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The Secretary,
Senate Economics Legislation Committee,
Suite SG.64, Parliament House
Canberra ACT 2600.

By email: economics.sen@aph.gov.au

Dear Sir/ Madam

Submission to Senate Committee on the Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005

Dear Sirs

CPA Australia welcomes the opportunity to provide a submission to the Committee on the abovementioned Bill.

We understand that the Bill has been referred to the Committee on the basis of concerns regarding the potential impact of the measures for the denial of access to the SBT for companies and groups with income in excess of $100 million in the proposed year of recoupment, with particular focus on industries such as the capital intensive resources industries and infrastructure investment.

CPA Australia has participated extensively in the consultations with Treasury officials on the structure and policy detail of the new 'loss recoupment' measures. In relation to the new continuity of ownership testing rules, this consultation has been, on the whole, very constructive, and has given rise to significant improvements to the Bill as introduced.

However, in the course of consultation we, along with other accounting and taxprofessional bodies, had expressed significant concerns in relation to the proposal to deny satisfaction of the same business test for companies and groups over a particular ($100M) income ceiling. These concerns were raised in our joint submission of 26 May 2005 to the Minister for Revenue and Assistant Treasurer, a copy of which is enclosed.

The explanatory materials (EM) accompanying the Bill on its introduction to Parliament indicates that, from a policy perspective, the SBT changes are closely linked to the relaxation of the COT testing rules. However, we do not accept that this link is either necessary or appropriate.

It is clear from the EM, and indeed the Bill itself, that the changes to the COT reflect the significant difficulties faced by certain 'widely held' companies and groups in applying the existing rules. These

rules, require that ownership be tested to underlying natural persons holding interests in the loss company, and those interests must be traced through any intervening entities. There has been some previous recognition of the difficulties that the COT testing rules created for public (listed) companies. However, the existing 'concessional' rules provided for those entities are extremely limited (ie to listed companies and their wholly owned subsidiaries) and still require tracing to shareholders holding a greater than 1% interest in the company.

The new tracing concessions contained in the Bill will apply in circumstances where ownership is very difficult or even impossible for the loss company to positively establish, where the revenue benefits substantially outweigh compliance costs, and where the likelyhood of loss trafficking by shareholders is remote. As such, these amendments reflect an appropriate application of the tax system to reduce unnecessary compliance costs, and to focus on those circumstances where there may be an actual risk to revenue.

The EM notes that as a result of the existing uncertainty with the COT, many companies and groups are currently forced to rely on the SBT. This may well be the case, but it does not follow from this that the SBT is a 'supporting' test for the COT under the current law. Rather the SBT under the current law, is specifically an alternative test to allow for the recognition of actual expenditure and losses incurred in circumstances where the COT has demonstrably failed. We therefore do not accept that the measures to improve the COT and to limit the SBT are inextricably linked[1].

Having regard to the denial of the SBT as a 'stand alone' amendment therefore, we do not accept that the statements in the explanatory material provide a sufficient policy justification for such a significant and potentially widely impacting change. Based on chapters 2 and 4 of the EM, the focus is on difficulties in determining satisfaction of the SBT for large and 'diverse' businesses, and the fact that that these problems will exacerbated for consolidated groups[2].

Chapter 4 contains the regulation impact statement (RIS) and states that the policy objective of the Bill is to:

- Reduce the uncertainty and compliance costs associated with applying the company loss recoupment rules to widely held companies and companies owned by widely held companies; and
- Broadly maintain the current rate of loss recoupment.

In considering possible modifications to the SBT, the RIS also suggests that 'The only practical means identified for excluding the SBT in cases where its application would be difficult or uncertain was on the basis of the size of the company or group' (see para 4.17).

[1] In any case, this linkage is only applied selectively. We have noted in our previous submissions that there will inevitably be a number of taxpayers that do not satisfy the eligibility for the new COT rules but which will in any case lose the benefit of the SBT as a consequence of the Bill. If the policy approach is to link the denial of the SBT to the COT changes, then, at a minimum, the denial should only apply for those companies and groups that can benefit from the COT changes.

[2] The removal of the consolidation 'entry history rule' is intended to support SBT testing in consolidated groups.

Paragraph 4.24 indicates that 'The companies that are affected by the removal of the SBT are those most likely to benefit from the simplified COT. In this sense, it is not expected that loss recoupment rates will alter over the longer term'.

In our joint submission of 26 May 2005 to the Minister for Revenue and Assistant Treasurer, the joint accounting and tax professional bodies requested that the costing for the removal of the SBT be reviewed, and advised that we do not accept on the current evidence that the cost will be revenue neutral. Instead, having had the benefit of reviewing the regulation impact statement, we consider that the more likely position is that the revenue cost of the package in its current form will in fact be revenue positive. The materials accompanying the Bill, as summarised above, make it clear that the main issue with the existing loss rules as regards the SBT, is not that the SBT is being applied in circumstances where the same business is not being carried on, but rather that it is being inappropriately used to support the COT.

As previously noted, the current SBT is intended to apply in circumstances where it is positively established that the COT is not satisfied, such as in the case of a 'corporate change' (eg a takeover) under the new rules. Other examples of circumstances where the COT will clearly not be satisfied are for significant joint ventures where one party sells their interest, where a closely held business is listed on the stock exchange, where an initial investor in a privatised asset sells their interest to another owner, and where an existing business funds growth through a capital raising.

We share the concerns of the wider tax community, that the focus of the new rules on the policy 'trade off' between the simplified COT and the limitation on the SBT has obscured the real and significant potential cost to the overall budget in devaluation of assets, increasing the risk associated with major projects and consequential potential reduction of necessary business activity and growth.

In summary, we strongly submit that the proposed removal of the SBT requires further and wider consideration, in order that the full ramifications of the proposal can be properly considered in the context of a 'stand alone' and significant change in policy, rather than merely as a consequential and necessary 'trade off' to the improvements to the COT.

Yours sincerely

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