The Parliament of the Commonwealth of Australia

Advisory Report on the

Tax Laws Amendment (2012 Measures No. 2) Bill 2012

Pay As You Go Withholding Non-compliance Tax Bill 2012

Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012

Passenger Movement Charge Amendment Bill 2012

House of Representatives
Standing Committee on Economics

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Chair's foreword

The Bills make a number of significant improvements to the tax laws across five issues, each of which the committee examined during the inquiry.

Schedule 1 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 and the Pay As You Go Withholding Non-compliance Tax Bill 2012 seek to make directors personally liable for their company's unpaid superannuation guarantee amounts. This will prevent unscrupulous directors from phoenixing their businesses to avoid their super responsibilities. This practice has cost Australian employees hundreds of millions of dollars in lost superannuation and the committee commends both the intent and the operation of the Bills in this regard.

Last year, the committee inquired into a package of Bills in similar terms. The committee recommended that the Government should investigate whether additional defences for directors should be inserted in the Bills. This has occurred. If passed, the legislation will give new directors 30 days, up from the current 14 days, to conduct due diligence before adopting a company's pre-existing obligations. Directors will also not be liable for a director penalty where they took reasonable care in a matter and applied the super legislation in a reasonable way.

The committee also recommended that the Government should investigate whether the provisions should only apply if an individual has been engaged in phoenixing. The Bills do not have this feature and industry argued that they should be amended along these lines. Ultimately, the committee has come to the view that such a change is not warranted because the provisions will only apply when a company has not only failed to pay a super amount, but that it has failed to notify the Australian Taxation Office (ATO) of this two months after the event. The provisions are only triggered by a consistent, high level of non-compliance.

Schedule 2 of the main Bill is designed to ensure that the tax treatment of financial arrangements is consistent with the taxation of financial arrangements (TOFA) tax timing rules. The provisions are to be retrospective from the commencement of other TOFA amendments on 1 July 2010 and this retrospectivity was the key issue in the inquiry. Stakeholders expressed concern that taxpayers who had chosen to adopt the new TOFA rules (rather than elect to keep prior arrangements) would be disadvantaged. However, the committee accepts that the measures restore the original policy intent and the Government had previously flagged that retrospectivity will be necessary with TOFA to restore the policy intent from time to time.

Schedule 3 aims to protect a $6 billion revenue risk that has arisen as a result of retrospective amendments in 2010 in relation to consolidation rules. These changes allowed consolidated groups to claim deductions back to 2002 in relation to the residual tax cost setting rule and the rights to future income rule. In 2011, revenue problems with the 2010 changes became apparent and the Board of Taxation conducted an inquiry into the matter. The Bill largely reflects the Board's report. Groups that have already received a refund or have an ATO ruling will generally be protected from the retrospective changes. Given the transparency of the process and the amount of revenue at stake, the committee again accepts that retrospective legislation is appropriate.

The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012 and Schedule 4 of the main Bill increase the tax rate on managed investment trusts for foreign investors from 7.5 per cent to 15 per cent. This is a partial reversal of the recent decreases on this tax rate from 30 per cent a few years ago. The committee is mindful that, as equity investments, the correct comparative rate is the company tax rate, currently set at 30 per cent. Although the industry sector was concerned about how the change would affect it, the committee accepts the Government's argument of the wider macroeconomic importance of Australia having a sound fiscal strategy, an important driver for the whole economy.

The Passenger Movement Charge Amendment Bill 2012 increases the charge from $47 to $55 from 1 July 2012 and indexes it to the consumer price index. Similar to the managed investment trust provisions, the issues revolved around an industry sector being concerned about how it would be affected by a revenue increase. Once again, however, the committee supports the provisions on a national basis because of the Government's overall fiscal strategy. The committee notes that the Government remains committed to the Tourism 2020 initiative and continues to support the industry through programs such as T-QUAL, infrastructure upgrades and maintaining and expanding tourism attractions.

The Bills represent a responsible package aimed at securing a sustainable revenue base for Australia, as well as protecting the superannuation entitlements of Australian workers. The Bills should pass.

On behalf of the committee I thank the organisations that assisted the committee during the inquiry through submissions or participating in the hearing in Canberra. I also thank my colleagues on the committee for their contribution to the report.

Julie Owens MP
Chair

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Membership of the Committee

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Terms of reference

On 24 May 2012 the Selection Committee requested the Committee to inquire into and report on:

- Tax Laws Amendment (2012 Measures No. 2) Bill 2012;
- Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012;
- Pay As You Go Withholding Non-compliance Tax Bill 2012; and
- Passenger Movement Charge Amendment Bill 2012.

Under Standing Order 222(e), reports of the Selection Committee are treated as having been adopted by the House when they are presented.

List of abbreviations

AAA	Australian Airports Association
AICD	Australian Institute of Company Directors
ASIC	Australian Securities and Investment Commission
ATEC	Australian Tourism Export Council
ATO	Australian Taxation Office
CPI	Consumer Price Index
GAAR	General anti-avoidance rule
IGT	Inspector General of Taxation
ITAA	*Income Tax Assessment Act*
MIT	Managed investment trust
OECD	Organisation for Economic Cooperation and Development
PAYG	Pay As You Go
PAYG (W)	Pay As You Go Withholding
PMC	Passenger movement charge
SG	Superannuation guarantee
SGC	Superannuation guarantee charge
STCRC	Sustainable Tourism Cooperative Research Centre
TAA	Taxation Administration Act

TOFA	Taxation of financial arrangements
TTF	Transport and Tourism Forum

Recommendation

2 Issues in the Bills

Recommendation 1

That the House of Representatives pass the Tax Laws Amendment (2012 Measures No. 2) Bill 2012, Pay As You Go Withholding Non-compliance Tax Bill 2012, Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, and the Passenger Movement Charge Amendment Bill 2012, as proposed.

1

Introduction

Referral of the Bill

1.1 On 24 May 2012 the Selection Committee referred the following Bills to the committee for inquiry and report:

- the Tax Laws Amendment (2012 Measures No. 2) Bill 2012;
- the Pay As You Go Withholding Non-compliance Tax Bill 2012;
- the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012; and
- the Passenger Movement Charge Amendment Bill 2012.

1.2 The first Bill has four schedules. The second and third Bills complement the first Bill and relate to its first and fourth schedules. These Bills are separate from it because of the constitutional requirements in relation to imposing tax. Overall, the Bills represent five issues, each of which the committee examined during the inquiry:

- making company directors personally liable for unpaid superannuation guarantee amounts of their company’s employees (Schedule 1 and the Pay as You Go Withholding Non-compliance Tax Bill 2012);
- amending the taxation of financial arrangement (TOFA) provisions to ensure that the tax treatment of financial arrangements that are part of a joining/consolidation event is consistent with the TOFA tax timing rules (Schedule 2);
- modifying the consolidation tax cost setting and rights to future income rules so that the tax outcomes for consolidated groups are more

consistent with the tax outcomes are more consistent with the tax outcomes that arise when assets are acquired outside the consolidation regime (Schedule 3);

- increasing the Managed Investment Trust (MIT) final withholding tax from 7.5 per cent to 15 per cent (Schedule 4 and the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012); and
- increasing the Passenger Movement Charge (PMC) from $47 to $55 and indexing it through the consumer price index (the Passenger Movement Charge Amendment Bill 2012).

Pay as You Go withholding non-compliance tax

Contrived corporate insolvency

1.3 There are cases where company directors or management who have deliberately sought to avoid paying liabilities, including taxation liabilities, wages, superannuation and leave entitlements and a variety of other responsibilities, such as supplier accounts, through the use of contrived company liquidation.

1.4 In cases where such activity involves the evasion of superannuation liabilities, it deprives workers of their financial security in old age, potentially contributes towards the creation of otherwise unnecessary welfare dependence and frustrates the efforts of successive governments to ensure the highest possible standard of living for Australians in their retirement.

1.5 The failure of companies to pay employees' entitlements or tax liabilities enables them to offer lower prices for goods and services. They can either reinvest money that compliant businesses would have to allocate to tax and superannuation payments or simply disburse this as profit or wages to the principals behind the phoenix scheme.

1.6 In some cases, companies that have liquidated in order to avoid liabilities literally rise from the ashes and resume trading through a new company structure controlled by the same person or group of individuals. Such action is known as phoenix activity and may be described as the use of the process of sequential company registration, liquidation and re-registration as a means of corporate fraud or tax evasion. A phoenix company may even be used to intentionally accumulate debts that the directors never intended to repay.

1.7 On occasion, phoenix operators may use family members or other associates to gain further benefits, such as inflated incomes or credit claims. There are cases where a family member or associate of a phoenix company director may be the commanding or controlling agent behind the company.

1.8 Contrived insolvency, including repeat phoenix activity, is conducted for personal enrichment or gaining an unfair competitive advantage. It invariably constitutes a gross and unprincipled abuse of the corporate form and the long established privilege of limited liability which is of essential importance to our economic system. It undermines the integrity of corporate regulation. It deprives the Commonwealth of revenue. It reduces public trust in the economic system, lowers the reputation of business and potentially deters investors. It also confers an unlawful benefit on those who evade the law and a disadvantage to those who comply with it.

Reports and reviews

1.9 Almost a decade ago, the Royal Commission into the Building and Construction Industry (The Cole Commission) was concerned about the frequency of phoenix activity in the building industry. The Commission made a number of recommendations addressing this issue, including that:

> The Commonwealth, after consultation with the Australian Securities and Investments Commission, consider the need for an increase in the maximum penalties provided in the *Corporations Act 2001(C'wth)* for offences that may be associated with fraudulent phoenix company activity.[1]

1.10 The Commission also called on the Commonwealth to consider the need to amend existing legislation in order to disqualify company directors guilty of fraudulent phoenix activity.[2]

1.11 Several years ago, Treasury estimated that phoenix activity cost the federal revenue approximately $600 million per annum.[3]

1 *Final Report of the Royal Commission into the Building and Construction Industry,* February 2003, 'Summary of Findings and Recommendations', Recommendation 108, p. 110.

2 *Final Report of the Royal Commission into the Building and Construction Industry,* February 2003, 'Summary of Findings and Recommendations', Recommendation 108, p. 111.

3 Mr Nick Sherry (then Assistant Treasurer), *Crackdown on Phoenix Activity*, Media Release No. 90 of 13 November 2009.

1.12 The subject of phoenix activity has been pursued by Parliament on a number of occasions in recent years. For example, the Joint Committee on Public Accounts and Audit were advised in 2009 by the ATO that the incidence of phoenix activity was increasing. Since 2008 the ATO employer obligations program had identified 6 013 companies as being a high-risk of defaulting on their obligations; of these over 4 600 had not complied with their PAYG withholding obligations and almost 3 000 had not met their super guarantee obligations.[4]

1.13 At that time the ATO explained the difficulty of prosecution because:

> ...in the early-2000s we obtained a number of high profile successful prosecutions, but after a few years we found that the penalties that were imposed on people who were successfully prosecuted became ineffective. We went from people getting custodial sentences to people getting home detention, which included a provision that allowed them out during daylight hours to conduct business, so there was essentially no penalty. I think that led to a loss of confidence and a loss of interest, to some extent. When you are dealing with the court system and the Director of Public Prosecutions, they have an enormous caseload of very serious cases. It is hard to get cases up when their assessment is that the penalty is likely to be a slap on the wrist.[5]

1.14 In March 2010 the Inspector-General of Taxation (IGT) published a report, *The Review into the ATO's administration of the Superannuation Guarantee Charge*. In this report he found that insolvent employers were responsible for approximately $600.8 million owed to the ATO under the superannuation guarantee charge (SGC) and that most of this debt had been written-off as lost employee retirement savings.[6]

1.15 The report also found that the groups most affected by the problem were employees of micro businesses, contracted and casual employees, younger employees; and employees in particular sectors — the arts and recreation services; the transport, postal and warehousing sectors; accommodation and food services; and the agriculture, forestry and fishing sector. The

4 Mr Mark Konza, Deputy Commissioner, Small and Medium Enterprises, ATO, Joint Committee of Public Account and Audit, Biannual Hearing with the Commissioner of Taxation: Hansard, 23 October 2009 pp. 8-9 and Mr Bruce Quigley, Second Commissioner, ATO, ibid, pp. 26-27.

5 Mr Mark Konza, Deputy Commissioner, Small and Medium Enterprises, ATO, Joint Committee of Public Account and Audit, Biannual Hearing with the Commissioner of Taxation: Hansard, 23 October 2009, p. 24.

6 The Inspector-General of Taxation (IGT), *Review into the ATO's administration of the Superannuation Guarantee Charge: A report to the Assistant Treasurer*, March 2010, p. 3.

mean salary and wages across each of these high risk segments is less than $30,000 a year, which indicated that those most at risk of having insufficient superannuation contributed on their behalf by employers were low-income employees.[7]

1.16 There was also anecdotal evidence to suggest that many employees are concerned that, if they query their employer about their superannuation guarantee entitlement or lodge a complaint with the ATO, then they could either lose their job or no longer be given work.[8] Finally, the IGT noted that:

> A delay in triggering ATO audit activity significantly increases the likelihood of non-payment of SGC debt (requiring more costly debt recovery action) and irrecoverability through insolvency. It also hampers the ATO's and government's efforts to maintain a level playing field amongst employers and ensure that compliant employers do not face a financial disadvantage against non-compliant competitors.[9]

1.17 The IGT recommended that the Government consider making company directors personally liable for the unpaid superannuation guarantee charge liabilities of their companies.[10]

The Government's 2009 proposals paper

1.18 On 14 November 2009 the Government released a proposals paper containing options to address contrived company liquidations.[11] The paper outlined a number of possible amendments to address the problem. These included the following actions in relation to taxation law:

- amending the director penalty regime to remove the ability of directors engaged in fraudulent phoenix activity to avoid personal liability for Pay As You Go (Withholding) (PAYG(W)) liabilities by placing the company into voluntary administration or liquidating the company;

7 The IGT, *Review into the ATO's administration of the Superannuation Guarantee Charge,* March 2010, p. 4.

8 The IGT, *Review into the ATO's administration of the Superannuation Guarantee Charge,* March 2010, p. 5.

9 The IGT, *Review into the ATO's administration of the Superannuation Guarantee Charge,* March 2010, p. 6.

10 The IGT, *Review into the ATO's administration of the Superannuation Guarantee Charge,* March 2010, p. 14.

11 See *Action against fraudulent phoenix activity: Proposals Paper,* November 2009, available at: <http://archive.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1647>.

- expanding the director penalty regime to apply to superannuation guarantee (SG) liabilities and other taxation liabilities such as indirect tax liabilities and a company's own income tax liability;
- amending the promoter penalty regime to ensure that the promoter penalty regime is able to target those individuals promoting fraudulent phoenix activity;
- expanding anti-avoidance provisions in the taxation law (either through an expansion of the existing general anti-avoidance rule (GAAR) or through the creation of a specific provision) to effectively negate any taxation benefit derived from fraudulent phoenix activity;
- reinstating the 'failure to remit' offence that would make it an offence for an entity not to remit the required PAYG(W) amounts;
- denying directors of companies (and potentially close relatives) from being able to access PAYG(W) credits in relation to their own income where amounts withheld have not been remitted (to the ATO) by the company;
- introducing an offence for claiming non-remitted PAYG(W) credits by making it an offence for directors to claim credits in relation to their own income for PAYG(W) amounts that have not been remitted by the company of which they are a director; and
- providing the Commissioner of Taxation with the discretion to require a company to provide an appropriate bond (supported by sufficient penalties) where it is reasonable to expect that the company would be unable to meet its tax obligations and/or engage in fraudulent phoenix activity.[12]

1.19 The paper also identified the following options in the corporations law:

- expanding the scope for disqualification of directors by giving a Court or the Australian Securities and Investment Commission (ASIC) a discretion to disqualify a person from being a director if the relevant company has been wound up and the conduct of the person, as a director of that company, makes them unfit to be concerned in the management of a company;
- restricting the use of a similar name or trading style by successor company and making directors personally liable for the debts of a

12 Australian Government, *Action against fraudulent phoenix activity: Proposals Paper,* November 2009, pp. 12-21.

liquidated company in circumstances where a 'new' company adopts the same or similar name as its previous incarnation; and

- adopting the doctrine of inadequate capitalisation by allowing the corporate veil to be lifted where a company sets up a subsidiary with insufficient capital to meet the debts that could reasonably be expected.[13]

The Government's 2011 Bills

1.20 Schedule 3 of the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 sought to amend the *Taxation Administration Act 1953* (TAA 1953) by:

- extending the director penalty regime to make directors personally liable for their company's unpaid superannuation guarantee amounts;
- allowing the Commissioner of Taxation (Commissioner) to commence proceedings to recover director penalties three months after the company's due day where the company debt remains unpaid and unreported after the three months passes, without first issuing a director penalty notice; and
- in some instances making directors and their associates liable to pay as you go (PAYG) withholding non-compliance tax where the company has failed to pay amounts withheld to the Commissioner.

1.21 The tax on directors and their associates to deny their credits was sought to be imposed by the Pay As You Go Withholding Non-compliance Tax Bill 2011.

