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## SENATE

STANDING COMMITTEE ON ECONOMICS

**Reference: Tax Laws Amendment (2006 Measures No. 7) Bill 2007**

MONDAY, 26 FEBRUARY 2007

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**SENATE STANDING COMMITTEE ON  
ECONOMICS**

**Monday, 26 February 2007**

**Members:** Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Bernardi, Chapman, Joyce, Lundy, Murray and Webber

**Participating members:** Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Fielding, Fifield, Forshaw, Hogg, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, McGauran, Mason, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

**Senators in attendance:** Senators Bernardi, Chapman, Joyce, Murray, Ronaldson, Stephens and Weeber

**Terms of reference for the inquiry:**

To inquire into and report on: Tax Laws Amendment (2006 Measures No. 7) Bill 2006

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**Committee met at 9.01 am**

**CHAIR (Senator Ronaldson)**—Good morning. I declare open this meeting of the Senate Standing Committee on Economics. This hearing has been convened to receive evidence in relation to the provisions of the Tax Laws Amendment (2006 Measures No. 7) Bill 2006, which the Senate referred to the committee on 8 February 2007. This bill is an omnibus bill which will implement changes to taxation in a variety of areas. The majority of submissions received by the committee confined their comments to schedule 2 of this bill, and it is on this schedule that today's hearing will concentrate. Schedule 2 of the bill makes changes to exemptions from interest withholding tax contained in sections 128F and 128FA of the Income Tax Assessment Act 1936. The committee is due to report to the Senate on 27 February 2007.

These are public proceedings, although the committee may agree to a request to give evidence in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that, in giving evidence to the committee, they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness should state the grounds upon which the objection is taken. The committee will determine whether it will insist upon an answer having regard to the grounds which are claimed. If the committee determines to insist upon an answer, a witness may request that the answer be given in camera. Such a request may also, of course, be made at any other time.

[9.03 am]

**BURKE, Mr Anthony John, Director, Australian Bankers Association**

**GREEN, Mr Wayne Robert John, Chairman, Australian Branch, Asia Pacific Loan Market Association**

**MILLER, Mr Greg, Member, Documentation Committee, Australian Branch, Asia Pacific Loan Market Association; and Executive Director, ANZ Investment Bank**

**CHAIR**—I welcome Mr Tony Burke, from the Australian Bankers Association; Mr Wayne Green, Chairman of the Australian Branch of the Asia Pacific Loan Market Association; and Mr Greg Miller. Do any of you wish to make an opening statement?

**Mr Burke**—Yes, please. Thank you for the opportunity to appear before the committee inquiry this morning on this important tax issue for banks and many other institutions in Australia. Firstly, I would like to give some background to the issues that we have with the bill as it stands. Since about 1998 there has been a quite effective regime for interest withholding tax. There were some amendments in 2005 to broaden the exemption, which industry supported at that time. For example, prior to 2005 a debenture had been needed. There were some growing concerns about debentures in the marketplace. For example, international practice in relation to syndicated loans was not to have such an instrument.

The 2005 amendments facilitated more efficient access by the syndicated loans market, for example, to an exemption that was already available to them. However, we understand that Treasury and the ATO had some concerns. They believed that the amendment had gone too far, but we were firmly of the view that the only area of concern was retail products, for example, retail bank accounts and other retail banking products. We provided the paper on request, which suggested some options for resolution to meet express concerns of Treasury and the ATO. Later in the year an amendment was drafted and introduced and we made a further submission raising concerns about the amendment itself. My colleague Wayne Green will give some examples and explanations of the products at issue, particularly syndicated loans.

In relation to the bill, schedule 2 specifically, it is our view that it reverses ongoing development legislation over the last few years but, on the face of it, it has retrospective application to do with the start date. We do believe that, if enacted, it would significantly impede the debt markets. We have a further concern about the regulation-making powers, the existence of which would cause further uncertainty in the marketplace. We do not believe that using the regulation-making power within the schedule would remedy the flaws that we see.

We think that we have provided a better approach to Treasury. We have provided a draft amendment, which they are considering. We have settled on an exclusion approach, the effect of which would be to provide that all products would be within the exemption unless specifically excluded, and excluded would be all deposits issued by banks and like financial institutions providing the deposit is not otherwise a debenture, as a result transferable or negotiable certificates of deposit which should still be exempt whether they be retail or wholesale and (b) any other dead interest not being a deposit or debenture offered at the retail

level. For example, this might include credit cards if these are not regarded as deposits. We believe our approach better implements the spirit of the 2005 amendments, that it directly targets the specific concerns raised by Treasury and the ATO. It would substantially reduce the need for later amendments to take account of market and product changes later on. It would give a speed to market and would move unnecessary regulatory risk. We are working with the minister and with the Treasury on our preferred approach and look forward to further consultation on our proposed solution.

**Mr Green**—The APLMA is an Asia in Australia based association focused on the growth and liquidity in the primary and secondary loan markets so we are concentrating on the aspect of syndicated loans. Syndicated loans are loans where one or more banks initially provide the loan transaction and underwrite the loan, and then it is actually sold down to a series of other banks both locally and offshore. The APLMA has 140 member institutions, including the top four major Australian banks and all the significant international banks based within the Australia and Asian region. We are very much in support of the ABA's submission for the current change. We have also lodged submissions with regard to the bill and the potential impact that we see it may have on the global syndications market as it has evolved over the last 10 years. We certainly were very supportive of the amendments that went through in 2005. We recognise that loans were dead interest and that certainly brought the Australian loan market in line with the global loan markets with regard to the seamless ability to sell and have foreign banks come into the Australian loan market.

There is some uncertainty with regard to the current bill and the treatment, potentially, of syndicated loans. We are concerned that, without the clarity that we have currently, it will cause some negative impact with regard to our ability to sell loans down into the universe of banks.

The other issue—and I think Tony has already raised it—is that there are some questions with respect to the retrospective denial of the withholding tax exemptions on loans that were put in place prior to December 2006 but have yet to be drawn down. From our perspective, the Australian syndicated loan market has grown dramatically over the last five or six years to the extent that towards the end of 2006 the loan market exceeded \$A80 billion—that is, in principle, syndicated loan transactions. The demand for loans in Australia has certainly grown through the investment in infrastructure and the growth of Australian and foreign companies. We want to see and encourage that growth in the loan market. We are very keen to see further investment in infrastructure, and the ability to syndicate loans offshore with the benefit of an exemption of withholding tax is critical to the growth of that market.

More recent transactions that have had the benefit of being able to be placed offshore with an exemption of withholding tax have included motorway developments in Brisbane such as RiverCity Motorway, which is the north-south tunnel bypass, which was a \$1.9 billion transaction. That loan was sold down to 23 banks, and 11 of those banks were knocked on this side in Australia and therefore required the exemption for withholding tax. A point to make on the withholding tax exemption is that if withholding tax is applied to these loans, it is not the bank that has to reduce its revenue; it is actually a gross-up charge to the borrower, so the impact is more on the borrower and the feasibility of the transaction than it is on the financing.

Further examples have been the Mitcham-Frankston Motorway in Victoria that runs east. That was also sold onto the offshore market, and more recently through refinancing.

Going forward, we have got some very large corporate deals coming into the market which will far outweigh the ability of the Australian market to absorb those loans. A classic example of that is the split-up of Toll. The Toll infrastructure deal will probably be in excess of \$5 billion, and the Australian market could not possibly absorb all of that loan. So we need to access the offshore banks and we need a seamless approach to withholding tax to be able to achieve that. This would also bring Australia into line with the overseas market, where the approach is very similar to what we are proposing.

The important thing about the current process is that the banks, the underwriting banks and the borrowers do it here to meet the current regime: the public offer test. These loans are for all intents and purposes treated as debentures. They are offered to a wider group of banks, and those banks then make the decision whether or not to come into those transactions. We understand the reason for the changes to the bill and the avoidance of any leakage, particularly from the retail sector, but we believe it does have some critical issues with respect to the wholesale loan syndication market. We are certainly in favour of working with the ABA and with their suggestion that we come up with the excluded list of products, and we are keen to work with Treasury and the tax office in putting that in place.

**CHAIR**—For the record, the range of borrowings has been greatly extended by a number of historical amendments to the act—I am just looking here; one of your colleagues has set it out quite well—128F relief has been expanded on a number of occasions; the business end use requirement in 1997; making funds available to foreign branch banks in 2001; and of course extending the relief to debt interest in 2005. I presume this has had a considerable impact on the borrowing ability of Australian companies, and we have seen the sorts of outcomes that you were talking about before through that. Would you agree that these exemptions must be targeted to protect revenue?

**Mr Burke**—The primary purpose, as I understood it, was as an integrity measure; and, yes, the revenue must be protected. But it is our view that maintaining the exemptions and the structure that we are proposing will not have a significant impact.

**CHAIR**—Yes, but in a general sense you would acknowledge that these exemptions have got to be targeted so that there is no risk to revenue.

**Mr Burke**—Indeed, quite so.

**CHAIR**—Mr Burke, have you done any work on or had any discussions about what, potentially, the revenue implications might be if your proposals were adopted?

**Mr Burke**—We have attempted to do so. We have raised with Treasury the possibility of having access to their costings, but that has not been possible.

**CHAIR**—So I take it from that that there is some risk of revenue implications.

**Mr Burke**—There may be, but we have not sized them.

**CHAIR**—No. Okay.

**Mr Miller**—Just to clarify that point in relation to the syndicated loan market, we do not expect there to be any revenue impact on that market by reason of the fact that the syndicated loan market was using the debenture type structures when those provisions were put in place. When the debt interests were introduced in 2005, that actually brought our market into line with what was happening offshore. So we do not expect that there will be any revenue implications for the loan markets, because those markets have been making use of the public offer test and interest withholding tax exemptions for some time.

**CHAIR**—Would it be reasonable to say that you are assuming that syndicated loans will still have their exemption but you want some certainty of that? Is that what you are saying?

