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SENATE ECONOMICS LEGISLATION COMMITTEE

CONSIDERATION OF LEGISLATION REFERRED TO THE COMMITTEE

Taxation Laws Amendment Bill (No.11) 1999

June 2000

Commonwealth of Australia

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Senate Economics Legislation Committee

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REPORT

Background to the inquiry

1.1 Taxation Laws Amendment Bill (No.11) 1999 was introduced into the House of Representatives on 9 December 1999. The Bill was referred to this Committee following a report by the Selection of Bills Committee on 10 May 2000, for examination and report by 20 June 2000. In its report, the Selection of Bills Committee requested that the Committee consider the following:

- unilateral over-riding of Australia's treaty obligations by amending domestic legislation; and
- retrospectivity, start dates and other issues.[1]

1.2 The committee secretariat contacted a number of interested parties and received 1 submission to the inquiry from the Corporate Tax Association of Australia. The Assistant Treasurer also subsequently wrote to the Committee on 30 May providing a response to the matters raised by the Corporate Tax Association and by the Committee. The Assistant Treasurer's letter is attached at Appendix 2.

1.3 The Committee conducted a public hearing on the Bill in Canberra on 23 May 2000. A list of witnesses who gave evidence at the hearing appears in Appendix 1, and the full transcript of the hearing is available at the internet address of http://www.aph.gov.au/hansard.

1.4 This is an omnibus bill dealing with a number of different issues. However, the Committee's inquiry focussed on Schedule 1, which deals with the alienation of real property through interposed entities.

Background to Schedule 1

1.5 Schedule 1 of this bill is designed to close off an opportunity for tax evasion exposed by a 1997 decision of the full Federal Court in *Commissioner of Taxation vs Lamesa holdings.*

1.6 According to the explanatory memorandum, Schedule 1 of the Bill amends the *International Tax Agreements Act 1953* by inserting section 3A to clarify the meaning of terms used in the Alienation of Property Article in Australia's tax treaties.

1.7 The amendment ensures that the Alienation of Property Article in the double tax agreements and conventions (DTAs) is read to cover alienations of shares or other interests in companies, and in other entities, whose assets consist principally of Australian real property, whether held directly or indirectly through a chain of interposed companies or other entities.

1.8 The Explanatory Memorandum explains that the amendment will protect Australia's taxing rights over income, profits or gains arising from effective sales of Australian real property, including mining rights. The new section applies to all DTAs containing the identified provision covering alienation of property where the provision came into force

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1 Selection of Bills Committee Report No. 7 of 2000.

domestically before 27 April 1998 and affects transactions occurring after 12 noon Australian Eastern Standard Time on 27 April 1998. The Treasurer announced this measure in Press Release No. 39 of 27 April 1998.[2]

Double Taxation Agreements (DTAs)

1.9 Australia has a total of 44 double taxation agreements with other countries. Of the 44 DTAs, 31 will be affected by this legislation. These agreements are designed to prevent double taxation in situations where a taxpayer earns income from a foreign source, or where a foreign taxpayer operating in Australia earns income in this country. Effectively, the agreements determine which country is entitled to claim the taxation revenue due as a result of the taxpayer's earnings. Without such agreements, the taxpayer may be taxed in both countries.

1.10 The Parliamentary Library's Bills Digest explains that DTAs generally require that the business profits of a non-resident business operating in Australia through a permanent establishment be taxable in Australia. If a non-resident company operates in Australia but does not have a permanent establishment, the country of residence is entitled to claim the taxation income. DTAs generally provide that the profits from the alienation of real property are taxable in the country in which the real property is located.[3]

The Lamesa case

1.11 The Lamesa case exposed a loophole in the Australia-Netherlands DTA. The case originated with the acquisition by a US company of an Australian mining company through a series of interposed entities including a Netherlands company, Lamesa BV. A series of acquisitions and takeovers followed, which included the shares in a listed mining company. These shares were eventually sold. Use of the Netherlands subsidiary meant that the Australia-Netherlands DTA applied.

