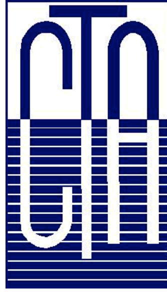


Level 11, 455 Bourke Street
MELBOURNE VIC 3000
Telephone: 03 9600 4411
Facsimile: 03 9600 4055
Internet: www.corptax.com.au

Level 3, 44 Sydney Avenue
FORREST ACT 2603
Telephone: 02 6233 0600
Facsimile: 02 6233 0699
Internet: www.minerals.org.au

21 October, 2005

Mr Peter Hallahan
Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
CANBERRA ACT 2600

(by way of email to economics.sen@aph.gov.au)

Dear Mr Hallahan

Senate Economics Legislation Committee Inquiry
Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005

The Minerals Council of Australia (MCA) and the Corporate Tax Association of Australia (CTA) welcome the opportunity to provide joint comments on aspects of the above Bill.

The MCA represents Australia's exploration, mining and minerals processing industry, nationally and internationally, and its contribution to sustainable development and society. MCA member companies between them produce nearly 90% of Australia's mineral output and account for a slightly higher percentage of minerals industry exports.

The CTA represents the taxation interests of Australia's 120 largest corporate groups.

Our comments are chiefly confined to Schedule 1 of the Bill, dealing with proposed modifications to the loss recoupment rules for companies.

As a preliminary comment, we would like to acknowledge the very positive and productive consultation process engaged in by Treasury on these measures over recent months. While there are still a small number of important issues to be

resolved (as indicated in the Minister for Revenue and the Assistant Treasurer's Media Release dated 14 September 2005, particularly the treatment of Dividend Access Shares, which is quite relevant to the minerals industry), the consultation process has resulted in a number of significant improvements to the operation of the revised Continuity of Ownership (COT) rules.

The government's policy approach on loss usage involves a fundamental trade off. On the one hand the COT test is to be significantly modified to make it easier for publicly listed companies to pass. On the other, as a *quid pro quo*, the fallback Same Business Test (SBT) will not be available in future for entities with income totaling more than $100 million a year.

The existing COT rules in practice have been quite unworkable, which has created enormous compliance costs and uncertainty for large listed corporate groups – even though the trading in their shares could ever be regarded as loss trafficking. The proposed COT changes are therefore most welcome in terms of reducing compliance costs and improving certainty.

However, what is very concerning to the MCA and the CTA is Treasury's apparent expectation that the proposed modifications to the COT, together with the removal of the SBT for large corporate groups will be revenue neutral. We do not share this view. It is, in fact, highly likely that the combined changes will have a significantly positive impact on revenue over time.

As important as they are, the proposed COT changes do not go much beyond restoring the pre-1997 position that normal trading in the shares of a publicly listed company should not lead to COT failure or its consequences – the wiping out of realised and unrealised losses and bad debts in the main. The fact of the matter is that to its credit, the Australian Taxation Office (ATO) has for the most part never adopted a strictly literal approach to the application of the COT since 1997. This means that as a practical matter the proposed COT changes will not represent a significant cost to the revenue.

The proposed SBT changes, on the other hand, will undoubtedly remove significant losses at the entity level as a result of future takeover and merger activity. Entity losses that would otherwise have been preserved at the entity level under the former SBT will increasingly fall by the wayside because of market based corporate activity. We are not in a position to accurately forecast the revenue gains, but based on past transactions Treasury could, with the assistance of the ATO, determine a range within which such revenue gains are likely to fall.

Throughout the Business Tax Reform process commencing early in 1999, Treasury has, in our view, consistently underestimated the revenue gains likely to arise from numerous business tax reform measures. This has in no small way contributed to the sky rocketing corporate income tax collections we have seen over the last six or seven years. Earlier this week, the Business Council of Australia highlighted the very high corporate income tax burden in Australia in its report: *Corporate Taxation – an International Comparison*.