**Mr Green**—Yes. It is a clarification issue to fully cover off on syndicated loans so we can continue to go through the process of structuring loans et cetera and selling those loans to the offshore market. But the participation in loans by foreign banks is by professionals; it is not widely uncontrolled. These are all registered banks in overseas markets who are not domiciled or do not have lending offices in Australia. As I said before, the Australian market probably has 30 reasonable lenders who are active in the syndicated loan market, and syndicated loans cover the whole range from corporate financing to infrastructure and project financing—all sectors which are critical to the Australian economy. So the loan market itself has outgrown the capacity for Australian based entities to fund those loans and hence we need to go offshore. For that we need to be seamless, I suppose, in our approach to placing those loans, without having any potential issue for concern whether or not we gain the exemption for the loan.

**CHAIR**—Nothing that I have read from the Assistant Treasurer and Minister for Revenue would indicate to me that syndicated loans would not retain their exemption, but I presume you are concerned that there be some element of certainty around them. Is that right?

**Mr Burke**—There is a lack of certainty, yes. It has never been an understanding, from the start of consultations on this matter, that syndicated loans would miss out, but we believe that schedule 2 does create uncertainty.

**CHAIR**—Well, as I said, nothing I have read would indicate to me that they are going to lose their exemption, but you want some clarification of that.

**Mr Green**—No, we are not seeing loans being targeted by the changes, but we are just seeking that clarity.

**CHAIR**—Yes, I understand. Colleagues, who would like to kick off the questions—Deputy Chair?

**Senator STEPHENS**—Thank you, Chair. Thank you, gentlemen, for your submission. I want to go to a point that you made, Mr Burke, in your opening statement. You told us that you had provided your paper to the ATO and Treasury. In terms of Treasury's response, you said you were working with the minister and were hopeful about it.

**Mr Burke**—Yes.

**Senator STEPHENS**—Given that we are here to examine the legislation as it stands and you have drafted an amendment—

**Mr Burke**—We proposed an amendment which we delivered to Treasury on Thursday. We have not had any response to date.

**Senator STEPHENS**—Okay. Chair, do we know when this bill is likely to be introduced into the parliament?

**CHAIR**—I think at the moment it is intended to be listed for debate this sitting week, but that is probably unlikely, I have to say, given the workload that is there.

**Senator STEPHENS**—Sure.

**Mr Burke**—May I continue with the answer to that question? We did not think it was appropriate to table it today unless and until Treasury had provided some response.

**Senator STEPHENS**—Okay. You have not got a response yet?

**Mr Burke**—No.

**Senator STEPHENS**—In terms of the issue of retrospectivity, which is always a concern to us, Mr Green, you made the point about loans that have not been drawn down but might be. Can you give us a quantum of what that represents?

**Mr Green**—Traditionally, loans, particularly in the project finance or infrastructure sector, are given up-front, as in the total amount of the loan. I do not have any dollar value details. But, for instance, we can look at ConnectEase. ConnectEase is a \$2 billion transaction. It is only drawn at this stage to about \$500 million because the way the process works is that the sponsor money goes in first then the project finance is drawn as it gets down to conclusion. It is not due to be completed for another 12 months. So at the moment almost three-quarters of that loan is yet to be drawn. There is a question therefore: when it is drawn, is that a new loan and therefore does it qualify for the exemption? That is one of our concerns going forward.

**Senator STEPHENS**—Is that an issue that you have raised with Treasury and the ATO?

**Mr Green**—Yes.

**Senator STEPHENS**—Did you get a response on that issue?

**Mr Burke**—Not specifically.

**Mr Miller**—Can I clarify that? There are two forms of loans which are put in place and then drawn at a later point in time. One is the progress draw loan that Wayne has just mentioned, but there is also what we call a revolving loan. A company requires funding over time and that funding will increase and decrease over time. That is more for a corporate structure rather than for a straight infrastructure type project or a construction facility. Nonetheless, it gives borrowers a lot of flexibility that they cannot get, for instance, from the capital markets, where the banks can allow loans to be drawn and then be repaid and drawn and repaid. That is the other way in which loans may be drawn under an existing facility some time in the future.

**Senator STEPHENS**—In that case, Mr Miller, you can see that in an infrastructure project you can almost map the process of drawing down, I suppose, as the project moved ahead. But, in the revolving loan, can you see that there are different issues in relation to the retrospectivity considerations in this bill?

**Mr Miller**—Certainly that concern would also apply to those loans. It is certainly something that the legal fraternity have had in the back of their minds and they have tried to come up with structures to try to deal with any risk. It is not to say that the risk is actually there; it is more dealing with the risk of that occurring. That is another way in which there can be a potential impact. The important thing there is that what borrowers look to from the bank market in relation to these revolving loans is flexibility and, certainly, to borrow interest in order to have those flexible types of loans.

**Senator STEPHENS**—Is there any evidence that the bill is causing disruption in the syndicated loan market now?

**Mr Green**—I think it has brought some caution to new loan transactions going forward, because we cannot give the same degree of confidence that we have prior to the bill going through in regard to the treatment of the loans going forward. This is particularly important for offshore entities and the borrower, of course, where they may be impacted by the gross-up clause. Also, when a bank is reviewing a loan opportunity or a credit opportunity, they will need to sign off in regard to the taxation position. If that is grey then they will not get that sign-off. It may stop them from coming into a new loan transactions that we are trying to sell out of Australia. So there is some caution at the moment—

**Senator STEPHENS**—Have you had those discussions with the ATO?

**Mr Green**—Yes, certainly, because I chair the association. At our meetings, it is a point of conjecture at the moment as to how this is going to go forward. As I said, the industry is not concerned so much about adhering to the guidelines and the rules. It is just having the clarity about what they are going to be and having no potential for interpretation going forward. Hence, with the 2005 adjustment, debt interest and qualifying for debt interest is clearly the process that we undertook.

**Mr Burke**—Can I add to that. I am not in the market as Mr Green is. I certainly speak to my colleagues in other industry associations and the sector. One of them will be here at the next hearing. The view that there is uncertainty is very widely held.

**Mr Miller**—There has been a very concrete impact. In 2005, when debt interests were introduced, the market did move to a more internationally recognised format—that is, it dropped the debenture concept and what we called a loan note concept. Once there were initial rumblings that there was a view from Treasury, or from the ATO, that the amendments went too far, the law firms reverted back to the debenture concept in relation to giving their advice. So most of the products that we saw moved back to the loan note type of structure. This structure is extremely cumbersome. It is necessary to create a concept of a registrar. It is also necessary to update the register every time there is a drawing or repayment, and it does create operational risk. Of course, at the end of the day, that is an operating risk that gets paid for by borrowers, through payments to registrars. So there has been that sort of impact as well.

My understanding of what these regulations do is that they require what falls within debt interest to be done by way of regulation, but also they allow for regulations to remove certain debentures from eligibility. Not only is there uncertainty created because the debt interest route is no longer used by the marketplace and the market has reverted to loan notes, but also

the possibility is created of regulations removing syndicated loans from eligible debentures. As the chair quite rightly pointed out, there has been no suggestion of that, but that does create an element of uncertainty and risk.

**Senator STEPHENS**—You are proposing a negative list of debt interests that are not eligible for exemption that should be included in the act. Is that right?

**Mr Burke**—In there, unless specifically excluded.

**Senator STEPHENS**—Mr Burke, you said the regulation-making powers do not fix the financial—something or other. You are concerned about it being in regulation. Can you elaborate on that?

**Mr Burke**—Sure. Firstly, we think that the matters upon which this discussion turns are crucial and they need to be in the legislation, not in some regulation-making power. Secondly, there can often be substantial delays in producing regulations in relation to a particular case—for example, upper tier 2 subordinated debts. We have been at that for nearly four years now. To have that level of uncertainty in these very large markets is unsatisfactory. We also think that, even from the point of view of the law-makers, the approach will be difficult because it will mean considering the market at some level of frequency to determine where there have been changes which need new regulations or modifications to existing regulations. Our approach, we believe, provides a fairly simple structure which will not need to be revisited every period of time to change.

**Senator BERNARDI**—Mr Burke, you mentioned credit cards in your opening statement. Can you clarify for me whether credit card debt is then sold offshore? Is that what you were suggesting?

**Mr Burke**—No. I was suggesting that if a credit card product were to be regarded as a deposit, which in some cases it might be—

**Senator BERNARDI**—As a deposit rather than a credit facility?

**Mr Burke**—Yes, because it has a deposit balance. You can have a deposit balance on a credit card. So the treatment of that particular product might be that it is a deposit and therefore it should be excluded, we believe.

**Senator BERNARDI**—Thank you. I was just intrigued as to how it fitted into this process.

**Mr Green**—I think it was more an example of a retail product that in some form or another needs to be excluded.

**Senator BERNARDI**—It could cross both sides of the spectrum, according to how you want to define it.

**Mr Green**—Yes.

**Senator BERNARDI**—Senator Stephens had some questions about retrospectivity, the drawdown of loans in infrastructure projects and also the revolving line of credit. Do you believe that these things should be treated differently? They seem very different products to me. The \$2 billion infrastructure loan, which has already been established, and which is going to be drawn down progressively seems to be a different product. It almost merits different

treatment from a revolving line of corporate credit where people can repay it and redraw and things of that nature. Do you have a comment on that?

**Mr Green**—We do not see any differentiation between the products. It is about the client's ability to borrow a certain loan amount, and that is the amount that we generally syndicate to a broader group of banks. I do not think a loan with a drawdown process should really have any different treatment to a loan fully drawn from day one. It is just the inference under legislation on the way it was treated—the revolving nature or the gradual drawdown process. Every drawdown could be seen as a new loan and therefore a new qualification.

**Mr Miller**—There are a couple of things there. One is that the actual body of the lending terms and conditions are exactly the same, irrespective of whether it is a term loan or a revolving facility. The actual provisions that deal with revolving facilities are quite a small part of the loan; it is only a couple of clauses. Also there are a number of loans which can be part revolving and part not revolving. A particular loan may have a term element and also a revolving element. We have also seen term loans with a particular tranche where, in particular circumstances, the borrower can repay it and then, for instance, after a two-month gap, redraw again. I do not think it is possible to say they are different products. They are just an elaboration on the same product.

**Senator BERNARDI**—I guess I am trying to deal with the retrospectivity issues. A loan that has already been partially drawn down under the old regime has a finite time—as with your \$2 billion infrastructure loan. But there is no finite time with an ongoing line of credit. I just wonder whether they do warrant differentiation. You had said, no, that you regard them as the same.