1.22 The proposed amendments were designed to provide disincentives for directors to allow their companies to fail to meet their existing obligations, particularly obligations to employees. They did not introduce new obligations on the company but, rather, penalised company directors who fail to ensure that their companies meet their obligations under the existing director penalty scheme.

1.23 The tax laws require companies to withhold amounts from certain payments they make, such as wages to employees and fees to directors. The withheld funds must be paid to the Commissioner or, where applicable, to pay estimates of those funds.

13 Australian Government, *Action against fraudulent phoenix activity: Proposals Paper,* November 2009, pp. 12-21.

1.24 The director penalty regime has always made directors of non-compliant companies personally liable for the amount that the company should have paid, through imposition of a penalty. While the existing director penalty regime makes directors liable to a penalty, at the end of the day the company is left with the responsibility to meet its obligation.

1.25 Furthermore, as the existing regime allows directors 21 days notice of the penalty before the Commissioner is able to commence proceedings to recover the liability, directors inclined to do so are free to extinguish their personal liability by placing the company into voluntary administration or liquidation within that notice period and before the Commissioner can sue to recover their personal liability. The 21 days notice is, in effect, an invitation to liquidate. This often means that the full amount of PAYG withholding liabilities is never recovered.

1.26 To compound matters further, company directors are currently able to claim PAYG withholding credits (for amounts withheld from payments to them by the company) in their individual tax returns, even when the company has failed to pay some or all of its PAYG withholding liability to the Commissioner.

1.27 It is also critical to note that while the director penalty regime addresses non-payment of PAYG withholding amounts to the Commissioner, non-payment of employee entitlements such as superannuation cannot be addressed through the regime. Thus, the Commonwealth has effectively established one standard for its debtors, while leaving other lawful creditors with less effective means of redress.[14]

The committee's report on the 2011 Bills

1.28 The committee reported on the Bills in November 2011. An objection to the Bills raised by industry was that they reversed the onus of proof and assumed the guilt of company directors, rather than extend the presumption of innocence.

1.29 The committee did not find this argument compelling and was not convinced that the Bills reversed the onus of proof or undermined established principles of natural justice. They simply extended the penalty provisions that already apply to PAYG to superannuation.

1.30 The ATO also pointed out that the existing regime has defences for directors so that they are not inadvertently swept up. These defences

14 Discussion drawn from the Explanatory Memorandum for the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011.

would have remained available to directors under the Bills. For example, the defences for director penalties include illness or some other reason such that it would be unreasonable to expect a director to take part in the management of a company at the relevant time, or if the director took all reasonable steps to ensure that a company complied with its obligations.

1.31 However, given the concerns expressed by industry at the hearings in relation to how the defences would operate in practice, the committee took the view that it would be worthwhile for the Government to investigate this matter further and determine whether it would be possible to expand and strengthen the defences for company directors.

1.32 Another concern raised by industry was that the Bills potentially applied to the broad range of directors whether engaged in phoenix activity or not. The committee concluded that the Government should investigate whether it is possible to tighten the provisions of the Bills to better target phoenix activity.

1.33 The committee stated that these provisions should be held pending while the Government re-assessed the issues raised in the inquiry. The committee's recommendations were:

> The Government explore whether to expand and strengthen the defences for company directors available in the Bills.
>
> The Government investigate whether it is possible to amend the Bills to better target phoenix activity.[15]

The current Bills

1.34 The current Bills are similar to the previous proposals in that they extend the director penalty regime to make directors personally liable for their company's unpaid superannuation amounts. They also make directors and their associates liable, in some circumstances, to PAYG withholding non-compliance tax where the company has failed to pay amounts withheld to the Commissioner.

1.35 The three main differences are that:

- the current Bills do not allow the Commissioner of Taxation to commence proceedings to recover director penalties without first issuing a director penalty notice. Instead, the Bills provide that directors

15 House of Representatives Standing Committee on Economics, *Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011,* November 2011, Recommendations 1 and 2, pp. 27 and 30.

cannot discharge their director penalties by placing a company into administration or liquidation when the super guarantee remains unpaid and unreported three months after the due date;

- the ATO may issue a director penalty notice with a director's tax agent, instead of personally on the director; and
- there are additional defences for company directors and the timing rules also offer them some protection. For example:
  - ⇒ a new director is not liable for a director penalty for company debts until 30 days after they become a director;
  - ⇒ the limitation on directors not being able to discharge their director penalties by placing a company into administration or liquidation where the super guarantee remains unpaid and unreported three months after the due date only applies after they have been a director for three months; and
  - ⇒ a director is not liable for a director penalty if they took reasonable care in the matter and applied the superannuation legislation in a reasonable way.

1.36 The defences in the previous Bills also remain, such as where a director was ill or had some other good reason for not being involved in the management of the company. Another defence is where a director took all reasonable steps to ensure the directors caused the company to meet its super obligations or for an administrator to be appointed or for the company to be wound up.[16]

1.37 In summary, the Government has largely responded to concerns raised about the initial proposals. This is confirmed by the response paper to stakeholder concerns that the Government recently released. It lists five concerns, of which the Government states that four have been addressed and these are discussed above. The one outstanding matter relates to the proposal to target the amendments to phoenix activity, which the Government has declined to implement.[17]

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16 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, pp. 9-44.

17 Department of the Treasury, Summary Document, 'Amendments to the director penalty regime,' <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Amendments-to-the-director-penalty-regime>, viewed 30 May 2012.

Revenue impact

1.38 The provisions are expected to generate additional revenue, shown in the table below. These amounts would be used to pay employees their superannuation entitlements.

Table 1.1 Revenue impact of proposed legislation

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Amount	$10m	$40m	$95m	$95m	$60m

Source *Explanatory Memorandum, p. 3.*

Consolidation and TOFA

Background

1.39 On 1 July 2002 a consolidated income tax regime was introduced, which allows wholly-owned corporate groups to choose to consolidate and operate as a single entity for tax purposes. The objective was to reduce compliance costs for business and improve the integrity of the tax system. The head company lodges a single tax return for the group, and the subsidiaries lose their individual income tax identities. The consolidation regime affects large businesses. Most small businesses and sole trader activities do not come under the regime.

1.40 Taxation of financial arrangements (TOFA) reforms were first announced in 1992 and have involved the implementation of various stages of arrangements in the ensuing years. The TOFA arrangements aim to reduce the influence of tax considerations on how financial arrangements are structured, emphasising other factors, such as risk, when making financing decisions.

1.41 The TOFA rules provide for the tax treatment of gains and losses on financial arrangements. The rules are contained in Division 230 of the *Income Tax Assessment Act 1997* (ITAA), and apply to those with large tax payment obligations. Division 230, representing stages three and four of the TOFA reforms, was introduced by the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009*. The rules include methods for calculating gains and losses from financial arrangements, and the time at which these gains and losses will be brought to account.

1.42 The TOFA rules generally apply to financial arrangements for financial years commencing on or after 1 July 2010, unless the taxpayer elected to apply the TOFA provisions from the previous financial year. TOFA transitional provisions allow a tax payer to elect to apply TOFA provisions to existing financial arrangements that started before the taxpayer's first TOFA year (referred to as 'ungrandfathering'). A transitional balancing adjustment is then made for these financial arrangements, based on calculations using the 'primary' or 'alternative' method. If the transitional balance is positive a quarter of the amount is included in the taxpayer's assessable income for the first year that Division 230 applies and for each of the next three years. If it is negative, then a deduction for a quarter of the amount is allowed over that four year period.[18]

1.43 TOFA consolidated interaction provisions are designed to ensure appropriate interaction between the consolidated and TOFA regimes.

1.44 When introduced, the Government foreshadowed that monitoring and further legislative refinements would be required. Following the enactment of Divisions 230, consultation with the industry and Australian Tax Office revealed technical deficiencies in the consolidation interaction provisions and how they interact with the TOFA transitional provisions.[19]

1.45 On 25 November 2011 the then Assistant Treasurer, the Hon Bill Shorten MP, announced that the Government would amend the TOFA consolidated interaction and transitional provisions to ensure that the tax treatment of financial arrangements that are part of the assets and liabilities in a consolidation (joining) event, are consistent with the TOFA tax timing rules and takes into account changes in value of financial arrangements that are liabilities.[20]

1.46 Treasury consulted on exposure draft legislation and related explanatory material in April 2012. Stakeholders expressed concern that the amendments would apply retrospectively from the commencement of the TOFA provisions, and that they may not be able to amend prior income tax assessments affected by the amendments. Concerns were also raised about the application of the amendments to financial arrangements that

18 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 69.

19 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 69.

20 The Hon Bill Shorten MP, *Changes to the income tax law affecting consolidated groups*, Media Release No. 159 of 25 November 2011.

are part of a tax consolidation of a wholly owned group and of chosen transitional entities.

1.47 In response to these concerns raised during the consultation, Treasury indicated that the following changes had been made to the proposed legislation:

- tax payers will be able to amend prior assessment within two years of the commencement of the amendments;
- financial arrangements of a chosen transitional entity will be carved out of the application of the amendments; and
- a head company's deemed assumption value for liabilities that are part of a pre-TOFA formation will be changed from the liability's accounting value to its tax carrying value.[21]

1.48 However, the retrospective application of these changes was retained. Treasury observed that it 'is consistent with prior Government announcements regarding amendments to the TOFA provisions and the retrospective application of all other amendments to the TOFA provisions.'[22]

1.49 The Tax Laws Amendment (2012 Measures No. 2) Bill 2012 was introduced in the House of Representatives on 24 May 2012, to address the problems raised by the 2010 amendments, and make improvements to consolidation and TOFA arrangements and interaction.

21 Department of the Treasury, *TOFA consolidation interaction and TOFA Transitional Balancing adjustment amendments: Summary of consultation process*, pp. 1-2, available at <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Changes-to-the-income-tax-law-affecting-consolidated-groups/TOFA>.

22 Department of the Treasury, *TOFA consolidation interaction and TOFA Transitional Balancing adjustment amendments: Summary of consultation process*, p. 2, available at <http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Changes-to-the-income-tax-law-affecting-consolidated-groups/TOFA>.

Schedule 2—Consolidaton and TOFA

1.50 Schedule 2 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 amends the *Income Tax Assessment Act 1997* and the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009.* It deals with the interaction between the consolidation regime and the TOFA rules. The Government anticipates that these amendments will 'clarify the operation of the TOFA consolidation interaction and TOFA transitional provisions', providing 'more certainty for consolidated groups.'[23]

1.51 The provisions in this schedule are to provide consistency in the tax treatment of financial arrangements that are part of a consolidation or joint event, and the TOFA tax timing rules. The amendments to the ITAA 1997 are to:

> ...ensure that, for consolidated groups applying Division 230 of the ITAA 1997 in relation to their financial arrangements, the head company is deemed to have received an amount for assuming an accounting liability that is, or is part of, a financial arrangement as part of a joining/consolidation event. This amount is deemed to be the accounting liability's accounting value at the joining time.[24]

1.52 The amendments to the TOFA transition provisions ensure that the TOFA consolidation interaction will apply in the following circumstances:

- a joining/consolidation event occurred prior to a consolidated group starting to apply the TOFA provisions in relation to its financial arrangements; and
- the head company has made an election to apply the TOFA provisions to its existing financial arrangements.[25]

1.53 The Assistant Treasurer, the Hon David Bradbury MP, stated that:

> ...this bill ensures the tax treatment of the financial arrangement is consistent with the TOFA tax timing rules, which recognise gains and losses from financial arrangements on an accruals basis as opposed to a realisation basis.

23 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 5.

24 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 67.

25 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 5.

> The changes also recognise the fact that, like financial assets, the value of a financial liability can change other than from the repayment of the liability.[26]

1.54 The provisions are expected to protect a significant amount of revenue over the forward estimates and generate a revenue gain of $253 million over that period.

Table 1.2 Revenue impact of proposed changes to TOFA consolidation interaction arrangements

Year	2012-13	2013-14	2014-15	2015-16
Amount	$66m	$46m	$61m	$80m

Source *Explanatory Memorandum, p. 5.*

1.55 The amendments will have effect from the commencement of stages three and four of the TOFA reform, which was 26 March 2009. TOFA consolidation interaction provisions will apply to the consolidated group from their first TOFA applicable income year. The TOFA transitional provision amendments will also apply retrospectively.

Consolidation

Background

1.56 The consolidation regime allows the head company of a consolidated group to lodge tax returns on behalf of all the entities in the group. It was introduced to reduce tax compliance costs. However, deficiencies in the consolidation regime were identified in the years following its introduction.

1.57 One area identified for improvement was in how the cost of an asset is recognised when acquired by a company. When a consolidated group acquires a company, the joining company's shares cease to be recognised for tax purposes and become assets of the head company. The tax costs of these assets are reset at an amount that reflects their respective share of the group's cost of acquiring the joining company. This amount is based on the relative market values of those assets. Some assets, such as cash, retain their original tax cost.

26 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 24 May 2012, p. 17.

1.58 This led to amendments in 2010 enacted by the *Tax Laws Amendment (2010 Measures No. 1) Act 2010*. The Act broadened the scope of the residual tax cost setting rule and introduced the rights to future income rule. These changes had retrospective effect from the commencement of the consolidation regime in 2002. Consolidated groups were able to make claims for tax deductions based on the rights to future income and residual tax cost setting rules from the 2002-2003 financial year.

1.59 The objectives of the 2010 changes were to reinstate the original intention of the consolidation regime and 'remove uncertainty in the law by clarifying that, for some assets, the reset tax cost of the asset (rather than its original tax cost) is used when a taxing point later arises for the asset.'[27] However, there were unintended consequences and a negative impact on revenue.

1.60 When the measures in the 2010 amendments were introduced they were expected to have an 'unquantifiable but significant' revenue impact. However, the Government did not anticipate that by 2011 there would be in excess of $30 billion dollars in claims, with further claims likely to be made.[28]

1.61 The Assistant Treasurer, the Hon David Bradbury MP, stated that:

> Shortly after passage of those amendments, it became clear that the new rules could result in the recognition of the tax costs of some assets being brought forward in an unanticipated way.[29]

1.62 On 30 March 2011 the Government asked the Board to Taxation to:

- examine the operation of the rights to future income and residual tax cost setting rules with a view to clarifying their scope; and
- propose changes to limit the scope of the rules, if necessary, and advise on the date of effect of those proposed changes (including whether they should apply retrospectively).[30]

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27 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 102.

28 The Board of Taxation, *Review of the Consolidation Rights to Future Income and Residual Tax Cost Setting Rules: A report to the Assistant Treasurer*, May 2011, p. 3.

29 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 24 May 2012, p. 17.

30 The Board of Taxation, *Review of the Consolidation Rights to Future Income and Residual Tax Cost Setting Rules: A report to the Assistant Treasurer*, May 2011, p. 1.

1.63 The Board of Taxation reported in May 2011, concluding:

> ...the scope of the rights to future income and residual tax cost setting rules, as enacted, is broader than what was intended at the time of their original announcement in 2005. The Board considers that, as a general principle, consolidated groups should not be able to claim types of deductions that are not available to taxpayers outside of consolidation. However the rights to future income and residual tax cost setting rules allow consolidated groups to access potential deductions which are not available under the general tax law outside of the consolidation regime. The Board has concluded that the rules could be improved so that they do not advantage consolidated groups over taxpayers outside consolidation.[31]

1.64 On 25 November 2011 the then Assistant Treasurer, the Hon Bill Shorten MP, announced that the Government would implement the Board of Taxation's recommendations for future consolidations. The Government indicated its intention to change the way consolidated groups can deduct the costs allocated to some assets following a corporate acquisition. It was anticipated that the changes would 'help protect potential threats to revenue by putting a limit on the scope of [the 2010] amendments', and ensure that consolidated groups could not continue to claim tax deductions that are not available to non-consolidated businesses.[32]

Schedule 3

1.65 Schedule 3 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 amends the ITAA 1997 to modify the consolidating tax cost setting and rights to future income rules so that the tax outcomes for consolidated groups are more consistent with the tax outcomes that arise when assets are acquired outside the consolidated regime.

1.66 The Assistant Treasurer, the Hon David Bradbury MP, stated that:

> The changes in this bill take away the unintended retrospective benefits arising from the 2010 amendments and are necessary to protect a significant amount of revenue that would otherwise be at

31 The Board of Taxation, *Review of the Consolidation Rights to Future Income and Residual Tax Cost Setting Rules: A report to the Assistant Treasurer*, May 2011, p. vii.

32 The Hon Bill Shorten MP, *Changes to the income tax law affecting consolidated groups*, Media Release No. 159 of 25 November 2011.