1.12 The Australian Taxation Office assessed Lamesa's tax liability resulting from the profits as $76,693,888 for 1993-94 and $128,022,859 for 1994-95. However, Lamesa successfully argued in the Federal Court that the alienation of real property should be literally interpreted and was inapplicable to the taxpayer's indirect interests.

1.13 The consequences of the decision were that under the Australia-Netherlands DTA, Lamesa's taxation liability was payable in The Netherlands. However, The Netherlands does not seek to collect taxes due to it in such situations. Consequently, Lamesa's profits were not taxed in either country.[4]

1.14 It is important to note that the issue of substance in the Commonwealth's case was not the fact that The Netherlands does not collect its share of revenue in cases such as this. Rather, what appears to have been at issue was whether the profits from the sale of shares (indirect interests), as distinct from property, should be taxed in Australia or elsewhere.

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2 Explanatory memorandum

3 Department of the Parliamentary Library, Bills Digest No. 107 1999-2000

4 This summary of the Lamesa decision is derived from analysis published in Bills Digest No. 107 1999-2000.

Issues

1.15 The major issues raised in evidence and in other contexts were as follows:

- Unilateral amendment of DTAs;
- Retrospectivity;
- Legislation by press release - the six month rule; and
- Definitional uncertainties.

Unilateral amendment of DTAs

1.16 Analysis conducted by the Parliamentary Library and others indicates that this legislation may be subject to challenge in the Courts on the grounds that it uses domestic legislation to unilaterally over-ride an international treaty. That is, the Australian Government is changing how a treaty is interpreted by amending domestic legislation without reference to the other treaty country. Courts in the United States have overturned such treaty over-rides, and the Library's Bills Digest suggests that there is a similar risk in this country.

1.17 The Corporate Tax Association also raised this issue in its submission and evidence, making similar points. The Association drew the Committee's attention to the Vienna Convention on the Law of Treaties to which Australia is a party. Article 26 of the treaty states that 'Every Treaty in force is binding upon the parties to it and must be performed by them in good faith'. Article 27 states that 'A party may not evoke the provisions of its internal law as justification for its failure to perform a Treaty…'. The Association maintained that damage may be done to Australia's international reputation as a result of the amendments.[5]

1.18 The Government, however, describes the effect of the legislation in quite different terms, stating that the measure had been introduced to:

> ... require that the tax treaties be interpreted in accordance with their intention of maintaining Australia’s taxing rights over alienations or effective alienations of real property situated in Australia. [6]

1.19 The Assistant Treasurer, Senator the Hon. Rod Kemp, further clarified the Government’s view in his letter to the Committee. Senator Kemp advised that the purpose was to ensure the provisions operated as originally intended:

> The proposed amendment will, however, simply ensure that the existing provisions in the *Alienation of Property* Article of our DTAs are rendered fully effective in achieving their intended purpose of addressing alienations of Australian real property.

1.20 The Minister pointed out that Australia’s taxing rights resulting from the alienation of property include effective alienations of ‘incorporated’ real property through the alienation of shares in a company, the assets of which consist wholly or principally of such real property. Senator Kemp supported his argument by referring to the official commentary to

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5 Submission by the Corporate Taxation Association of Australia, p. 10.

6 Second reading speech.

the comparable provision of the United Nations Model Double Taxation Convention, which provides that:

> This paragraph is designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of such property, it is necessary to tax the sale of shares in such a company.

1.21 The Minister concluded that it follows that for an 'incorporated real property' provision to be fully effective, it must apply to 'incorporated' real property held through interposed entities.[7]

1.22 The Committee notes the logic of the Minister's argument. However, the question remains as to whether the matter may be subject to court challenge. The Committee pursued this matter with officers of the Australian Taxation Office.