**Mr Green**—I think under a finance project or infrastructure type transaction there is also flexibility because, as we know, not all projects go to the timetable. There can be a deferral of those drawdowns over time as well, subject to reaching certain benchmark hurdles in the progress of that project.

**Senator BERNARDI**—But, if part of it has been drawn down, you could mount the argument that the loan falls under this regime and any future loan facility established has not been previously approved, whereas the case is slightly different because that could go on forever.

**Mr Green**—Revolving, yes.

**Mr Miller**—The other element to that is that that is certainly the view the law firms have taken. For the purposes of doing a public offer test, the view that seems to be recognised within law firms is that that initial public offer test or exemption applies to the full life of the loan, whether it has been repaid or not. They have used a couple of techniques to do that. That does not remove the uncertainty, of course. But there were also some tax determinations last year which suggest that the ATO adopted a similar view, that loans which were repaid and redrawn had the same debt interest—they used debt interest in that context. Certainly the question of the uncertainty in relation to this change has been brought up by the firms. We are getting quite technical and probably out of the expertise of the three of us, but that is an uncertainty that has been brought up.

**Senator BERNARDI**—It is the masters of the universe who decide how this works. Is that right?

**CHAIR**—You are obviously not lawyers because you have only given one opinion.

**Mr Burke**—I would like to add a comment. The complexity of what has been a fairly brief discussion indicates why for us the approach of trying to define a whole set of products by regulation is fundamentally flawed. Our approach is a fairly simple approach. It excludes deposit products for which there are very widely accepted definitions in the corps act and FSR.

**Mr Miller**—That is a very valid point. The difficulty is that these products are evolving. They are market based. There is no definition around them; there is no need to define them. For instance, what is the definition of a syndicated loan? It is very difficult to put a definition around that. So to try to introduce the concept into legislation would be extremely difficult because of the fact that they are evolving. There are subtleties around those concepts, about which I will not bore you with the details. The question is: where do you draw the line?

**Senator BERNARDI**—But there is an industry accepted definition: if you referred to a syndicated loan, your industry would know what you were talking about, wouldn't they?

**Mr Miller**—As a general concept, you would, but then it comes down to the devil in the detail. For instance, we are doing a transaction at the moment where an Australian borrower has found banks themselves and introduced banks. Certain terms are consistent across the banks, but certain terms are not consistent across the banks. That is not a traditional syndicated loan structure, but it is probably something that would appear in the league tables as being a syndicated loan. So the question is always how you actually define these things. As well as looking at some of the other products that are out there, again these things do evolve. New products develop over time, things such as I mentioned before with the revolvers: a term loan that you can actually repay but then redraw further down the track. Those things are evolving depending on the requirements of the borrower.

**Senator BERNARDI**—But as things do evolve, there is ministerial discretion in this bill, is there not, to provide other exemptions?

**Mr Miller**—And I think the issue then comes back to Mr Burke's opening comments about the time to market. If there was a requirement, when you are structuring a product, to go and get ministerial approval, I would suggest that people would probably throw their hands up and go with what they have got. In a lot of situations, speed to market is extremely important, so there is not a lot of time to structure a transaction. It needs to be done in a very short period of time, particularly around some of the bid processes such as the bids for infrastructure finance and also the bids for some of the other event driven financings in the marketplace. Confidentiality is also crucial. So the degree of uncertainty that comes with having a new product and then having to go and get a regulation passed in order to include it would be fraught with a little bit of danger from the perspective of the industry.

**Senator MURRAY**—I wanted to deal with that point. I will start with that. To me, the danger that you have just outlined is that the government's policy of reducing regulation is defied by this provision and you are going to get a degree of central planning injected into what is presently a highly dynamic real-time process. Is that right?

**Mr Miller**—Yes, that is correct.

**Senator MURRAY**—It seems odd to me. When a legislator sees that a provision has no financial impact and it is an existing provision, the automatic assumption before you look at it is that it is either an efficiency measure or a clarification measure. However, the wording of this measure is specifically directed at improving integrity. If you improve integrity, you should have a financial impact. So I cannot find the reasons that this should be brought forward. At 2.9 on page 46 of the explanatory memorandum this statement appears:

However, interpretative pressure on the relevant law has the potential to substantially widen the range of debentures and debt interests that could qualify for exemption from interest withholding tax, beyond the original policy intent.

**CHAIR**—I am glad you raised this, Senator, because that was going to be one of my next questions also.

**Senator MURRAY**—There is no financial impact from this measure, so they do not expect to close any integrity holes—no money coming forward. That means they are forecasting something which is indeterminate. Are there any market signals about ‘interpretive pressures’—whatever that means? Is that courts? Is that market practice? Is there somebody losing money somewhere? What is this leakage?

**Mr Burke**—We have not seen it. We also find the term ‘interpretive pressure’ curious as we are not observing it in the marketplace. We understand that, to the best of our knowledge, one party asked for an interpretation from the ATO in relation to a deposit product. I do not know whether that constitutes interpretive pressure. That is the only example that we have seen.

**Mr Miller**—I understand that the ATO is speaking later on this morning. We argue that the suggested amendments that were put forward by the ABA and supported by the APLMA get over those types of concerns. It identifies the type of product that we understand Treasury and the ATO are concerned with and deals with it with some definitions and some language that relate to retail in the FSRA space. This is looked at quite widely in the marketplace because of the importance of those provisions. So there is a lot of certainty and clarity around the type of products that would be excluded.

**CHAIR**—But today’s product is not necessarily tomorrow’s product, is it?

**Mr Miller**—That is correct.

**Senator MURRAY**—Which is why you want a dynamic market, which you don’t interfere with, with regulation. That is right, isn’t it? That is your point.

**Mr Miller**—Yes.

**Senator MURRAY**—Let me just understand this, because it is a very technical area. We have an existing market circumstance, which this law proposes to adjust, which will then require regulation, which we all know takes many months to clarify if a problem emerges. To your knowledge, there is no problem whatsoever identified in terms of market integrity or loss of revenue. Certainly the EM does not spell that out. Therefore, they are correcting something which is just expressed in highly generalised terms; it is not related back to a court case, a

tribunal decision or an ATO ruling problem—nothing of that sort exists out there. Is that correct?

**Mr Burke**—Not that we have seen. Concern was raised about deposit products. As my colleague Mr Miller said, ‘If that is a concern, then here’s an approach which squarely addresses that.’ As opposed to that approach, a simile is to look at the galaxy and try to define every star, including those which won’t come into being for some time into the future.

**Senator MURRAY**—Before I get to the issue of promissory notes, how far back does the retrospectivity go in this provision? You say it is a retrospective application.

**Mr Burke**—My recollection is 7 December.

**Senator MURRAY**—I see. When I think of promissory notes, a little bell rings in my head because there was a court case concerning Westpoint which indicated that there were some difficulties with the fitting of promissory notes into this broad area of determination. That affected the way in which a prospectus could be offered. The obligations under the Corporations Law follow on with the whole Westpoint mess. I wondered if this was a mechanism by which that court case could be addressed, although you say it is only December.

**Senator WEBBER**—I initially want to return to the issue of your proposed amendment. Have Treasury or ATO or anyone given you any feedback on when they expect to be able to come back to you with a view?

**Mr Burke**—I spoke to Treasury on Friday, in the middle of the day, who indicated that they were considering it, who indicated that they were preparing a paper for the minister. I attempted to make contact with her again this morning, but failed.

**Senator WEBBER**—This is perhaps more a general discussion for the committee, but I personally would be reluctant to proceed with the legislation until we have had further discussion about an amendment that some of us, particularly those of us from the opposition, have not seen and don’t know whether that is the approach we want to take. This is something we can obviously talk to them about, but if we are not sure that they are going to come back this week, it would make it hard. I know that the minister is in a bit of a hurry for us to deal with this legislation, which is why we are here today rather than later in the week. What would your recommendation be if they come back to you and say: ‘We don’t need to amend the legislation; we’ll fix your concern by further regulation’? Would you recommend that we pass the legislation?

**Mr Burke**—No.

**Senator WEBBER**—What will the impact be on the market if we keep fixing these things by legislation? If we adopt your approach, which you say gives certainty and allows flexibility, will we keep facing bills like this if we go down the Treasurer’s line of amending the legislation every time there is something new that we have to consider?

**Mr Burke**—That would be our view: either amendments to the head legislation or amendments to regulations; or, that new regulations are put in place or a withdrawal of regulations. These markets do change in character rapidly for varying reasons. International

legislation and practice is changing and Australia needs to keep pace with that. As I think we have discovered together in this fairly brief discussion, these are very technical matters.

**Senator WEBBER**—Yes. They are far too technical for me, that's for sure.

**Mr Burke**—To revisit them every year, or whatever the time frame might be, seems an unwieldy approach.

**Mr Miller**—I would like to make another point on those types of issues: there are double-tax treaties with the US and the UK. It is certainly not my area of expertise but my understanding is that payments of interest going from Australia into those two countries are exempt from withholding tax. So effectively you will have two regimes: one in which you do have some certainty; another in which you could have an element of uncertainty, which will skew the involvement of banks lending in this market towards the UK and US banks.

**Senator MURRAY**—If you cannot determine the immediate effect of any uncertainty in a financial market you just add a premium to your risk, whatever that is, don't you? It is just the cost of capital.

**Mr Green**—In this case that risk is passed on to the borrower in the form of withholding tax.

**Senator MURRAY**—That is right. So uncertainty translates into a defined economic cost to the user of capital.

**Senator WEBBER**—And it is an interesting dynamic in the marketplace when that uncertainty comes from legislation and bureaucratic regulation, and it is one that we should be able to fix.

**CHAIR**—I find this discussion fascinating. I take a slightly different view from Senator Murray. There is acknowledgement that the integrity of revenue has to be protected, and I think we have acknowledged that this is a very fluid area and that there are constant changes. There is still the opportunity for parliamentary debate on regulations and disallowable instruments, which can be dealt with very quickly by the parliament. I am a bit concerned; we are all acknowledging there can be rapid change. Earlier, Senator Murray quoted the EM, but if you look at clause 2.3, it states:

The Schedule does not seek to upset the long held and accepted market views as to what constitutes a debenture. It will, however, provide a safeguard against unintended broadening of the range of financial instruments eligible for exemption.

Isn't regulation the very way that you deal with changing situations in order to protect the integrity of the system?

