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SUBMISSION

TO THE RALPH COMMITTEE

1 EXECUTIVE SUMMARY

1.1 We strongly support all moves directed to improve the position of Australia as an international financial centre.

1.2 We strongly oppose the introduction of an active business test into the FIF regime (whether it comes from the CFC regime or otherwise).

1.3 We strongly oppose the introduction of a deferred company tax system particularly in the manner set out.

1.4 We strongly support the rationalisation of the anti-avoidance provisions in the tax legislation. However, this cannot simply be a matter of introducing a new general anti-avoidance provision with a ridiculously low threshold.

1.5 We believe averaging within the CGT regime should be altered rather than abolished.

1.6 We strongly reject any attempt to re-introduce sufficient distribution requirements.

1.7 We strongly support the introduction of a CGT rollover in respect of scrip for scrip transactions in a wide application.

1.8 We are concerned to ensure that changes to the tax system which are being justified on the basis of a need to improve the integrity of the tax system must be more carefully scrutinised and the impact on taxpayers fully considered before being implemented. In many cases the stated objective can be achieved without the enormous compliance burden or disadvantage to the community that, based on past practice, invariably seems to follow.

1.9 We believe that greater efforts need to be made to reduce the compliance burden on taxpayers, particularly those in small business.

1.10 We agree with the suggestion that the ATO should be overseen by a board which delegates the day to day running to the Commissioner of Taxation.

1 AUSTRALIA AS A FINANCIAL CENTRE

1.1 We strongly support all moves directed to improve the position of Australia as an international financial centre.

1.2 We believe that all such measures should be given absolute priority in terms of implementation and the sorry record to date in relation to these matters not repeated.

2 TAXATION OF FIFS

2.1 We strongly oppose the introduction of an active business test into the FIF regime (whether it comes from the CFC regime or otherwise).

2.2 We strongly believe that the FIF regime should be abolished in its present form and reintroduced in the manner that the original CFC proposals called for, ie to supplement the CFC legislation by ensuring that there was no obvious avoidance by just falling outside the CFC test.

2.3 Alternatively, we strongly support the exclusion from the FIF system of FIF interests in companies and trusts which are in tax jurisdictions comparable to Australia.

3 TREATMENT OF DISTRIBUTIONS

3.1 We strongly oppose the introduction of a deferred company tax system particularly in the manner set out.

3.2 At a time after the United Kingdom has decided to phase out its ACT system, the case for the introduction of the proposed system has not been made out.

4 ANTI-AVOIDANCE PROVISIONS

4.1 We strongly support the rationalisation of the anti-avoidance provisions in the tax legislation.

4.2 However, this cannot simply be a matter of introducing a new general anti-avoidance provision with a threshold that is lower than the dominant objective purpose.

4.3 It is necessary to stand back and reevaluate what is being done to the tax system.

4.4 The courts have affirmed the efficacy of Part IVA, the general anti-avoidance provisions of the taxation legislation.

4.5 Notwithstanding this very few cases have been taken to the court system in which taxpayers have challenged the application of Part IVA and succeeded. This suggests that the provisions are more than adequate other than in respect of areas which were not covered by the provisions (and still are not covered).

4.6 However, there has been a creeping tendency for the tax law to be further amended in such a way as add additionally anti-avoidance provisions and simultaneously to significantly lower the threshold for those new provisions to be attracted.

4.7 This is having the effect of forcing business to concentrate on the potential application of the numerous anti-avoidance provisions to what would previously been regarded as

totally innocuous transactions thereby taking the main eye of the commercial transactions and directing them inwardly - worrying about the tax consequences of what is done to the point where it stops normal everyday transactions from occurring.

5 CAPITAL GAINS TAX - REMOVAL OF AVERAGING

5.1 The original concept of averaging for capital gains was very poorly implemented and did not reflect the spirit of what was actually intended.

5.2 In those circumstances it is not appropriate to criticise the concept as producing tax rorts when in fact it has been poor implementation by the draftsman which has created that possible situation.

5.3 Further the fact that a more sympathetic solution, such as that below, has not been put forward is a significant indication of the problem facing tax reform in Australia.

5.4 Hence, if the original purpose is looked at again which was effectively to smooth gains over a 5 year period it would have been much more appropriate to have the tax rate to be applied to the income of that particular year determined on a 5-year averaging method similar to that employed in relation determining private production average taxable income.

5.5 The effect of this would be to redress the alleged rorts uncovered by the ATO while permitting a smoothing to take place to provide an example, if a business operates and produces a taxable income of $20,700 for a sole trader in each of 4 years and then the business is sold in the fifth year and realises a taxable capital gain of say $60,000 the effective tax rate under the various scenarios would be:

(a) no averaging - as for $60,000;

(b) under the current system - as for $10,000; and

(c) under a proper arranging system - as for $[work it out] the contrast is quite significant. However, there does not seem to be any justification to penalise those not rorting the system in an effort to penalise those who are regarded by the ATO as rorting the system.

6 CAPITAL GAINS TAX - SCRIP FOR SCRIP ROLLOVER RELIEF

6.1 We strongly support the introduction of a CGT rollover in respect of scrip for scrip transactions. This would remove the inhibitor which is currently holding back shareholders from agreeing to mergers and amalgamations which will greatly improve the operation of market forces and the evolution of stronger enterprises.

6.2 We believe that it should not be restricted and should apply widely covering both listed and unlisted participants, trusts and extend to the operations of CFCs where the country of jurisdiction of the CFC also grants some form of comparable rollover relief.

7 TREATMENT OF TRUSTS

7.1 At a practical level, if all discretionary trusts are treated as companies for tax purposes and their income taxed, when distributed one would expect the beneficiaries to receive franked dividends and have the benefit of the imputation credits.

