16 April 1999

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Dr Alan Preston
Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
Canberra ACT 2600

Dear Dr Preston,

I wish to express Telstra's appreciation at being given the opportunity by Government to provide a submission on the various options being considered as part of the reform of business taxation.

Telstra believes that the Australian economy must be internationally competitive. The increasing pressures of globalisation and international commerce makes it imperative that Australia has an internationally competitive tax system that supports rather than restricts Australian business.

In recent years Telstra has actively lobbied Government on various defects in the current taxation regimes. These representations include tax relief for the cost of acquiring a spectrum licence (which received tax relief on 11 March 1998) and also the cost of acquiring an Indefeasible Right of Use ("IRU") in respect of an international submarine cable system. It is noted that tax relief for IRU's is included in the options set out in *A Platform for Consultation*.

The proposed capital allowance provisions for rights and other wasting assets is a positive feature of the reform agenda which Telstra strongly supports. The failure of the current tax system to provide tax relief for these types of expenditure is symptomatic of the need for business tax reform.

It has been Telstra's experience that the present tax system has failed to keep pace with developments in both the domestic and international economies. The shortcomings in the Australian taxation system have been exacerbated over the last decade by increasing globalisation of the Australian economy and the consequential impact on the information technology and telecommunications sector. Recent innovations such as e-commerce and the commercialisation of the Internet testify to this phenomenon.

The Government has noted the increasing importance of information technology and telecommunications to national economic growth and welfare by the full deregulation of the telecommunications industry in 1997 and the establishment of the National Office for the Information Economy in the Department of Communications, Information Technology and the Arts.

One matter that was not addressed in *A Platform for Consultation* is the future of the R&D tax concession. It is understood that the concession will not change under business tax reform. However, there is a separate Government inquiry being conducted by the Department of Industry, Science and Resources into the concession.

Telstra strongly supports the continuation of the concession as a means of stimulating investment in R&D, especially in capital intensive and high technology industries. The importance of R&D to the future economic growth of Australia cannot be underestimated and any Government inquiry into its viability must be fully cognisant of this fact.

In summary, Telstra supports any changes to Australia's current taxation system that will assist in achieving the stated policy objectives of Government in respect of increasing the country's international competitiveness with the positive flow-on benefits to employment, savings and standard-of-living. Telstra is mindful that growth of the Australian information technology and telecommunications industry is an essential pre-condition to facilitate overall growth in all sectors of the Australian economy.

If you wish to further discuss any matters raised in this submission, please do not hesitate to contact Mr John Burke, Group General Manager Taxation, on (02) 9298 4851.

Yours sincerely,

EXECUTIVE SUMMARY

This executive summary sets out Telstra's position in relation to a number of options raised in *A Platform for Consultation*.

Taxation of Physical Assets

Telstra will support the abolition of accelerated depreciation in exchange for the proposed cut in the corporate tax rate to 30%, subject to the adoption of the following recommendations:

1. The adoption of an economic life regime as the basis for write-off of a physical asset with clear provision for the inclusion of technological obsolescence in the estimation of the economic life of the asset.

2. A change in the rate of depreciation after depreciation has commenced where there is virtual certainty that the effective life of the asset has dramatically shortened.

3. The changes to the capital allowance regime and the corporate tax rate should be done contemporaneously or within a relatively short period of time (say 2 years).

4. The broadening of the capital allowance base to include current items of 'blackhole' expenditure.

5. The adoption of a "pooling model" under which low cost items are pooled and depreciated as a single unit. For example, all items that cost less than $1,000 acquired by a business within the income year are pooled and depreciated over 4 years.

Taxation of Financial Assets and Liabilities

Telstra considers that the combined application of the mark to market method, timing adjustment method and the realisation method for the recognition of gains and losses on financial instruments would improve the current treatment of such gains and losses.

Taxation of Rights

1. The criteria or rules used to determine if a taxpayer has the requisite economic interest in a physical asset for capital allowance purposes must be clear and precise.

2. A capital allowance regime for physical assets and for rights in a physical asset must be as closely aligned as possible.

3. The depreciation of a right should be similar to that for a physical asset by allowing the right to be written off over its economic life.

Taxation of Entities

Telstra supports the Resident Dividend Withholding Tax option as an alternative to the Deferred Company Tax option.

