidation

While supporting the general principles outlined for consolidation, AIP has a concern over the proposals for a requirement for groups entering a consolidation regime to have a resident holding entity at the head of the group. This provision could force

…/4

unnecessary restructuring on groups with an overseas parent, in instances where Australian subsidiaries are grouped on functional lines, rather than national lines. As all the Australian subsidiaries would have a common overseas parent, there seems no reason to form a local parent to allow consolidation. Furthermore, the formation of a local parent could have adverse tax implications overseas.

Recommendation

Consolidation be allowed without a resident holding entity for groups with a common overseas parent

Thin Capitalisation Provisions

In *The Platform for Consultation,* the Review notes that Australia's current thin capitalisation provisions are not fully effective at preventing excessive gearing of Australian operations by multi-national corporations. Two options for strengthening the interest deductibility provisions for foreign controlled operations are outlined: the application of world-wide group gearing to a group's Australian operation; or the application of a fixed gearing ratio.

AIP believes that companies should be able to determine their own gearing strategies. While recognising the concerns over effective thin capitalisation provisions, AIP suggests that, rather than set an arbitrary gearing rate, the tax regime should set a test of what is a reasonable level of gearing. In the case of listed companies, the market will decide what is a reasonable level of gearing. If a company is not listed, the test should be whether it would be reasonable to expect the Australian operations of a multi-national to obtain the level of gearing determined by the operation's management, if it were operating on an arm's length basis from the overseas parent.

AIP also points out that the application of any new requirements on thin capitalisation to existing structures would amount to retrospective taxation. AIP urges that, if changes are made to thin capitalisation provisions, they do not apply to existing structures or that suitable transition provisions are put in place.

AIP Recommendations

No arbitrary gearing limits should be imposed on Australian operations of overseas multi-nationals. Rather, a test of 'reasonableness for an arm's length operation' be set to assess the levels of tax-deductibility for gearing by Australian operations of multi-nationals

Changes to the thin capitalisation provisions should either not apply to existing corporate structures, or suitable transition provisions should be put in place.

…/5

Carried Forward Losses under Consolidation

The Review canvasses a number of options for treatment of carried-forward losses on consolidation. In AIP's view, this could be an important strategic issue, as the value of carried-forward losses can be very important to establish the saleability of small emerging businesses. A tax regime that creates an excessively high barrier for the carrying forward of losses in a consolidation may have the unintended consequences of discouraging emerging businesses.

Of the options outlined, AIP supports those put forward by the BCTR, but also believes that the option to allow carry-forward losses to be brought into a consolidated group subject to a modified Same Business Test is a workable route. If properly administered, a Same Business Test can present a sufficiently, but not excessively high hurdle for the carry-forward. The modification could allow for losses to be claimed over a five-year period, which seems a reasonable limitation to protect revenue.

AIP Recommendation
Carry-forward losses be allowed to be brought into a consolidated group.

Consolidation Costs

If there are changes to consolidation rules under the Review of Business Taxation, this may force corporate groups to restructure to conform to the new tax regime. This could have a number of adverse consequences. For example, corporations would incur significant stamp duty costs in restructuring to meet the corporate tax requirements. This would be an unintended tax burden on companies. Accordingly, AIP urges more consultation on this issue, and that there be relief from stamp duty costs incurred as a result of corporate restructuring within a defined time period of the institution of the new tax regime.

AIP Recommendation

There should be more consultation on the adverse effects of any new consolidation regime, and there should be relief from stamp duty costs of corporate restructuring within a defined period following the establishment of the new corporate tax regime.

Capital Gains

AIP supports the overall proposals of the BCTR.

AIP would like, in particular, to draw attention to the importance of further evaluation of proposals to replace indexation, and to extend such proposals to all tax paying entities. From an evaluation of the impact of the replacement of indexation among

…/6

AIP member companies, it is clear the loss of indexation could lead to significant adverse effects, particularly if there is a return to a high inflation environment. It is important that companies retain the ability to offset the effects of an inflationary environment in any restructuring of the capital gains tax

Recommendation

Any restructuring of capital gains tax should allow companies to offset the effects of inflationary environment on assets with a capital gains tax liability

Treatment of Blackhole Expenditures

The Review of Business Taxation has identified the problems and inequities of 'blackhole expenditures'. Possible treatments for a number of 'blackholes' are outlined. AIP supports the implementation of these measures. However AIP urges there should be a general provision that ensures a deduction is available. The proposal outlined in the Review, that of listing blackhole expenditures, raises the risk that a blackhole expenditure will be missed, thus replicating the existing problem.

AIP Recommendation

The treatment for 'blackhole' expenditures outlined in 'A Platform for Consultation' be implemented. There should be, in addition, a general provision that ensures a deduction is available for any 'blackhole' expenditure.

Scrip-for-scrip Rollover Relief

AIP supports the proposal for scrip-for-scrip rollover relief.

AIP would be happy to discuss any aspects of this submission. Any questions should be directed, in the first instance, to Ewen Macpherson, Manager Government and Public Policy at AIP.

This submission is being submitted by email. AIP will also supply two hard copies.

Yours sincerely

JC STARKEY
Executive Director