> risk. These changes demonstrate the government's commitment to maintaining the equity, fairness and integrity of the tax system.[33]

1.67 In referring the Bill to the committee, the Selection Committee noted the 'retrospective application of tax charges' in the changes to the consolidation measures as an issue for consideration.[34]

1.68 The EM outlined that as the 2010 amendments had retrospective application, the amendments in Schedule 3 would need to have effect back to 2002. Provision is made in the Bill for a range of different circumstances. How the proposed changes will affect specific consolidated groups will depend on the time at which acquisitions were made in relation to the announcement of the changes on 12 May 2010 and the announcement on 30 March 2011 that the rules would be subject to review. Schedule 3 proposes three distinct categories of rules:

- Pre-rules (prior to the announcement of the changes on 12 May 2010);
- Interim rules (between 12 May 2010 and 30 March 2011); and
- Prospective rules (after 30 March 2011).

1.69 The key changes affecting corporate acquisitions under the consolidation arrangements are outlined below:

> The pre-rules, which apply broadly to the period before 12 May 2010, will restore the original tax cost setting rules that operated prior to the 2010 amendments, with modifications to:
>
> - limit deductions for rights to future income to unbilled income assets;
> - ensure that a deduction is allowed for the reset tax costs for consumable stores; and
> - treat certain assets as goodwill.
>
> The interim rules, which apply broadly to the period between 12 May 2010 and 30 March 2011, will restore the current 2010 residual tax cost setting and rights to future income rules, with modifications to:
>
> - treat certain assets as goodwill;
> - ensure that no value is attributed to certain contractual rights to future income; and
> - ensure that the reset tax costs for consumable stores are deductible.

33 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 24 May 2012, p. 17.

34 House of Representatives Selection Commission, *Report No. 53*, 24 May 2012, p. 4.

The prospective rules, which apply broadly to the period after 30 March 2011, will:

- restrict the operation of the tax cost setting rules to CGT assets, revenue assets, depreciating assets, trading stock and Division 230 financial arrangements;
- apply a business acquisition approach to the residual tax cost setting rule;
- ensure that the reset tax costs for rights to future income that are WIP amount assets and consumable stores are deductible; and
- treat rights to future income, other than WIP amount assets, as retained cost base assets.[35]

1.70 Provision is also made for groups that have private rulings from the ATO, including written advice under advance compliance agreements. Actions taken in these situations will stand.[36]

1.71 While these provisions are not expected to generate revenue, it is anticipated that they will protect a 'significant amount of revenue' by restricting the scope of tax deductions by consolidated groups.

Managed investment trusts

Introduction

1.72 The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012 amends the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* to increase the managed investment trust (MIT) final withholding tax from 7.5 per cent to 15 per cent on fund payments made in relation to income years that commence on or after 1 July 2012.[37] This applies to distributions from managed investments to residents of a country with which Australia has a tax information exchange agreement.[38]

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35 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, pp. 105-106.

36 The Hon Bill Shorten MP, *Changes to the income tax law affecting consolidated groups*, Media Release No. 159 of 25 November 2011.

37 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 133.

38 An information exchange country is a country listed in the Taxation Administration Amendment Regulations 2008 (No. 2).

1.73 Managed investment trusts are typically used to invest in infrastructure and property projects. Trustees of Australian managed investment trusts may be required to withhold an amount from a fund payment where they are authorised to make a payment to a place outside Australia or where the recipient has an address outside Australia.[39]

1.74 This measure is estimated to have a gain to revenue of $260 million over the forward estimates period, as shown below.[40]

Table 1.3 Revenue impact of the amendments to MIT final withholding tax

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Amount	-	$50m	$65m	$70m	$75m

Source *Explanatory Memorandum, p. 7.*

Background to the managed investment final withholding tax

1.75 During the 2007 election campaign, the Australian Labor Party committed to lower the rate of MIT withholding tax from 30 to 15 per cent on distributions to foreign residents.

1.76 The *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* was enacted following an announcement by the Government as part of the 2008-09 Budget that the rate would eventually be lowered from 30 to 7.5 per cent.[41]

1.77 Prior to the introduction of this Act, trustees of Australian managed investment trusts were required to withhold at a rate of 30 per cent on the fund payment part of managed fund distributions to foreign resident investors. Those investors were then subject to the normal Australian income tax rules on their distributions. As the amount withheld was of a non-final nature, the foreign resident recipients of the payments were still required to lodge Australian tax returns.[42]

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39 Australian Tax Office, *New withholding arrangements for managed fund distributions to foreign residents*, 18 December 2008, <http://www.ato.gov.au/taxprofessionals/content.aspx?menuid=0&doc=/content/00174238.htm&page=1&H1 >, viewed 30 May 2012.

40 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 31.

41 L Nielson, *Budget Review 2012-13: Increase in Managed Investment Final Withholding Tax*, Parliament of Australia, Canberra, 2012.

42 Australian Tax Office, *New withholding arrangements for managed fund distributions to foreign residents*, 18 December 2008, <http://www.ato.gov.au/taxprofessionals/content.aspx?menuid=0&doc=/content/00174238.htm&page=1&H1>, viewed 30 May 2012.

1.78 The 2008 Act replaced the non-final withholding regime with a new final withholding tax regime which relieved foreign investors of the compliance burden of filing Australian tax returns on those distributions.[43]

1.79 These previous recent changes also incorporated an undertaking by the Government to cut the rate of the withholding tax from 30 per cent to 7.5 per cent in three stages:

- 22.5 per cent for the 2008-09 income year
- 15 per cent for the 2009-10 income year
- 7.5 per cent for the 2010-11 and subsequent income years.

1.80 Because of this staged approach to the lowering of the MIT Withholding Tax, the 7.5 per cent rate has only been in place for distributions made since the 2010-11 financial year.

1.81 The Bill will return the withholding tax for managed investment trusts to the level of the original 2007 election commitment of 15 per cent.[44]

1.82 In his second reading speech, the Hon David Bradbury MP, stated that the increase to the final withholding tax ensures that 'Australia receives a fair return on profits generated in Australia' and that the 15 per cent rate remains 'competitive with rates in other countries.'[45]

1.83 Withholding Tax regimes on foreign investors are common within the Organisation for Economic Cooperation and Development (OECD). With an increase in the withholding rate to 15 per cent, Australia would be similar to the rates in like countries in the OECD.[46]

Industry reaction

1.84 Industry reacted with concern to the announcement of an increase in the MIT withholding tax rate. Managed investment trusts expressed surprise at the announcement and warned that the sudden reversal of recent policy to lower the rate would cause concern among foreign investors about stability of Australia's investment environment. Mr Christian Holle, tax

43 Australian Tax Office, *New withholding arrangements for managed fund distributions to foreign residents*, 18 December 2008, <http://www.ato.gov.au/taxprofessionals/content.aspx?menuid=0&doc=/content/00174238.htm&page=1&H1 >, viewed 30 May 2012.

44 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 31.

45 The Hon David Bradbury MP, Assistant Treasurer, *House of Representatives Hansard*, 24 May 2012, p. 18.

46 L Nielson, *Budget Review 2012-13: Increase in Managed Investment Final Withholding Tax*, Parliament of Australia, Canberra, 2012.

partner of PricewaterhouseCoopers has criticised the lack of warning from the Government on its intention to increase the tax rate arguing that people have made investments in Australia based on an expectation of an ongoing 7.5 per cent rate and that there should be a transition period.[47]

1.85 Reported reactions from other industry representatives have warned that the tax rate rise could potentially jeopardise investment in crucial infrastructure and undermine efforts to develop asset management in Australia.[48]

1.86 However, others in the industry admitted the withholding tax rate is not the sole consideration for investors. While the existing 7.5 per cent rate was welcomed by the industry as making Australia more competitive in the region, other factors such as Australia's stable government and application of the rule of law, proximity to Asia and strength of the economy were also recognised as making Australia an attractive investment destination.[49]

Passenger Movement Charge

Introduction

1.87 The Passenger Movement Charge Amendment Bill 2012 (the Bill) will increase the Passenger Movement Charge (PMC) from $47 to $55 per person from 1 July 2012 and enable automatic indexation, based on the Consumer Price Index (CPI), from 1 July 2013.[50]

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47 F Chong, 'Tax Flip sends 'an appalling message', *The Australian,* 10 May 2012, <http://www.theaustralian.com.au/business/property/tax-flip-sends-an-appalling-message-to-foreign-investors/story-fn9656lz-1226351333214>, viewed 30 May 2012.

48 J Keho and J Wiggins, 'Industry slams rise in withholding levy', *Australian Financial Review,* 10 May 2012, p. 13; F Chong, 'Tax Flip sends an appalling message', *The Australian,* 10 May 2012, < http://www.theaustralian.com.au/business/property/tax-flip-sends-an-appalling-message-to-foreign-investors/story-fn9656lz-1226351333214>, viewed 30 May 2012; P Hopkins, 'Property investment to suffer', *Sydney Morning Herald,* 14 May 2012, <http://www.smh.com.au/business/property/property-investment-to-suffer-20120513-1ykry.html>, viewed 30 May 2012.

49 P Hopkins, 'Property investment to suffer', *Sydney Morning Herald,* 14 May 2012, <http://www.smh.com.au/business/property/property-investment-to-suffer-20120513-1ykry.html>, viewed 30 May 2012.

50 Explanatory Memorandum, Passenger Movement Charge Amendment Bill 2012, p. 5.

1.88 Over the forward estimates the measure will deliver an additional $610 million. [51] The Government has allocated $61 million of this over four years to the Asia Marketing Fund. This fund will promote Australian tourism and business opportunities in Asia. The tourist industry has been critical of the proposed increase to the PMC, and argues it will discourage international visitors. [52] However, previous modelling by the Sustainable Tourism Cooperative Research Centre (STCRC) has indicated that an increase to the PMC could increase gross national income and would have a small negative effect on the tourism sector. [53] In contrast to the current proposal, an assumption in the modelling was that none of the funds collected would be directed back to the tourism sector.

Background to the Passenger Movement Charge

1.89 The Passenger Movement Charge was introduced in July 1995 (replacing departure tax) and is imposed on a person departing from Australia, whether or not the person intends to return.[54] The PMC is levied under the *Passenger Movement Charge Act 1978* and collected under the *Passenger Movement Charge Collection Act 1978*. It is administered by the Australian Customs and Border Protection Service (Customs and Border Protection).

1.90 Commonly, carriers moving passengers through Australian customs enter into formal remittance arrangements with Customs and Border Protection. The carrier then levies the PMC at the time a ticket is sold and remits the PMC to Customs and Boarder Protection within an agreed timeframe.

1.91 Where a person departs without a ticket, or equivalent authority, the PMC is collected by Customs and Border Protection officers directly from the passenger, captain or agent at the point of departure. This generally applies to people on private flights and sea craft. There are a number of exemptions to the PMC, including:

- passengers under 12 years of age;
- 'traditional inhabitants' travelling to the Torres Strait or Papua New Guinea;

51 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 11.

52 Tourism & Transport Forum, *Australia to New Zealand: 'We're Sorry'*, 17 May 2012, <http://www.ttf.org.au/Content/mediareleases.aspx>, viewed 30 May 2012.

53 P Forsyth, S Hoque, L Dwyer, T D Pham and R Spurr, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, p. 4.

54 Australian Customs and Boarder Protection Services, *Passenger Movement Charge*, <http://www.customs.gov.au/site/page6068.asp>, viewed 30 May 2012.

- on-duty foreign defence personnel, and their spouse and children;
- crew members, and their spouse and children;
- transit passengers;
- emergency passengers;
- certain consular and diplomatic officers;
- protective service officers; and
- passengers travelling to the External and Indian Ocean Territories.[55]

1.92 The PMC has been set at $47 per passenger since 1 July 2008. The Government announced the $8 increase, and subsequent indexation, to the PMC in the 2012-13 budget.[56] The measure is estimated to increase revenue by $610 million over the forward estimates period.

Table 1.4 Revenue impact of the Passenger Movement Charge

Year	**2011-12**	**2012-13**	**2013-14**	**2014-15**	**2015-16**
Amount	-	$85m	$140m	$175m	$210m

Source Budget Paper 2012-13, Part 1: Revenue Measures, p. 11.

1.93 The Government has flagged the Asia Marketing Fund as the recipient of $61 million over four years of the funds raised by the PMC. According to Budget Papers:

> The fund will support the promotion of Australia to growing markets in Asia and is intended to encourage investment by the private sector, and State and Territory governments.[57]

1.94 The Minister for Home Affairs, the Hon Jason Clare MP, stated in his second reading speech that the Asia Marketing Fund will promote Australia 'as a premium holiday and business travel destination.'[58]

1.95 Industry groups have expressed the concern that the increase to the PMC will act as a barrier to entry for international passengers and reduce

55 Australian Customs and Boarder Protection Services, *Passengers Exempt from the Passenger Movement Charge*, <http://www.customs.gov.au/webdata/resources/files/PMCExemptions-Final-March2009.pdf>, viewed 30 May 2012.

56 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 11.

57 Australian Government, *Budget Measures: Budget Paper No 2: Expense Measures No. 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 1.

58 The Hon Jason Clare MP, Minister for Home Affairs, *House of Representatives Hansard*, 23 May 2012, p. 13.

international visitor numbers.[59] Indeed, during a press conference, Mr John Lee, the CEO of Tourism and Transport Forum Australia (TTF), apologised to New Zealand visitors for the imposition of this cost. Mr Lee went on to argue:

> The PMC was introduced to cover the cost of passenger processing at Australia's international gateways and massively over-collects on that task. Delivering the Australian government around $300 million more each year than it spends on passenger processing.
>
> The rise – and the future indexation of the PMC to inflation – will give the government an extra $610 million over the next four year – all coming out of the pockets of tourists.[60]

1.96 In 2011 the STCRC undertook modelling to predict the impact of a 20 per cent rise in the PMC ($9.40 in current terms) on 'tourism output' and the economy more broadly.[61] The researchers looked at a range of economic indicators and reviewed the impost on foreign and domestic travellers. It was postulated that 'contrary to conventional wisdom' increasing the PMC would increase the gross national income by $49 million but decrease tourism output by $7 million.[62] It was conceded that the tourism industry could be negatively impacted particularly where it relied on international tourism. The study concluded that:

> ...the PMC works, in effect, as a transfer payment from tourism to non-tourism industries, as most of the total economic positive effects accrue to the non-tourism industries. This effect magnified as there is no tourism-specific use of the extra Government revenue benefit...[63]

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59 See for example: Travel Blackboard, 'Budget: Help or hinder for tourism industry', <http://www.etravelblackboard.com/article/131480/budget-help-or-hinder-for-tourism-industry>, viewed 30 May 2012; Lisa Allen, 'Shocked operators bag passenger charge hike', *The Australian*, <http://www.theaustralian.com.au/business/shocked-operators-bag-passenger-charge-hike/story-e6frg8zx-1226351431849>, viewed 30 May 2012.

60 Tourism and Transport Forum, *Australia to New Zealand: 'We're Sorry'*, 17 May 2012, <http://www.ttf.org.au/Content/mediareleases.aspx>, viewed 30 May 2012.

61 P Forsyth et al, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, Queensland, pp. 1-49.

62 P Forsyth et al, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, Queensland, p. 18.

63 P Forsyth et al, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, Queensland, p. 18.

1.97 The modelling assumed that no funds would be put back into promoting Australia's tourism sector. However, as discussed, the Government has committed to putting $61 million into promoting Australian tourism in Asia.

Key features of the Passenger Movement Charge Bill

1.98 Section 6 of the Bill repeals the PMC from $47 and substitutes $55 beginning 1 July 2012.[64] Subsection 6(1) states that a person pays the rate of PMC based on when they purchase a ticket, not when they actually travel. Subsections 6(2)(3) set out the formula to calculate the rate of PMC after 1 July 2013, rounded down to two decimal places (i.e. former rate of charge x indexation factor).

1.99 Section 7 ensures that the measures outlined above are consistently implemented for passengers not using a commercial ticket or equivalent authority.

1.100 Section 8 sets out the formula for determining the indexation factor.[65] Section 8(1) provides that the indexation factor is based on a comparison of the March indexation number for the year indexation occurs and the previous March quarter. The index number is the CPI number published by the Australian Statistician for the March quarter. If the indexation factor is less than or equal to 1, the rate of PMC will not change (Subsection 8(3)). The indexation factor is calculated in a method similar to other taxes and levies subject to indexation.[66]

1.101 An application provision provides that amendments outlined above can be applied after 1 July 2012, and it also ensure that persons who purchase tickets prior to this date do not pay the increase.

Objectives and scope of the inquiry

1.102 The objective of the inquiry is to investigate the adequacy of the Bills in achieving their policy objectives and, where possible, identify any unintended consequences.

1.103 In referring the Tax Laws Amendment (2012 Measures No. 2) Bill 2012, Income Tax (Managed Investment Trust Withholding Tax) Amendment

64 Explanatory Memorandum, Passenger Movement Charge Amendment Bill 2012, p. 5.
65 Explanatory Memorandum, Passenger Movement Charge Amendment Bill 2012, p. 6.
66 Explanatory Memorandum, Passenger Movement Charge Amendment Bill 2012, p. 7.

Bill 2012, and Pay As You Go Withholding Non-compliance Tax Bill 2012, the Selection Committee stated:

> REASONS FOR REFERRAL/PRINCIPAL ISSUES FOR CONSIDERATION: In relation to the managed investment trust withholding tax—doubling of tax, impact on investment in Australia, sovereign risk issues and impact on long term infrastructure investment. In relation to consolidation measures—retrospective application of tax charges.