Taxation of Entity Groups

1. A consolidation regime for group companies is not the most appropriate means to rectify the problems associated with loss duplication and value shifting.

2. If consolidation was to proceed, then serious consideration should be given to reconciliating the proposed regime with the existing corporate law regimes for consolidation.

Taxation of Fringe Benefits

Telstra fully supports -

1. the proposal to adopt a fringe benefit legislative regime of specific inclusion rather than the current approach of general inclusion; and

2. the general principle that the tax liability levied on fringe benefits should be transferred from employers to the recipient of the benefits.

Further Consultation

Telstra considers that public consultation should continue in relation to business tax reform following the tabling of the final recommendations to the Parliament.

SUBMISSION ON
A PLATFORM FOR CONSULTATION

TAXATION OF PHYSICAL ASSETS

The reform of the capital allowance regime for physical assets is of primary importance to Telstra. The matter should also be of importance to all Australians because the capital intensive sector provides essential infrastructure that is widely used by the general community and by business. The provision of essential infrastructure, such as telecommunications, goes right to the heart of Australian economic growth.

Accordingly, it is important to ensure that the provision of essential infrastructure is not compromised under tax reform. There must be a balanced approach to the write-off of physical assets and the rate of tax levied on the business income derived from their use to ensure the continued competitiveness of important industries both domestically and internationally. It is possible that some economically important infrastructure development projects would not proceed in the absence of such an approach.

It is well understood by all parties to the tax reform debate that modern infrastructure is critical if Australia wants to achieve sustainable economic growth. A competitive capital allowance regime will play an important role in assisting the viability of infrastructure and other capital intensive projects and thus in promoting long-term economic growth.

Capital intensive projects are often large scale and generally involve significant flow-on or trickle-down impacts throughout the economy. These projects increase the productive base of the Australian economy and improve international competitiveness of Australian businesses.

Telstra accepts the view that certain industries, such as finance, tourism and retailing, are important and Australia must continue to develop them to optimise its long-term economic growth. However, these industries, although not capital intensive in themselves, heavily depend on a range of infrastructure for their livelihood. As such they also should support an adequate capital allowance regime.

The Government has also recognised this fact when it introduced competition into the telecommunications industry. Virtually all businesses in all industries use telecommunications as an input to their production of goods and services. This may be in the form of basic telephony (voice) services or the transmission of data (eg. facsimiles, Internet, e-commerce).

It is in this context that Telstra must approach any debate that may result in a substantial change to the capital allowance regime.

Technological Obsolescence

An internationally competitive capital allowance regime that allows the depreciation of physical assets over their economic life must be fully cognisant of the increasing impact of technological obsolescence. A capital allowance regime that does not fully address technological obsolescence would place Australian businesses operating in the international marketplace at a substantial competitive disadvantage. This will especially be the case where competitors are resident in countries that provide tax incentives for investment in plant and equipment.

Rapid technological advancement is shortening the effective useful life of productive assets. Nowhere is the impact of technological advancement more pronounced than in the telecommunications industry. Furthermore, the international telecommunications industry has witnessed unprecedented growth in the transmission of data and video traffic as a result of the increasing use of the Internet, cable television and e-commerce etc. over recent years.

The course of technological change, changing customer demands and requirements set by regulators and governments is having a continuing impact on Telstra’s investment decisions notwithstanding a substantial modernisation of the Telstra network over the course of this decade.

An example of technological obsolescence brought about by government requirements is the closure of the analogue mobile network (AMPS). At the time the Government considered the introduction of competition to the Australian telecommunications industry a decision was taken that Telstra should close its analogue mobile network in 2000. This decision has resulted in both the extension of Telstra’s digital mobile network (GSM) and the construction of a replacement mobile network (CDMA) that uses the latest available technology.

Coupled with the need to replace substantial amounts of plant and equipment with the change from AMPS to CDMA, there is also some ‘blackhole expenditure’ being incurred as a result of the exercise. This is brought about by the non-deductibility of capital expenditure under the general deduction provisions of the Income Tax Assessment Acts and the restrictive nature of what constitutes the cost base of an asset for capital gains tax purposes.

Telstra is also commencing substantial investments in new technology for the switching of data traffic, value added products etc., to meet the miscellaneous demands placed on the Corporation. The need to continually invest in new and emerging technology is a feature of the industry and failure to keep pace with developments will quickly result in the loss of domestic and international market share.