1.23 Mr Kenneth Allen, Assistant Commissioner (International Tax Division), advised the Committee that the ATO was confident that the Courts would uphold the legislation and that there are Australian legal precedents to support this view:

> We are confident, Senator, that such an appeal would not be successful. In the first place, we are confident that the amendment is consistent with the intent of the relevant provision of the existing treaties. In any event, tax treaties are given the force of law by domestic legislation, as you rightly mention—that legislation prevails for the treaties to prevail over the domestic law. Nevertheless, there are a series of cases on the point...

1.24 Mr Allen went on to quote a number of Australian High Court cases including Horter v the Commonwealth, Polites v the Commonwealth and Polikovic v the Commonwealth. Committee members questioned the relevance of such cases:

> **Senator Murphy**: Do those cases have application in terms of the matter we are considering here?
> **Mr Allen**: Certainly, because they concern provisions of domestic law which related to treaty obligations and—
> **Senator Murphy**: In what respect? In respect of double taxation?
> **Mr Allen**: Not in respect of double taxation, but we consider that they have the same principle.

1.25 A further issue in respect to Australia's actions examined by the Committee was the reaction of affected countries. Mr Allen indicated that four countries - Belgium, The Netherlands, New Zealand and Singapore, had expressed dissatisfaction with the Government's decision.[8] Committee members questioned whether the countries in question would terminate their DTAs with Australia as a consequence.

1.26 In response, the Assistant Treasurer noted that New Zealand had withdrawn its objection and that it is 'extremely rare for countries to terminate DTAs given their broad trade and investment effects and the wider impact on international relations'. The Minister advised the Committee that the ATO is confident that the objections by the other three

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7 Letter from Assistant Treasurer, p. 2.

8 Evidence, p. 11.

countries can be satisfactorily dealt with by the offer to renegotiate the relevant provisions of the affected DTAs on a bilateral basis.[9]

Retrospectivity

1.27 Retrospectivity was the second major issue considered by the Committee during consideration of this Bill. The Committee notes that the Senate Scrutiny of Bills Committee also raised a number of concerns in this regard.[10]

1.28 The Bill does not affect transactions that were complete at the time of the Treasurer's press release. For example, the Lamesa transaction itself is not reversed by this amendment. However, based on the evidence received during the inquiry, transactions initiated but not completed prior to the announcement will be affected.

1.29 The Corporate Tax Association argued that there is a risk the legislation will be retrospective in its effect. In particular, the Association expressed concern about the impact of the legislation on transactions that were already in process at the time the Government announced the legislation.[11]

1.30 Mr Watkins, an adviser to the Association, told the Committee that the Association's concerns about the matter centred on the lead times associated with such transactions:

> ... the transaction that was involved in Lamesa was the sale of shares in companies, and indeed that is what these amendments will be directed at: the sale of shares in companies. That sort of transaction will not always be an instantaneous transaction, it could be a transaction which occurs over a period of time, for example, by way of a takeover or perhaps by way of a scheme of arrangement which may have a long lead time during which various steps need to be taken: court approvals, shareholder approvals, et cetera. So the entire course of the transaction may take a period of time, albeit that it is not finally completed until obviously the last step.[12]

1.31 Mr Watkins advised the Committee that the Association is concerned about the risk that parties may have commenced but not completed a course of action before the press release, in accordance with the law as it prevailed at that time. He said that there are in fact a number of examples in other legislation that recognise the lead-time associated with these sorts of transactions. He maintained that in such cases, where there is objective and verifiable evidence, then it is appropriate that that transaction can continue to proceed subject to the previously prevailing law.

1.32 Mr Watkins quoted two such examples in tax legislation, the share buy-back rules and the commercial debt forgiveness rules. He argued that such transitional provisions were included to prevent any risk of retrospectivity for transactions, which have commenced but have not yet been completed.[13]

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9 Letter, p. 2.

