ICAA Handout for Senate Economics Committee hearing

29 July 2003

Schedule 8 Losses

Senate Economics Affairs
Legislation Committee
Inquiry: Taxation Laws Amendment Bill (No. 5) 2003

Tabled Document
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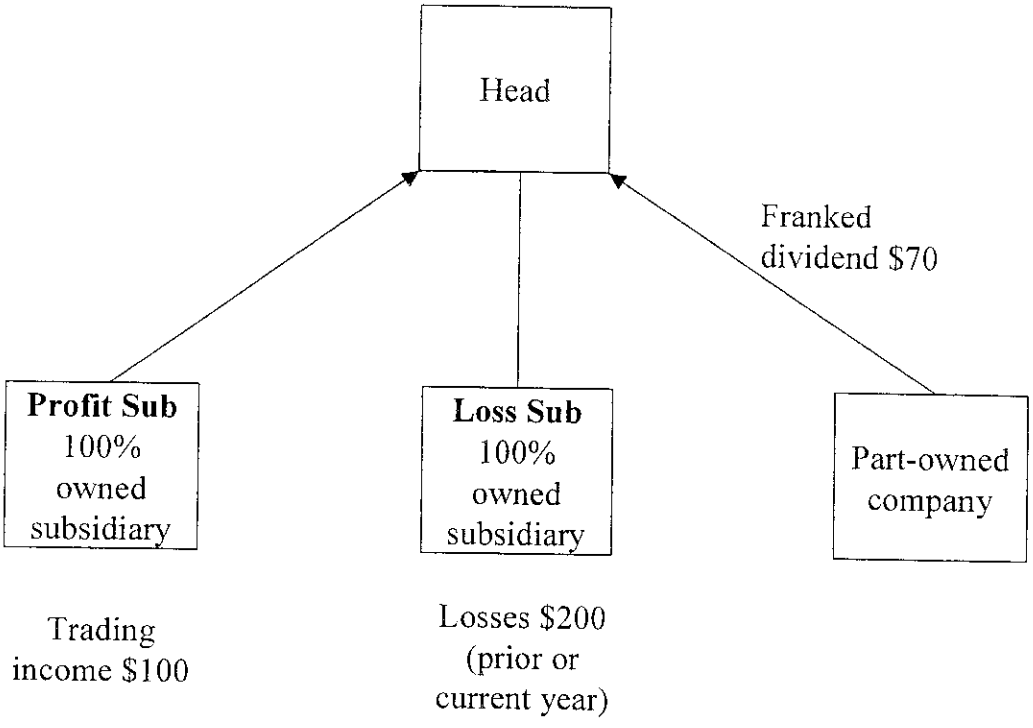
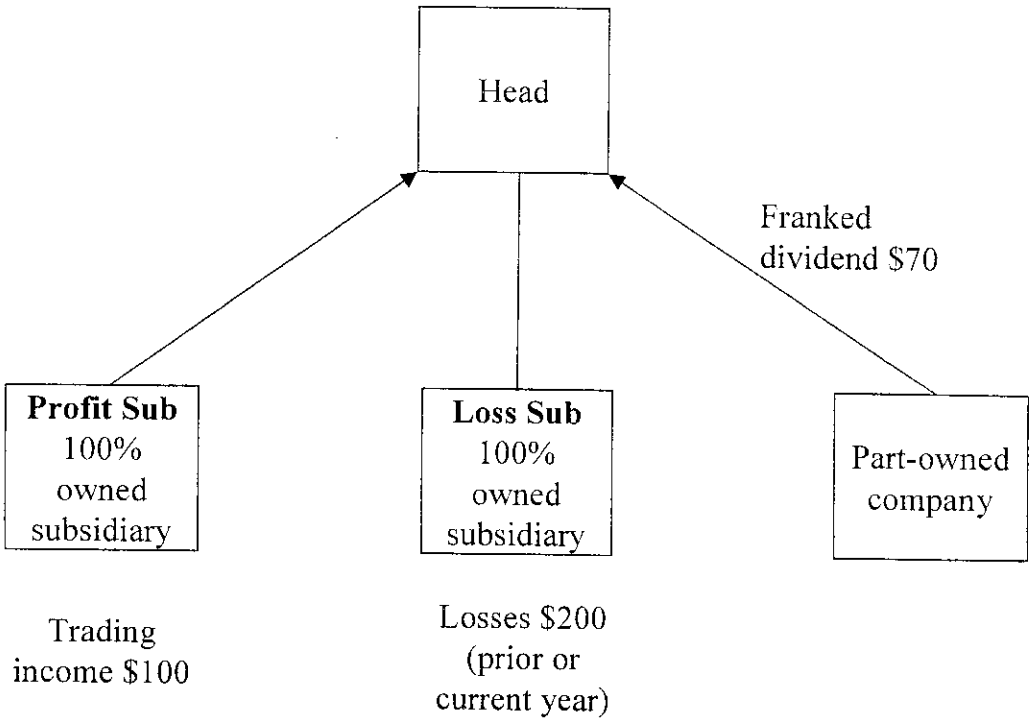
Before Consolidation