**Senator MURRAY**—There is no financial impact, and that is what worries me. If they had said, 'We're going save \$10 million a year from this.' I would say, 'Okay, you've identified a leak and this is your method of solving it.'

**CHAIR**—I think there is more cost to revenue if there are unintended consequences. I think there has been an acknowledgement at the table that things are changing very rapidly, and there may well be unintended consequences from that. Do you acknowledge the interpretative range of exemptions and that changes in markets may well test the current exemption interpretation?

**Mr Green**—I think that will always be the case going forward. We are reasonably selfish in our representation and submissions. We are focused on one part of the market where, within the certain rules and regulations we have been operating under, everything had been fine. But this has brought up a lot more grey to the whole equation. That uncertainty will have an impact on our market going forward.

**Senator WEBBER**—To be fair, I think this is a more dynamic discussion. Numerous times before the committee has been faced with legislation from Treasury with regulation to follow, but the regulation is not drafted and often we do not see it for 18 months. So there have been some problems with marrying the two things up. That is my hesitancy in relation to the certainty in public policy. Your predecessor as chair had huge issues with Treasury.

**CHAIR**—If you take the syndicated loan aspect of it, on which I think we all agree there needs to be some clarification, just as a matter of principle: are you better able to react to these things by way of regulation or by way of a convoluted loose-leaf process? We all have obligations to protect the revenue base for expenditure in other areas, and I think we all acknowledge that; it is how you best respond to threats to that.

**Mr Burke**—Chair, I would like to respond. Firstly, there are grey areas in the EM. You drew our attention to 2.3, which states:

The Schedule does not seek to upset the long held and accepted market views as to what constitutes a debenture.

You can see a grey area if you compare that with 2.10, which in the middle of the paragraph states:

The scope of the term debenture is generally considered to be a matter of some uncertainty, with the terms debenture and security having broad common law meanings.

And it goes on.

**Senator MURRAY**—And so it should; isn't that the basis of a market?

**Mr Burke**—Absolutely.

**Senator MURRAY**—The market must be uncertain because it is constantly changing.

**CHAIR**—But the question is whether you respond to that by way of regulation, which is far more easily implemented, or whether you go through a convoluted legislative process. And I suppose that is what the committee will discuss. So, gentlemen, thank you very much for your time; we have now run out of it.

[9.52 am]

**BAXTER, Mr Duncan, Member, National Tax Technical Committee, Institute of Chartered Accountants in Australia**

**NOROOZI, Mr Ali, Tax Counsel, Institute of Chartered Accountants in Australia**

**CHAIR**—Gentlemen, would either of you like to make an opening statement?

**Mr Noroozi**—Thank you. The Institute of Chartered Accountants in Australia has over 44,000 members who span government practice, commerce and so on. Much of what we were going to say has to some extent already been said, but I would like to recap and reiterate a few points. Mr Baxter will then follow on with perhaps a little more detail.

The issue here is that we had a definition that worked. It was updated to recognise that we look at the substance of things rather than form, so you have debenture and debt interest. What is proposed limits that definition. Our two main concerns are with two regulation-making powers, which have already been discussed. One is that, even from this more narrow definition, there is a power that allows you to exclude certain debt products from that limited definition. There is a second regulation-making power that then allows you to include particular types of debt products.

The first regulation-making power creates uncertainty because, even if you feel you fall within the definition, there is a chance that, some time down the track, regulation may be made that will disallow that particular debt product from benefiting from the exemption. The second one, again because of the limitation, saying, 'It can be included by regulation-making power,' can be a lengthy time lag, as has already been pointed out. I think Senator Webber mentioned 18 months. We have had similar experiences and it is just not a practical solution for a market such as this, and we were told earlier that the time to market is a crucial factor.

Also a general point that I would like to make, and we have seen this before, is that it is using a sledgehammer where a nutcracker would have done quite well. Our understanding is that the ATO had a particular concern with retail banking products. I do not think it is a convoluted legal process, as it was referred to earlier. I am not sure whether that is correct. I think if it can be dealt with very succinctly, as the ABA and our submission say. As mentioned before, we have all been talking to Treasury. It can be very neatly put into the legislation, which will deal with the concern of the ATO. We acknowledge that there may be a concern in that area, but that can be dealt with quite neatly. We do not need to use a sledgehammer, which causes widespread damage.

If I may give an example of where this has been done before, it is division 7A. There was a problem with section 108. All of a sudden you had division 7A, which has caused widespread damage, particularly at the small end of town. Government has correctly now moved in and made an announcement—very much around the same time as this particular piece of legislation came out—to correct what was effectively an over-reach.

**Senator MURRAY**—Chair, just a reminder of what is on the record. If you need to follow up in the report, the Joint Committee of Public Accounts and Audit has examined this issue

and there is some interesting material in the *Hansard* record from a discussion in Launceston last year if you need a record on this very point you are talking about.

**Mr Noroozi**—But the government has correctly moved and corrected that problem now and there was an announcement just before the end of the year. This committee now has an opportunity to nip this one in the bud before it causes problems, making sure that if there is a mischief we just address the mischief and not have this over-reach that is going to tamper with a debt market that is working well. As we have said before, the government had done the right thing when it introduced the debt equity rule whereby, if it looks like a debt, irrespective of what it is called, it is a debt. That is what the debt equity rule is. It is a move away from form to substance. Again, the government correctly amended the withholding tax legislation to deal with debt interest—in other words, move away from form to substance.

**Senator MURRAY**—That was in 2005?

**Mr Noroozi**—Yes, which has been referred to earlier. Again, I think what we have at the moment works well. We acknowledge that there may be a perceived mischief. Our submission highlights what has been told to us to be the mischief, which is the retail banking products issue—the term deposits and the like. If that is the case, then let's deal just with that; let's not have an over-reach.

At this point I will pass over to Mr Baxter, who might want to address more of the detail. But I just want to recap and reiterate, without making reference to section numbers and what have you, so that we know what the big picture is.

**Mr Baxter**—I am the practice head of tax at Blake Dawson Waldron, but I appear today as a member of the Institute of Chartered Accountants and also as a member of the International Tax Subcommittee of the National Tax Technical Committee. I think everybody agrees—and indeed the explanatory memorandum acknowledges—that the purpose of section 128F, the exemption, is to reduce the financing costs for Australian businesses. The reason that it was introduced was that it was a clear perception of government when they imposed withholding tax in 1968 that it would largely be borne by the foreign lender—that it would be deducted, it was a tax that was in turn to be paid by them. Unfortunately, what happened was that that was not the outcome. The outcome was that foreign lenders were in a position to demand that the Australian borrower increase the amount of interest that they paid—

**CHAIR**—Grossing it up.

**Mr Baxter**—Grossing it up, so that they got the same amount at the end of the day. So tax that was intended to be borne by non-residents in fact was being borne by Australian residents. That was not the original intention and there was a clear need for some form of exemption to, in essence, level the playing field back again and say, 'If in fact we cannot make the non-resident lender bear the brunt of this tax then we certainly never intended that it was going to be borne by the Australian resident borrower.'

The public offer test, or previously the wide distribution test—it has morphed slightly over the years—is really intended to identify circumstances in which it would be fair to expect that the Australian borrower would bear the cost of the withholding tax. That is largely because if you have something like a tradeable security you do not want the withholding tax status to depend, for example, on who holds it, whether it is an Australian resident or a nonresident.

You want something which is quite certain, where the payment mechanism provided for in the original loan documentation can be made free of withholding tax and free of compliance obligations. So the purpose of the public offer test is essentially to select, from the wide universe of possible debt products, those where it is reasonable to expect people to be in the gross-up required.

Over the nearly 40-year history of this exemption there has been bilateral support for extending it, where required, to meet changes in financial markets. In one of the earlier submissions that we made to Treasury I actually listed certainly more than a dozen changes that had been made to the withholding tax exemption as changes occurred in the financial markets concerned. In more recent years and particularly since 1981 the Australian tax system has started to focus very closely on taxing the substance of a financial arrangement or transaction and not its form. I picked 1981 because that was the year in which the general anti-avoidance provisions were introduced, and they were clearly aimed at ensuring that this was the general profile.

That trend has continued, and one example of that trend was the amendments in 2001 to introduce the debt equity rules. What those rules do is ask of any particular financial arrangement: does this have sufficient debt-like characteristics that we should treat it as debt or does it have sufficient equity-like characteristics that we should treat it as equity? Of course, the tax treatment of those two is quite different. The return to the holder of an equity interest may well be franked under the dividend imputation rules, therefore at least to some extent tax free, certainly often tax advantaged, but that return is not deductible to the issuer; it is essentially treated like a dividend. On the other hand, if you look at interest: typically deductible to the issuer, fully assessable to the lender, and very rarely is there any credit involved there. So the rules basically said: 'We don't want to have to mess around with the particular form that a transaction takes. What we want to do is to look at a substance and tax it on the basis of that substance.'

It then took about four years for legislation to be introduced in essence to harmonise the treatment of debt interests under the withholding tax exemption with what had already been done in other contexts. So when you look at the amendment that came through in 2005 to include within the scope of the exemption debt interests, it needs to be understood against that background, that in a very real sense what it was intended to do was to continue that trend towards taxing substance over form and to say, 'If you have something which is in substance a debt interest, even if it is not technically a debenture, it should attract the exemption that is available for debt-like instruments if it satisfies some of the other requirements, particularly the public offer test.' So we would argue very strongly that the 2005 amendment was a very important step in making the Australian tax system more consistent and more focused on the substance of a transaction and not just its legal form.

We do understand that Treasury is concerned about retail deposit products in particular and the fact that they are debt interests, as ordinarily understood, and that there may be circumstances in which a retail deposit product may inappropriately satisfy the public offer test and therefore qualify for the exemption notwithstanding that there is very little likelihood of the bank being required to gross up the deposit interest rate. We therefore accept the need for an amendment of some form. But our concern is that, the way this amendment has been

drafted, it essentially excludes, either actually or potentially, almost every form of debt instrument out there.

