Senator Andrew Murray: Australian Democrats Minority Report

Senate Standing Committee on Economics October 2006

Tax Laws Amendment (2006 Measures No. 4) Bill 2006

The *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* ('the Bill') contains four schedules, each with their own purpose but all relating to various aspects of Australia's tax law regime.

Briefly, Schedule One modifies provisions relating to capital gains tax (CGT) implications associated with asset disposals arising from marriage breakdowns. Schedule Two contains amendments which modify the interaction between the consolidation rules and demerger rules. Schedule Three amends the simplified imputation system that exists between Australia and New Zealand. Schedule Four significantly alters the application of Australia's CGT rules as they apply to foreigners (including both residents and non-residents).

Schedule Two relates to changing the operation of some demerger and consolidation rules. These provisions seem fairly uncontroversial, perhaps with the exception of the modelling of the costs. The Explanatory Memorandum (EM) has the negative financial impact at $35m over four years, but the cost estimates are undoubtedly just that, estimates.

Mr Brown—…..He really wants some kind of breakdown of the basis of that particular costing of the consolidation change in schedule 2.

Senator MURRAY—Yes, because, essentially, it anticipates market activity, specifically in demerger circumstances, and I really do not know how you compute that.

Mr Brown—Such costings are an estimate and they are based on average levels of activity that have been observed in the past. As with any costing, actual activity will determine whether or not the cost is as set out.

Senator MURRAY—Yes. As you know, the difference between Treasury estimates and those elsewhere is that it is an educated thumb that they suck, but it is still a thumb-suck![1]

The estimates will have had to heavily rely on a forecast trend, otherwise how else can the number and value of mergers and consolidations be calculated into the future. However, costing often involves assumptions like these, so it is perhaps more just the accuracy of the amounts arrived at which can be questioned.

Schedule Three seems relatively uncontroversial and appears to relate to a technical taxation matter that was unintentionally not dealt with appropriately previously.

Contentious issues are present in both Schedules One and Four.

A point that merits noting is the apparent lack of informed public awareness concerning this bill, as judged by the few submissions received, although there has been some media commentary on these proposed amendments. The Senate Standing Committee on Economics' Inquiry into the Bill only received five submissions in total from various industry bodies and associations. All expressed support for the Bill. Given that Schedule Four alone has an estimated cost to revenue of $245m over the financial years 2006-07 to 2009-10, a lowish level of public awareness is concerning.

The key question arising is: given other competing priorities for Government funds, are these new tax concessions really necessary?

Schedule One

Schedule One extends the existing Capital Gains Tax CGT rollover relief as it applies to marriage breakdowns so that the CGT rollover applies to the main residence exemption and marriage breakdown settlements do not result in CGT liabilities.

Currently, the roll-over applies automatically to a relevant CGT event arising from:

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- a court order under the *Family Law Act* or a corresponding foreign law;
- a court-approved maintenance agreement under section 87 of the *Family Law Act* or a corresponding agreement approved by a court under a corresponding foreign law; or
- a court order under a state, territory or foreign law relating to de facto marriage breakdowns.

Schedule One extends the operation of the marriage breakdown roll-over provisions to an additional three situations:

- a financial agreement binding under the *Family Law Act*;
- an arbitral award made under the *Family Law Act*; or
- a written agreement that is binding because of a state, territory or foreign law relating to de facto marriage breakdowns.

As the Bills Digest notes[2]

> *Parliament may note that the measure will make no changes to availability of the roll-over relief: only heterosexual couples, married or in de-facto relationships, will benefit from the expansion of the relief. It will continue to be unavailable to same-sex couples.*

This represents the continuation of on-going tax discrimination against homosexuals, and is thus a violation of equity.

It is one thing to take time to phase in changes to laws that are explicitly discriminatory, but which are costly and/or complicated to unravel. It is quite another thing to introduce new or extended discrimination, which this bill does. I can think of only one of three reasons for this to have occurred:

- it was an oversight;
- there are (as yet) unexplained (and justifiable) reasons why this is necessary; or
- the Government is homophobic.

[2] Bills Digest 15 August 2006 No 16 Page 4

I hope the first reason is the one. As for the second possible reason, I cannot see any possible justification which would merit extending discrimination through this legislative action - certainly not the Minister's 'it's not the right time and this isn't the right vehicle' argument.[3]

As for the third possibility – if the first two possible reasons fall away, then this third reason remains.