Accordingly, Telstra is very conscious of the impact of technological obsolescence in the determination of the economic life of a physical asset. Any competitive capital allowance regime that allows depreciation of an asset over its economic life must give full weight to the importance of technological obsolescence. Failure to do so will directly result in distortions that will damage growth in capital intensive industries.

A competitive capital allowance regime would also provide taxpayers with the ability to change the rate of depreciation of an asset after depreciation has commenced where there is virtual certainty that the effective life of the asset has dramatically shortened. A classic example of this situation is the closure of AMPS.

Where conditions have emerged that demonstrate that an asset will be replaced much sooner than anticipated, there should be the ability to increase the rate of depreciation over its remaining life. The provision for an increase in the depreciation rate accords with the general matching principles that underlie the economic life regime.

In summary, it is submitted that there should be clear provision for the inclusion of technological obsolescence in the estimation of the economic life of a physical asset and the ability to change the rate of depreciation after depreciation has commenced where there is virtual certainty that the effective life of the asset has dramatically shortened. These provisions will help to ensure that Australia has an internationally competitive capital allowance regime.

International Competitiveness

There is a general acceptance that any change to the capital allowance regime (without the inclusion of targeted tax incentives) will eliminate investment distortions in the domestic economy. However, this is not the situation where businesses operate on an international basis or must compete with foreign businesses who can manage their affairs by holding assets in more favourable tax jurisdictions. In other words, there is little point in Australia adopting a comprehensive tax system that achieves domestic economic equity if it undermines the international competitiveness of Australian businesses.

The advent of globalisation has increased the relevance of international competitiveness as an important pre-condition for long-term and sustainable economic growth. Taxation can be a significant factor when an international transaction or investment is considered. Many countries have specifically tailored their tax system with the objective of attracting investment. Accordingly, Australia must continue to offer a competitive tax system so as to encourage overseas businesses to locate in Australia and equally to retain current businesses operating here. An effective capital allowance regime is an important element of such a tax system.

Australian businesses must also compete with foreign competitors, resident in more favourable tax jurisdictions, for the acquisition of scarce resources. This situation was recently faced by Australian telecommunications carriers in relation to the spectrum auctions held by the Australian Communications Authority. It was possible for foreign carriers to out-bid their Australian counterparts because of the more favourable after-tax position they held on purchase of a spectrum licence. Specific legislative relief (contained in the Taxation Laws Amendment Bill (No. 6) 1999) was required to rectify this problem.

We agree with the proposition that a reduction in the corporate tax rate combined with some other aspects of the tax reform agenda would improve Australia's position in retaining existing businesses and attracting further businesses. However, any reduction in the corporate tax rate must be coupled with a balanced change to the capital allowance regime.

In this regard it is considered that a lower tax rate coupled with a comprehensive capital allowance regime that allows depreciation of physical assets over their economic lives, with full allowance for technological obsolescence, should ensure that Australia's tax system remains internationally competitive.

Timing

The possible magnitude of change to the Australian capital allowance regime relative to the regimes now adopted by our major trading partners could lead to assets or major capital intensive projects being transferred off-shore to more favourable tax jurisdictions. This potential problem will be mitigated if the benefits flowing from the introduction of the new business tax system are introduced contemporaneously with the removal of any tax incentives.

Accordingly, there is a need to minimise any adverse economic impact associated with the transition from the current to the new business tax regime. It is considered that any reduction in the corporate tax rate should be done contemporaneously with, or within a relatively short period of time (say 2 years) of, the changes made to the capital allowance regime.

Cost of Compliance

A capital allowance regime that achieves ease of compliance and administration is of major importance to business. Excessive use of resources to comply with a cumbersome regime could diminish the overall economic benefits associated with direct investment in plant and equipment.

The cost of compliance and the associated issue of economic efficiency in relation to accounting for physical assets must be balanced against the economic equity principles under a comprehensive tax base model. The need to balance these sometimes competing demands is highlighted by the options contained in the Discussion Paper concerning low cost items. It is considered that the administrative costs associated with the collection, recording and continued accounting for low cost items outweighs the economic equity argument that all assets of a similar nature should receive similar treatment.

The problems associated with low cost items was appreciated by the Australian Taxation Office in 1986 when it released Taxation Ruling IT 2264 and the Government in 1992 when it legislated for immediate tax relief for items costing less than $300.