10 See Alert Digest 1/2000, p. 31-2.

11 Evidence, p. 4.

12 Evidence, p. 5.

13 Evidence, p. 5.

1.33 The Association sought an amendment to the legislation to incorporate a similar transitional arrangement to the effect that where a course of action commenced prior to 27 April 1998, this can be established by objective verifiable facts and the disposal occurs after 27 April 1998, the disposal be excluded from the amendments.[14]

1.34 The Committee questioned the ATO officers about the bill's apparent retrospective effect. Mr Allen maintained that the ATO does not see the effect of the legislation as retrospective:

> In that respect, we from the tax office do not consider there is any question of retrospectivity in relation to that application clause. It provides for the member to apply only in relation to relevant alienations or dispositions that occur after the time of the Treasurer's press release and alienations or dispositions that were legally effective before that time remain unaffected.[15]

1.35 Mr Allen also questioned the need for transitional provisions. He argued that the tax profession would have been aware of the Commissioner's view of how the DTA was intended to operate from a reading of the judgement. He further argued that the profession would also have been aware that the Government was unlikely to countenance the serious revenue consequences of the decision and that it 'was not unprecedented for the government of the day to legislate as a consequence of a court decision adverse to the commissioner'.

1.36 Mr Allen further argued that making exceptions for actions commenced but not finalised would place such actions in a privileged position as compared with later transactions, or transactions involving incorporated real property but without the interposed entities arrangements. He concluded that accordingly, to make exceptions for those cases would not appear to be justified.

1.37 The Assistant Treasurer made similar points in his letter to the Committee. The Minister pointed out that making exceptions would involve a large potential risk to revenue. The Minister noted that it had not been possible to exactly quantify the magnitude of this risk because of the absence of data due to the transactions occurring offshore and the Australian assets being held indirectly.

1.38 The Minister pointed out that the Lamesa case involved a revenue loss of approximately $74 million, and that the Government was aware of another case involving $79 million tax payable on an alienation that occurred after the 27 April 1998 Press Release, indicating the magnitude of the amounts potentially involved.

Legislation by press release and the six month rule

1.39 The Corporate Tax Association drew the Committee's attention to an apparent breach of the six month rule in respect of the introduction of this bill. The Parliamentary Library's Bills digest also identified this issue.

1.40 The six month rule provides that where the Government has announced, by press release, its intention to introduce a bill to amend taxation law, and that bill has not been introduced into the Parliament or made available by way of publication of a draft bill within 6 calendar months after the date of that announcement, the Senate shall, subject to any further

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14 Submission, p. 7.

15 Evidence, p. 8.

resolution, amend the bill to provide that the commencement date of the bill shall be a date that is no earlier than either the date of introduction of the bill into the Parliament or the date of publication of the draft bill. *(8 November 1988 J.1104)*[16]

1.41 The amendment has effect from 27 April 1998, the date of a press release released by the Treasurer. More than 6 months elapsed between the announcement and the publication of the bill, and no draft bill was released during the period.[17]

1.42 In its submission to the Committee, the Corporate Tax Association endorsed the principle of the Senate's resolution. The Association argued that there was a need for certainty beyond that provided in press releases:

> Taxpayers need to be provided with certainty beyond scant details contained in press releases. This is particularly so in an increasingly complex taxation environment involving significant business tax reforms…[18]

1.43 The Association submitted that in accordance with the terms of the Senate's resolution, the date of commencement of the Bill should be 9 December 1999.

1.44 The Assistant Treasurer expressed strong disagreement with the Association's proposition. He said that to change the commencement date as suggested by the Association 'would allow those who chose not to fall in with the Government's intention as announced by the Treasurer on 27 April 1998 to escape the application of the amendment'.[19]

1.45 The Minister explained that there were a number of reasons that contributed to the delay in presenting the legislation:

> The delay in the Treasurer's announcement of remedial action was due to the need for careful consideration by the Commissioner and the Government of the various ways in which Australia could act to preserve its taxing rights, which might otherwise be significantly undermined by leaving the effects of the decision unaddressed. Given the number of Australia's DTAs involved and the ramifications of the Government's remedial action, it was essential that the Government's response be very carefully considered and this took some time.[20]