1.104 In relation to the Passenger Movement Charge Amendment Bill 2012, the Selection Committee stated:

> REASONS FOR REFERRAL/PRINCIPAL ISSUES FOR CONSIDERATION: The government told the industry that they were not going to increase the passenger movement charge—the industry did not have an adequate consultation process prior to it being flagged. It will likely have an adverse effect on the tourism sector and would be worthwhile allowing stakeholders to have input.

Conduct of the inquiry

1.105 Details of the inquiry were placed on the committee's website. On 25 May 2012 the Committee Chair issued a media release announcing the inquiry and seeking submissions.

1.106 Thirty submissions were received on the various bills being considered. Submissions are listed in Appendix A.

1.107 A public hearing was held in Canberra on Monday 4 June 2012. A list of the witnesses who appeared at the hearing are available at Appendix B. The submissions and transcript of evidence are available on the committee's website at: www.aph.gov.au/economics.htm.

2

Issues in the Bills

Company directors and the superannuation guarantee

2.1 At the hearing, the Australian Institute of Company Directors (AICD) outlined its concerns with the provisions. The key issues are discussed below.

Restricting scope to phoenixing

Background

2.2 Currently, the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 and the Pay As You Go Withholding Non-compliance Tax Bill 2012 extend the existing penalty provisions of the PAYG Withholding Tax to the Super Guarantee, and strengthen the defense provisions for both. Director penalties were introduced in 1993 as a trade-off to removing the Australian Taxation Office (ATO) as a preferred creditor.[1]

2.3 The amendments do not distinguish between whether a company director is engaged in phoenixing or not. Broadly, a general liability is to be imposed on directors where the company involved fails to notify the ATO if it does not pay its employees' super in full.

2.4 The Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011 aimed to prevent directors from escaping their superannuation obligations. They worked the same way as the current Bills and in the previous inquiry industry

1 Ms Kate Preston, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 3.

expressed concern that they would affect 'all directors of all companies throughout Australia – over two million, in fact.'[2] In its 2011 advisory report, the committee noted that the Bills did not add to existing requirements, but instead applied a more effective penalty regime. However, given industry concerns, the committee recommended that the Government investigate whether it was possible to amend the Bills to better target phoenix activity.[3] Following further consultations, the Government did not amend the Bills in this regard.

2.5 Industry reiterated its preference for targeting phoenix operators in this inquiry. The Institute stated:

> ...the problem with this bill is it is not confined to fraudulent phoenix operators. By failing to define fraudulent phoenix activity, it instead targets all of Australia's 2.2 million directors including those who volunteer their time to work for charities and community organisations. Following submissions to this committee last year, it recommended the government investigate whether it was possible to amend the bills to better target phoenix activity. Yet the government has made virtually no attempt to target phoenix activity in revising the bill. We strongly recommend this bill not be passed until a definition of fraudulent phoenix activity is inserted and until it is amended so that the measures only apply when fraudulent phoenix activity is suspected.[4]

2.6 The Institute accepted that company directors should be responsible and accountable for the payment of their employees' superannuation. However, it did not accept that directors should be liable for it.[5]

Analysis

2.7 The committee notes that, in order for a company director to be subject to these provisions, there would need to be an ongoing period of non-compliance. The superannuation guarantee operates on a quarterly basis. If a company does not pay any superannuation during a January to March

2 Professor Bob Baxt AO, AICD, House of Representatives Standing Committee on Economics, *Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011,* November 2011, p. 26.

3 House of Representatives Standing Committee on Economics, *Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011,* November 2011, p. 27.

4 Mr John Colvin, AICD, *Committee Hansard,* Canberra, 4 June 2012, p. 2.

5 Mr John Colvin, AICD, *Committee Hansard,* Canberra, 4 June 2012, p. 11.

quarter, then this raises a superannuation guarantee shortfall. The company would be required to report this shortfall to the ATO by 28 May. If the shortfall is not reported by then the directors will be liable for director penalties for this amount from this date.[6]

2.8 Further, as Treasury advised the committee, the act of not reporting a shortfall is a key requirement for a director penalty:

> The aspect of the measure that does not allow a company to remit a penalty by liquidating or going into administration if a debt is three months old is targeting people who are trying to avoid detection, because those provisions only have application if the debt is unreported. The bill was never intended only to apply to phoenix operators; it could not, because it builds on existing law. It was intended to protect workers' entitlements and it does that.[7]

2.9 In other words, there must be an extended period of non-compliance for a director to be liable, not just in terms of not paying super, but also in terms of not communicating this fact to the ATO. The former may be restricted by a company's cash flow, but the latter only requires correspondence.

2.10 Witnesses at the hearing discussed how these provisions might operate in different sized companies. In larger companies, as the Institute stated, the directors would be less involved in the day to day running of the company and they would not have direct knowledge of whether super had been correctly paid. One effect of the provisions would be to push more superannuation-related information up to boards.[8] Treasury also noted that larger companies tend to have strong systems covering salaries and employee benefits. The real difference will occur in more closely held entities.[9]

Conclusion

2.11 The committee accepts that company directors have a large number of obligations and that this potentially adds to them. However, extended and consistent non-compliance is required before personal liability applies. Not only must super be unpaid, but the company must omit the simple step of reporting it to the ATO. This compares with the position of sole

6 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 16.

7 Ms Kate Preston, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 4.

8 Mr John Colvin, AICD, *Committee Hansard,* Canberra, 4 June 2012, pp. 9-10.

9 Ms Kate Preston, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 4.

traders who are already personally liable for non-payment of superannuation.[10]

2.12 The Committee questions whether it is practical to limit the Bills to cases where pheonixing is suspected, as requested by industry. Since pheonixing happens after the fact, it would place an unreasonable expection on the ATO to identify possible future breaches. It could be argued that it would add a layer of unfairness and considerable room for error. These amendments only apply where a company has consistently not met its obligations and failed to notify the ATO of this for several months and provides strengthened defence provisions for directors. The committee has come to the view that no amendments are required.

New directors

Background

2.13 Sections 269-15 and 269-20 of the *Taxation Administration Act 1953* provide that directors must cause a company to comply with an 'obligation' and that they are liable to pay a penalty 'at the end of the due day'. Someone who becomes a director after the due day adopts this obligation 14 days after they become a director.

2.14 The Bills extend this 14-day period for new directors to 30 days. This is a key difference from the package of Bills last year. It recognises that new company directors will have extra obligations in that they must turn their minds to the company's superannuation affairs, in addition to its tax affairs.[11] Importantly, this extension applies both to directors' tax and super obligations.

2.15 Despite accommodating the interests of directors, the Institute argued at the hearing that making a director liable for something that occurred before they were appointed was inherently unfair:

> No person in Australia in any occupation should commence a new job or a new position only to find that within 30 days they become personally liable for a breach that occurred before they commenced work in the role, which involve acts which they, by definition, cannot have taken part in and cannot be held culpable for. We are of the view that applying automatic liability on new

10 Mr Adam Craig, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 6.

11 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, pp. 14-15.

> directors for acts of the company which occurred before they were a director is particularly offensive to the rule of law. We recommend that a penalty regime not apply to directors unless they were a director at the time of the company's original breach and had some level of culpability in relation to the company's offence when it is confined to phoenix activity.[12]

Analysis

2.16 At first glance, there may be a question mark about making someone liable for something that they did not do, or did not omit to do. However, it is important to also ask the counterfactual question: 'What would happen if new directors were not made personally liable?' Treasury responded that unscrupulous operators could use a new director defence as a loophole against liability:

> That is already a characteristic of some phoenix operators. They will appoint a spouse or someone. In fact the ATO will point to instances where people have basically gone through the phone book and picked out names and listed those people as directors. Yes, if there were no penalty against new directors then that is exactly what could happen. You could just cycle through directors.[13]

2.17 In other words, allowing a new director to avoid liability for the superannuation guarantee charge simply because they are new would provide the sort of loophole that phoenix operators are adept at exploiting. What is important is that there must be some balance between the interests of new directors and employees' rights to their superannuation. The mechanism in the Bill to achieve this balance is extending the period of grace for new directors from 14 to 30 days.

Conclusion

2.18 It is appropriate to make new directors liable for the superannuation guarantee charge of a company where the super liability arose before they became a director. There are three reasons for this. Firstly, if they were not liable in some way, this would be an easily exploitable loophole for phoenix operators. Secondly, directors will have a longer, 30-day period of grace to ensure that either the super and tax affairs of a company are in

12 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 2.

13 Mr Adam Craig, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 11.

order, or advise the ATO of the liability, which would in practice lead to the ATO and the entity agreeing on a payment arrangement.

2.19 Finally, the position of a director of a company is different to that of an ordinary individual. A company is a legal device created to facilitate commerce through protecting investors with limited liability. In order to achieve this, directors must have high standards of ethics, skills and leadership. The committee fully supports legislation that requires these standards of directors when they join a company in relation to its employees' superannuation.

Not-for-profit organisations

Background

2.20 At the hearing, the Institute noted that not-for-profit organisations incorporated under the *Corporations Act 2001* would be affected by the provisions and that this would be very onerous on organisations that are run by volunteers.

> ... 11,700 companies limited by guarantee are in operation at the moment. I assume many of those would be charities, like the one I was on, for example, and that directors per this legislation—because it refers to Companies Act directors—would be picked up in that area...
>
> These guys are volunteers: would some of them have the capacity to sit down and work out all the problems they need to do? Would company directors have done a company directors course to work all this out? The answer is it would be a hard ask for these people.[14]

Analysis

2.21 The committee analysed this issue in its report last year. In particular, Treasury provided the committee with evidence that most not-for-profit organisations do not come under the *Corporations Act 2001*:

> Clubs and associations are commonly incorporated under the incorporated associations legislation in the various states and territories. As clubs, sporting associations and not-for-profits are generally not run as companies under the *Corporations Act 2001*,

14 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 12.

> the director penalty provisions and proposed changes will not alter their status, obligations or potential implications.[15]

2.22 This is confirmed by data published by the Australian Bureau of Statistics. In June 2007, there were 41,008 not-for-profit organisations in Australia.[16] According to the Institute's figures, up to approximately one quarter of these are companies limited by guarantee.

2.23 Further, it is well known that the compliance obligations for corporations under national law are more onerous than for state or territory-based associations. An example is the website advice given by the Queensland Council of Social Service:

> Generally speaking, the regime for incorporated associations under the Queensland Associations Incorporation Act is simpler and more straightforward than the regime for companies under the Commonwealth Corporations Act.
>
> Queensland's Associations Incorporation Act was specifically designed to provide a simple and inexpensive means of incorporating not-for-profit groups. It is likely that, with help from resources that explain the Associations Incorporation Act (ideally supported by a good operations manual), most people would be able to assist in the running of an effective association without specialist skills or training.
>
> In contrast, the Corporations Act is a much more complex, lengthy piece of legislation that governs both for-profit companies, as well as not-for-profit companies limited by guarantee.[17]

2.24 Therefore, it is reasonable to expect that the more volunteer-driven community groups would be incorporated under simpler state or territory legislation. Groups incorporated under the *Corporations Act 2001* would be used to a higher level of compliance and those incorporating under it have fair notice of the higher compliance costs involved.

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15 Treasury, *Submission 17,* p. 1, from the House of Representatives Standing Committee on Economics, Inquiry into the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011.

16 Australian Bureau of Statistics, Not-for-profit Organisations, Australia, 2006-07 (Re-issue), Cat. No. 8106, 'Overview,' <http://www.abs.gov.au/ausstats/abs@.nsf/ Products/8106.0~2006-07+(Re-Issue)~Main+Features~Overview?OpenDocument>, viewed 7 June 2012.

17 Queensland Council of Social Service, 'Incorporated association or a company limited by guarantee,' <http://www.communitydoor.org.au/incorporated-association-or-a-company-limited-by-guarantee>, viewed 7 June 2012.

Conclusion

2.25 The committee reiterates the comments that it made on this issue in its report on the 2011 phoenixing measures. It is concerned that there is significant confusion about the status and responsibility of directors and office holders in the voluntary and not-for-profit sectors, most of whom are governed by the less onerous requirements of state and territory associations legislation. Based on evidence to the committee and publicly available statistics, there is no reason to believe that the Bills have any negative implications for the sector.

Disputing an estimate

Background

2.26 The Bills apply the current estimates system to any unpaid superannuation guarantee amounts. The estimates system is designed to allow the ATO to take prompt action to recover amounts so that non-compliant entities do not escape their liabilities.

2.27 Under Division 268 of the *Taxation Administration Act 1953*, the Commissioner may estimate an unpaid and overdue amount of a liability. The Commissioner must estimate what is reasonable based on all relevant information and must give the taxpayer written notice of the estimate. A taxpayer can have an estimate reduced or revoked through information within an affidavit or statutory declaration provided to the Commissioner, within seven days, or longer if the Commissioner agrees to an extension. If the amount is not paid within seven days of the notice, then the general interest charge will apply to any remaining liability, dated from when the original liability arose.

2.28 At the hearing, the Institute expressed concern about how the estimates system would translate to the superannuation guarantee charge in practice, in particular that the seven day period may not be sufficient to collect the required information:

> My concern remains with this, essentially, around the whole estimates procedure and the capacity to issue an estimate. It may be that a particular former employee feels that the super obligations were not met and has a chat to the ATO, and the ATO issues an estimate. The estimate may be wrong. The employee's knowledge may be imperfect. There is not a lot of detail around

> the whole estimate procedure. I guess that is a concern. Once you kick off that estimate, it all rolls on...[18]
>
> If it is some years down the track, it is a question of assembling the information. Seven days is tight, it really is. People might have moved on and you do not have their latest address. I have certainly been involved in that. I know it is difficult, and seven days is just extraordinarily tight.[19]

Analysis

2.29 At the hearing, Treasury made two responses to this criticism. Firstly, it stated that the seven day period for estimates has applied to tax matters generally and that it has operated satisfactorily in a field more complex than superannuation:

> I would also like to say that it has been said that the estimates regime for pay-as-you-go withholding has been seven days since it has been in existence. I do not see what is more difficult about working out a superannuation guarantee obligation which is simply known—if you look at how much salary and wages have been paid, it is nine per cent. With pay-as-you-go withholding you have got marginal tax rates that differ from the level of salary paid to the employee. I think it would be harder to work out your pay-as-you-go withholding obligations. It has been seven days all along and it seems to be working.[20]

2.30 Treasury also suggested that, if a company is communicating and cooperating with the ATO, it would have the option of extending the seven day period for the taxpayer to provide the affidavit to the ATO. In fact, one of the key purposes of the director penalty regime is to encourage directors 'to enter into a conversation with the ATO.'[21]

2.31 The Institute made its own counter-arguments. In relation to Treasury's first point, it stated that although calculating a superannuation entitlement was simple, the question in many superannuation disputes was whether an individual was an employee or contractor.[22] Treasury responded that

18 Mr Shayne Carter, AICD, *Committee Hansard,* Canberra, 4 June 2012, pp. 6-7.

19 Mr Shayne Carter, AICD, *Committee Hansard,* Canberra, 4 June 2012, p. 8.

20 Mr Adam Craig, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 8.

21 Ms Kate Preston, Treasury, *Committee Hansard,* Canberra, 4 June 2012, pp. 8, 11.

22 Mr Shayne Carter, AICD, *Committee Hansard,* Canberra, 4 June 2012, p. 8.

directors were protected in this instance by the reasonable care and reasonably arguable defence.[23]

2.32 In relation to Treasury's second point, the Institute queried whether a taxpayer could or should rely on the goodwill of the Commissioner.[24] However, the Institute did not provide evidence to the committee that the ATO does not apply its discretion appropriately when considering whether to extend the seven day period for estimates. Rather, the committee is of the view that effective administration in agencies often depends on officials exercising their judgement. The committee also notes that the current ATO practice statement on enforcement measures for collecting liabilities requires ATO staff to cooperate with compliant taxpayers. Clause 26 states:

> The Commissioner will make an estimate and issue a notice in circumstances where there is reason to suspect that there is a liability to withhold and remit and where:
>
> - there is difficulty in establishing that liability expeditiously
> - there is reason to suspect that the debtor has reported less than the total amount of withholdings in a period
> - there is a history of a failure to notify liabilities as required by the law or a history of late payment and there is no reason or evidence to believe that a liability has not been incurred
> - attempts to establish debts are met with a lack of cooperation - for example, phone calls are not returned, or there is a refusal to provide details of amounts withheld when requested, or there are continuing delays or excuses for not making details available
> - the debtor refuses access to, or cooperation with, field officers
> - the debtor continually breaks appointments or refuses to meet with tax officers
> - the debtor claims that no amounts have been withheld but there is evidence to suggest that amounts have, in fact, been withheld...[25]

2.33 Clause 29 requires ATO staff to consider extensions of the seven day period when this will assist in determining the correct liability amount:

> The Commissioner only seeks to recover an amount equivalent to the underlying liability...Accordingly, in the interests of

23 Mr Adam Craig, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 8.

24 Mr Shayne Carter, AICD, *Committee Hansard,* Canberra, 4 June 2012, p. 8.

25 ATO, 'Practice Statement Law Administration PS LA 2011/18', 14 April 2011, <http://law.ato.gov.au/atolaw/view.htm?locid='PSR/PS201118/NAT/ATO'&PiT=99991231235958#P22>, viewed 8 June 2012.

ascertaining the correct amount of the liability, the Commissioner will consider a request to extend the time for lodgment of the statutory declaration where the debtor can satisfy the Commissioner that it cannot be completed or lodged within the required time.[26]

Conclusion

2.34 The estimate process is designed to allow the ATO to quickly recover liabilities where there is evidence that monies are at risk through non-compliance. It has been working effectively to date and the committee sees no additional risk in extending it to the superannuation guarantee charge. This is especially so, given ATO practice of cooperating with compliant taxpayers.