While retention of the current treatment for low cost items is Telstra's preferred position, it is possible to satisfy both the requirements of economic equity and efficiency by the adoption of a pooling model under which low cost items are pooled and depreciated as a single unit. The balance between economic equity and efficiency may be resolved if all items that cost less than $1,000 acquired by a business within the income year are pooled and depreciated over 4 years. Depreciation will commence from the start of the year following the creation of the pool.

Precedent for this model may be found in the pooling method available for software in the Taxation Laws Amendment (Software Depreciation) Bill 1999 which is currently before the Parliament.

Who is entitled to the Capital Allowance

Telstra agrees with the general principle that the economic owner of a physical asset should be the party entitled to claim the capital allowance if the asset is used to produce assessable income. It is believed that the economic substance of a transaction involving physical assets is subordinated to its legal form thereby creating a distortion as to the appropriate party who should be entitled to claim the capital allowance in respect of the assets.

The problems associated with restricting the entitlement to the capital allowance solely to the legal or absolute owner of an asset was highlighted in Bellinz's case. The Federal Court in Bellinz's case was restrained by legal precedent while recognising that there are circumstances where a substantial beneficial interest in an asset may be sufficient to confer entitlement to the depreciation deduction. The Commissioner of Taxation has long recognised this position in relation to leasing and hire purchase agreements.

The submissions made by Telstra to the Department of the Treasury on Indefeasible Rights of Use (IRU) in relation to international submarine cable systems stems directly from the problems created by Australian taxation authorities adopting a strict legal or absolute ownership basis for entitlement to the capital allowance. This situation has created major distortions in the investment decisions made in respect of acquiring an interest in a cable system. It also places Australian carriers at a substantial competitive disadvantage relative to their foreign competitors, who are resident in countries that have adopted an economic basis for establishing ownership for tax depreciation purposes (eg. US & Canada).

Accordingly, Telstra fully supports the option at paragraphs 1.15-1.17 inclusive to replace the current legal concept of ownership with a concept that recognises a requisite economic interest in the asset.

Conclusion

Telstra would support the abolition of the accelerated depreciation tax incentive in exchange for the proposed cut in the corporate tax rate subject to the adoption of the following recommendations. It is felt that these recommendations are important to ensure that Australian capital intensive businesses can continue to compete in the international marketplace.

1. The adoption of an economic life regime as the basis for write-off of physical assets must be fully cognitive of the increasing impact of technological obsolescence.

2. A change in the rate of depreciation after depreciation has commenced where there is virtual certainty that the effective life of the asset has dramatically shortened.

3. It is submitted that any changes to the capital allowance regime and the corporate tax rate should be done contemporaneously or within a relatively short period of time (say 2 years).

4. Telstra supports the option for the broadening of the capital allowance base to include current items of ‘blackhole’ expenditure.

5. It is submitted that the adoption of a “pooling model” under which low cost items are pooled and depreciated as a single unit will achieve an appropriate balance between economic equity and efficiency. It is suggested that all items that cost less than $1,000, acquired by a business within the income year, could be pooled and depreciated over 4 years.

6. Telstra fully supports the option to replace the current legal concept of ownership with a concept that recognises a requisite economic interest in the asset.

TAXATION OF FINANCIAL ASSETS AND LIABILITIES

Telstra supports the position that taxation policy should not unduly influence the choices between economically equivalent financial instruments or the timing of purchase and disposal decisions. Telstra believes that aligning the taxation treatment of such instruments with the current accounting treatment for such instruments would alleviate many of the weaknesses inherent in the current system and would reduce compliance costs and unnecessary complexities in the law.

Generally, Telstra considers that the combined application, depending on the relevant circumstances, of the three methods (mark to market method, timing adjustment method and the realisation method) proposed by Government for the recognition of gains and losses on financial instruments would improve the current treatment of such gains and losses for taxation purposes.

The following comments are made in relation to each of the proposed methods.

Mark to Market Method

Given the enormous disadvantages that have been discussed in *A Platform for Consultation* (ie cash flow issues, valuation issues etc) which could arise from the application of the mark to market method and the differing circumstances of taxpayers (ie banking taxpayers as opposed to non-banking taxpayers) Telstra agrees that the use of this method should be on a purely elective basis. In relation to the application of an eligibility criteria for the adoption of the method, Telstra supports "Option 3 - A combination of approaches" as it provides the necessary flexibility required for the application of this method.