1.46 The ATO also provided information about the reason for the delay. Mr Allen told the Committee that the matter involved the application of a particular treaty provision and had flow-on effects to other treaty provisions. He explained that because a treaty was involved, the considerations that the Government and the Commissioner had to take into account in developing remedial action were more time consuming than would have been the case if only domestic law had been involved.[21]

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16 Standing Orders and other orders of the Senate, Procedural orders of continuing effect, No. 25, p. 127.

17 See Alert digest 1/00 pp32-33 .

18 Submission, p. 5.

19 Letter, p. 3.

20 Letter, p. 4.

21 Evidence, p. 8.

1.47 The Committee is of the view that it would have been preferable for this legislation to have been prepared and presented in a more timely manner as the timing of its presentation constitutes a clear breach of the six month rule.

1.48 However, the Committee accepts that on this occasion there were mitigating circumstances. Further, if the rule is applied to this bill, there may be substantial risks to revenue. Accordingly, the Committee is of the view that on this occasion, the six month rule should not be applied.

Definitional uncertainties

1.49 The Corporate Tax Association drew the Committee's attention to what it considered were a number of definitional uncertainties in the legislation. In particular, the Association submitted that the words "alienation" and "disposition" are not expressly defined in Australia's tax legislation, and that there are a number of attendant risks of ambiguity. (see submission p. 8)

1.50 The Assistant Treasurer responded to this issue in his letter. He advised that the language used (‘alienation or disposition’) reflects the language of the DTAs themselves, and that the lack of a definition in the DTAs follows normal international practice. The Minister concluded that that he did not consider that the legislation should address the issue.[22]

Recommendation

1.51 The Committee recommends that the bill be passed. The Committee further recommends that the Senate pass a resolution that the six month rule not apply in respect of the bill.

Senator the Hon. Brian Gibson
Chairman

22 letter, p. 5.

LABOR SENATORS' MINORITY REPORT

Labor Senators reserve their position on this legislation.

Senator Shayne Murphy
Deputy Chairman

Senator George Campbell

MINORITY REPORT - AUSTRALIAN DEMOCRATS

The Australian Democrats retain a number of concerns about this legislation. In particular, the Australian Democrats are concerned about the possible implications of the Government's unilateral decision to over-ride Australia's international treaty obligations.

The Australian Democrats are also concerned about possible retrospective effects. While the Australian Taxation Office assured the Committee that the legislation would not affect alienations finalised prior to the date of announcement, it is clear that actions initiated but not completed prior to the announcement will be affected. Arguments for a transitional provision bear closer examination before a final decision is made on this matter.

Finally, the Australian Democrats note that the Government is asking the Senate to pass a bill with legally difficult legislative implications and extended retrospective effect that does not comply with the six month rule and has unknown revenue implications. We are as yet unconvinced that the Government has advanced a reasonable argument for passing this bill unamended.

Senator Andrew Murray
Australian Democrats

APPENDIX 1

LIST OF WITNESSES

APPEARING BEFORE THE COMMITTEE

Tuesday, 23 May 2000
Committee Room 1S6
Parliament House, Canberra

Corporate Tax Association

Mr John Gonsalves, Assistant Director
Mr David Watkins, External Adviser

Australian Taxation Office

Mr Kenneth Allen, Assistant Commissioner (International Tax Division)
Ms Lynette Redman, Executive Officer
Mr Andrew Stephens, Executive Officer, Capital Gains Tax Centre of Excellence
Mr Gregory Trigg

APPENDIX 2

CORRESPONDENCE FROM SENATOR THE HON. ROD KEMP, ASSISTANT TREASURER

ASSISTANT TREASURER

Senator The Hon. Rod Kemp

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Senator Gibson
Chairman
Senate Economics Legislation Committee
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CANBERRA

Dear Senator Gibson

The Corporate Taxpayers Association (CTA) have raised a number of issues in relation to the proposed measure in *Taxation Laws Amendment Bill (No. 11) 1999* concerning the interpretation of provisions of Australia's double tax agreements (DTAs) addressing the alienation of real property held through interposed entities. You will recall that the proposed measure is intended to address the impact of the Federal Court's decision in the *Lamesa* case.