Head – Taxable Income

Trading income	100
Dividend	70
Franking gross-up	30
	200
Less partial tax loss transfer from Loss Sub	(100)
Taxable income	100
Tax	
Corporate Tax	30
Franking offset	(30)
Net Tax	Nil
Remaining Tax Losses	$100

In Consolidation and No TLAB 5 Schedule 8



Head – Taxable Income

Trading income	100
Dividend	70
Franking gross-up	30
	200
Loss of Loss Sub	(200)
Taxable income	Nil
Tax	
Corporate Tax	Nil
Franking offset	Nil
Net Tax	Nil
Remaining Tax Losses	Nil

Supplementary submission

Dividend rebates and loss absorption – consistency with recommendations of the Ralph Review of Business Taxation

The Institute adds the following supplementary material in support of its submission already provided to the Committee in relation to Schedule 8 of the Bill, that "the change to a gross-up and credit approach was recommended by *A Tax System Redesigned* (the Ralph report) ... the Ralph report acknowledged that this would lead to a major change in the effectiveness of both current and prior year losses."

The Ralph Report there included an express recommendation to insulate companies' tax losses from dividend income (which receives concessional tax treatment).

The Ralph Report recommendation 11.5 and discussion material were as follows:

> "**Recommendation 11.1 Deduction for carry-forward losses**
>
> **That entities (including consolidated groups) be able to choose the proportion of their carry-forward losses to be deducted in a year.**
>
> During consultation two main concerns were raised about the effect of distributions on losses.
>
> - First, as noted in respect of Recommendation 11.4, concern was raised about the rate of absorption of losses under the gross-up and credit approach for preventing double tax through the entity chain.
> - Second, concerns were raised that the proposed consolidation regime would force groups to apply distributions received by them to losses earlier than under the existing law. Currently, groups usually ensure that distributions from outside the group are paid to the holding company with any losses held by subsidiaries. Under the current loss transfer provisions, the holding company and subsidiary can agree on the amount of loss to be transferred. This allows the holding company the option of not absorbing group losses against distributions received by the holding company from outside the group. The pooling of group losses under consolidation would remove this option in the absence of a specific measure.
>
> Both these concerns will be overcome by allowing entities (including consolidated groups) to choose the proportion of carry-forward losses to be deducted in a year. Under the current law, a company cannot choose the amount of carry-forward loss it wishes to deduct. A company is forced to claim the amount of loss necessary to absorb the excess of assessable income over allowable deductions. As noted, in contrast, under the existing loss transfer provisions, groups can choose the proportion of loss to transfer within the group.
>
> The recommended measure will allow consolidated groups and single entities — as well as unconsolidated groups — to avoid having a carry-forward loss absorbed by grossed-up franked distributions received from other entities or groups. This will provide consistency of treatment across these taxpayers. It also provides a mechanism for single entities or groups to fully frank distributions of profit even when they have large carry-forward losses. By not fully claiming the losses, the group or entity could pay sufficient tax to frank the distributions.

Carry-forward losses will still have to be reduced by the amount of net exempt income derived by an entity, consistent with the existing law.

This measure will not apply to individuals or complying superannuating funds. Unlike entities, individuals and complying superannuating funds will not be affected by the absorption of carry-forward losses by franked distributions received by them. The proposal to refund excess imputation credits effectively gives these taxpayers the full benefit of the losses immediately."

This measure had its origins in delivery of the Ralph Report recommendation for consolidation, a measure which was supported by Labor and the minor parties in the Senate.

The measure is now somewhat wider than the basic Ralph recommendation in now allowing for a choice on utilisation of current year losses as well as prior year losses. That is, there is a "current year loss extension" of the original prior-year-loss proposal.

The ICAA supports the extension of this principle, which arose through submissions by the ICAA consolidation representatives and those of other professional and business bodies.

The Ralph Review focus on prior-year losses was on the basis that this was the most immediate and most obvious problem. The same principle is applicable to current-year losses. To the knowledge of the ICAA the Ralph Review did not consciously exclude current year losses from the same treatment as a result of any conscious policy decision or limitation. Rather, the current-year-loss extension was just not considered at the time and was a typical detail issue identified after release of the report, in the ongoing consultation process.

The Ralph Recommendation 11.5, and consolidation generally, had not been rejected at any earlier time by the Labor Party and had not been signalled for rejection.

In the circumstances any action by the Senate for rejection of this measure will create a tax trap for consolidating groups.

Such action would represent a very dangerous precedent, and imperils the neutrality and proper outcomes of tax consolidation.

It would amount to a selective implementation of consolidation, taking all the revenue-positive measures and not delivering other measures intended as an integral part of tax consolidation.

Such action would create a new very volatile element into the delivery of tax reform in Australia, and to the confidence of business in relation to the ongoing proper delivery of tax consolidation law to Australia's corporate sector.