Timing Adjustment Method

Telstra considers that the application of the timing adjustment method would limit many of the inequities existing in the current system. Telstra considers it appropriate to apply the three general principles set out in the Discussion Paper (ie certainty, deferral opportunities and compliance cost considerations) in ascertaining whether the timing adjustment method is appropriate to be applied to a particular instrument. It is considered that the use of commercial accounting methods would be the most appropriate timing adjustment benchmark, especially where the relevant taxpayer is subject to an external annual audit in which such methodology has been accepted as correctly reflecting the economic substance of the transaction. Such a benchmark would address the three general principles and would obviously assist in aligning the accounting and taxation treatment of financial instruments. To use benchmarks that differ from the method accepted by the external auditor as giving a true and fair statement of the transaction would unnecessarily increase compliance costs and complexity in the rules related to the application of this method as two series of calculations would need to be made for each transaction.

Telstra agrees that the application of the timing adjustment method would be inappropriate in relation to foreign exchange gains and losses, even in relation to "soft currency". Whether a currency is "soft" is a relative concept and a matter of personal opinion. Accordingly, it is considered that any system which advocates a distinction between "soft currency" and other currency would be totally unworkable.

Realisation Method

Telstra agrees that a change in legal ownership should, as a general rule, be the cornerstone in determining whether there has been a disposal under the proposed new system. However, it is accepted that any concept of disposal should be sufficiently wide to include the economic disposals referred to in the Discussion Paper. Nevertheless, it is considered that little will be achieved if the new system has complex disposal rules.

Treatment of Gains on the Extinguishment of Liabilities

Telstra does not favour any of the three options proposed by the Government in relation to the treatment of gains on the extinguishment of liabilities. Telstra considers that the current debt forgiveness provisions adequately account for any such "gains". Consequently, of the three options outlined in the Discussion Paper, Telstra believes that the third option, amended to remove the need for the "clear link between the relevant liability and the expenditure or asset" should be the recommended option.

Quarantining of Losses

Telstra does not advocate any proposal for the quarantining of losses arising from the realisation of financial instruments. It is accepted that the realisation method as applied to financial instruments can be exploited by means of accelerating losses and deferring gains through selective realisation of instruments. However, it is considered that quarantining losses introduces further complexities and inequities in the system.

It also creates artificial differences between the accounting and taxation treatment for such instruments (which is inconsistent with the whole thrust of the proposal) and thereby increases compliance costs. A taxpayer who has genuinely suffered a loss should not be disadvantaged by the taxation system. Any possibility of exploitation should be addressed through the general or specific anti-avoidance provisions.

Hedging Rules

Telstra does not believe that any future system would benefit from the inclusion of complex hedging rules. It is believed that the current realisation based system is the more appropriate method for the treatment of hedging gains or losses. It is considered that a mandatory set of rules in relation to hedging would suffer many of the problems highlighted in the Discussion Paper in relation to a mandatory mark to market method. Accordingly, we believe that the adoption of specific hedging rules, if deemed necessary by the Government, should also be on an elective basis. Notwithstanding this, Telstra believes that the considerations set out in paragraph 6.69 of the Discussion Paper would be extremely difficult (or time consuming and costly) to apply given the increasing use of general hedges as opposed to specific hedges.

Transitional Application

Introducing a new regime for the taxation of financial assets which has retrospective application is considered extremely inequitable and out of line with acceptable practices in relation to the introduction of new taxation laws and policies. Consequently, Telstra considers that any new regime should only have prospective application, with an option for taxpayers to bring “old” instruments within the ambit of the new regime should it be considered appropriate.

Taxation of Debt/Equity Hybrids

Telstra agrees that the treatment of debt/equity hybrids under the current taxation system is definitely in need of reform.

The essence of any proposed system should be merely to provide a “tie-breaker” in characterising the financial instrument. It is considered inappropriate for the tax system to dictate what instruments (the use of which is often based on commercial considerations) are or are not acceptable by the application of ad hoc punitive tax treatment.