Consolidation and TOFA

2.35 The taxation of financial arrangements (TOFA) provides an overarching framework in relation to the taxation of financial arrangements. The emphasis of the arrangements is on economic considerations, rather than the prior tax law emphasis on legal form. The previous approach led to inconsistencies and layers of complexity.[27]

2.36 TOFA was introduced to reduce the influence of tax considerations on how financial arrangements are structured, emphasising other factors, such as risk, when making financing decisions.

2.37 Division 230 rules covering the tax treatment of gains and losses on financial arrangements were introduced in 2009, to apply generally from 1 July 2010. Taxpayers had the option to elect to 'ungrandfather' their existing financial arrangements, which involved bringing their existing financial arrangements into the new TOFA regime.

2.38 Taxpayers were required to elect to ungrandfather their financial arrangements on, or before, their first income tax return was due under

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26 ATO, 'Practice Statement Law Administration PS LA 2011/18', 14 April 2011, <http://law.ato.gov.au/atolaw/view.htm?locid='PSR/PS201118/NAT/ATO'&PiT=99991231235958#P22>, viewed 8 June 2012.

27 Australian Tax Office website, *Guide to the taxation of financial arrangements (TOFA) rules*, <http://www.ato.gov.au/businesses/content.aspx?doc=/content/00194622.htm&pc=001/003/109/001/002&mnu=0&mfp=&st=&cy= >, viewed 6 June 2012.

the Division 230 rules. The option to ungrandfather was intended as a compliance mechanism to enable taxpayers to apply a single set of rules.

2.39 At the time tax payers had to make a judgement about whether to ungrandfather their existing arrangements, taking into consideration how the adjustment arrangement under TOFA might affect them, in contrast to the ongoing administrative demands of separately assessing some arrangements that were subject to Division 230 and the prior financial arrangements that would have different requirements.

2.40 A number of submitters raised concerns about Schedule 2 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012.[28] The main issue considered during the inquiry was the retrospective application of the proposed provisions.

Retrospectivity

Background

2.41 The amendments proposed in Schedule 2 are to ensure that the tax treatment of the financial arrangements is consistent with the TOFA tax timing rules. This involves recognising gains and losses from financial arrangements on an accruals rather than realisation basis. These changes are intended to have retrospective effect from the commencement of the TOFA (Division 230) rules on 1 July 2010.

2.42 The Tax Institute acknowledged the logic of the amendments on a 'go-forward' basis,[29] but objected to the retrospective element of Schedules 2 and 3 of the Bill. It expressed concern that the retrospective application of some of the measures in Schedules 2 and 3 would be detrimental to certain taxpayers, and stated:

> ...while the circumstances for some parts of the legislation before us have been justified in terms of retrospective change and there are some minor elements, it is certainly not the case for the vast majority of the measures in this bill. It appears that the government has taken the opportunity to go far beyond those small measures where retrospective application is appropriate.

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28 The Tax Institute, *Submission 3*; Greenwoods & Freehills, *Submission 5*; and Deloitte Tax Services, *Submission 7*.

29 Mr Andrew Hirst, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 18.

> As I have discussed, the outcome will be the cause of significant commercial detriment for a large number of taxpayers.[30]

2.43 In evidence to the committee, the Tax Institute outlined what the proposed changes in Schedule 2 involved and how they could affect certain groups, stating:

> The issue really arises in relation to financial arrangements where you have a consolidated group...
>
> The announcement was made on 25 November 2011 and, in essence, it operates to effectively deem A Co. to have received an amount equal to the accounting value of that swap at the time when B Co. joined the group. So, in essence, it says, 'You're treated as effectively having received $100,' which means that if A Co. then closes out of that swap the next day and pays $100, A Co. will no longer get a deduction in relation to that.[31]

2.44 In particular, submitters expressed concern about the impact on groups who had chosen to ungrandfather their financial arrangements when they moved under the TOFA rules. The Tax Institute argued that:

> ...we are in a situation where if a taxpayer has made this compliance ungrandfathering election (1) they are in a worse position than taxpayers who are not subject to TOFA, because they still get the deduction, (2) they are in a worse position than taxpayers who are subject to TOFA but did not make this compliance ungrandfathering election, because they would still get the deduction because these provisions would not apply to their historic arrangements and (3) they are in a worse position than the other class of taxpayers who have been granted this further exception under the provisions.[32]

2.45 Certain classes of taxpayers, such as those who had received Australian Taxation Office (ATO) rulings would not be affected by the retrospective application of this schedule.

Analysis

2.46 At the public hearing on 4 June 2012, the committee and witnesses discussed the merits and drawbacks of retrospective legislation, generally, and specifically in relation to Schedule 2.

30 Mr Robert Jeremenko, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 16.

31 Mr Andrew Hirst, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 16.

32 Mr Andrew Hirst, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 17.

2.47 Treasury indicated that when the TOFA regime was introduced, the Government foreshadowed that 'as we identify unidentified issues or the law does not achieve its original policy intention, further refinements through retrospective legislation, might be necessary.'[33]

2.48 In relation to the effect of the Schedule 2 changes on particular taxpayers, Treasury clarified that:

> ...there could be assessable income and allowable deductions with respect to a liability. Normally people think about liability as only deductions. When it is related to an out-of-the-money swap, the market value can move in a positive direction, which gives you an assessable income, or it can move in a negative direction, which gives you an allowable deduction. So there could be gains and losses associated with a particular liability. I think Mr Hirst is talking about a deduction in relation to a liability. That is only true if, in the period that we are talking about, the market moved against this particular derivative. If the market moved for this derivative in the same period, you could have unrealised gains.[34]

2.49 Treasury noted that the ungrandfathering election was required to be made early in a taxpayer's move to the TOFA regime, to prevent taxpayers making a decision in hindsight as to which choice would provide a tax advantage.

2.50 Treasury indicated that the Schedule 2 measures were restoring the original intent of the TOFA rules, stating:

> ...in relation to the vast majority of TOFA taxpayers which have made the [ungrandfathering] election to match their tax with accounting—that is what we call the fair-value taxpayer, financial report taxpayer or foreign currency retranslation taxpayers—what is in schedule 2 was the original policy intention. So there was no policy shift with respect to those taxpayers, and that was clearly spelt out in the EM and in the following consultations. In one of the consultations, with the banking industry, we actually said at the consultation that making this transitional election could potentially wipe out your permanent differences between tax and accounting. Therefore it is a purely technical amendment for those taxpayers.[35]

33 Ms Nan Wang, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 17.

34 Ms Nan Wang, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 17.

35 Ms Nan Wang, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 19.

Conclusion

2.51 When the TOFA regime was introduced, the Government foreshadowed that retrospective changes to the law were possible to ensure that the TOFA regime achieves its policy intent.

2.52 The committee's view is that groups who chose to ungrandfather their financial arrangements will not be unfairly disadvantaged by the provisions in Schedule 2 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012. The decision for a group to ungrandfather its financial arrangements when moving into the TOFA regime in 2010 was never intended to be based on what would provide the taxpayer with a greater tax advantage. It was designed to simplify compliance.

2.53 The provisions in Schedule 2 restore the original policy intention for the interaction of consolidated groups and the TOFA rules in relation to the treatment of financial assets.

Consolidation

Retrospectivity

Background

2.54 Consolidation arrangements commenced in 2002. The consolidation regime allows the head company of a consolidated group to lodge tax returns on behalf of all the entities in the group. It was introduced to reduce tax compliance costs. However, deficiencies in the consolidation regime were identified in the years following its introduction. One area identified for improvement was in how the cost of an asset is recognised when acquired by a company.

2.55 Legislative changes in 2010 broadened the scope of the residual tax cost setting rule and introduced the rights to future income rule. This enabled consolidated groups to claim tax deductions in relation to these rules, effective from 2002.

2.56 The changes had a significant negative impact on revenue, which the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 seeks to address. Treasury explained to the committee that:

> ...[problems] started to emerge towards the end of 2010 when the tax office brought to our attention that significant claims were

> coming in. Early in 2011 the Board of Taxation raised concerns directly with the government that it thought that some activity that was happening was undesirable. That is what led the government to undertake the review and see if it could establish the concerns being raised.[36]

2.57 Schedule 3 of the Bill proposes to modify the consolidating tax cost setting and rights to future income rules so that the tax outcomes for consolidated groups are more consistent with the tax outcomes for non-consolidated groups when acquiring assets.

2.58 How the changes will affect consolidated groups will depend on when the asset was acquired. Schedule 3 proposes three distinct categories: pre-rules (prior to the announcement of the changes on 12 May 2010); interim rules (between 12 May 2010 and 30 March 2011); and prospective rules (after 30 March 2011).

2.59 The pre-rules are to restore the original tax cost setting rules that operated prior to the 2010 amendments. The rules will apply to acquisitions prior to 12 May 2010 (when Parliament passed the 2010 amendments). Schedule 3 also modifies the rules to:

- limit deductions for rights to future income to unbilled income assets;
- ensure that a deduction is allowed for the reset tax costs for consumable stores; and
- treat certain assets as goodwill.[37]

2.60 The interim rules restore the current 2010 residual tax setting and rights to future income rules and modifies the rules to:

- treat certain assets as goodwill;
- ensure that no value is attributed to certain contractual rights to future income; and
- ensure that the reset tax costs for consumable stores are deductible.[38]

2.61 The rules will apply broadly to the period between 12 May 2010 and 30 March 2011. These rules are designed to 'protect taxpayers who acted

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36 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 25.

37 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 105.

38 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 105.

on the basis of the current law before the Board of Taxation review was announced.'[39]

2.62 The prospective rules will apply generally after 30 March 2011, when the Government announced that it had asked the Board of Taxation to examine the rights to future income rules and the residual tax cost setting rules.

2.63 In evidence to the committee, Treasury explained the reason for the changes and how the different rules would apply:

> One of the issues that the Board of Taxation raised and was concerned about was that the 2010 amendments did bring in a specific deduction that was available only for consolidated groups. The board emphasised that, in its view, consolidated groups should only get deductions that are available for all other taxpayers. So, under both the pre rules and the interim rules, there still is a specific deduction that is available only for consolidated groups; but under the prospective rules that has been removed, so you revert to deductions that are available for other taxpayers.[40]

2.64 Submitters opposed the retrospective application of certain amendments contained in Schedule 3.[41] In evidence to the committee, the Tax Institute commented that:

> ...part of the proposed amendments in schedule 3 are quite appropriate in clarifying that certain items such as customer relationships would constitute goodwill and there would be no deduction in respect of those types of assets. Where I think it is not appropriate is going back some 10 or 12 years and denying deductions that taxpayers would have thought, or did think, were available given the combined effect of the December press release through to the amending law in 2010.[42]

2.65 Treasury noted that in a recent speech the Assistant Treasurer covered the issue of retrospectivity in tax law, stating:

> One of the things [the Assistant Treasurer] said was that beneficial retrospective tax changes that go too far carry with it the risk that

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39 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 103.

40 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 22.

41 The Tax Institute, *Submission 3*; TPG Telecom, *Submission 4*; Greenwoods & Freehills, *Submission 6*; Deloitte Tax Services, *Submission 7*; and Ernst & Young, *Submission 8*.

42 Mr Peter Murray, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 20.

> the government will need to subsequently introduce adverse retrospective tax changes. The consolidation measures are a good example of this. The key reason why the amendments announced in 2011 needed to be retrospective was that the beneficial 2010 amendments were also retrospective to 2002.[43]

2.66 Treasury maintained that the pre-rules and interims rules in Schedule 3 must be retrospective, as they are 'taking away the unexpected and unintended retrospective benefits of the 2010 changes to law and is necessary to protect a very significant amount of revenue that is otherwise at risk.'[44] Treasury estimate the revenue risk to be in the order of $6 billion, based on claims from around 60 large consolidated groups.

Analysis

2.67 At the public hearing participants acknowledged that the 2010 changes had significant revenue impact that had not been anticipated by the Government or industry, with the nature of certain claims not envisaged in 2010.[45]

2.68 In discussion with the committee, Treasury advised that the retrospective nature of the pre-rules was necessary to address the significant impact on revenue. Treasury stated:

> ...the primary reason for introducing the pre-rules...is to protect the significant amount of revenue that would otherwise be at risk because people are able to take advantage of the retrospective changes that were made in 2010 in an unexpected way. We are talking about revenue in the order of $6 billion, so it is very significant.[46]

2.69 The Tax Institute argued that the interim rules in Schedule 3 go beyond protecting taxpayers and have 'taken away deductions in respect of customer contracts.'[47]

2.70 However, Treasury maintained that the modifications are 'largely consistent with recommendations that were made by the Board of Taxation to clarify those rules for that period.'[48]

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43 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 28.

44 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 25.

45 Discussed in *Committee Hansard*, Canberra, 4 June 2012, p. 21.

46 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 21

47 Mr Peter Murray, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 21.

48 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 21.

2.71 The Tax Institute expressed concern about the date from which the prospective rules will apply. It proposed that a more appropriate date for the prospective rules to take effect was 25 November 2011, when the intended changes were announced. It argued that, although from 30 March 2011 it was known that the Board of Taxation was investigating these matters, the resulting prospective changes were not known.[49]

2.72 Treasury indicated that the prospective rules apply 'from the date that the government said it would review the operation of the rules.' Treasury also noted that the modifications are 'to a large degree' consistent with some of the Board of Taxation recommendations, with refinements made when developing the proposed changes.[50]

2.73 Treasury acknowledged that some of the changes in the Bill go beyond what was contemplated in 2010. The prospective rules propose 'fundamental changes' to address the problems that emerged following the 2010 amendments. Treasury stated:

> One of the key problems from the 2010 amendments is that, with this consolidation tax costing process, some taxpayers revisited the assets that they were identifying for consolidation purposes. They started in particular to identify a range of intangible type assets, which are not generally recognised under the tax system. The difficulty with that is that, where such assets are not recognised under the tax system, they get allocated a cost. Taxpayers reasonably seek to find a way to deduct that cost. Under the prospective changes a key change is that under consolidation you only recognise assets are those that are ordinarily seen by the tax system and therefore there will be a way to deal with them. That is where they differ.[51]

2.74 Consolidated groups that have already made a claim and received a tax refund, or have an ATO ruling, will generally be protected from the retrospective changes in the pre-rules and interim rules. Treasury confirmed at the hearing that taxpayers who 'have received money from the ATO...will essentially be protected from the changes, except in a very unusual circumstance.'[52]

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49 Mr Peter Murray, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, p. 21.
50 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 21.
51 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 24.
52 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 26.

2.75 The retrospective changes are to address the $6 billion revenue risk. No significant revenue impact is expected for the prospective changes. Treasury stated that:

> ...under consolidation you go through an exercise of resetting the tax costs of assets. To do that you work out the allocable cost amount. In the basic case, the allocable cost amount is the cost of buying a joining entity's shares plus the value of the joining entity's liabilities...The amount that is allocated is not changing. Certainly the assets which it gets allocated to is changing, but the amount that is being allocated is not changing, so the view is that there is not going to be a significant revenue impact as a result of that.[53]

Conclusion

2.76 The amendments in 2010 were intended to clarify the reset tax costs of certain assets and tax outcomes for rights to future income assets. However, they provided a windfall through tax deductions for some consolidated groups. These deductions were not available to non-consolidated groups. It was not the intention of the Bills to introduce inconsistency in tax treatment.

2.77 The 2010 changes were retrospective to the 2002 commencement of the consolidation regime, as they were thought to give effect to the original policy intent. Once implemented it became clear that the changes went beyond what had been foreshadowed and had significant negative revenue implications. The nature of claims for tax deductions subsequently made by consolidated groups had not been anticipated by the Government or industry.

2.78 Schedule 3 of the Tax Laws Amendment (2010 Measures No. 2) Bill 2012 will clarify the arrangements in relation to the tax cost setting and rights to future incomes rules.

2.79 The three categories of rules (pre, interim and prospective) provide a measured application of the changes to take into account what taxpayers could reasonably have known or expected the rules to be at the relevant time. There are protections for groups who have already received tax refunds or ATO rulings.

2.80 These changes are necessary to address the $6 billion revenue risk, clarify these arrangements and provide greater certainty for consolidated groups.