Certainly in the immediate wording, it makes no attempt to include any debt interest other than what is described as a non-equity share—that is, a share in a company which is classified for tax purposes as a debt interest—anything else which is not itself a debenture is not included within the wording of the legislation. If you just look at the words without having regard to any regulations that might be issued, you would think that this is a massive reduction in the scope of this exemption. The legislation then says, ‘If we issue a regulation then we will include extra things within the scope of the exemption.’ That is the legislation as it stands; that is all that we have seen. More importantly even than that is the continuing ability by regulation to exclude things again, including things that have been for the best part of 40 years accepted as falling within the scope of the exemption. Even if you have a debenture—

**CHAIR**—Despite what the EM says.

**Mr Baxter**—That is right. It is very difficult to reconcile the statements in the EM that there is no present intention to exclude anything with the comments about concern about interpretative pressure. Indeed the wording of the regulation power itself clearly refers to excluding things which are debentures. The uncertainty that some of the previous speakers have referred to comes partly out of the way that the legislation as drafted is going to work and partly out of the possibility of regulations in a very unpredictable way dealing with existing instruments.

The Institute of Chartered Accountants along with a number of other industry bodies provided input to the consultation process, but the legislation that we finally saw did not bear a great deal of resemblance to what we expected. We were very surprised not only at the transitional measures, for example, but also at the form that it had taken: exclude almost everything and cherry pick what we put back.

Our submission is really directed at looking for policy guidance on two bases. Firstly, that there is no attempt by the government to reverse this 40-year history of ensuring that the withholding tax does not become a burden on Australian borrowers. We do not imagine that was the intent; it would be nice to get some clarity around that. Secondly, that the welcome trend towards tax in substance not formed is intended to continue. And so, to the extent that we have legislation here which purports to do something different, to start distinguishing between instruments on the basis of their legal form, that that in fact is not intended and is not the way that it is going to proceed.

If there is no change in policy intended then the 128F exemption should be available for all debt interests if they meet the public offer test, as a general proposition. Some identified kinds of debt instruments, particularly retail bank deposits, if they are a source of particular concern, can be specifically excluded in the legislation itself. We would encourage the use of the legislation because we see it as having greater scrutiny and perhaps a bit more certainty in terms of the way that it will eventually work. We would argue quite strongly that if Treasury’s concern is focused on quite a small subset of instruments then there is no justification for a general power to make regulations to exclude things again. There is always the ability, as

particular problems arise, to introduce further legislation. We do not see there as being some nebulous group of instruments out there that are likely to cause a problem.

Finally, we would very much emphasise that the amendments should not only grandfather, if you like, or give transitional treatment to debt interests that had been issued as at the date of the legislation but also to debt interests issued under facilities that had been entered into before that date. The reason being that the definition of debt interest is a very blunt instrument in distinguishing between circumstances where taxpayers are effectively committed to a particular borrowing before that date—the pricing had been done, they had perhaps even selected from a range of withholding taxable versus withholding tax exempt instruments, as at that date. So to now come along and require them to tear up the agreement—if they even can—would be quite unreasonable, particularly if you only are doing it based on whether a particular instrument had been issued beforehand.

**Mr Noroozi**—I have just a couple of small points. I will make them very quickly. One of the senators asked earlier, ‘What would you do with the legislation, given the right?’ My suggestion would be that first of all we would have wording that I think Treasury, to their credit, are working on at the moment. That might be something that you could have a look at and approve quickly. But that may not be possible. The bill as a whole has some very good measures in it, such as the capital protected borrowing and the CGT concession for small business. Our suggestion would be to let the bill go through but pull schedule 2. If you do not have time to consider the amendments that Treasury will put forward then that would be our suggestion.

There is another point I wanted to make. The banks have talked quite a lot about the larger projects. We completely agree with them. But for the small players this is probably more of a big issue. At the big end of town the borrower will have their own advisers who will negotiate the terms of the debt instrument. But at the smaller end of town you have less opportunity to do so. You basically may be tied into signing documentation that is drawn up by a foreign lender. They are more likely to fall foul of these terms because they may not have as much opportunity or expertise to ensure that they fall within this narrow definition.

**Senator MURRAY**—Would you agree that the weakness of the Treasury case on the face of it, without hearing from them, is that they cannot quantify the integrity consequence? If they could quantify it and say, ‘Look, we are going to save \$20 million a year,’ you would know that that is their target. But they do not quantify it, which indicates to me a lack of certainty in their own minds as to the financial consequences for revenue of this measure.

**Mr Noroozi**—That is why I suggest that pulling schedule 2 may not be such a bad thing. But, having said that, we are saying that we acknowledge the problem that we understand they have identified. There is a way of dealing with that in any event, without having this overreach. If you were able to move quickly and agree to the amendments we are working on, it would not become an issue. The issue you are raising is: if you pull the whole schedule right now, what will be the damage? That has not been quantified as yet, as far as I understand—you are right.

**Mr Baxter**—I might add that we had a degree of surprise at the figures that were included in here and the financial impact of nil, as I think you raised earlier, Senator. But also there is a

compliance cost impact which is given as negligible. Speaking momentarily and changing hats, as a lawyer who practices in tax—

**CHAIR**—Mr Baxter, I do not want to interrupt but—

**Mr Baxter**—it is not negligible.

**CHAIR**—we do not have time. Two hats are good, but three hats are very rarely given, as you know. I think we might move to questions from senators.

**Mr Baxter**—That is fine.

**Senator STEPHENS**—I would like to pursue that issue about compliance costs, because it does seem to me that, particularly in relation to smaller borrowers, that could be an unintended consequence.

**CHAIR**—I am happy for you to pursue that, but I wanted you to be given an opportunity to ask some questions.

**Senator STEPHENS**—The question is this: have you actually considered that compliance cost and calculated it?

**Mr Baxter**—Yes, we did. Indeed, I recall—Ali and I were talking about this over the weekend—a conversation I had with a merchant banker several years ago about the section 128F exemption. He said, ‘Don’t bother for anything less than \$50 million.’ In other words, if the borrowing is not more than about \$50 million, do not bother accessing the exemption, because the cost of particularly the debenture as it then stood—it was a debenture based exemption in those days—and the cost of preparing the documentation, managing the whole issue and getting legal advice on it all was likely to outweigh the benefit of the withholding tax exemption at that point. That meant, of course, that larger borrowers who had access to sophisticated advice had a better negotiating position on the terms and would be okay. The smaller borrowers would not be. One of the things that was particularly pleasing about the harmonisation in 2005 was the ability that it gave the whole profession to draw up much simpler loan agreements and, indeed, in a lot of cases, as I think we heard from some of the industry people, to actually take global standard documentation and make far fewer changes to it.

The law firms, as I think was referred to, are almost put in the position of being gatekeepers of this legislation because we had to make the call as to whether it was sound advice not only on the basis of the law as it stood, but also the law as we understood it to be developing. To say to a client, ‘Yes, you may now throw away the old, cumbersome debenture arrangement and move to a more streamlined arrangement,’ is perfectly correct.

For a period the advice in the industry was, ‘Things have been simplified, we can take advantage of that.’ Then, as this issue developed, progressed, became more of a problem, we have changed our advice. We have said, ‘No, it is not safe to assume that you will get an exception if you structure it in a more streamlined way.’ Most recent issues I have seen, indeed the advice we have given, has been, ‘Keep the old debenture notes structure, because it’s the only thing that stands a chance at the moment of, at least for the foreseeable future, satisfying the provisions.’

**CHAIR**—I presume you heard the discussion before about regulation versus legislation and the ability of the parliament to discuss this matter if appropriate motions were moved for that occur. I presume, as part of the cocktail that would be by way of regulation on legislation, that you would have ATO interpretive decisions, which would give some indications in relation to this area.

**Mr Baxter**—The ATO has been very good—and I do not often say that, I must admit—at issuing rulings which take account of commercial reality and market practice. So there are rulings that the ATO has issued on matters to do with 128F, which we would regard under state of law as quite concessionary. Not wrong, but the view that they have taken of the law is one which is clearly informed by practice and making it work.

**Senator MURRAY**—You are saying more liberal than restrictive.

**Mr Baxter**—That is exactly right. So it has been quite pleasing the way the existing exemption has been made to work in the areas where the tax office has some flexibility to move. The problem is that the uncertainty created by legislation in this form will take an endless stream of rulings to correct, because the tax office initially is going to need to give some rulings on what some of these regulations mean, the way they interpret it and so on. That cannot possibly even commence until they see the regulations themselves. And it would be expected that by the time even an interpretive decision type product happens, which is one of the shortest in terms of getting it into the market, it will be a year or two down the track. We will have at least a one- or two-year period of uncertainty, and it will be repeated every time a new regulation comes in.

**Mr Noroozi**—Also, bear in mind that, because the documentation is such that the lender passes on the withholding, the lender is not likely to want to hang around forever for such a product to come out. At the end of the day, even if there is withholding tax, they are not going to be paying it.

**CHAIR**—I take it that this thing that people have been talking about as being fixed in stone is getting interpreted all of the time.

**Mr Baxter**—The existing exemption?

**CHAIR**—Yes.

**Mr Baxter**—It is in the sense that most of the large products or large issues would have a tax opinion as part of the formal legal sign off.

**CHAIR**—If that is occurring, why wouldn't you want the benefit of regulation for in and out to clarify these matters as required?

**Mr Baxter**—Our contention is that you do not need the in and out regulation if the legislation itself works. In other words, at the moment we have legislation which mostly works.

**CHAIR**—Which has been interpreted by the ATO.

**Mr Baxter**—Yes, it has been interpreted by the ATO. There are central positions in relation to particular forms of product. One of the things that sometimes is not appreciated, certainly on the larger transactions, is there will be a legal adviser for both sides. Those legal advisers

get to decide first whether they agree that the particular transaction has the effect that is contended for. There is some jockeying before you get even remotely close to the tax office. A transaction generally cannot go ahead unless the advisers agree that the outcome will be something sensible.

But if you have legislation that simply builds on what is already there—that framework, that accepted market practice—and just says, ‘This particular instrument was not intended to satisfy this exemption and therefore should not satisfy it,’ all of that, as you say, ‘set in stone’ legislation, all of that interpretive work, all of that current practice can still sit there. It just sits alongside a particular subset of products which do not benefit from the exemption—and that, everybody can live with. I do not think anybody has suggested, for example, that retail bank deposits should get the benefit of the exemption. The only question is: how do we make sure they don’t?