Telstra believes that the proposed new system should be as simple as possible and therefore advocates the application of the "blanket approach". In order to ensure the simplicity of the system, it is considered that a single determinative factor (option 2) should be the basis for characterisation of the instrument. Any new system should not include any punitive tax treatment regardless of "which side of the line" the transaction falls on.

Synthetic Arrangements

While Telstra acknowledges that synthetic arrangements can be used to manufacture taxation benefits, it is considered that the general anti-avoidance provisions contained in the current tax legislation are sufficiently robust to deal with such arrangements and that any introduction of specific synthetic anti-avoidance rules would unnecessarily complicate the proposed new system.

Conclusion

1. Telstra believes that aligning the taxation treatment of financial instruments with the current accounting treatment for such instruments would alleviate many of the weaknesses inherent in the current system.

2. Telstra considers that the combined application of the mark to market method, timing adjustment method and the realisation method for the recognition of gains and losses on financial instruments would improve the current treatment of such gains and losses.

3. Telstra agrees that the use of the mark to market method should be on a purely elective basis with the adoption of eligibility criteria "Option 3 - A combination of approaches".

4. It is submitted that the use of commercial accounting methods would be the most appropriate timing adjustment benchmark.

5. It is submitted that the three options proposed in relation to the treatment of gains on the extinguishment of liabilities are inappropriate.

6. It is submitted that the proposal to quarantine losses arising from the realisation of financial instruments is inappropriate. Any possibility of exploitation should be addressed through the general or specific anti-avoidance provisions.

7. It is submitted that the current realisation based system is the most appropriate method for the treatment of hedging gains or losses.

8. It is submitted that any new regime should only have prospective application, with an option for taxpayers to bring “old” instruments within the ambit of the new regime.

9. Telstra would accept the adoption of the “blanket approach” in relation to debt/equity hybrids. It is considered that a single determinative factor (option 2) should be the basis for characterisation of the instrument.

TAXATION OF RIGHTS

Over recent years Telstra has made a number of submissions and representations to Government on the taxation of rights. The general lack of tax relief for the cost of acquiring a right (with limited exceptions with regard to intellectual property, and more recently, software and spectrum licences) creates a major inequity between intangible and physical assets leading to a distortion of some major investment decisions.

The most recent representations made by Telstra to the Treasury and the Australian Taxation Office have involved Indefeasible Rights of Use (IRU) in respect of submarine cable systems. The substance of the IRU submission was to seek tax relief for the cost of acquiring a substantial interest in a cable system through an IRU arrangement.

An IRU is an indefeasible right that gives the IRU holder substantial interest in the plant and equipment that comprises the cable system. Because an IRU holder does not obtain legal ownership of the cable system there is no tax relief on acquiring the right other than a capital loss on its disposal.

Telstra is of the view that the rights obtained under an IRU are sufficient to establish a degree of ownership in the cable system to allow the holder to claim a depreciation deduction under the capital allowance regime for physical assets. This view is not held by the Australian Taxation Office. Hence the submission to Treasury seeking clarification of the law by way of specific legislative relief.

Telstra’s involvement in the debate about the appropriate treatment for the cost of acquiring an IRU in an international submarine cable system has brought home the need for clear guidance about when a business has a sufficient degree of ownership in a physical asset to be entitled to a depreciation deduction. The distinction is important because a business needs to know whether the expenditure incurred should be depreciated under the capital allowance provisions for physical assets or under a different provision, if one is available. Accordingly, the criteria or rules used to determine if a taxpayer has the requisite economic interest in the asset for capital allowance purposes (paragraphs 1.15-1.17 inclusive of the Discussion Paper) must be clear and precise.

It is considered that the depreciation of a right should be similar to that for a physical asset by allowing the right to be written off over its economic life. The arguments put earlier for the importance of including full consideration of technological obsolescence in the estimation of the economic life of a physical assets is equally important for certain rights. Many rights pertaining to technological-based knowledge are subject to a very high degree of economic obsolescence.

An adoption of a legal life basis for depreciation for all rights is inappropriate as it will fail to recognise that many rights economically expire before the end of their legal life.

A legal life basis of write-off would also create a major distortion between the write-off of physical assets and rights. Accordingly, the capital allowance regime for physical assets and for rights in a physical asset must be as closely aligned as possible or else taxpayers may seek to classify the nature of their interests to fall within the regime that provides the greater benefit.

