CORPORATE TAX ASSOCIATION
Level 11/455 Bourke Street
Melbourne Vic 3000
Tel: (03) 9600 4411
Fax: (03) 9600 4055
Email: admin@corptax.com.au

To: Peter Hallahan
Senate Economics Committee

Fax No. (02) 6277 5719

Tel. No. ....

Company : ....

From: Frank Drenth ☑
~~Joy Lambert~~ ☐
~~Miguel Timmers~~ ☐

Date: 1 August 2003

No. of Pages incl. cover sheet (4)

☐ Urgent ☐ For your Review ☐ Reply ASAP ☐ Please Comment

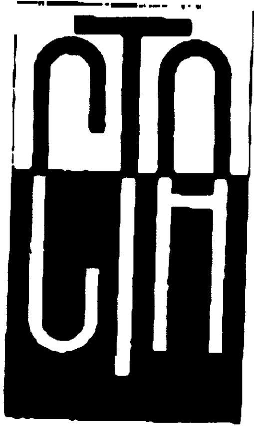
MESSAGE:

Additional information re TLABS requested by Chairman of Committee.

Kind Regards,

Frank Drenth

Corporate Tax Association



CORPORATE TAX
ASSOCIATION
of Australia incorporated

1 August 2003

The Chairman,
Senate Economics Legislation Committee
Parliament House
Canberra ACT 2600

Dear Senator Watson

ENQUIRY INTO TAXATION LAWS AMENDMENT BILL (NO.5)

When the Corporate Tax Association was giving evidence to the Senate Economics Legislation Committee last Tuesday 29 July, you asked what the revenue impact might be of Schedule 8 not being passed by the Senate. I have taken it that your request was directed at both the CTA and the ICAA, whose representatives gave evidence on the same point. I have conferred with Mr Stolarek about these matters, and this letter represents our joint views,

As I mentioned at Tuesday's hearing, the Treasury estimates that accompanied the Explanatory Memorandum both understate and overstate the revenue impact of Schedule 8.

They overstate the cost to revenue because the current system enables companies to pay tax voluntarily by not fully utilising prior year losses. This practice is widespread. A number of companies do pay more tax than they are legally obliged to because of the value the market attaches to franked dividends. We are aware of at least three large public companies that operate in this way at the present time. Others have done so in the past and others again may wish to do so in the future, given the opportunity.

The three companies we are aware of currently pay around $300 million in voluntary tax per year, which in itself would overwhelm the estimated cost to revenue of $125 million for the three years ended 30 June 2006.

This phenomenon illustrates the very positive impact that the dividend imputation system has had on corporate behaviour. In these cases, it is the

Level 11, 455 Bourke St,
Melbourne 3000, Victoria.
Telephone (03) 9600 4411
Facsimile (03) 9600 4055
Email Address
admin@corpt

appetite of investors for franking credits rather than any enforcement activities on the part of the ATO that drives corporate tax payments.

It is expected that almost all large corporate groups will elect to adopt the consolidation system by the end of next year. Without the measures proposed under Schedule 8, which protect both current and prior year losses from being "wasted" by being offset against franked dividends, there would also be no mechanism that enables companies to modify their rate of utilisation of prior year losses.

Hence any Senate rejection of Schedule 8 of the bill, combined with the widespread adoption of consolidation, would prevent such companies from voluntarily prepaying tax. Clearly, this would have an adverse impact on the revenue.

The other side of the coin is represented by those companies who receive franked dividends into consolidated loss groups. Companies across all sectors may receive franked dividends from outside their wholly owned groups - for example, insurance companies with significant investment portfolios, building and construction companies or mining companies operating specific projects through 50% owned joint venture companies with others.

As explained in the CTA and ICAA submissions, the introduction of consolidation makes it virtually impossible to separate franked dividends from operating losses, and the measures in Schedule 8 in the Bill are designed to overcome these problems in relation to both prior year and current year losses. On a "do nothing" basis, the failure to adopt the measures in Schedule 8 would create enormous problems for any group that has a tax loss when it receives franked dividends from outside the wholly owned group.

It is difficult to be precise about the amount of revenue potentially involved, but based on comments received from a number of member companies, the amount of double tax potentially payable due to the wastage of losses could approach an amount well in excess of $1 billion per annum, depending on where companies are in the business cycle.

Having said that, the commercial consequences of the wastage of significant tax losses (including the impact on share prices) are so serious that corporate groups would need to look at ways of operating outside the consolidation system.

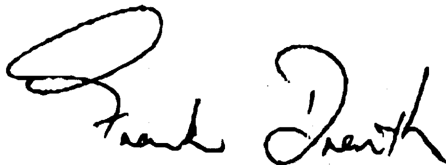
We would expect that most corporate groups affected by this problem would be forced down this path, even though under the current law this would mean not having access to the ability to transfer losses or roll over assets for capital gains tax purposes. This would create significant additional compliance costs, which do nothing to add to our productivity as a nation, while at the same time creating all sorts of inefficiencies and uncertainties, for both the business community and the revenue.

Our best guess is that the net revenue impact if not passing Schedule 8 would be negative from the point of view of the government. In other words, voluntary tax payments of some $300 million a year (and probably more) would no longer be forthcoming. At the same time, however, it is likely that many other companies would be forced to adopt less efficient business structures in order to avoid the wastage of losses. This would limit any revenue windfalls accruing to government from this source, apart from companies that may already be trapped by such Senate action in the year just ended.

I apologise for not being able to be more precise in making these additional comments. It is notoriously difficult to forecast the impact of behavioural changes that may occur in response to particular policy changes. We have done the best we can in the short time available, and I trust these comments will assist the Committee in its deliberations.

Please feel free to contact the undersigned again should you require any further clarification.

Yours faithfully,



(Frank Drenth)
Executive Director