I recognise that recent legislated changes to the Australian federal definition of marriage may mean that same-sex couples may find it difficult to seek to be on the same statutory basis with respect to CGT events as *married* couples. However, Schedule One also covers *de facto* relationship breakdowns, so same-sex couples are entitled to seek to be on the same basis with respect to CGT events as *de facto* heterosexual couples.

My question on notice[4] on this matter was addressed by Treasury as follows:

> *My question is a very simple one: to address the issue of providing the same marriage breakdown rollover provisional law changes proposed in this bill to de facto same-sex couples, would that require a change in law? Would that actually require an amendment?*
> *Answer: Yes to both questions.*

This continuation of official discriminatory behaviour is frustrating because this is a new rule, and rather than extending discrimination, this legislation should be used as an 'engine of change'. As I understand Coalition Government policy, including as enunciated by the Prime Minister, the Coalition do not support continued discrimination against gay and lesbian Australians with respect to property matters.

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[3] See Footnote 5 Bills Digest 15 August 2006 No 16, referring to the Hon Mal Brough, then Minister for Revenue and Assistant Treasurer, Answer to Question on Notice No. 243 'Taxation, Capital Gains Tax', from Mr Michael Danby MHR, 9 December 2004, Hansard Page 193.

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Prime Minister Howard has said that he is

> *Strongly in favour…of removing any property and other discrimination that exists against people who have same-sex relationships.*[5]

One of the few witnesses to the Inquiry, The Institute of Chartered Accountants, had no *taxation* objections to this discrimination being overturned. At the public inquiry into this Bill, following a discussion on this same-sex couples issue, I asked on notice[6]:

> *Would the Institute of Chartered Accountants have any in-principle objection to the roll-over provisions applying generally to the break-up of couples?*
>
> *Answer: Whilst, from a purely technical taxation perspective, The Institute of Chartered Accountants in Australia has no in-principle objection to the roll-over provisions applying generally to the break-up of couples, it is also clearly acknowledged that there may be other policy considerations involved on which the Institute is not competent to comment.*

The Human Rights and Equal Opportunities Commission is conducting a *National Inquiry into Discrimination against People in Same-Sex Relationships*. They note[7] that same-sex couples do not attract the tax concessions available in relation to property transfers following family breakdowns that are available to heterosexual families.

The measures attempting to be introduced by the Bill will only apply to heterosexual couples who are either married or in a de-facto relationship:

> *…this is contrary to the way in which the government is moving, it is contrary to the remarks of the Prime Minister and the Minister for Finance and is contrary to the views of most parliamentarians I know. It may also infringe*

[5] Prime Minister John Howard, Transcript Press Conference Commonwealth Parliamentary Offices Sydney, 22 December 2005

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> *international law. Some countries, such as Canada actually allow marriage of same-sex couples*.[8]

Schedule Four

Schedule Four proposes amendments which will heavily modify the CGT regime as it applies to both (Australian) resident and non-resident foreigners. Schedule Four narrows the range of assets subject to the Australian CGT regime as it applies to foreign residents and strengthens the application of CGT to foreign residents by applying CGT to non-portfolio interests in interposed entities under certain conditions

As the amendments currently stand, the Bill will substantially narrow the range of assets on which a foreigner will be liable for CGT. It replaces the 'necessary connection with Australia test' of an asset with a test of 'taxable Australian property', which is limited to including taxable Australian real property (any real property situated in Australia, plus mining, prospecting and quarrying rights); indirect Australian real property interests (interests held through an interposing entity or entities); assets used in carrying on a business through a permanent establishment in Australia; an option or right to acquire one of these interests; and any CGT assets covered by subsection 104-165(4) of the *Income Tax Assessment Act 1997*.