Conclusion

1. The criteria or rules used to determine if a taxpayer has the requisite economic interest in the asset for capital allowance purposes must be clear and precise.

2. The depreciation of a right should be similar to that for a physical asset by allowing the right to be written off over its economic life with full account of technological obsolescence.

3. Telstra submits that a capital allowance regime for rights should be as closely aligned to the regime for physical assets so as to minimise any avoidance behaviour.

TAXATION OF ENTITIES

Telstra supports the general principle that the integrity of the imputation system needs to be improved.

However, it is submitted that the investor and not the entity or investment vehicle should bear the financial burden for direct taxes associated with investments made in the entity. The taxation of dividends, together with the availability of any imputation credits, is one of the elements taken into account by investors when a decision is being made to place investments funds with competing investment options. The introduction of a comprehensive income tax model with full integration of the taxation affairs of an entity or investment vehicle with that of the investor can conflict with other commercial and legal matters that govern the operation and affairs of a corporation.

The one option that avoids this conflict between the competing demands on the entity and that of its investors, ensures economic efficiencies and removes any distortion in investor decision making is the Resident Dividend Withholding Tax ("RDWT") option. The beneficial features of RDWT are:

- It does not result in any significant adverse impact on an entity's cashflow, share price, earnings per share, international competitiveness or cost of capital.
- It will not adversely impact on, or influence, the gross amount of dividends payable by the entity.
- It will not unreasonably influence an entity's commercial decisions and planning strategies.
- It will not adversely influence the efficient and optimal allocation of resources.
- It is relatively simple to implement and will have a minimal impact on compliance costs.
- It will not require a change of Australia's Double Tax Agreements.

Telstra does not object to the introduction of the Taxing Unfranked Inter-Entity Distributions option. However, it is considered that public company recipients of unfranked inter-entity distributions should be excluded from this option.

Telstra is strongly opposed to the introduction of the Deferred Company Tax ("DCT") option. This is for the following reasons:

- It will adversely impact on, unduly influence and distort the quantum of dividends to be paid by an entity, the earnings per share and dividend policy of the entity resulting in a greater retention of profits, even where the entity may have excess cash and capital reserves.
- It will adversely impact on Australian entity's international competitiveness and financial attractiveness particularly to foreign investors due to decreased after-tax profitability, lower earnings per share and capital gains tax free capital growth. In regard to Telstra the confidence of international investors will be critical to the Government's objective of maximising sale proceeds from the further dilution of its equity interest in the Corporation under the Telstra (Transition to Full Private Ownership) Bill 1998.

- It will have a significant impact on an entity's after-tax profit if the entity has a high dividend payout ratio and a significant amount of tax preferred income. In Telstra's case this is a major issue if Telstra decided to pay a special dividend in addition to its normal semi-annual interim and final dividends or engage in an off-market share buy back to optimise or re-align its balance sheet structure.

- It will significantly impact on an entity with a significant number of non-resident equity investors, especially where institutional investors which are exempt from tax in their home jurisdiction are involved. In the absence of appropriate changes to Australia's current Double Tax Agreements there is a strong possibility that foreign investors will not receive a foreign tax credit in their home jurisdictions for the DCT thereby reducing their after-tax return.

- The telecommunications business is highly technical, rapidly changing and capital intensive and Australian carriers require a significant working capital to fund their day to day operations which they may raise from both domestic and international (Euro and US) capital markets and debt providers. The potentially significant adverse impact on the Australian carriers after-tax profits and cashflows as a result of the DCT being introduced would significantly increase the cost of capital as analysts would perceive the Australian carriers to be a riskier investment compared to other international telecommunications companies and multi-national companies seeking debt funding.

- It will unreasonably influence an entity's commercial decisions and planning strategies and could result in an inefficient and sub-optimal allocation of resources.

- It applies to public companies in addition to private companies where scope for deferral or avoidance is greatest.

- Unlike the franking deficits tax, the DCT is not creditable against future company tax payable.

- It will not necessarily result in a regime which is significantly less complex than the current dividend imputation system including the anti-avoidance dividend and capital streaming provisions.

Conclusion

Telstra supports the Resident Dividend Withholding Tax option as an alternative to the Deferred Company Tax option.