The issues raised by the CTA in their written submission and at the public hearing on 23 May 2000 were previously raised by the CTA with the Senate Standing Committee for the Scrutiny of Bills. My comments below also reflect those made in response to the CTA's submission to that Committee.

Legislation said to be contrary to our international obligations – need to renegotiate treaties rather than legislate

The CTA expressed concern over 'amendment by Press Release' and at the effect on Australia's international reputation. It noted the provision in the *Vienna Convention on the Law of Treaties* that a country may not invoke its internal law provisions as justification for its failure to perform its international obligations, and said the proper course would be bilateral renegotiation of affected DTAs.

The proposed amendment will, however, simply ensure that the existing provisions in the *Alienation of Property* Article of our DTAs are rendered fully effective in achieving their intended purpose of addressing alienations of Australian real property. It prevents easy avoidance of the intent of the Article by, for example, insertion of one or more corporations to take advantage of the separate legal personality of corporations.

To understand this aspect of the proposed measure, it is important to recognise that the *Alienation of Property* Article in our DTAs provides a taxing right to the country in which real property, as defined in the Agreement, is situated, in cases where the property is alienated. This right specifically extends, in the DTAs affected by this legislation, to cover effective alienations of 'incorporated' real property through the alienation of shares in a company, the assets of which consist wholly or principally of such real property.

The object and purpose of such 'incorporated real property' provisions is best expressed in the official Commentary to the comparable provision of the *United Nations Model Double Taxation Convention*, which provides that: 'This paragraph is designed to prevent the avoidance of taxes on the gains from the sale of immovable property. Since it is often relatively easy to avoid taxes on such gains through the incorporation of such property, it is necessary to tax the sale of shares in such a company.'

It follows that for an 'incorporated real property' provision to be fully effective, it must apply to 'incorporated' real property held through interposed entities.

To have taken an approach of renegotiating all the affected DTAs (which number more than thirty) rather than legislating, would have involved major delays and costs. It could have sent the signal that we will only move with the agreement of all DTA partners, and some countries (especially those lacking the land and mineral wealth of Australia) might, whether they share our understanding of the provision's intent or not, have sought a 'quid pro quo' for the DTA amendment that we could not give. However, for DTAs concluded subsequent to the Treasurer's Press Release, it has been Australia's practice to deal with the matter during negotiations and to ensure that the wording of the DTA is unequivocal on this issue.

Australia has been very open with its DTA partners about the proposed legislation. They were notified by letters from the Commissioner of Taxation dated 28 April 1998 (following the Treasurer's Press Release of the previous day announcing the proposed legislation) and from the Acting Commissioner of Taxation dated 15 December 1999 (following the introduction of the legislation in Parliament). Australia has also outlined its position to the appropriate OECD forum for discussion of tax treaty issues.

Should any of our DTA partners request bilateral treaty renegotiations on the issue, Australia has offered to negotiate an amendment to relevant DTAs to the same effect as the legislation, but with the legislation operating in the meantime, as provided for in paragraph 4 of Clause 3A of the Bill. This strikes a balance between the bilateral character of the DTA relationship, and the need to act quickly to confirm what we regard as the allocation of taxing rights intended under the DTAs. While it appears that most countries do not regard renegotiation as necessary, productive negotiations have already commenced with two countries on this basis.