7.2 However, the present operation of the 45-Day Rule in relation to franking credits will automatically disentitle every beneficiary of a discretionary trust form the benefit of the franking credits with the result that double taxation will apply compared to a comparable position with a company. This is not levelling the playing field. It is something else.

7.3 We are concerned that the implementation of such a change together with the existing operation of the 45 day rule relating to the entitlement to franking credits will mean that in many cases, small business will be disadvantaged because they will effectively be subjected to a double taxation situation. The operation of an exception such as was made in relation to "family trusts" when the 45 day rule was introduced does not cover all of the situations here.

7.4 In our view this means that the 45 day rule must be revised from its present operation to be more consistent with the use of trusts in the small business area (as opposed to the investment in shares area which has been its main focus to date involving trusts).

7.5 There needs to be additional consultation with a view to ensuring that by changing the existing law, there are no unfair and/or anomalous situations resulting. For example, in the context of the previous introduction of the 45 rule, there was an effective grandfathering of the previous tax position for existing shareholdings. In the context of this proposal, it is very difficult to restructure in an efficient manner (eg without exposure to stamp duty and the operation of the CGT provisions) for example to enable the trust to split into two or to enable the trust to introduce a unit trust and then have the discretionary trust split into 2 or more discretionary trusts.

7.6 An outcome involving double taxation (ie at the trust/company level and at the beneficiary/shareholder level) will certainty be the case where businesses are conducted through a trust effectively involving more than one family (which may for example have used a unit trust with the units held by separate discretionary trusts). There does not appear to have been any consideration given to the practical problems that will be faced by those effected or any suggested remedies provided. This needs to be addressed as the people most likely to be affected are those who would not be aware of the impact until after it has been implemented (for example it could move them from an effective 30% tax rate to an effective 57% tax rate).

7.7 Additionally, consideration should be given to providing a limited timeframe to dismantle trusts in a tax neutral manner, eg permitting a tax free distribution of assets to occur until the end of the first year of operation of the new provisions with the CGT profile of the assets distributed being inherited by the transferee. This would permit the removal of many potentially adverse or anomalous situations without effectively distorting the tax system.

8 PUBLIC COMPANY VERSUS PRIVATE COMPANY DISTINCTION

8.1 We believe that there is a need to have a public clarification of the basis upon which the tax system distinguishes between public companies and private companies.

8.2 This distinction had effectively disappeared in 1987 with the abolition of the sufficient distribution requirements.

8.3 However, it has been gradually reemerging.

8.4 Given the tests in section 103A of the Income Tax Assessment Act 1936 contain extremely wide discretions to treat public companies as private companies and private companies as public companies it seems important that there is a reaffirmation of the approach that the ATO will follows. Failure to do so leaves an unacceptable degree of uncertainty.

8.5 The most recent public statement on this would appear to be "Public Information Bulletin No 3".

8.6 A perusal of this document suggests that it reflects a reasonably sensible approach and on that basis should either be endorsed by way of reissue in a wider context or alternatively the approach of the ATO should be enunciated publicly in a manner that all taxpayer may rely upon in a self-assessment environment.

9 REQUIREMENT OF SUFFICIENT DISTRIBUTION

9.1 The Discussion Paper briefly discusses a proposal to require a private company to make a "sufficient distribution" of profits on an annual basis or alternatively be subjected to an undistributed profits tax.

9.2 The tax legislation previously contained a regime providing for the imposition of undistributed profits tax on private companies. This was abolished in 1987 and should remain abolished.

9.3 Any approach which seeks to reduce the general corporate tax rate from 36% to 30% but simultaneously requires the after-tax profits to be distributed to the shareholders, in either part or whole, will be simply seen as an exercise in revenue raising (including the reduction of the accelerated depreciation and other tax deductions available to companies).

9.4 We strongly reject any attempt to re-introduce sufficient distribution requirements.

10 CONSOLIDATION OF GROUPS

10.1 The proposal as it currently stands will mean that companies which are currently treated as group companies because they have a common non-resident parent will no longer be able to group losses and engage in other inter-group transactions.

10.2 There does not appear to be any justification made out for withdrawing such benefits on a selective basis.

10.3 It seems impliedly suggested that such an approach (of either having consolidated status or no status) is dictated because of the current difficulties that the ATO perceives in the integrity of the system relating to loss transfers under section 80G. We are convinced that such perceived difficulties are in fact difficulties which justify the automatic dropping of these provisions. If the concern is because of other issues, then perhaps it is important to address those issues before effectively forcing corporate groups into more expensive compliance exercises.

11 INTEGRITY ISSUES

11.1 Throughout the course of consultation "integrity issues" have been put forward as being reasons for making changes to the taxation system.

11.2 We believe that changes to the tax system which are being justified on the basis of a need to improve the integrity of the tax system must be more carefully scrutinised and the impact on taxpayers fully considered before being implemented.

11.3 In many cases the stated objective can be achieved without the enormous compliance burden or disadvantage to the community that invariably seems to follow.

11.4 However, often this is not the case.

12 MANAGEMENT OF THE ATO

12.1 We agree with the suggestion that the ATO should be overseen by a board which delegates the day to day running to the Commissioner of Taxation.

12.2 This would give a greater objectivity to prudential and strategic decisions.

12.3 However, we believe that what is currently proposed does not go anywhere near far enough.

12.4 Further it is critical that there is a separation of the "policy" side of taxation from the "practical" side of taxation. Unfortunately, the present approach seems to bias towards how can more be obtained out of the existing cake rather than how can the cake be increased.

13 COMPLIANCE COSTS

13.1 We believe that greater efforts need to be made to reduce the compliance burden on taxpayers, particularly those in small business.

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