TAXATION OF ENTITY GROUPS

Telstra understands that the proposed consolidation regime is intended to address the costs of compliance for business and threats to the Revenue. However, it is considered that it will not deliver the expected savings in terms of costs of compliance and reduction of complexity. Instead consolidation will result in an increase in the costs of compliance. This is evidenced by overseas experience.

It is considered that the added complexities that a consolidation regime will impose on businesses outweighs the anti-avoidance concerns expressed by Government. It should be expected that the proposed strengthening of the general anti-avoidance provisions would rectify any problems associated with loss duplication and value shifting.

The ability for wholly-owned groups to elect whether to consolidate does not offer any real choice as it is coupled with the abolition of the grouping of losses and the roll-over of assets.

Accordingly, Telstra does not support the proposed consolidation regime. However, if consolidation was to proceed, then serious consideration should be given to a reconciliation of the proposed regime with the existing corporate law regimes for consolidation.

The requirement to consolidate for tax purposes must be considered in the context of what is done for statutory accounting and financial reporting purposes. If the tax consolidation regime does not reconcile to the requirements of the Corporations Law, then separate consolidations will be required. It is likely that it will still be necessary to prepare separate taxable income calculations for each entity in the group. Accordingly, consolidation will not achieve the objectives of reducing costs of compliance or complexity.

Conclusion

It is submitted that consolidation for group companies is not the most appropriate means to rectify the problems associated with loss duplication and value shifting. However, if consolidation was to proceed, then serious consideration should be given to reconciling the proposed regime with the existing corporate law regimes for consolidation.

TAXATION OF FRINGE BENEFITS

There are a number of options raised in A Platform for Consultation relating to the taxation of fringe benefits that Telstra feels would be of benefit to business.

The principal concern of Telstra in relation to the Fringe Benefits Tax system is the cost of compliance. The recent introduction of the new fringe benefits reporting measures in A New Tax System (Fringe Benefits Reporting) Bill 1998 has increased the cost of compliance for those benefits not included in salary package arrangements.

The new reporting measures highlights the persistent problems associated with the current regime. There are substantial compliance costs associated with certain non-packaged benefits that arise from the ordinary consequences of carrying on a business. These are required to be separately reported against individual employees. Such measures create economic inefficiencies that run contrary to the general principles of equity and simplicity.

Accordingly, Telstra fully supports the proposal to adopt a fringe benefits legislative regime of specific inclusion rather than the current approach of general inclusion. This has the potential to significantly relieve employers of substantial administrative costs. It is submitted that a specific inclusion regime that is aimed at the high value fringe benefits would provide significant administrative savings at little cost to the Revenue.

Telstra also supports the general principle that the tax liability levied on fringe benefits should be transferred from employers to the recipient of the benefits. This is simply a matter of economic equity. This initiative, when viewed with requirements being introduced to include certain fringe benefits on employee group certificates for certain non-income tax purposes demonstrates that the Government is aware that the liability associated with a fringe benefit should rest with the recipient. However, it is understood that there are political restraints on the Government to fully implement the appropriate changes to the taxation of fringe benefits.

Conclusion

1. Telstra fully supports the proposal to adopt a fringe benefits legislative regime of specific inclusion rather than the current approach of general inclusion.

2. Telstra also supports the general principle that the tax liability levied on fringe benefits should be transferred from employers to the recipient of the benefits. The appropriate marginal rate of tax would be levied on the value of the fringe benefits received by the employee.

FURTHER CONSULTATION

The question of continuing public consultation following the tabling of the final recommendations to the Parliament together with relevant legislation on 30 June is very important to the successful implementation of the tax reform agenda. If the eventual legislative regime introduced is flawed or administratively cumbersome, then the benefits that the Government hopes will flow from the exercise may not be fully realised.

Recent experience with the new Fringe Benefits Tax reporting rules introduced in A New Tax System (Fringe Benefits Reporting) Bill 1998 has demonstrated a need for continued consultation to minimise any potential implementation difficulties. Full and transparent consultation should continue between Government and business until the final and successful implementation of the tax reform agenda. This must include a receptive response from Government on matters of legislative detail and implementation.

Clearly economic efficiencies associated with tax reform will only be achieved if the legislation giving effect to it is clear, precise and practical. There should also not be an unnecessarily large degree of pain associated with businesses needing to change policies, procedures and systems to comply especially in an environment where they are currently coping with the demands of the Year 2000 Software issue and the introduction of the Goods and Services Tax.