53 Mr Anthony Regan, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 25.

The retrospective application of the pre-rules and interim rules are appropriate to counteract effects of the 2010 changes, which were also retrospective. Schedule 3 will restore the policy intent of consolidation and clarify future arrangements.

Managed investment trust final withholding tax

2.81 The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012 increases the managed investment trust (MIT) final withholding tax on foreign investors from 7.5 per cent to 15 per cent. The tax will apply on fund payments made in relation to income years that commence on or after 1 July 2012. Over the forward estimates this measure is estimated to have a gain to revenue of $260 million.[54]

Grandfathering

Background

2.82 Industry has questioned both the substance of the Bill as well as the manner of its introduction. Industry and investors argue that they were taken by surprise, particularly given that recent government policy has seen a lowering of the tax rate since 2008.

2.83 Several MIT bodies have criticised the move to double the tax rate without clear price signalling. Infrastructure Partnerships Australia (IPA) argued:

> The 7.5 per cent rate was an incentive to attract investment into Australia, and protection must now be given to investors who, in good faith, relied on the expectation of that reduced rate going forward over the term of their investment.[55]

2.84 Industry groups broadly oppose the measure outright. However, if the tax increase is to proceed, they have suggested several measures the most prominent being the proposed grandfathering of the 7.5 per cent rate for investments made on the expectation that this rate would continue.[56]

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54 Explanatory Memorandum, Tax Laws Amendment (2012 Measures No. 2) Bill 2012; Pay As You Go Withholding Non-compliance Tax Bill 2012; Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, p. 133.

55 Infrastructure Partnerships (IPA), *Submission 10*, p. 3.

56 Mr Martin Codina, Financial Services Council (FSC), *Committee Hansard*, Canberra, 4 June 2012, p. 34.

Analysis

2.85 At the hearing, participants discussed the recommendation presented by industry groups that the current 7.5 per cent tax rate be grandfathered for investments made on the assumption that this rate would continue. This rate has been applied to distributions to foreign investors since the 2010-11 income year. However, Treasury responded by noting the complexity and impractical nature of such a move:

> Who are you effectively giving that grandfathering to and why? That becomes quite an interesting and complex question. Are you looking at just people who have invested since 1 July 2010 or are you looking more broadly than that? Are you looking at assets that came into existence after that time or at all assets? Those are some of the sorts of questions that would need to be considered.[57]

Conclusion

2.86 Creating grandfathering arrangements for investors at the 7.5 per cent tax rate is likely to be unwieldy in its implementation. It would also leave a difficult precedent that individuals and business should expect to get grandfathered rates on changes made to other kinds of tax rates in the future.

Investor confidence

Background

2.87 Industry warned that the unexpected increase in the withholding tax rate has the potential to damage foreign investor confidence and Australia's reputation as a secure and stable investment destination. AMP in their submission argued:

> The suddenness of the announcement without consultation or discussion with industry created unease within the international investment community as to whether further changes could arise that would fundamentally change the nature of investment in Australia.[58]

2.88 Testimony was given at the hearing that the proposed tax increase has already resulted in capital flight by foreign investors and will significantly decrease the incentive for foreign capital investments in Australia in the

57 Mr Anthony McDonald, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 35.

58 AMP, *Submission 13*, p. 1.

future. For this reason both the Property Council of Australia (PCA) and the Financial Services Council (FSA) questioned the accuracy of the assumed revenue flows from the increase as they predict reduced foreign investment.[59]

Analysis

2.89 Treasury responded that the potential for reputational damage to Australia as a safe investment destination must be seen in the broader context of the Australian economy. The Government has prioritised fiscal consolidation in the context of reduced revenue in order to improve budget sustainability.

> In the course of doing that, the government has reached the view that that 7½ per cent rate for managed investment trusts for non-residents was something that was not consistent with that broader sustainability in achieving the medium-term fiscal strategy, which...is a very important part of our AAA credit rating.[60]

2.90 Treasury argue that given these circumstances:

> By setting out a clear path for a sustainable medium-term fiscal strategy, my proposition would be that that would enhance, rather than reduce, foreign investors' confidence in the policy framework in Australia.[61]

2.91 Furthermore, prior to the measures announced in the 2008-09 budget, the MIT withholding tax was at the company tax baseline of 30 per cent. This is because investments made through MITs are in equity and taxes are paid on income comparable to the company tax paid on profits. The MIT withholding tax is not comparable to taxes paid on interest earned from 'debt' investments. Treasury pointed out that the 15 per cent rate is still concessional when compared to the company tax rate of 30 per cent.[62]

Conclusion

2.92 The increase to the MIT withholding tax to 15 per cent maintains the original policy intent of the promise to lower the withholding tax. It maintains a concessional rate to attract investors when compared to the

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59 Mr Verwer, Property Council of Australia (PCA), *Committee Hansard,* Canberra, 4 June 2012, p. 30.

60 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 30.

61 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 31.

62 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 39.

company tax rate of 30 per cent, while balancing this with the need to create and maintain budget sustainability.

Revenue forward estimates

Background

2.93 At the hearing, industry groups queried the method used by Treasury to determine the expected gain to revenue of $260 million over the forward estimates. They argued that the increase in the tax rate would lead to capital flight and a decrease to potential revenue.[63]

Analysis

2.94 Treasury explained that the approach used to calculate the effect of this budget measure was the same 'adopted by successive governments and set out in relation to the Charter of Budget Honesty'.[64] This approach takes into account the immediate 'first-round' implications of the policy but not potential 'second-round' flow on effects. These are not straightforward to predict and need to take into account effects across the economy rather than just those immediate to the industry. To constitute a meaningful analysis one would also need to model the effect on the economy of alternative savings in the budget if the cuts were not made in this sector.[65]

2.95 In general Treasury has found that while there may be implications of 'second-round' effects to an individual sector, these tend to balance out through the economy as a whole.[66]

2.96 While it was recognised that the impact of the tax increase may make some investments less attractive to some investors and negatively affect some MITs, Treasury stated that movement by investors will not necessarily result in a reduction of capital in the economy overall:

> ...if we are looking at financial flows there would be a greater reduction in the flows that occur through managed investment trusts but what we are interested in is what happens to the aggregate base and that is a different thing.[67]

63 Mr Peter Verwer, PCA, *Committee Hansard,* Canberra, 4 June 2012, p. 30.
64 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 31.
65 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 31.
66 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 40.
67 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 40.

2.97 Treasury also argued that tax revenue gives benefits to all Australians through government spending:

> GDP does not necessarily directly relate to the wellbeing of Australians. It relates closely but not perfectly. One of the things we do think about is, 'How does that increase production and benefit the Australian economy as a whole?' One of the important ways in which that is done is through an appropriate sharing in the proceeds and the profits from those ventures through the tax system.[68]

Conclusion

2.98 Treasury have calculated the expected revenue from this measure through the forward estimates using the accepted approach adopted by previous governments and set out in the Charter of Budget Honesty.

2.99 While the Committee recognises that the increase to the tax rate has the potential to make certain other investment opportunities more attractive to some investors, concessions to support any one industry has to be balanced with ensuring that the wider Australian population also benefits by obtaining a fare share through the tax system. This measure does this by providing an increase that is still concessional and well below the previous 30 per cent rate.

Effective tax rate

Background

2.100 Finally, some stakeholders are concerned that the MIT Withholding tax as a final withholding tax does not allow investors to make deductions or allowances for their outgoings. The issue is that the final nature of the tax means that some investors' Australian tax will be higher than before the MIT final withholding tax was introduced in 2008.[69] While the headline tax rate puts us in the middle of like nations, industry is concerned that the effective tax rate, particularly in light of the tax's final nature, is actually much higher when compared with other effective tax rates around the globe.

68 Mr Anthony McDonald, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 40.

69 Ernst and Young, *Submission 14*, p. 1.

Analysis

2.101 Treasury pointed out that, as recently as 2007, the FSC supported a final withholding tax, even at a rate of 15 per cent, because it relieves foreign investors of the burden of lodging a tax return.[70] Treasury also noted that 'in many cases, the tax that is paid in Australia is able to be credited in the other country.'[71] This means that it is difficult to do a meaningful comparison of effective tax rates around the world as the tax laws within the investor's home jurisdiction must also be taken into account.

2.102 Treasury reiterated that the headline tax rate at 15 per cent is 'broadly in line with other advanced economies' and 'somewhat lower than other rates in the region.'[72]

Conclusion

2.103 Stakeholders have been supportive of having a final withholding tax at a 15 per cent rate in the past. While it is understandable that industry would prefer to keep the tax rate as low as possible, the final nature of the tax was specifically sought by them to provide a simpler tax system for foreign investors. Australia will remain competitive in the region and with like countries around the world at the increased tax rate of 15 per cent.

Passenger Movement Charge Amendment Bill 2012

Background

2.104 The Passenger Movement Charge Amendment Bill 2012 (the Bill) will increase the Passenger Movement Charge (PMC) from $47 to $55 per person from 1 July 2012 and enable automatic indexation, based on the Consumer Price Index, from 1 July 2013.[73] Over the forward estimates the measure will deliver an additional $610 million.[74]

2.105 The Committee heard from a range of industry bodies about the difficulties currently faced by the tourism sector. These included global economic instability, the high Australian dollar and high fuel costs. It was

70 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 34.

71 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 32.

72 Mr Anthony McDonald, Treasury, *Committee Hansard,* Canberra, 4 June 2012, p. 31.

73 Explanatory Memorandum, Passenger Movement Charge Amendment Bill 2012, p. 5.

74 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 11.

posited that the Government was over-collecting on the PMC for consolidated revenue and not sufficiently supporting the needs of the tourism industry. Industry witnesses did not support the $8 increase to the PMC nor its indexation.[75] The Australian Airport Association told the Committee:

> If nothing else, we beg that the indexation be removed. If you look at the past budgeted amounts for the passenger movement charge versus what has come in, it is quite cyclical; it goes up and down. Let us not lock ourselves into indexation. Let us see how the tourism industry goes. We are struggling in regional areas in particular.[76]

2.106 The Government has allocated $61 million of the monies raised by the PMC to the Asia Marketing Fund.[77] This initiative will further the Government's 2020 Tourism strategy. In addition, the Government will continue to support a range of initiatives which underpin and promote the visitor economy, including $40 million over four years to the T-QUAL Grants project, infrastructure upgrades, rolling out the NBN which will improve the industry's digital capabilities, and funding national cultural and natural heritage attractions.[78]

Analysis

2.107 The Committee was presented with a range of impacts associated with increasing the PMC, and its indexation. These included:

- decreasing Australia's competitiveness in the global tourism market;[79]
- the PMC being a poorly designed 'tourism tax';[80]
- the PMC over-collects from the tourism sector for general consolidated revenue without sufficient monies being returned to passenger

75 Ms Caroline Wilkie, Australian Airport Association, *Committee Hansard*, 4 June 2012, p. 44.

76 Ms Caroline Wilkie, Australian Airport Association, *Committee Hansard,* 4 June 2012, p. 44.

77 Australian Government, *Budget Measures: Budget Paper No 2: 2012-13*, Commonwealth of Australia, Canberra, 2012, p. 11.

78 Tourism Australia, *2020 Tourism: Overview*, <http://www.tourism.australia.com/en-au/documents/Corporate%20-%20Research/Tourism_2020_overview.pdf>, viewed 6 June 2012; Department of Resources, Energy and Tourism, *T-QUAL Grants – Tourism Quality Projects: Fact Sheet*, Commonwealth of Australia, Canberra, 2012, p. 1.

79 Ms Juliana Payne, National Tourism Alliance, *Committee Hansard*, 4 June 2012, p. 43.

80 Accommodation Association of Australia, *Submission 19*, p. 5; Tourism and Transport Forum, *Submission 20*, p. 4.

facilitation or border agencies such as customs and border protection, quarantine and immigration;[81]

- further disadvantaging a sector that is struggling in Australia's 'two-speed' economy, particularly in regional areas;[82] and
- being a particular disincentive for the short-haul market from Asia and New Zealand.[83]

2.108 The global financial crisis has resulted in a $150 billion write-down in government revenue since the 2008-09 budget.[84] However, the Government has taken measures to ensure Australia retains its AAA credit rating, while meeting its policy priorities. Despite this difficult fiscal backdrop the Government has remained committed to the Tourism 2020 initiative.[85] Tourism 2020 is a whole-of-government and industry strategy which will grow tourism in Australia. Its six key areas are:

- grow demand from Asia;
- build competitive digital capability;
- encourage investment and implement regulatory reform agenda;
- ensure tourism transport environment supports growth;
- increase supply of labour, skills and indigenous participation; and
- build industry resilience, productivity and quality. [86]

2.109 The proposed Asia Marketing Fund will directly contribute to realising the Tourism 2020 strategy. In addition the Government will continue to assist the tourism sector both directly, by funding projects like T-QUAL, and indirectly, by funding infrastructure upgrades to roads, public transport

81 Ms Caroline Wilkie, Australian Airport Association, *Committee Hansard*, 4 June 2012, p. 43; Mr John King, Australian Tourism Export Council, *Committee Hansard*, 4 June 2012, p. 46; Tourism and Transport Forum, *Submission 20*, p. 1; Melbourne Airport, *Submission 16*, p. 2, 9.

82 Mr John Lee, Tourism and Transport Forum, *Committee Hansard*, 4 June 2012, p. 44; Cairns Airport, *Submission 15*, p. 1.

83 Mr John Lee, Tourism and Transport Forum, *Committee Hansard*, 4 June 2012, p. 45; Qantas, *Submission 22*, p. 2.

84 Mr Tony McDonald, Treasury, *Committee Hansard*, Canberra, 4 June 2012, p. 30.

85 Tourism Australia, *Tourism 2020*, < http://www.tourism.australia.com/en-au/default_6111.aspx>, viewed 5 June 2012.

86 Tourism Australia, *Tourism 2020*, <http://www.tourism.australia.com/en-au/default_6111.aspx>, viewed 5 June 2012.

and the NBN.[87] It will also continue to fund Australia's world class cultural institutions and national parks.

2.110 As discussed in chapter one, the Sustainable Tourism Cooperative Research Centre modelled the impact of a 20 per cent rise in the PMC ($9.40 in current terms) on 'tourism output' and the economy more broadly.[88] It was postulated that 'contrary to conventional wisdom' increasing the PMC would increase the gross national income by $49 million but decrease tourism output by $7 million.[89]

2.111 It is acknowledged by the committee that the tourism sector is experiencing difficult economic times. The high Australian dollar, fuel prices and global instability have all impacted on the industry. Recent, data from Tourism Australia contained some positive news for the tourism sector:

- There were 5.9 million visitor arrivals for year ending March 2012, an increase of 1.0 per cent relative to the previous year.
- There were 1.6 million visitor arrivals to Australia during the three months to March 2012, an increase of 4.1 per cent relative to the same period of the previous year.
- There were 544,200 visitor arrivals during March 2012, an increase of 8.6 per cent relative to the same month of the previous year.[90]

Conclusion

2.112 The PMC has not been increased since 2008 and an $8 increase to the PMC is considered a small amount in the context of international travel. The Government remains committed to supporting and growing the tourism sector in Australia. Ten per cent of the additional revenue raised as a result of the increase will be dedicated to the Asia Marketing Fund on an ongoing basis. More generally, it will support the operations of Customs and Border Security and continue to invest in other Government priorities

87 Australian Government, *Budget and Additional Estimate Statements 2012-13: Department of Resources, Energy and Tourism*, Commonwealth of Australia, Canberra, 2012, pp. 49-57. Department of Resources, Energy and Tourism, *T-QUAL Grants – Tourism Quality Projects: Fact Sheet*, Commonwealth of Australia, Canberra, 2012, p. 1.

88 P Forsyth et al, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, Queensland, pp. 1-49.

89 P Forsyth et al, *The Impacts of the Passenger Movement Charge on Tourism Output and the Economy*, 15 March 2011, Sustainable Tourism CRC – The Centre for Economics and Policy, Queensland, p. 18.

90 Tourism Australia, *Visitor Arrivals Data*, <http://www.tourism.australia.com/en-au/research/5236_6469.aspx>, viewed 5 June 2012.

including upgrading infrastructure and supporting public institutions. It is the Committee's recommendation that the Passenger Movement Charge Amendment Bill 2012 be passed by the House unamended.

Overall conclusion

2.113 The Bills make a number of significant improvements to the tax laws. Schedule 1 of the Tax Laws Amendment (2012 Measures No. 2) Bill 2012 and the Pay As You Go Withholding Non-compliance Tax Bill 2012 seek to make directors personally liable for the superannuation guarantee charge of their company. This will prevent unscrupulous directors from phoenixing their businesses to avoid their super responsibilities. This practice has cost Australian employees hundreds of millions of dollars in lost superannuation and the committee commends both the intent and the operation of the Bills in this regard.

2.114 Last year, the committee inquired into a package of Bills in similar terms. The committee recommended that the Government should investigate whether additional defences for directors should be inserted in the Bills. This has occurred. If passed, the legislation will give new directors 30 days, up from the current 14 days, to conduct due diligence before adopting a company's pre-existing obligations. Directors will also not be liable for a director penalty where they took reasonable care in a matter and applied the super legislation in a reasonable way.