The Committee expressed concern that the four countries who have objected to Australia's proposed legislative action (Belgium, the Netherlands, Singapore and New Zealand) may seek to terminate their DTAs with Australia as a consequence of the Government's legislative action. However, I am advised by the ATO that New Zealand has effectively withdrawn its objection and that it is extremely rare for countries to terminate DTAs given their broad trade and investment effects and the wider impact on international relations. The ATO is confident that the objections by the other three countries can be satisfactorily dealt with by the offer to renegotiate the relevant provisions of the affected DTAs on a bilateral basis.

Article 27 of the Vienna Convention on the Law of Treaties, which was referred to by the CTA, is designed to ensure that countries do not rely on their constitutions or other domestic laws as the reason why they cannot meet their treaty obligations. Here there is no failure to meet our DTA obligations, and we are not relying on the legislation in the fashion contemplated by that provision. Rather, the proposed legislation is simply designed to clarify the intention of the relevant DTA provisions following a decision which was open to the court on the wording of those provisions, but which, it is considered, does not fully reflect the intent of the provisions as negotiated.

I understand that the Committee expressed concerns during the 23 May hearing at the possibility raised by the CTA of the amendment in the Bill being declared invalid by the courts on the grounds of it being in breach of our treaty obligations.

As I have already indicated, however, the amendment is consistent with the intended operation of the relevant provisions of the affected DTAs and is not considered to conflict with our treaty obligations. In any event, the amendment is to legislation within the power of the Commonwealth Parliament and I am advised by the ATO that there is a series of Australian High Court decisions which establish that the validity at international law of a clearly expressed provision in such legislation will not be questioned in a court of law in Australia.

Six month rule

The CTA have submitted that, in accordance with the 'six month rule' regarding the announcement of legislation by press release, the date of the commencement of the Bill should be 9 December 1999.

The proposed legislation was delayed for a number of reasons, most notably the federal election in 1998 and the amount of time required for the Commissioner of Taxation to consult and discuss the proposals with representatives of the 32 affected double taxation agreement partners. The feedback from these consultations and meetings were factored into the form of the legislation, as was our experience of developments in the OECD and UN fora.

The CTA have also submitted that 'an effective date of 9 December 1999 should not frustrate the Government's intention. The issue of the Press Release has already had the effect of discouraging properly advised taxpayers from commencing a "*Lamesa*-style" transaction after 27 April 1998. Accordingly, even if the legislation is introduced with effect from 9 December 1999, the effect of the Press Release will be that, practically speaking, the Government's intention will have been widely known and regarded as "de facto" law from 27 April 1998.'

I strongly disagree with the CTA's comments regarding their proposal for the commencement date to be altered to 9 December 1999 in accordance with the Senate's 6 month rule. This would allow those who chose not to fall in with the Government's intention as announced by the Treasurer on 27 April 1998 to escape the application of the amendment.

Retrospectivity and transactions in progress

The CTA have expressed the view that the Bill should not apply where there is objective evidence that a relevant transaction was under way at the date of the Press Release and have submitted a draft application provision reflecting their view. The CTA argues that 'during the period prior to 27 April 1998, taxpayers were entitled to act in accordance with settled law, including the decision in *Lamesa*'. The CTA also proposes that if the commencement date for the legislation is ultimately later than proposed in the Bill, the legislation should exclude cases where there is objective evidence of the transaction being under way at that later date.

I do not consider that such exceptions should be made. The Commissioner of Taxation's position has always been that the taxing right under the DTAs could only be effective if it applies despite the existence of interposed entities, and that the DTA should be interpreted accordingly. This understanding by the Commissioner would be evident to a reader of the Court's judgment.

The *Lamesa* decision created opportunities for relatively easy tax planning to avoid the taxing right accorded to Australia by the relevant provisions of the DTAs, with serious revenue consequences, and the tax profession would have been aware that this was a situation the Government was unlikely to countenance.