Much fuss has been made about the supposed fact that this brings Australia into line with international and OECD standards and guidelines. The EM for the Bill[9] contends that the changes will:

> *further enhance Australia's status as an attractive place for business and investment by addressing the deterrent effect for foreign investors of Australia's current broad based CGT tax base.*

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[7] Human Rights and Equal Opportunities Commissions, *Same-Sex: Same Entitlements*, Discussion Paper II, September 2006

[8] Senator Andrew Murray Committee Hansard Thursday 14 September 2006, Page E5

[9] Explanatory Memorandum to *Tax Laws Amendment (2006 Measures No. 4) Bill 2006*, p32

I have seen no empirical evidence produced that a deterrent effect exists for foreign investment in Australia. To the contrary, my impression has been that foreign investment has been at a high level. The Investment and Financial Services Association Ltd (IFSA) obviously disagree with me. IFSA commented:

> *Historically, there are number of reasons why the flow of funds from non-resident investors into Australia has been relatively low. In this regard, any significant enhancement to the international tax regime, such as the proposed changes to capital gains tax and non-residents, are a step in the right direction*.[10]

'Relatively low' implies some credible form of benchmarking, and I would like to see that before I accept this proposition. I am not aware that Australia has had a problem attracting foreign investment – indeed many Australians have expressed concern at a high level of foreign investment and ownership of Australian assets.

Interestingly, there is evidence to suggest that CGT is an unimportant or even irrelevant consideration for investors when choosing their investment or business location.[11]

In their 'Comment'[12] the Bills Digest says *Foreign investors holding shares in Australian companies will gain significant benefits from this measure* and the Digest refers to a 30 June 2006 Legal Update from Corrs Chambers Westgarth Lawyers saying this will provide a good stimulus for mergers and acquisitions [by foreigners].

Yet reforms to Corporations Law and Tax laws (particularly the 'consolidations' measures), all supported by the Democrats, have in 2005/6 produced the highest level

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[10] Investment and Financial Services Association Ltd, *Submission 4,* pp 1–2.

[11] H Wunder (2001): 'The Effect of international Tax Policy on Business Location decisions', 24 Tax Notes International, Page 1331, which sets out the results of a survey which confirmed this. The survey has been recently cited with approval in A Eason (2004) 'Tax Incentives for Foreign Direct Investment', Kluwer Law International, the Hague Page 57.

[12] Bills Digest 15 August 2006 No 16 Page 10

of merger and acquisition market activity in Australia's history, of which a very high percentage is foreign. Current reports indicate that 2006/7 will prove even stronger.

Back then to the obvious question that arises: why the need for a further tax concession that *may* give foreigners tax advantages that Australian residents and citizens do not share?

In the same 'Comment' section the Digest also quotes from law firm Minter Ellison's legal update of 20 July 2006 which envisages far more activity by [foreign] *non-residents.* Reforming tax law for foreigners resident in Australia is a different matter, but the case or justification for this tax concession for foreign non-residents is not made, based on the material before us in this Inquiry.

In the same section of the EM quoted above, the EM goes on to state that:

> *...the amendments will encourage investment in Australia by aligning Australian law more consistently with international practice. This results in greater certainty and generally lower compliance costs for investors.*

Whilst it is true that a significant degree of foreign investment in Australia continues to be desirable, lowering or removing foreigners' potential CGT liability *may* also mean that we are giving foreigners an advantage over Australian citizens. This is another equity consideration, that the Government has seemingly failed to address adequately.

Why do I use the word *may*? Is it possible for the Government to show that foreigners will not be advantaged over Australians as a result of these changes? Or that some will and some won't? CGT regimes differ across countries. Raising this matter at the Inquiry Hearing resulted in an allegation by Mr Ali Noroozi, Tax Counsel at the Institute of Chartered Accountants in Australia[13] that it reflected an attitude of "economic xenophobia".

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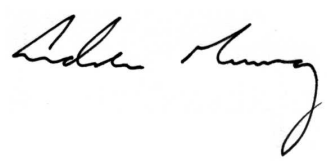
I took the opportunity to remind Mr Noroozi that what is at issue is a matter of equity and basic principle - namely that Australian law must not have the effect that Australians are treated less favourably than foreigners under our tax laws, or that non-Australians are given an unjustifiable competitive advantage over Australian citizens and residents.

At the Hearing I did not find the assurances of Treasury persuasive – they assert that Australians will not be treated less favourably than foreigners under our tax laws, and that non-Australians will not be given an unjustifiable competitive advantage over Australians. Treasury had no evidence, modelling or cameos that could justify their assertions.

At the very least the Treasury could have provided illustrative sets of cameos showing how these provisions affected citizens and residents from our five largest countries sourcing foreign investment in Australia.

As for the globe itself - the fact is that it is very difficult to model such a cross-country, cross-regime scenario over the world's 200+ countries and their residents: there would be a huge amount of data needed, there are different laws and legal regimes in place that are continually subject to change, as well as differing economic conditions and innumerable situations to be accounted for.



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