Senate Economics Legislation Committee

New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002

Submission No. 3C

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Attachments? No Attachments

Lancsar, Angela (SEN)

From: John Morgan [John.Morgan@freehills.com]
Sent: Tuesday, 8 October 2002 7:11 PM
To: Economics, Committee (SEN)
Cc: carol@lawcouncil.asn.au; plowenst@liv.asn.au
Subject: Submission to the Senate Economics Committee on the NBTS (Consolidation and Other Measures) Bill 2002 - See submission that general value shifting regime provisions should be removed and exposed to public comment and assessment by the Board of Taxation be

Dr. Kathleen Dermody
Committee Secretary
Senate - Economics Committee

Inquiry into the NBTS (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002

I am responding to your 25 September 2002 letter inviting submissions on the above Bill. Thank-you for the opportunity to do so.

I will make some comments about the Consolidation and Demerger provisions in this Bill and in particular questioning the balance being struck between business efficacy and supposed revenue protection imperatives.

They provide a preface however to my main submission which is that the Senate should excise the General Value Shifting provisions from the Bill and recommend that we test the suggestion that we need change of this magnitude and kind by referring the matter to the Board of Taxation. In my view the Senate should be suspicious of major reform suggestions that have not been subjected to this discipline. Optimising the balance between the business and revenue objectives of our nation is in my submission, a vital issue which we should be constantly alert to. Gone are the days when we can afford a haphazard or lop-sided assessment of any piece of suggested legislation. If the Committee is not prepared to refer this issue to the Board of Taxation, is this Committee itself prepared to assess whether we are unnecessarily putting 'lead in Australia's saddle'?

Consolidation
I made some earlier submissions about particular aspects of the Consolidation regime which I thought needed correction. No doubt there are many other things that can and should be said about that regime, which I'm trusting others will have had the time and insight to detect and include in submissions to your Committee.

At least this regime is something that has the broad support of the business community, has had the benefit of intensive consultation with the private sector in its development (in large part anyway) and there does appear to be resources being directed to correcting its short comings during the development phase. If would be wise however if this effort was maintained up to the date the final piece of legislation is enacted and then for another couple of years (to correct problems that emerge over a shake down period).

Even with this more promising heritage (c/f the value shifting regime discussed below) there are policy problems besetting this regime that are a concern and are of a type similar to the General Value Shifting regime mentioned below. The type of problem is, I submit, of a type which was described once (many years ago) by a officer in a pro-business part of the Federal public service as 'fiscal paranoia'. It may not be unfair to ascribe that as the reason for at least two waves of retrospective 'integrity' measures back to 16 May (in this Bill) and back to 27 June (in the third Bill) that distort the way the regime should work and create impediments to its smooth operation. Further the loss transfer and utilisation rules include a complexity and difficulty that may exaggerate the threat to the revenue and provide a lasting impediment to business.

This is difficult to assess, but the issue does need to be raised as to whether all the hurdles built into the legislation are really necessary.

Demergers

This legislation shares, with the consolidation regime, the benefits of

introducing a regime that business broadly wants and there has been consultation on the form of the legislation (more truncated than with consolidation, but consultation nonetheless).

I am not in a position to make detailed comments on the demergers provisions, and trust others are doing that. I understand that the process is grinding on by which the provisions are being made more useful to reflect business realities and the Government's intention to have measures that are of practical use, whilst not prejudicing the integrity of the revenue.

The broad policy disappointment with these provisions is, as I'm sure others have pointed out, that the Commissioner has dealt himself back in as "gate-keeper" for virtually every demerger transaction by making the dividend relief dependant on the vague and unworkable tests in s45B of the ITAA36 (Schedule 16, Part 2, item 11). Instead of having a rule capable of objective assessment, it will be necessary to ask the Commissioner for a ruling on any demerger where dividend relief is needed (which is most) in order to get the deal away, just as it is currently necessary for share buy-backs and the like. Another objectionable aspect of this is that the rule will not be administered as it is written (like the current s45B). The section is essentially triggered if the relevant transaction has as any of its purposes (albeit more than an incidental purpose) to get a better tax treatment than would be the case if they received a dividend (and most of those transactions are predicated on there not being a dividend - to some extent at least - so the test boils down to whether this is more than an incidental purpose). This is a 'hair trigger' that no-one in the real world is prepared to risk and hence the need for a ruling. The ruling is then dispensed in substance on grounds different from the more than "incidental" wording of the section. It is abstracted to unwritten tests in the minds of the bureaucrats given the power to issue these rulings about whether the particular transaction is too 'willing' in tax effect having regard to the quantums involved and various aspects of the transaction. In other words they have some unpublished ideas about what they are prepared to allow and what they are not which can't really be tested administratively because that's no what the law really says. Even if there were some logic in this, and even if they were doing quite a good job, it doesn't make for good law or administration and it is certainly inefficient compared with a law that can realistically be interpreted and applied objectively by taxpayers and advisers without resort to a ruling in most cases.

