KPMG Tax

A.B.N. 51 194 660 183

KPMG House
161 Collins Street
Melbourne Vic 3000
Australia

GPO Box 2291U
Melbourne Vic 3001
Australia

Telephone: +61 (3) 9288 5555
Facsimile: +61 (3) 9288 6666
DX 30824 Melbourne
www.kpmg.com.au

Kathleen Dermody
Secretary
Senate Economics Legislation Committee
Parliament House
CANBERRA ACT 2601

Our ref Demerger03-Submission-PP-1008-TL

8 October 2002

Dear Kathleen

New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002
Submission in respect of Demergers Provisions

Please accept this submission to the Economics Legislation Committee in respect of its consideration of the above Bill. The submission is limited solely to the provisions in the Bill dealing with demergers.

By way of background, I have been involved in consultations with Treasury and the Australian Taxation Office ("ATO") in respect of proposed demerger tax relief over the past two years. Generally, the provisions outlined in the Bill are welcome as they will reduce prohibitions for Australian businesses to naturally demerge where appropriate. Such demerger activity would otherwise not have occurred due to prohibitive tax costs.

General Comments

It is noteworthy that the provisions provide for capital gains tax ("CGT") relief at the corporate level as well as relief at the shareholder level, and also provide for dividend taxation relief at the shareholder level.

In this regard, the measures go beyond the recommendations in the Ralph Review, and this is totally appropriate and consistent with demerger tax relief available in other leading economies including the USA, Canada, UK, Germany and Japan. It is obvious that the Ralph Committee did not fully apprehend the requirements for effective demerger relief. Providing CGT relief at the shareholder level only, as the Ralph Committee recommended, would be ineffective, as CGT at the corporate level and dividend taxation will in themselves prevent much demerger activity.

A number of shortcomings have been identified in respect of the proposed demerger provisions contained in the Bill, including the treatment of shareholders on revenue account and the treatment of employee options and shares. These issues will have been raised elsewhere in other submissions.

Treatment of non-listed entities

This submission will focus solely on the treatment of non-listed corporates and trusts. Throughout the consultation process leading up to the current form of the Bill, it is clear that Treasury and the ATO intended that demerger tax relief be available for both broadly and narrowly held entities. This was clearly the Government's intention as outlined in Assistant Treasurer Senator Coonan's press release dated 6 May 2002.

Instead, the original Bill provided that the relief was not available where the demerging entity has a corporate or trust share or unit holder with a greater than 20% interest in the demerging entity. This restriction would prevent most entities from demerging, as most entities would typically have a corporate or trust share or unit holder with a greater than 20% interest. This problem has been partly addressed in the latest amendments by providing that listed entities can demerge notwithstanding that they have a corporate or trust shareholder with a greater than 20% interest.

However, non-listed entities remain unable to elect for demerger relief where they have a corporate or trust shareholder with a greater than 20% interest. As you may be aware, it is quite typical for non-listed entities to have such a share or unit holder, more so than is the case for listed companies. The effect of the provisions in the current Bill therefore are that non-listed entities will typically be unable to elect for demerger relief. This is a problem faced by non-listed entities generally, regardless of whether they are characterised as large, medium or small businesses.

In my view, it is inappropriate and unjust to deny demerger tax relief to entities simply on the basis that they are not listed. There is no apparent policy justification for excluding most non-listed entities from the ambit of the measures. Further, the Bill excludes most non-listed entities in an arbitrary manner, ie. those non-listed entities which by coincidence do not have a corporate or trust share or unit holder with a greater than 20% interest will still benefit from the relief.

It has been expressed by the Treasury and ATO during the consultation process, as well as by the Assistant Treasurer in the above press release, that additional anti-avoidance measures *may be* appropriate for narrowly held entities. If there is a case for such additional anti-avoidance measures, and I note that no case for such measures has been publicly articulated, then such measures should be considered.

For example, the existing scrip for scrip rollover provisions contain integrity measures for non-widely held entities, and these measures apply to non-widely held entities in general. They do not arbitrarily exclude a class of non-held entities from the relief, as is the case with the proposed demerger measures.

A demerger of businesses is a normal corporate evolution which enables separated businesses to grow and maximise their value for the benefit of their owners, employees and the broader community. This process is just as important to the non-listed as the listed sector.

Accordingly, I submit that the proposed demerger measures in the above Bill be amended to allow non-listed entities access to demerger relief irrespective of whether or not they have a share or unit holder with a greater than 20% interest.

I would be pleased to give evidence to the Committee in respect of this submission, including the broader rationale for demerger tax relief extending to corporate CGT and dividend taxation relief.

Yours sincerely

Peter Poulos
M&A Tax Partner
KPMG