2.115 The committee also recommended that the Government should investigate whether the provisions should only apply if an individual has been engaged in phoenixing. The Bills do not have this feature and industry argued that they should be amended along these lines. Ultimately, the committee has come to the view that such a change is not warranted because the provisions will only apply when a company has not only failed to pay a super amount, but that it has failed to notify the ATO of this two months after the event. The high level of non-compliance required to trigger the provisions will protect directors and companies who do the right thing.

2.116 Schedule 2 of the main Bill is designed to ensure that the tax treatment of financial arrangements is consistent with the TOFA tax timing rules. The provisions are to be retrospective from the commencement of other TOFA amendments on 1 July 2010 and this retrospectivity was the key issue in the inquiry. Stakeholders expressed concern that taxpayers who had chosen to adopt the new TOFA rules (rather than elect to keep prior arrangements) would be disadvantaged. However, the committee did not accept this because the measures restore the original policy intent and the Government had previously flagged that retrospectivity will be necessary with TOFA to restore the policy intent from time to time.

2.117 Schedule 3 aims to protect a $6 billion revenue risk that has arisen as a result of retrospective amendments in 2010 in relation to consolidation rules. These changes allowed consolidated groups to claim deductions back to 2002 in relation to the residual tax cost setting rule and the rights to future income rule. In 2011, revenue problems with the 2010 changes became apparent and the Board of Taxation conducted an inquiry into the matter. The Bill largely reflects the Board's report. Groups that have already received a refund or have an ATO ruling will generally be protected from the retrospective changes. Given the transparency of the process and the amount of revenue at stake, the committee again agrees that retrospective legislation is appropriate.

2.118 The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012 and Schedule 4 of the main Bill increase the tax rate on managed investment trusts for foreign investors from 7.5 per cent to 15 per cent. This is a partial reversal of the recent decreases on this tax rate from 30 per cent a few years ago. The committee is mindful that, as equity investments, the correct comparative rate is the company tax rate, currently set at 30 per cent. Although the industry sector was concerned about how the change would affect it, the committee supports the provisions because of the wider macroeconomic importance of Australia having a sound fiscal strategy, which an important driver for the whole economy.

2.119 The Passenger Movement Charge Amendment Bill 2012 increases the charge from $47 to $55 from 1 July 2012 and indexes it to the CPI. Similar to the MIT provisions, the issues revolved around an industry sector being concerned about how it would be affected by a revenue increase. Once again, however, the committee supports the provisions on a national basis because of the Government's overall fiscal strategy. The committee notes that the Government remains committed to the Tourism 2020 initiative and continues to support the industry through programs such as T-QUAL, infrastructure upgrades and maintaining and expanding tourism attractions.

2.120 The Bills represent a responsible package aimed at securing a sustainable revenue base for Australia, as well as protecting the superannuation entitlements of Australian workers. The Bills should pass.

Recommendation 1

2.121 **That the House of Representatives pass the Tax Laws Amendment (2012 Measures No. 2) Bill 2012, Pay As You Go Withholding Non-compliance Tax Bill 2012, Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, and the Passenger Movement Charge Amendment Bill 2012, as proposed.**

Julie Owens MP
Chair
15 June 2012

Dissenting Report

Company directors

Introduction

The Tax Laws Amendment (2012 Measures No. 2) Bill 2012 and the Pay As You Go Withholding Non-compliance Tax Bill 2012 (the "PAYG Bill"), amend the Taxation Administration Act 1953 and four other Acts to extend director penalties so that directors are personally liable for a wide range of company guarantees in relation to superannuation and pay as you go (PAYG) tax withholding: even if a company is placed into administration or liquidation. The Liberal members of the Committee are concerned that the Government has not adequately addressed bi-partisan concerns previously raised during the last inquiry into the measures.

Importantly, the Bill has failed to appropriately target 'phoenix' activity, and concerns liability would apply indiscriminately to all directors, including those of charities and not-for-profits that are limited by guarantee – as many are. Some 11,700[1] companies in Australia are limited by guarantee, and it is typical of this Labor Government to saddle directors of those companies, even those where there is no illegitimate activity, with undue liability.

Questions were also raised about whether directors of a company may be liable to pay these measures if they join a board after the fact. They were not adequately answered. It is repugnant to not only the rule of law and processes of natural justice, but also (in assigning all directors indiscriminate liability) the history of company law and the legal principle of *persona ficta*. Finally, the Australian Institute of Company Directors, and many other stakeholders contend (and the

1 Mr John Colvin, AICD, Committee Hansard, Canberra, 4 June 2012, p. 2.

Liberal members of the Committee concur) that phoenix activity is not appropriately defined in the Bill.

The Consolidation Tax Cost Setting Arrangements and Related Taxation of Financial Arrangements (the "Consolidation and Arrangement changes") are retrospective tax changes. The Liberal Members of this committee are fundamentally opposed to *postfactum* law, especially taxation legislation. This Government has failed, both to the public, and to the Liberal Members of this Committee, to justify the retrospective aspect of this legislation.

Similar issues arise in The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012 (the "MIT Bill") which amends the Income Tax (Managed Investment Trust Withholding Tax) Act 2008 to increase the managed investment trust (MIT) final withholding tax from 7.5 per cent to 15 per cent. Both the investments made, especially in infrastructure, and the reputation of Australia as a safe and stable place to will now be placed at risk because of the vacillation of the Government.

Taxpayers who made sound effort to comply with the prevailing law as it was when they entered into financial agreements are particularly affected. In submissions made to the Committee, there were instances of entities that, with these changes in place, may not have entered into the financial agreements outlined. Fundamentally, it is a function of the mismanagement and incompetence of the Government, and only serves to encourage the lack of certainty that already plagues public confidence.

The Passenger Movement Charge Amendment Bill 2012 increases the passenger movement charge (PMC) from $47 to $55 from 1 July this year; and indexes the charge to the Consumer Price Index (CPI) from 1 July next year. The rise is simply a revenue raising measure by the government, and presents an enormous cost to the tourism sector, not only directly, but also in the competitive disadvantage it presents.

The Liberal members of the committee have taken the opportunity to highlight in this dissenting report a number of serious concerns with the bills and, based on the reasons outlined, recommend they not be passed in their current form.

Indiscriminate liability

The Liberal members of the Committee hold the view adding indiscriminate liability to all of Australia's directors presents a considerable burden to business. These measures include: making directors personally liable for unpaid superannuation; extending director penalties that cannot be discharged by placing a company into administration; and making directors and associates liable for PAYG withholding non-compliance tax where a company has failed to pay.

The government has not adequately addressed the bi-partisan concerns of the House Economics Committee inquiry into the Government's previous attempt at legislating this measure. Particularly Mr John Colvin of the Australian Institute of Company Directors noted that:

> We are disappointed that since the last time the Australian Institute of Company Directors appeared before the committee on the same issue, the government has not made significant changes to the original bill, nor has it picked up all of the recommendations of this committee, particularly the phoenixing recommendation.[2]

It is telling that the Government ignored stakeholder concerns, in pursuit of its own political agenda, and now refuses to change the legislation.

Because the measures intended to address phoenix activity have not appropriately targeted that activity, the liability would indiscriminately apply to all directors across the board. It is, unfortunately, typical of this Government to both burden all directors with liability regardless of their guilt, by improperly defining the activity that would appropriate it.

> …as we have said on numerous occasions, the problem with this bill is it is not confined to fraudulent phoenix operators. By failing to define fraudulent phoenix activity, it instead targets all of Australia's 2.2 million directors including those who volunteer their time to work for charities and community organisations. Following submissions to this committee last year, it recommended the government investigate whether it was possible to amend the bills to better target phoenix activity. Yet the government has made virtually no attempt to target phoenix activity in revising the bill.[3]

This indiscriminate proportioning of liability, and indeed the possibility of holding new directors liable, after the fact, is repugnant. This automatic liability is a perturbing move by the government if intentional, and if accidental, a glaring error.

> …[It] is particularly disappointing that this bill fails to uphold the principles of the rule of law by making new directors liable for a company's breach which occurred before they were a director. I find it strange that on the way to this committee we walked past the Magna Carta, which is regarded as one of the great documents of a democratic society and which was founded on the basis that the rule of law is fundamental to any civilised society. No person

2 Mr John Colvin, AICD, Committee Hansard, Canberra, 4 June 2012, p. 46.

3 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 2.

> in Australia in any occupation should commence a new job or a new position only to find that within 30 days they become personally liable for a breach that occurred before they commenced work in the role, which involve acts which they, by definition, cannot have taken part in and cannot be held culpable for. We are of the view that applying automatic liability on new directors for acts of the company which occurred before they were a director is particularly offensive to the rule of law.[4]

Inherent in this proposition of automatic liability on new directors, is the dissuasion it presents when being appointed to a board under this regime. Recruiting highly skilled directors is internationally competitive, and with these arduous provisions, Australia will come-off second best.

Liberal Members of the Committee are concerned about phoenixing activity and recognise the need for legislative safeguards. The key issue is the manner in which protective action can be undertaken which is specifically directed and focused on phoenix activity, rather than broad-based and non-targeted. The Government's current Bill continues to be flawed in this regard.

Significant regulatory compliance cost

In saddling corporate Australia with red and green tape, this Government is strangling productivity, at a time when other nations are encouraging it. The imposition of such onerous directors' liability, in the opinion of the Liberal members, would see directors focused more on compliance than performance.

For Australia to remain competitive locally, and internationally, the regulations that businesses face must be efficient and effective. The Liberal members of the Committee are not convinced that the Government has done 'due diligence' with regard to productivity costs associated with the additional indiscriminate duties imposed on directors.

> We ask this committee: where is the regulatory impact statement which looks at the bill outside the context of fraudulent phoenix activity? Where is the analysis of the costs of these measures in how they may impact on companies and directors who are not involved in phoenix activity for those companies and also for the economy as a whole? [5]

The Government has failed to present the Committee, nor the public, with evidence to this effect; most likely because that analysis would be adverse.

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4 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 2.

5 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 2.

Finally, the wider impact on the general public has not been adequately considered by the Government. Committee members are concerned the liability assigned to board members of charities will act as a disincentive, and have wider societal impacts.

> …it is critical for the committee to be aware that the bill applies to all directors of not-for-profits, charities, sporting clubs and small businesses in their own electorates. I received a text today indicating that there are some 11,700 companies limited by guarantee. Those include many charitable organisations. I have experience as a lawyer at one stage and also as director of a charity—a company limited by guarantee like many of them. [6]

Retrospective Taxation Legislation

The consolidation tax costs setting arrangements and changes to the taxation of financial arrangements contain retrospective measures. The Liberal members of the committee are fundamentally opposed to retrospective legislation, especially taxation laws.

> …legislation should not apply retrospectively except in very specific and exceptional circumstances. The application of this principle should not be dependent on the number of or the type of business or investment or tax profile of the taxpayers who may be affected by the amending legislation. So to reiterate: we do not recommend or support retrospective tax law amendments that may be disadvantageous to taxpayers for a number of reasons.
>
> I will go briefly into some of those. Certainty in the law: taxpayers clearly enter into transactions on the basis of the law as it is on the day they enter into them, not the law as it may be rewritten at some time in the future after the transactions have occurred. As a result, retrospective changes that alter a taxpayer's tax liability are likely to disturb the substance of a bargain that had been struck between taxpayers who have made every effort in good faith to comply with the prevailing law at the time of the agreement. In addition, typically taxpayers undertake transactions based on what they consider to be known exposures to tax liabilities. Retrospective changes could give rise to unexpected joint and several liabilities for taxpayers.

6 Mr John Colvin, AICD, *Committee Hansard*, Canberra, 4 June 2012, p. 2.

> Financial statements: many entities have prepared and issued financial statements which in this particular case before us, in schedule 3, may include the impact of rights to future income deductions that would change tax liabilities. Subsequent changes to these statements, as a result of retrospective legislative change, would have adverse implications for investors and capital markets that have relied on those financial statements.
>
> Investment decisions: taxpayers have committed to investment decisions on the basis of a particular tax profile for a particular entity. Retrospective amendments to change such a tax profile, as these measures before us do, can materially impact on the financial viability of investment decisions and the pricing of those decisions.
>
> Dividend policies: taxpayers have framed dividend policies based on profit levels, which in some cases have assumed rights to future income deductions. If the deductions are now disallowed retrospectively, there is the potential for adverse impacts on dividend policies, including available (indistinct) levels.
>
> Advisory costs: taxpayers have incurred significant valuation and advisory fees in relation to the identification and quantification of the law as it is and as it will no longer be if this legislation passes. So those advisory costs would be rendered redundant.[7]

Liberal Members of the Committee are opposed to retrospective tax changes as a general matter of principle: they can change the substance of bargains struck between taxpayers who have made every effort (and sometimes at considerable expense) to comply with the original law.

Furthermore, retrospective measures can expose taxpayers to penalties when taxpayers could not possibly have taken steps at the earlier time to mitigate the potential for penalties to be imposed.

Finally, these measures they may change a taxpayer's tax profile (and it is noted submissions were received to this effect) which in turn can materially impact the financial viability of investment decisions and the pricing of those decisions.

No justification for retrospectivity

The Government has not made a compelling enough case publicly, to justify the retrospective application of this legislation. Notably the Legislation Handbook states that:

7 Mr Robert Jeremenko, The Tax Institute, *Committee Hansard*, Canberra, 4 June 2012, pp. 15-16.

> Provisions that have a retrospective operation adversely affecting rights or imposing liabilities are to be included only in exceptional circumstances and on explicit policy authority[8]

This is simply a belated attempt by the Labor Government to amend the consequences of mistakes, made back in 2010 (the Consolodation and Arrangement changes) and 2008 (the MIT Bill). Taxpayers should not be expected to pay for these consequences of Labor's incompetence and mismanagement through retrospective tax changes.

Increase in the Managed Investment Trust Withholding Tax

It is proposed that the Coalition confirm its (previously announced) decision to oppose the increase in Managed Investment Trust (MIT) withholding tax.

These Bills would double the MIT withholding tax for foreign investment from 7.5 per cent to 15 per cent and would be retrospective in that they apply to all income distributions made after 1 July 2012 irrespective of when the original investment decision was made.

Risk to Existing Investments and Government Revenue

Industry expectations are that this measure would put billions of dollars of infrastructure investments already made, and future investments, at risk.

The government asserts that this measure would raise $260 million over the next four years. But analysis conducted by the Allen Consulting Group for the Property Council, and provided to the Committee as a confidential submission, casts serious doubt over those revenue forecasts.

The analysis conducted showed that the proposed increase in the final withholding tax revenue from MITs would have a 'profound adverse impact' on the economy without raising the expected revenue.

It was also found that if there was a $1 billion drop in investment as a result of the increased tax, the net tax revenue in 2015-16 would be $35 million, due to decreased receipts – less than half the $75 million predicted by Treasury. It also found that by 2015-16 the increased tax would reduce GDP by $580 million and cost more than 4,600 jobs a year.

Mr Verwer of the Property Council also raised questions about Treasury modelling, and the potential for the increased rate to actually reduce receipts:

8 *Legislation Handbook*, Department of Prime Minister and Cabinet, 1999, p. 29.

> …on any one of our reckonings, the decline in the rate caused a huge surge in foreign investment which resulted in tax revenue. The analysis that Treasury did last time was wrong because they used the wrong assumptions.[9]

Given the serious doubts the report raises over Treasury forecasts and that time and time again billions have been added to public debt because of incorrect forecasts, the Coalition's is of the view that this is reason enough to abandon this bill.

Perceptions of sovereign risk

But the uncertainty that this government has shown in dealing with the rate of the MIT withholding tax and the other retrospective measures raises the issue of perceived sovereign risk. Certainly to investors looking at Australia, the equivocation by the Government, and the unjustified retrospective changes, do not inspire confidence.

In a speech to the Canada-United Kingdom Chamber of Commerce David Denison, President and CEO of the Canada Pension Plan Investment Board (managers of $150 billion in investment assets on behalf of 17 million Canadians) stated that:

> "In this era of fiscal restraint and additional direct and indirect taxes, we are becoming increasingly concerned that some risks associated with ownership of infrastructure are expanding. For instance, it is easy to envision the regulatory rate setting process becoming politicized instead of objective and fair. The same could occur with taxes - in fact, Australia's budget that was tabled last week effectively doubled the tax burden on our real estate and infrastructure holdings in that country. If we conclude that these kinds of risks within any country become significant enough to call into question the predictability and stability of cash flows that are at the heart of the investment rationale for infrastructure, our response will be very quick and rational – we will simply stop investing there."[10]

The government's constant chopping and changing in relation to the MIT withholding tax has yet again reduced our predictability in the eyes of international investors.

9 Mr Peter Verwer, Property Council of Australia, *Committee Hansard*, 4 June 2012, p. 29.

10 Mr David Dennison, Canada Pension Plan Investment Board, *Speech to the Canada-United Kingdom Chamber of Commerce: Winning Conditions to Foster and Attract Long-Term Investing*, London, 15 May 2012, pp. 8-9.