Section 45B and its related provisions are arguably earlier examples of 'fiscal paranoia' and candidates for reform themselves rather than giving it a new job to do as well which runs the risk of infecting a new tax measure designed to make Australia more efficient.

General Value Shifting Regime

These are monster provisions which I must confess I have not got on top of - and I would suggest you don't recommend passing them unless you can honestly say you've got on top of them too (which I that you can).

They have the far less promising heritage of not being supported by business (but of course, few if any so called 'integrity' measures ever are). Of even more telling impact therefore, is the fact that these provisions have not been the subject of any meaningful public consultation to my knowledge.

I would recommend that they be excised from the Bill and referred to the Board of Taxation for proper exposure to public consultation. The provisions broadly expand the value shifting provisions found in Division 138, 139 and 140 of the ITAA97, and it is difficult therefore to see that there is any gaping wound in the side of the revenue for this period of consultation. Its not like there is nothing there at the moment.

This legislation will effectively or nearly create a domestic transfer pricing regime domestically which is a huge change both in tax policy terms and in practice for business. The impacts of doing so have not been assessed or tested to my knowledge and neither have the supposed fiscal imperatives that are said to justify these changes and this avalanche of paper ink and complexity. There is a risk that the fiscal imperatives are exaggerated. That is not for me to say, but let us test the proposition before the Board of Taxation after being properly exposed to the public.

Let us remind ourselves of the track record of measures sold to us by the

Revenue authorities as a good idea when tested in this way. Treasury got the ear of the Ralph (RBT) committee and suggested "entity taxation". When exposure draft legislation was released, the disquiet was such that the Treasurer deferred the provisions and referred them to the Board of Taxation, where 2-3 years on nothing has emerged. Even if something does emerge (and the Board of Taxation says something will) it will be very different to what was proposed to us as necessary and worthwhile. This is because it was exposed to public comment and informed reasonably neutral assessment.

Likewise, Treasury suggested, and Ralph recommended the "Tax Value Method" of calculating taxable income. Again a huge change to the tax and business landscape which was suggested for supposed tax advantages which were later judged not worth the trouble. After a detailed and historic form of public consultation run by the Board of Taxation, the Board recommended against TVM and the Government has just confirmed it is dropping the proposal.

Finally, let us remind ourselves of what happens if we don't stop this tax litter building up on the doorstep of Australia's business effectiveness and efficiency. We realise 10 or 20 years afterwards that the provisions have been hurting the national interest and that we have to do something about it. We then embark on difficult and possibly insufficiently bold review of the system like we are doing now with international transactions tax laws. They are now recognised as hurting our international competitiveness, but practitioners and commentators tried to point this out at the time they were being introduced and subsequently, but to no avail. The Board of Taxation didn't exist and there wasn't the forum to resist the earnest assertion of Treasury or the Tax Office that this was necessary and an optimal balancing of the competing issues. Now there is such a forum, and it should be used.

I urge you not to pass legislation like this again. We don't want to be coming back in 10 or 20 years time to look at repealing these provisions because of the unjustified harm it is then recognised it is doing. If the measure is really necessary, it will stand up to the test of being properly exposed for public comment and assessed by the Board. In the interim we have the existing anti-avoidance provisions which most think are quite intrusive enough.

The legislature should not become the rubber stamp of the executive and the Senate has a proud history of not doing this. Even so, it has been susceptible to being seen as a rubber stamp, I submit (with respect), with regard to the passage of complicated tax legislation where it is assured by the executive that the legislation is necessary for revenue integrity purposes or to counter tax avoidance. You need no longer be put in this position. The proposition that it is necessary can be tested by public exposure and assessment by the Board of Taxation.

My submission therefore, is that you should be suspicious of any major taxation measure that has not been subjected to this discipline, and act accordingly.

By way of conclusion, I note that I am a tax partner with Freehills, but I make this submission in my own capacity. I am also a member of the Law Council of Australia and Law Institute of Victoria's tax committees (being Chair of the latter). I will send this submission to those organisations in case they want to support the submission, but I cannot necessarily say that they will.

I have no objection to this submission being made public.

Thank-you,

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