**Mr Noroozi**—As I said, it is a question of addressing the mischief without a huge overreach, and that is what we are concerned about.

**CHAIR**—Thank you most sincerely, gentlemen. That was very interesting. I gather you are regular attendees of these hearings, and I thank you for your ongoing commitment to the committee. Thank you for that.

**Senator MURRAY**—And thank you for a very clear exposition, Mr Baxter; that was very good.

[10.28 am]

**LATHAM, Mr Craig Ian, Acting Assistant Commissioner, Australian Taxation Office**

**PITTARD, Mr Ian, Manager, Australian Taxation Office**

**LADUZKO, Mrs Josephine Anne, Manager, International Tax and Treaties Division, Department of the Treasury**

**RAWSTRON, Mr Michael Brian, General Manager, International Tax and Treaties Division, Department of the Treasury**

**CHAIR**—Welcome. I will recap a couple of matters for the benefit of the officers. The Senate has resolved that an officer of a department of the Commonwealth or of a state should not be asked to give opinions on matters of policy and should be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister. This resolution prohibits only questions asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. Do you wish to make an opening statement?

**Mr Rawstron**—No, we do not wish to make an opening statement.

**CHAIR**—Senators, questions?

**Senator STEPHENS**—Yes, I will start. You heard the previous witnesses, so I suppose the first question is: what do you see as the mischief that the bill is intended to address?

**Mr Rawstron**—The bill is directed at restating the original policy intent behind the 2005 amendment—that is, simply to reflect the changes that were occurring at the time with the TOFA legislation, which dealt with changes to the debt equity rules. Simply put, the bill is attempting to restate the policy, which is that the interest withholding tax measure was always aimed at providing relief for equity raising of debenture types and those which meet the public offer test. It was drawn to our attention that, potentially, the words in the 2005 amendment could be interpreted in a much broader way than was ever intended.

**Senator STEPHENS**—So you are saying that potentially it could be, but the EM actually mentions ‘interpretive pressure’. Has there been interpretive pressure?

**Mr Rawstron**—It is a question you would have to ask my colleagues at the ATO, but my understanding is that the answer is yes.

**Senator BERNARDI**—Pressure brought by whom?

**Mr Rawstron**—Well, people will apply to my colleagues at the ATO—they will be able to answer when they arrive!—for private rulings, and some of the applications that they were receiving were applying what you might call unique interpretations of what is a debt interest and how you might interpret what a debenture is.

**Senator BERNARDI**—How does that differ from the private rulings that people seek with regard to other tax treatments?

**Mr Rawstron**—It is no different. That is my understanding.

**Senator BERNARDI**—So it is the same process?

**Mr Rawstron**—There would be no difference. The only issue, I suppose, is from a policy point of view, and it is probably something the previous witnesses said: what do the words of the legislation mean as against what the policy intent is? There was some concern that maybe the words could be interpreted beyond what the drafters of the words thought they meant.

**Senator BERNARDI**—Which is the role of every lawyer in Australia, isn't it?

**Mr Rawstron**—That is right.

**Senator BERNARDI**—With all due respect to lawyers! Thank you.

**Senator WEBBER**—Is it the view of Treasury that the legislation as it stands completely addresses the mischief, or is it anticipated that we will need regulation for that?

**Mr Rawstron**—You have to look at the bill as a whole. It is in a sense restating the original policy intent but recognising that the market has moved on. As a form of architecture, in terms of designing the bill, the view was taken that the easiest way to restate the policy and recognise that the market had moved on and deal with the future was to use the regulation-making mechanism. That was seen as the best way to achieve that. So, for a lot of the submissions you have received, it is a question of how you design the policy, how you actually implement it, and our best judgement was that using the regulation mechanism provided the government with the flexibility both to address the current changes in the marketplace and to make decisions about what it wanted to do for the future.

**Senator WEBBER**—But there is no capacity, therefore, to get the legislative framework right in the first place. Instead, we are going to have this legislation as it stands and then the capacity for a lot of disallowable instruments to come into the parliament every time there is movement in the market.

**Mr Rawstron**—Our intention was that the development of the regulations and the development of the legislation were contemporaneous, so a lot of the developments in the marketplace will be addressed through the regulations.

**Senator WEBBER**—So, if they are contemporaneous, are there draft regulations?

**Mr Rawstron**—We were in the process of doing them at the time the measure was being put before the parliament.

**Senator WEBBER**—Are they available to the committee?

**Mr Rawstron**—No.

**Mrs Laduzko**—They are not, predominantly because that process has not progressed while this process is being addressed.

**Senator WEBBER**—This committee is often faced with the problem of accepting legislation on face value, being told that the regulations are coming later and they are going to address any concerns that we may or may not have. But then we do not get to see the regulations for a long time. It is very difficult when you are dealing with market certainty to accept that something you do not see is going to address the problem. So is there a time line for when the regulations are going to be out?

**Mrs Laduzko**—Like I said, industry has stopped participating in the regulation consultation process while they have deliberated through this process. It had been our

intention to have the regulations drafted as soon as possible with the commencement of the act. Before you were also alluding to the negative reg power, which some of the other witnesses spoke about. It was not our intention to be drafting regulations to use that power.

**Senator WEBBER**—The last time we dealt with—

**CHAIR**—Sorry to interrupt you, Senator Webber, but could you walk me through that again, Mrs Laduzko?

**Mrs Laduzko**—A number of the other witnesses, and also I think some of the submissions, alluded to the regulation power to carve things out of the exemption. The explanatory memorandum to the bill said we had not intended to use that power. We did not intend to unwind current practices, particularly interpretive practices around debentures, and that was still the case. We went into consultations with a view to finding out what instruments might need to be included in the exemption. We were not consulting on the basis of excluding things.

**CHAIR**—That is very important.

**Senator BERNARDI**—This is in regard to the ABA proposal about the negative list?

**Mrs Laduzko**—Yes.

**Senator WEBBER**—Is that actually written down somewhere? Is that part of the framework or do we just learn this through this process? It seems to me we need some kind of more rigorous commitment on that than just an exchange between us.

**Mrs Laduzko**—The explanatory memorandum to the bill indicates that it was not the government's intention to use the negative reg power at this time.

**CHAIR**—That is a very important clarification, I have to say.

**Mr Rawstron**—If I may add to my colleague's comments, we have been aware since mid last year of the concerns that industry had about the particular measure, so we are well alert to their issues around syndicated loans et cetera.

**Senator WEBBER**—And is it Treasury's view that the legislation as it stands addresses industry concern?

**Mr Rawstron**—When taken with the regulation-making power.

**Senator WEBBER**—With the regulations that the committee will not see before it passes the legislation.

**Mr Rawstron**—I can understand your point.

**Senator WEBBER**—The committee has been down this road before. We take on face value that the concerns the committee may have with a piece of legislation are going to be fixed by regulation. We never see the draft regulation. The draft regulations come in 18 months later and they do not necessarily address the concerns we initially had, but we all go on memory and some kind of understanding. This is a big and dynamic market. I would have thought we needed a bit more than this to correct a bill. The last time we looked at it was in 2005. Two years later we are passing a new piece of legislation and then we are going to fix it

all by regulation. It seems to me we are constantly tinkering at the edges rather than fixing the problem.

**CHAIR**—That is probably an opinion on the policy.

**Senator WEBBER**—Our previous witnesses said—and I am paraphrasing and probably taking them completely out of context—the draft legislation is a bit different from what they thought it would look like through the consultation process. Do you have any comment on that?

**Mrs Laduzko**—We initiated a consultation process when we first realised that we needed to amend the legislation to reflect the government's original policy intent. A number of people made submissions, including the gentlemen here as witnesses this morning.

**Senator STEPHENS**—Just while Senator Webber is regrouping and the ATO grab their breath, can I go back to your asking us to place great faith in the explanatory memorandum. It actually says that the regulation-making power will only be used where specific abuses emerge. Can you elaborate for us on against which criteria that will be determined and what could constitute a trigger for prescribing an instrument? What monitoring do you intend to do?

**Mrs Laduzko**—Our ATO colleagues can flesh this out somewhat, but the particular reason we had the negative regulation put into the bill was to address various concerns that may have arisen from the ATO's perspective in terms of interpretation of 'debenture'; it was not actually a focus on the debt interest predominantly. We worked through those issues and we concluded that, rather than attempting to more circumscribe the concept of 'debenture' in the law at present, we would leave it to run the appropriate interpretive outcomes through the ATO but reserve this power in case there was evidence in the future about systemic deliberative issues of instruments just to achieve the debenture outcome. Part of our concern was also that the pressure on debenture would have worked to undermine the amendments we were making to circumscribe the debt interest eligibility back to what the government had originally intended.

The negative reg, as we call it, was actually intended as a middle ground, as opposed to attempting to actually prescribe more tightly what 'debenture' means—a term that I think other witnesses would agree has a very wide and broad meaning under the tax law at present. Our attempt was in fact to not upset current practices by putting in primary law certain attempts to circumscribe it which actually might have been more destabilising.

**Senator JOYCE**—Is there anything in this that would be captured under a capital gains tax net?

**Mrs Laduzko**—No, in the sense that we are only dealing with payments of interest on instruments.

**Senator JOYCE**—So there is no looking into it as tradeable instruments?

**Mrs Laduzko**—Obviously some instruments when they are traded would have capital gains implications, but that is not the focus of these provisions.

**CHAIR**—Senator Webber, are you collecting your thoughts?

**Senator WEBBER**—I'll feel free to interrupt you!

**CHAIR**—I wasn't too sure whether you had finished your questions.

**Senator WEBBER**—I will come back to it—I have some issues I want to come back to.

**Senator JOYCE**—Sorry about that, Senator Webber. I just wanted to get on the *Hansard* that I'm here!

**CHAIR**—I thought I'd made that very clear early on, Senator Joyce. Senator Bernardi, you have some questions.

**Senator BERNARDI**—How do you respond to claims that some deposit accounts like retail accounts and maybe credit cards will be caught under this schedule?

**Mr Rawstron**—When you say 'caught' you mean?

**Senator BERNARDI**—They could qualify for exemptions.

**Mr Rawstron**—Depending on how you define 'debt interest' and how you apply the public offer test you could argue that a freely available account which is a debt interest could meet the definition of the exemption under the legislation.