International competitiveness & forecasts

The doubling of the withholding tax rate would also reduce Australia's international competitiveness and reputation as an attractive and certain destination to invest in. Such a move would put Australia out of step with comparable rates in the Asia Pacific region. It would no longer 'lead the pack' when it comes to the headline rate of the tax. If passed this Bill would undermine Australia's objective of becoming a regional financial services hub in the Asia-Pacific.

Attracting more foreign investment is important to achieve stronger economic growth leading to increased government revenue without the need for the Government's tax hikes or new taxes.

Passenger Movement Charge

It is evident to the Liberal members of the committee that the Government's increase of the Passenger Movement Charge (PMC) is patent revenue raising and will effectively be a 'tax on tourism'. However, for the industry, it could not have been introduced at a worse time.

The PMC represents a $55 cost to every overseas visitor holidaying in Australia. This to an industry already facing a carbon tax and its impact on domestic airfares and travel costs, this $1 billion tax slug will make holidaying in Australia even more expensive for every overseas visitor.

The claims by the Prime Minister and other Ministers that the cost increases will be "good for tourism" are manifestly imprudent. The increase charge is universally opposed by industry. The Ministers ought to open a newspapers and read about the sector's concerns are about the government's tax hike will have, especially the deleterious effect on jobs and investment.

The Liberal members of the committee are convinced that foreign tourists considering a trip to Australia, facing the higher costs in airfares that this increase represents, will seek out other destinations without excessive fees and charges, or spend less on food and entertainment if they do travel to Australia.

It also seems illogical that while increasing a tax originally introduced to cover costs associated with boarder protection and customs, that the funding for customs officers at Australian airports will be cut. It seems that the only effect of this will be to increase delays and harm Australia's international reputation as a holiday destination.

Overall position of the industry

It is no secret that Tourism, as a sector, is suffering at present. In the draft of the chair's report into this inquiry, the Government members of the committee noted:

> It is acknowledged by the committee that the tourism sector is experiencing difficult economic times[11]

This admission was borne out in testimony during the inquiry, given by Tourism and Transport Forum:

> **Mr BUCHHOLZ:** Mr Lee, have you done some modelling with reference to the overall surplus or deficit position of the tourism sector recently?
>
> **Mrs Labine-Romain:** Are you talking about the balance of trade?
>
> **Mr BUCHHOLZ:** Yes.
>
> **Mrs Labine-Romain:** That is work that we have a look at that whenever the satellite accounts come out, or whenever the forecasts come out, so we can see that over the last decade it has come from a net positive of $3.5 billion to a $5 billion deficit this year. So that is the difference between Australian visitors going outside—
>
> **Mr BUCHHOLZ:** Sorry, from $3.5 billion to—
>
> **Mrs Labine-Romain:** A $3.5 billion surplus in, I think, 2003-04 to a deficit this year of around $5 billion in 2011-12 and projecting beyond that $6 billion, $7 billion and $8 billion in the coming years.[12]

While the Government openly accepts the difficulties that the industry faces, the Government has now imposed one of the highest departure taxes in the world. The only apparent rationale for the imposition of this tax is the Government's erosion of Australia's fiscal position.

Lack of proper scrutiny

Government disingenuousness is particularly evident, when examining the introduction of this measure. In the evidence heard by the committee about the lack of consultation on the measure; Mr John Lee of the Tourism and Transport Forum was particularly incensed:

11 Draft Advisory Report on Bills Referred on 24 May 2012, House of Representatives, Standing Committee on Economics, 14 June 2012, p. 57.

12 Mrs Labine-Romain, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 47.

> We were very disappointed about a lack of consultation for this measure. We met with the Prime Minister on 2 February and outlined very clearly that this was one of the five most worrying potential impacts for our industry. TTF also met with representatives of the Treasurer's office and the chief of staff to the Treasurer, Jim Chalmers, before the budget to suggest that if there was any suggestion that this might change then we would like to be consulted, because industry had some views about how it could be dealt with. The phone never rang. The email was never sent. We were not consulted, and industry is very angry.[13]

Hypothecation

As the bulk of the PMC is directed into consolidated revenue - as many submissions noted - and not to passenger facilitation, this increase is, for all intent and purposes, a 'tax on tourism'. Perversely, at the time the PMC is being increased, funding of Border Protection Agencies and Customs is decreasing. Mr John King, Chairman of the Australian Tourism Export Council pointed out:

> …the tax already provides significant over-collection for the purpose for which it was hypothecated, and both the NTA and the TTF have clearly outlined that case. But we see further increases and over-collection going straight into consolidated revenue at a time when our international tourism competitiveness is at an all-time low and profit margins are very tight—and , in some cases, non-existent. It is a further erosion of our international competitiveness.[14]

This was also reinforced by Mr John Lee of the Tourism and Transport forum:

> What we cannot reconcile is the government's repeated public acknowledgement that tourism is doing it tough because of both the high dollar and the global economic uncertainty, especially in some of the regional areas of Australia. And then do they really think it would be some form of assistance to increase the PMC and at the same time cut funding to Customs, so expecting them to do more with less or, in other words, for an international visitor: 'You will pay more and wait longer'?[15]

It is striking that the PMC does not provide meaningful price signals related to the costs or risks associated with border protection, and is on a relatively narrow base.

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[13] Mr John Lee, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 45.

[14] Mr John King, ATEC, *Committee Hansard*, Canberra, 4 June 2012, p. 46.

[15] Mr John Lee, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 45.

Yet the government plans to increase the tax, without an increase in either the base, or the cost of provisioning border protection.

The Government's approach with respect to the tourism sector is at odds with its approach to other sectors:

> …you need to do something with the hypothecation. Ten cents out of every dollar going back into our sector is daylight robbery—nothing more, nothing less. We deserve at least 50 per cent hypothecation. If you are not going to vote against the tax, vote for tourism and vote to give us a chance to survive like the car industry, with $6 billion allocated to it this year alone in terms of commitments from federal ministers.[16]

Ms Caroline Wilkie of the Australian Airports Association gave similar testimony:

> **Ms Wilkie:** The AAA represents over 285 members nationally. Of those, we represent all of the international airports as well as over 200 regional airports around Australia. The main reason we are very concerned about the increase to the passenger movement charge is what this will mean about numbers of passengers going through our airport infrastructure. We believe that any increase in the passenger movement charge is unfounded. The government already overcollects on this tax, and as it is we do not have enough resources within our airports to process the passengers that we already have coming through. To now be charged even more money for the passengers to overcollect and still not have a good enough service is, quite frankly, unacceptable. To then have it indexed, despite the fact that the global economy is slowing, that tourism numbers are slowing and that we are facing potential downfalls from major source markets—I find it incredible that we are looking at an increase of this magnitude at this time, with the global economy the way it is. [17]

Indexation

The indexation of the Charge is patently ill-thought-out and it is further evidence of this being a 'cash grab' by the Government. To have the charge increase automatically, serves no other purpose than to generate additional revenue:

[16] Mr John Lee, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 53.

[17] Ms Caroline Wilkie, AAA, *Committee Hansard*, Canberra, 4 June 2012, pp. 43-4.

> As a minimum, MPs should stop the indexation. There is no other indexation on a tax. In terms of pure philosophical, hard Keynesian economics, you should reject it on that basis alone.[18]

Considering that this change will be levied on all international visitors, it is concerning that the Australian CPI may not be comparable to those visitors' home countries, or in the current economic climate, anywhere else in the world. It will only serve to make other destinations more competitive to visitors considering Australia, or for those who do come, to spend less on discretionary items or services.

Liberal Members of the Committee are particularly concerned about the manifest unfairness of the Government's indexation of the PMC.

Disproportionate impact on short-haul routes

Furthermore to the general effects of raising the PMC, there would be a disproportionate impact on short-haul markets, given the lower cost nature of services offered on these routes. The Liberal Members of the Committee are particular concerned about the potential effect on these routes, given these markets represent both the largest inbound tourist market (New Zealand), and an important emerging market (Asia). In fact, in the QANTAS submission presented to the committee, it was noted:

> … [That] the increase in the PMC will have a disproportionate impact on shorter haul international travel, especially those focussed on price sensitive leisure destinations. To this end, the tax will have a disproportionate impact on Jetstar services especially those to and from Asia and New Zealand. Although New Zealand is our single biggest inbound tourism market, the PMC is now up to one third of the cost of a Jetstar flight from Sydney to Auckland. Similarly, the impact is most likely to be felt in demand for Australian leisure based destinations like Cairns, Darwin and the Gold Coast.[19]

International Competitiveness

Tourists looking to Australia already face increasing ticket prices, coupled with the vast distance between Australia and other regional hubs, increasing fuel prices, and the domestic the effects of the Carbon Tax. The increase in the PMC represents an unnecessary impost, and will be one of the highest in the world:

[18] Mr John Lee, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 53.

[19] Mr Euan Robertson, QANTAS Submission to Committee

> **Mr BUCHHOLZ:** What countries have a lesser passenger movement charge than we do?
>
> **Mrs Labine-Romain:** Most.
>
> **Ms Wilkie:** Most. We have one of the highest ones.
>
> **Mr BUCHHOLZ:** Most of them—really?
>
> **Mrs Labine-Romain:** Yes. We are the highest in the short haul.[20]

Furthermore, Mr King of the Tourism and Transport Forum pointed out the additional disadvantages Australian tourism operators face in the form of excessive regulation:

> As well as battling a high Australian dollar, our tourism exporters have been hit with an almost endless tsunami of government regulation, red tape, the carbon tax, inflexible and inappropriate labour laws and imposed costs, all of which are increasingly destroying our competitiveness. Australia unfortunately is now one of the most expensive and difficult countries to get to and to travel in.[21]

The Tourist market is increasingly competing with more international destinations. To make Australia less competitive harms the industry; Ms Wilkie of the Australian Airports Association:

> By way of explanation as well, there is a lot of debate along the lines of: 'Look, it's $8 a ticket. Does that make a difference?' Our international airports are travelling globally so that they can get international airlines to come to this country. When you are talking to someone, it is not about whether or not they are going to go to Sydney or Melbourne; it is about whether or not we get the aircraft or Rio gets the aircraft. When you start looking at a passenger movement charge on top of that, it does have an impact.[22]

Conclusion

The Coalition members of the Committee oppose the Bills on the basis that they unduly increase taxation, propose retrospective measures without proper

[20] Mrs Labine-Romain, TTF, *Committee Hansard*, Canberra, 4 June 2012, p. 52.

[21] Mr John King, ATEC, *Committee Hansard*, Canberra, 4 June 2012, p. 46.

[22] Ms Caroline Wilkie, AAA, *Committee Hansard*, Canberra, 4 June 2012, pp. 43-4.

justification, give rise to automatic and indiscriminate liability to directors, and put investment and tourism under pressure.

The indiscriminate and potentially automatic increase in the liability of directors under the PAYG Bill represents a perversion of natural justice. This is compounded by the fact that 'phoenix' activity is not adequately defined in the Bill. The liability would serve to dissuade to potential directors, and pose onerous requirements businesses especially on charities.

Liberal Members of the Committee are concerned about phoenix activity and support targeted legislative initiatives that are efficient and effective in dealing with the problem. The Government's Bill, however, is neither efficient or effective.

We are concerned about measures altering the Consolidation and Arrangement rules and that the MIT Amendment Bill will have retrospective activity. Not only does this punish taxpayers who in good faith complied with the prevailing law, and made investment decisions based on it. It also, however, contributes to perception of sovereign risk for international investors. This is especially evident in the case of the MIT Withholding Tax and the lack of consultation surrounding it.

The increase in the PMC is nothing more than a tax grab, in an attempt to remedy Labor's erosion of Australia's fiscal position. Concerningly, this tax increase is forced on an industry already struggling under the weight of Government regulation, and at the hands of a slowing market. This is compounded by the fact that proportionally less of the revenue raised from the measure will be spent on passenger amenities and border protection.

Especially in the case of the MIT Bill and the PMC Bill, it seems concerning that in an attempt to raise revenue; the Government has overlooked the wider impact that reduced volume of investment may have on receipts.

Recommendation

The House does not pass the Tax Laws Amendment (2012 Measures No. 2) Bill 2012, the Pay As You Go Withholding Non-compliance Tax Bill 2012, the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, and the Passenger Movement Charge Amendment Bill 2012 in their current form.

Mr Steven Ciobo MP, Deputy Chair

Ms Kelly O'Dwyer MP

Mr Scott Buchholz MP

A

Appendix A – Submissions

1. Australian Institute of Company Directors
2. Australian Institute of Superannuation Trustees
3. The Tax Institute

3.1 The Tax Institute

4. TPG Telecom Limited
5. Greenwoods & Freehills Pty Ltd (Schedule 2)
6. Greenwoods & Freehills Pty Ltd (Schedule 3)
7. Deloitte Tax Services Pty Ltd
8. Ernst & Young
9. Confidential
10. Infrastructure Partnerships Australia
11. King & Wood Mallesons
12. Financial Services Council
13. AMP Services Limited
14. Ernst & Young
15. Cairns Airport Pty Ltd
16. Melbourne Airport
17. Australian Airports Association
18. National Tourism Alliance
19. Accommodation Association of Australia

20. Tourism & Transport Forum
21. Brisbane Airport Corporation Pty Ltd
22. Qantas Airways Limited
23. International Air Transport Association
24. Confidential

24.1 Supplementary to Submission 24

25. Sydney Airport
26. Property Council of Australia
27. Exhibition & Event Association of Australasia
28. Confidential
29. Canadian Pension Plan Investment Board
30. Property Funds Association

B

Appendix B – Hearing and witnesses

Monday, 4 June 2012, Canberra

Attorney-General's Department

Mr Anthony Coles, Assistant Secretary, Border Management and Crime Prevention Branch

Australian Institute of Company Directors

Mr John H.C. Colvin, Chief Executive Officer and Managing Director

Mr Shayne Carter, Representative

The Department of the Treasury

Ms Kate Preston, Manager, Small Business and Trusts Unit, Business Tax Division, Revenue Group

Mr Adam Craig, Analyst

Mr Anthony Regan, Principal Adviser, Business Tax Division, Revenue Group

Ms Nan Wang, Manager, Finance Taxation Unit, Business Tax Division, Revenue Group

Mr Tony McDonald, General Manager, International Tax and Treaties Division, Revenue Group

Ms Amanda Zanardo, Manager, International Tax Base Unit, International Tax and Treaties Division, Revenue Group

The Tax Institute

Mr Robert Jeremenko, Senior Tax Counsel

Mr Andrew Hirst, Representative

Mr Peter Murray, Representative

Property Council of Australia

Mr Peter Verwer, Chief Executive Officer

Mr Sam Bolbol, Representative

Financial Services Council

Ms Carla Hoorweg, Senior Policy Manager, Global Markets & Tax

Mr Martin Codina, Director of Policy

Australian Airports Association

Ms Caroline Wilkie, Executive Director

National Tourism Alliance

Ms Juliana Payne, Chief Executive Officer

Tourism and Transport Forum

Mr John Lee, Chief Executive Officer

Mrs Adele Labine-Romain, National Manager, Research and Projects

Australian Tourism Export Council

Mr John King, Chairman

Customs and Border Protection Service

Mr Jeff Buckpitt, National Director, Passenger Division

Ms Robyn Miller, National Manager, Passenger Policy and Practice

C

Appendix C – List of advisory reports

Below is a list of advisory reports tabled by the House of Representatives Standing Committee on Economics in the 43rd Parliament.

No.

1. Inquiry into the Income Tax Rates Amendment (Temporary Flood Reconstruction Levy) Bill 2011; and the Tax Laws Amendment (Temporary Flood Reconstruction Levy) Bill 2011
2. Inquiry into Indigenous economic development in Queensland and advisory report on the Wild Rivers (Environmental Management) Bill 2010
3. Advisory report on the Taxation of Alternative Fuels Bills 2011
4. Advisory report on the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011
5. Advisory report on the Competition and Consumer (Price Signalling) Amendment Bill 2010 and the Competition and Consumer Amendment Bill (No. 1) 2011
6. Advisory report on the Food Standards Amendment (Truth in Labelling - Palm Oil) Bill 2011
7. Advisory report on the Corporations (Fees) Amendment Bill 2011
8. Advisory report on the Tax Laws Amendment (2011 Measures No. 8) Bill 2011 and the Pay As You Go Withholding Non-compliance Tax Bill 2011

9. Advisory report on the Minerals Resource Rent Tax Bill 2011 and related bills
10. Review of the Tax Laws Amendment (2011 No. 9 Measures) Bill 2011
11. Review of the Insurance Contracts Amendment Bill 2011
12. Advisory report on the Tax and Superannuation Laws Amendment (2012 Measures No. 1) Bill 2012
13. Advisory report on the Clean Energy Finance Corporation, Clean Energy Legislation Amendment Bill 2012, Clean Energy (Customs Tariff Amendment) Bill 2012 and Clean Energy (Excise Tariff Legislation Amendment) Bill 2012