In evidence given to the Senate Economics Legislation Committee in relation to the *International Tax Agreements Amendment Bill 2003* (dealing with the United

Kingdom double tax agreement) on 13 October 2003, Treasury officials made it clear that Treasury's practice is to only factor in the direct revenue impact of proposed taxation measures into the forward estimates. However, 'second round' behavioural impacts on revenue are in Treasury's view too uncertain to warrant inclusion in the forward estimates. This admission was not confined to one particular item of legislation, but described Treasury's approach to revenue estimates across the board. Given the level of tax reform measures in recent years, it should come as no surprise, therefore, that company income tax collections have been increasing at a much faster rate than profit growth.

What these unduly conservative practices have meant is that some quite desirable and worthwhile business tax reform measures, which would help make Australia's tax system more competitive internationally and promote economic growth in this country, have not been pursued because they were thought to be unaffordable.

We see the current Bill as a spectacular example of unduly conservative revenue estimates which blatantly ignore the obvious revenue gains that will accrue through the removal of SBT for large corporate groups.

The windfall revenue gain that the current Bill will produce for future governments could be reduced by preserving the SBT where a publicly listed group is acquired. There are sound policy reasons for doing so, since those kinds of transactions are commercially based and would never be motivated by so called loss trafficking motives.

An additional approach involves addressing Australia's serious under-investment and critical infrastructure projects. Because major infrastructure projects typically experience start up losses that take some years to reverse (due mainly to very long constructions phases), they are particularly susceptible to the removal of the SBT. These sorts of projects typically involve start-up investors who stay on during the planning and construction phase, but tend to exit the project once it is up and running.

In addition to the listed group carve out, specific infrastructure projects (determined on an objective net community benefit basis) could be carved out of the $100 million SBT cap.

An alternative might be to leave the SBT cap in place and to consider a carefully designed tax loss flow-through arrangement that would apply to specially designated infrastructure projects (again, objectively determined on a net community benefit basis).

In this context, the MCA and the CTA also note the discussion in the House of Representatives on 12 October 2005, where the issue of flow-through shares for exploration expenditure was raised.

The MCA, as a member of the Minerals Exploration Action Agenda (MEAA) Implementation Group has advocated the introduction of flow-through shares to address a range of impediments and distortions facing junior exploration companies in raising capital. Among these impediments is a tax related market

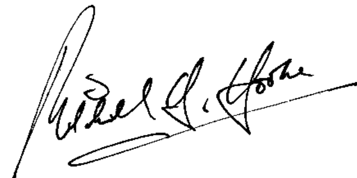
failure, which has meant that access to finance has been particularly difficult for junior exploration companies. Companies without taxable income cannot gain access to the benefits of the immediate deductibility of exploration expenditure. The current circumstances of continued weakness in exploration spending, despite the strength of the commodity cycle, gives further foundation to our arguments that the causes of the decline in minerals exploration expenditure are structural moreso than cyclical. The CTA has also noted it has no objection to the introduction of flow-through shares for junior explorers.

In conclusion, the MCA and the CTA, while supporting the broad COT/SBT tradeoff, are highly skeptical about the claimed revenue neutrality of this package of measures. If the government wants to increase the overall tax burden on business it should do so in an overt way, not by fudging the figures when estimating the revenue impact of business tax reform measures.

Finally, the amendments proposed in Schedule 2 are consistent with the MCA's and the CTA's views on this issue and are fully supported by both organisations.

Schedule 2 to this Bill makes changes to provide tax relief for conduit foreign income, which generally is foreign income received by a foreign resident through an Australian corporate tax entity. Generally, the measure only applies to foreign income that is ordinarily sheltered from Australian tax when it is received by the Australian corporate tax entity. The MCA and CTA note these changes implement the Government's decision to establish foreign income account rules, in response to Recommendation 3.11(1) of the Board of Taxation's report to the Treasurer, the Hon Peter Costello MP, on international taxation. The decision was announced in the Treasurer's Press Release of 13 May 2003.

Yours faithfully



(Frank Drenth)
Executive Director
Corporate Tax Association

Mitchell H. Hooke
Chief Executive
Minerals Council of Australia