**Senator BERNARDI**—But Treasury does not have any particular problems with that?

**Mr Rawstron**—Yes.

**Mrs Laduzko**—Treasury does have problems with that. That is part of the issue that we are seeking to address with the amendments currently before the House.

**Mr Rawstron**—The concern was that you could interpret the current words well beyond their intended meaning, just on the face of it. What is a debt interest? Sure, it may be a bank account; a bank deposit might be a debt interest. And the only other proviso is that it needs to meet a public offer test. Well, is the mere fact that it is advertised in a newspaper enough to be a public offer? So the amendment is aimed at recasting or restating the policy: that it has never been intended that those types of transactions, those types of instruments be exempt from paying interest withholding.

**Senator BERNARDI**—I thought we heard earlier from another witness that this legislation does not address that. Have I misunderstood what the ABA said this morning?

**Mrs Laduzko**—The current bill as it stands is intended to exclude deposit type instruments. It is actually intended to restore the policy to where the government had intended it to be. As a corollary of that, it also safeguards against deposit instruments getting eligibility for interest withholding tax exemption. A lot of the pressure is around interpretations of the public offer test. However, industry has been very firm in its opinion that it would rather we did not revise our definition or interpretations of the public offer test because that may have consequential impacts on existing exemptions in place in the debenture market.

**Senator WEBBER**—Earlier we heard from the ABA and they said they had presented a proposed amendment. Do we have a timeline for when that is going to be considered and when advice is going to be given? I obviously do not want to know that. It is just that, again, the committee is in an awkward position in that they have flagged a potential amendment, which we have not seen, and we do not know whether it is going to be accepted or not, yet the government has us under pressure to deal with the legislation.

**Mr Rawstron**—Certainly the ABA has provided Treasury with some suggested drafting, but that suggested drafting has not really been tested at this stage. We are looking at it to see whether it delivers what the ABA says it delivers and then obviously it will be a matter for the government to decide whether it wishes to adopt that or not.

**Senator WEBBER**—Is it going to take you a while to look at it and see—

**Mr Rawstron**—I imagine that we would need to actually express a view sooner rather than later, given the timing of the matter before parliament. But, again, it is a matter for the government.

**Senator WEBBER**—I understand, but in terms of the timeline for when the Senate is going to consider the legislation—I would be reluctant to deal with it before you have been through that process.

**Mr Rawstron**—The key issue is: where does it draw the line as against the current proposed amendment? It may have implications for the way in which revenue is currently collected under the interest withholding tax. Obviously the government would need to balance that against other competing interests.

**CHAIR**—Can I direct a question to the ATO. There was a question raised before about interpretive pressure, which Treasury quite rightly indicated the ATO would be better able to answer. Has there been interpretive pressure in relation to this whole question?

**Mr Latham**—There has been some querying of what actually comes within this and it has been dealt with in a couple of ATO interpretive decisions.

**CHAIR**—Is there a concern within the ATO that there may be interpretive pressure in the future in relation to the rapid expansion and fluidity—if that is the right word—of this whole area, which was generally agreed in the evidence that was given before us?

**Mr Latham**—Yes.

**CHAIR**—Has that underpinned the decision and the recommendations made by the ATO?

**Mr Latham**—Treasury has been running the legislation and we have informed them of these potential pressures.

**CHAIR**—But the EM refers to interpretive pressure. Where did that advice come from—yourselves?

**Mr Latham**—Yes.

**CHAIR**—The EM states:

The continuing requirement that debentures and debt interests meet the public offer test limits the range of debentures and debt interests qualifying for interest withholding tax exemption. However, interpretive pressure on the relevant law has the potential to substantially widen the range of debentures and debt interests that could qualify for exemption from interest withholding tax, beyond the original policy intent. This represents a threat to the integrity of the tax system.

**Mr Latham**—For example, one of the ATO IDs deals with certificates of deposit, which represented an extension from the wholesale market out into the retail market, and that was an example of that interpretive pressure.

**CHAIR**—I take it you are envisaging further changes with the expansion of this whole area. I am trying to find out what is underpinning all this.

**Mr Latham**—There could be those pressures. Currently it is in the early days.

**Senator WEBBER**—Can you expand on that? You are saying that there have been a couple of—

**Mr Latham**—There was a ruling request.

**Senator WEBBER**—A ruling request?

**Mr Latham**—Yes, that talked about certificates of deposit that were going to be made available to the retail market.

**Senator WEBBER**—I do not in any way want to diminish the work of the ATO or the market, but there has been a ruling request and there could be further interpretive pressure, and that is the basis for this section of the legislation?

**Mr Latham**—Treasury would need to answer that one.

**Senator WEBBER**—I am trying to work out what is driving this. We did not get it right in 2005 if you are having to restate a policy commitment.

**Mr Rawstron**—Basically, the issues which were behind the policy went to how you interpret the concept of a debenture and how the market is evolving. You could argue that it is a bit more inventive regarding what falls within the definition of 'debenture'.

**Senator WEBBER**—I understand that, but I want to deal with certainties—not what I could argue in future may be interpretive pressure. Where is the evidence for it? Where is the evidence that it is happening now, that it is really a problem and we have to fix it? Because if there is a problem it means that we got it wrong in 2005.

**Mr Rawstron**—Sections of the market have been approaching the ATO asking for preliminary views about whether certain things fall within the current wording of the legislation. That raises concerns that perhaps in the marketplace there is a view forming that the meaning of the words of the provision are far broader than the policy ever intended. From my point of view, there are two ways of approaching this. You can decide to leave the legislation as it is and then deal with the outcome in the market. The market will move very quickly—as you are probably well aware—and then you will have to deal with the consequence. You could say, 'If we did not expect to give up that tax revenue, do we go back and try to claw it back or do we let it go through to the keeper?' Or, 'Do we move now before the market has fully moved and restate the policy and then deal with what has happened in the market until now through regulation?' You could argue the fact that this approach is actually clearer than leaving it uncertain and effectively placing the government in a very difficult position in deciding what it should do if the industry decides to test the existing law and we discover that you can interpret the existing law to mean everything is a dead interest and there is in fact no withholding.

**Senator STEPHENS**—So this is a pre-emptive strike?

**Mr Rawstron**—I would not regard it as a pre-emptive strike. It is simply restating the policy to provide clarity around the intention of the original 2005 measures.

**Senator WEBBER**—So there is significant evidence that the policy that was stated in 2005 is not being interpreted in the right way and that it needs to be fixed—or we think that might be the case?

**Mr Rawstron**—We have been advised that there is risk to those words.

**Senator WEBBER**—Can you quantify that for me? Again, this is a face value discussion.

**Mr Rawstron**—Quantify?

**Senator WEBBER**—So far I have one ruling and there may be interpretive pressure. I need some kind of quantification of the problem.

**Mr Rawstron**—I do not have the figures in front me but I know that interest withholding generates, in terms of revenue, hundreds of millions of dollars.

**Senator WEBBER**—But in terms of ‘if we don’t do this’, what is the problem going to be?

**Mr Rawstron**—If you do not do this then I suppose, as a matter of government, you can make a decision and run the risk of losing a particular revenue stream. The other thing that you have to bear in mind is that Australia has a tax treaty network. While we may be talking about the benefits to foreign lenders to Australian business, on the other side of the coin there are the benefits Australian financial institutions have when operating in overseas markets. My area is also responsible for negotiating tax treaties. One of the things that we use to get benefits for Australian financial institutions and other lenders is this: ‘If we don’t tax your interest withholding you won’t tax ours.’ If, by stealth, you unilaterally lose the ability because of interpretation pressure, that is not a bargaining chip I can actually use in negotiations because we do not have that. Over time you may end up with no interest withholding tax. That is an extreme view, but that is one argument that you can put.

**CHAIR**—I take it this has arisen because there was a very different and large expansion of the allowable instrument flying out of 2005 and expanded use of the term ‘debenture’.

**Mrs Laduzko**—It is partly that. We have been saying that we have been attempting to restate the government’s policy intent with these amendments. I think it was the way we constructed the 2005 provisions, with the use of the word ‘dead’ interest which, as a matter of law, is a very broad term. You cannot ascertain it as something else. Previous witnesses noticed that a very concessional and accommodating interpretation of the public offer test meant that the effect of the law was potentially considerably broader than the government had intended at the time it made the amendments in 2005. The amendments we have moved now are to restore the law back to what the policy intent was. However, there is regulation-making power included in that to address some of the issues that other witnesses have raised around the question: ‘Would we like to take the policy further in certain areas?’ That is what the consultation process we initiated was intended to look at.

**Senator WEBBER**—The EM says the financial impact of this will be nil.

**Mrs Laduzko**—I would really like to have our revenue forecasters here to explain that. It is a technicality about a correction restoring an original intent, which means because it has not yet happened. It is something I would rather get some advice on, clarifying why there is a

genuine and substantial risk to revenue as opposed to something that says nil as a financial impact.

**Senator STEPHENS**—Is that some advice that you are able to provide?

**Mrs Laduzko**—Yes.

**Senator WEBBER**—I think that would be very helpful.

**CHAIR**—Do you want to take that on notice?

**Mrs Laduzko**—I would like to take that on notice, because it is not something I feel comfortable giving the correct explanation for.

**Senator WEBBER**—And how did we establish that the compliance cost impact will be negligible?

**Mr Rawstron**—I suppose you had industry witnesses who expressed their view, but our understanding is that the cost of converting an instrument into a debenture is quite low compared to the borrowings involved.

**Senator STEPHENS**—We heard evidence—

**Mr Rawstron**—It is the opposite, it is quite significant.

**Senator STEPHENS**—that absolutely that was not the case.

**Mr Rawstron**—As I understand it, if you are borrowing hundreds of millions of dollars, compliance costs may be less than \$100,000. I am not quite certain.

**Senator WEBBER**—Can you take that on notice and find out for us? If we say the compliance costs are negligible but we do not really know, then it is a moot point.

**Mrs Laduzko**—It is also a relative assessment as to how many instruments had yet moved in the marketplace to take advantage of the broadening from 2005. It is probably not the case that the greater proportion had not yet adjusted their practices.

**Mr Rawstron**—One issue which does happen, and it is pretty easy to understand, is that converting an instrument into a debenture is not something well understood overseas. Certainly there is a cost in trying to convince your overseas banker that you need to do it this way, so time and effort has to be put into that. My understanding is that creating the instrument is not a significant dollar cost compared to what you are borrowing.