Although the CTA have argued that prior to the date of the Treasurer's Press Release, taxpayers were entitled to act in accordance with settled law, including the decision in *Lamesa*, the tax profession would have been aware that some form of remedial action in response to the Court's decision was likely. Prior to the Treasurer's Press Release, the media reported an Assistant Commissioner of the Australian Taxation Office stating 'the ATO was reviewing the decision'. The decision was also the subject of Parliamentary questions during that period. In addition, it is not unprecedented for the Government of the day to close off risks to the revenue exposed by an adverse Court decision, and a like precedent to the proposed provision exists in subsection 3(11) of the *International Tax Agreements Act 1953* covering permanent establishments of business trusts that was enacted in 1984.

The delay in the Treasurer's announcement of remedial action was due to the need for careful consideration by the Commissioner and the Government of the various ways in which Australia could act to preserve its taxing rights, which might otherwise be significantly undermined by leaving the effects of the decision unaddressed. Given the number of Australia's DTAs involved and the ramifications of the Government's remedial action, it was essential that the Government's response be very carefully considered and this took some time.

The approach outlined in the Treasurer's Press Release of 27 April 1998 was decided upon, as a fair and balanced approach which reflected the intent of the DTA provisions, but did not affect already completed alienations.

It has not been possible to exactly quantify the risk to the Revenue, because of the absence of data due to the transactions occurring offshore and the Australian assets being held indirectly. However, the *Lamesa* case involved a revenue loss of approximately $74 million (the tax payable on the $204 million profit) and the Government is also aware of another case involving $79 million tax payable on an alienation that occurred after the 27 April 1998 Press Release. Those known cases are indicative of the potential revenue risk involved.

To make exceptions where alienations had not occurred, but were in train at the time of the Press Release, would put such arrangements in a privileged position (as compared with later transactions, or transactions without interposed entities) that would not appear to be justified, and would involve a large potential risk to the revenue. It would also allow for the argument that alienations a long time into the future were set in train prior to the Press Release, even if the alienation did not occur for months or perhaps even years later. A provision fairly dealing with transitional cases might also have to deal with each case on a factual, case by case, basis that could create uncertainties of its own.

Some of the legislation referred to by the CTA shows the difficulty of constructing a transitional regime that is effective and does not itself give the opportunity for tax avoidance, or preserve a competitive advantage for long periods of time. The Australian Tax Office advises that it is not aware of any rulings being sought on the issue during the period while consideration was being given to the most appropriate response. For all these reasons, I consider that a transitional arrangement is not warranted in the proposed legislation.

Certainty

The CTA has also suggested that the terms ‘alienation’ and ‘disposition’ should be defined in the proposed legislation, for the sake of certainty. The language used (‘alienation or disposition’) does no more than reflect the language of the DTAs themselves. Some DTAs refer to ‘alienation’ and some refer to ‘alienation or disposition’. Neither the DTA nor the legislation seek to define what those terms mean, since they have broad international meanings. The ATO advises that this broad interpretation is well recognised, including by commentators and the OECD Model Tax Convention Commentary. The DTAs therefore accord a taxing right in respect of legally effective alienations or dispositions broadly defined, and in a practical sense, the domestic taxation laws reflect that broad coverage, whether or not they use those exact terms.

The lack of a definition in the DTAs follows normal international practice (as in the OECD and United Nations Model DTAs, for example) and did not attract criticism in the *Lamesa* decision. Nor has it been a point of criticism of our DTA practice. The CTA has been represented on the ATO’s Tax Treaties Advisory Panel, which advises the Australian Tax Office on proposed new DTAs, and while the ATO advises that the issue has not arisen in that context, it is one that the CTA is certainly entitled to raise in that forum, especially in the context of the current review of DTA policy. I do not, however, consider that the proposed legislation should address the issue.

In conclusion, then, I do not see the proposed legislation as trespassing unduly on personal rights and liberties, but as effectively confirming Australia’s negotiated taxing rights, and operating in a manner that is fair to taxpayers generally, as well as those directly affected.

I trust that the above information is useful in the Committee’s deliberations in relation to these matters.

Yours sincerely

ROD KEMP