**CHAIR**—But it was the cumbersome use of that debenture that was causing problems internationally, and hence those 2005 amendments were to ‘deburden’ it to a certain extent. That is my understanding of the principles that underpinned that.

**Mrs Laduzko**—You have already heard evidence about the TOFA amendments with the debt equity rules. A couple of years after those amendments, there was an adjustment that said non-equity shares that would once have been equity with dividends would now be regarded as debt interest. Then there was a change to the law in 2003 that deemed that dividends paid on these types of debt shares would be interest, which meant it was an interest stream.

The 2005 amendments were targeted at those hybrid instruments that shifted from being equity to being debt. They had lost the benefits of dividend imputation and other things that go with the dividend stream, and we said: ‘They’re quite harmoniously capital raising. They

would have been shares in another form or they would be a debenture issue, and now we've changed the law to say that those dividends under that type of share are now interest.' Our view at the time was that they should be allowed to seek the IWT exemption on the basis that we had changed their character and probably carved them out of some other concessions.

**CHAIR**—The institute of accountants gave evidence that that opened up the market to a different range of people who previously were probably advised that, because of the costs associated, unless it was \$50 million they were not in the hunt. My understanding of the evidence given was that it opened the market up further.

**Mrs Laduzko**—The legal effect of the amendments we made was that, but that was unintended.

**Senator STEPHENS**—Mr Rawstron, can I come back to the points you were making. First of all, Senator Webber asked you what would be the impact if we did not pass this. I am paraphrasing you, but you said you would make a decision that you are prepared to forgo that revenue. That is not really the impact of not accepting schedule 2, is it?

**Mr Rawstron**—We would not be moving the amendment unless we thought there was an integrity matter that we needed to address. The government decided that it wanted to do something else. Obviously, you would have to count the consequences of doing that. All I am saying is that I do not think you can draw the conclusion that there is not a consequence for deciding to remove schedule 2. There is a consequence—over time there will be.

**Senator STEPHENS**—Sure, although you cannot quantify the consequence in terms of revenue for us.

**Mr Rawstron**—The consequence would be at the extreme that you lose the ability to raise interest withholding tax on anything which is a debenture and broadly defined as debt interest. As I said, that would amount to hundreds of millions of dollars per annum.

**Senator STEPHENS**—Sure, but that would only be if there was a challenge. You suggest that some of the lawyers might actually challenge some of the interpretations that currently exist or currently are being applied in the legislation as it stands. There are some quite clear interpretations in rulings so far about what is applicable under the act. We are not looking at this being a massive loss of revenue to the government if this did not go ahead in its current form, are we?

**Mr Rawstron**—All I can do is say what I said before. We do not administer the legislation. The ATO administers the legislation. They are the ones who can see what happens in the marketplace. It is not for me to make that decision. It is for the government to make a call about that.

**Senator STEPHENS**—When we talked about what the mischief was that was intended to be addressed in this bill, you said that the ATO had been asked to rule on a unique case. Is that the certificate of deposits you were referring to before? Was that the unique interpretation?

**Mrs Laduzko**—We might have misparaphrased each other, but I did allude to the fact that the regulation power that is currently within the amendments to carve things out from eligibility was intended as a mid-ground outcome to concern there were pressures on the debenture side of things. Rather than putting into the primary law certain carve-outs or

clarifications about what we meant 'debenture' to be, which might have created even more uncertainty in the marketplace than is currently alluded to, we chose this path in case the ATO gave us advice in the future that there was a systemic and deliberate program of deliberately trying to get the debenture exemption, and we would leave it at that point rather than trying to address what we thought were the pressure points at the time. The concern around debenture is quite closely aligned to what we were trying to do with the amendments on the debt interest side, which meant that, if we had not fixed the debt interest to restore the policy intent, pressures on debenture could have undermined the effect of that amendment and made the whole thing redundant.

**Senator STEPHENS**—Is that how the ATO interprets the situation?

**Mr Latham**—Yes.

**Senator WEBBER**—It still sounds very pre-emptive, though—this could happen if this may happen.

**Senator STEPHENS**—And reserving the powers for some future opportunity.

**Senator WEBBER**—I do not have any of the expertise that any of you do.

**Mrs Laduzko**—I can only note that industry itself did flag with us certain ways one could look at the public offer test, which drew attention to this issue.

**Senator STEPHENS**—There is one point I wanted to go back to. Mr Rawstron, you suggested that the idea of using IWT exemptions in treaty negotiations was something that you do. With what countries do we have that negotiation?

**Mr Rawstron**—Australia has over 40 tax treaties.

**Senator STEPHENS**—Could you take that on notice and provide the ones where you have used that negotiation?

**Mr Rawstron**—Certainly the United Kingdom and United States tax treaties provide reciprocal exemption from IWT. Most of the syndicated loans probably organised through those two countries—

**Senator JOYCE**—Does the United States have a reciprocal capital gains tax exemptions, where you just provide them with the real property asset capital gains tax exemption?

**Mr Rawstron**—Most of our treaties are moving towards residence based taxation, which effectively means that you would lose—

**Senator JOYCE**—Does the United States have that? If I am here and I buy and sell Continental Airlines in the United States, is that capital gains tax free in the United States and only taxed in Australia?

**Mr Rawstron**—I will have to take that on notice.

**CHAIR**—I want to take you back, Ms Laduzko, to some comments you made. Clearly what was put to us this morning by a number of witnesses was that there is a view that there are two proactive parts to the regulation: you have told the committee that one part will be proactive and one part effectively will be kept in reserve. Would you acknowledge that that might be leading to some uncertainty?

**Mrs Laduzko**—Obviously, it must be because that is what the witnesses have been saying to you. Unfortunately, that wasn't our intent; it was as a better outcome to making prescriptive changes in the law to what might be meant by debenture. Admittedly, as one of the senators mentioned, you can only take our aim on faith. As I said, it was not our intention to use that regulation making power but I reiterate that the interest withholding tax provisions are about enforcing a taxing right we have, and there are some significant integrity aspects to those provisions which we would look to be able to safeguard.

**Senator WEBBER**—It is Treasury's view that if we do not pass this, the entire regime is under threat—that is the message I am getting.

**Mrs Laduzko**—It is Treasury's view that there are some risks to revenue beyond what the government intended associated with this—

**Senator WEBBER**—See: we are still grappling with the unknown.

**Mrs Laduzko**—It was never the intention that the concession be given to a range of standard depository products. The way the law works it possibly could be extended that far, and industry has raised those speculations with us. The fact that they have not yet acted upon them does not mean they cannot or will not.

**CHAIR**—I take it from what you are saying that you believe regulation is the best way to address a rapidly changing market situation to protect the integrity of the law as it stands. Is it Treasury's view that you need that regulatory power to respond quickly rather than through a legislative process?

**Mrs Laduzko**—We had thought that the regulatory making power would be a positive in the sense that it allowed us to consider extensions to the policy if the government so wished and was prepared to trade off the gains to the marketplace versus the revenue cost to Australia, and that we would be able to do it through a reg faster than we can amend primary law. We also thought—the explanatory memorandum alluded to this—that the regulations could function to transition instruments that had inadvertently received eligibility since 2005. That was part of the consultation process we had initiated. But things can obviously be viewed differently by different parties.

**CHAIR**—You were coming from the point of view that positive discrimination was more likely to lead to additions to the withholding tax exemption. The witnesses have put to us the potential for reductions in that list and therefore the uncertainty. I take it that was not the intent.

**Mrs Laduzko**—That was never our intent. We can appreciate their concerns, but that was never our focus.

**Senator WEBBER**—So how are we going to fix it? To be fair, if they are interpreting this move, the consultation process, the draft legislation and the lack of regulations one way—that is, the industry versus the way you interpret it—we have a gulf of understanding and we have to fix it; otherwise it makes people like me very hesitant about accepting the legislation. If the people who are going to deal with the legislation and use it every day have a different view of the impact than you do, then we have a problem.

**Mrs Laduzko**—Treasury would support industry's views around the transitional arrangements. We always intended appropriate transitioning, and they have quite rightly brought to our attention a technical matter which we would need to address and we are happy to move an amendment.

**CHAIR**—That is the staggered draws and—

**Mrs Laduzko**—Yes.

**Senator WEBBER**—What are your appropriate transitional arrangements?

**Mrs Laduzko**—We would accept eligibility along the lines proposed.

**CHAIR**—If this is a matter that is policy advice to the minister, you should not answer it if there has been a firm decision. If you are commenting on policy, then do so; if it is still the subject of policy advice, then you should not.

**Senator WEBBER**—I accept what you say, Chair, although surely the market has the right to know what the transitional arrangements will be.

**CHAIR**—I suspect what we have been told is that this is going to be addressed, but I do not think it is—

**Senator WEBBER**—So, again, it is going to be addressed perhaps some time in the future in some form of draft, but we have to accept all of that at face value and pass the legislation.

**CHAIR**—I acknowledge that. I think we would be entitled to indicate in our report that we believe this matter should be addressed, and I suspect from what we have heard that it is going to be taken on board. I just don't want to compromise these officers by—

**Senator WEBBER**—Yes, I understand, but I would want to know how it is going to be done.

**Senator STEPHENS**—Has the issue of grandfathering been considered?

**Mrs Laduzko**—That is what we mean with the transitioning provisions, yes.

**CHAIR**—That is the staggered draw and the redraw aspects of it.

**Mr Rawstron**—We are well aware of those issues.

**CHAIR**—And they have been taken on board?

**Mr Rawstron**—Yes.

**Mrs Laduzko**—We have been having discussions with industry around that matter.

**Senator STEPHENS**—To raise an issue that was raised by the witnesses this morning, do you envisage that any forms of syndicated loans would be prescribed as ineligible?

**Mrs Laduzko**—It is not our intention to propose that outcome.

**Senator STEPHENS**—Thank you.

**CHAIR**—We have achieved a fair bit this morning. It is just a matter of putting it all together.

**Senator WEBBER**—Some of us have had a crash course in this!

**CHAIR**—All right. Thank you very much for your assistance. That now finishes this hearing. I thank everyone for their attendance.

**Committee adjourned at 11.11 am**