The Senate

Standing Committee on Economics

Tax Laws Amendment (2006 Measures No. 4) Bill 2006 [Provisions]

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Senate Standing Committee on Economics

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CHAPTER 1

Background

1.1 The Tax Laws Amendment (2006 Measures No. 4) Bill 2006 was introduced into the House of Representatives on 22 June 2006 by the Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce, MP.

1.2 On 16 August 2006, on the recommendation of the Selection of Bills Committee, the Senate referred the provisions of the Bill to the Economics Legislation Committee for inquiry. The Committee was initially asked to report by 31 August 2006 and an interim report was presented on 31 August 2006 and tabled on 4 September 2006. Subsequently, the Committee's reporting deadline was extended to 4 October 2006.

Conduct of the inquiry

1.3 The Committee invited witnesses to attend a public hearing on 4 September 2006. The hearing was held at Parliament House in Canberra. Witnesses who presented evidence at the hearing are listed at Appendix 2.

1.4 The Committee received 5 submissions (including 1 supplementary submission) to its inquiry which are listed at Appendix 1.

1.5 The Hansard transcript of the Committee's hearing is tabled with this report. These documents, plus the Committee's report, are also available on the Committee's website at http://www.aph.gov.au/Senate/commitee/economics_ctte/tlab_3/index.htm

1.6 The Committee thanks those who participated in the inquiry.

Provisions of the Bill

1.7 The provisions of the Bill provide the following amendments:

- Schedule 1 – extending 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;
- Schedule 2 – improving the interaction between the consolidation rules and the demerger rules by removing the integrity measure from where a consolidated group or multiple entry consolidated group forms after a demerger, provided that specified conditions are satisfied;
- Schedule 3 – further enhancing the simplified imputation system by ensuring that franking credits are available to an Australian company which receives a franked distribution that is non-assessable non-exempt income from a New Zealand company that has elected into the Australian imputation system; and

- Schedule 4 – narrowing the range of assets subject to the Australian CGT regime as it applies to foreign residents and strengthening the application of CGT to foreign residents by applying CGT to non-portfolio interests in interposed entities under certain conditions.[1]

1.8 The Selection of Bills Committee (Report No. 8 of 2006) identified Schedule 4 of the Bill as the principal area for consideration and inquiry by the Committee. However, the Committee also made limited inquiries into Schedule 1 of the Bill at its public hearing in Canberra. This report examines only matters relating to Schedule 4.

Schedule 4 – Capital gains tax and foreign residents

1.9 Schedule 4 will amend Division 855 and Subdivision 960-GP of the *Income Tax Assessment Act 1997* and repeals Division 136 of this Act. It also includes amendments to some provisions within the *Income Tax Assessment Act 1936*.

1.10 The amendments contained in Schedule 4 are part of further reforms targeting disincentives in the CGT regime which may be deterring foreign investors from investing in Australia. Reforms to the international taxation system were originally flagged in 1999 following the *Review of Business Taxation*.

1.11 The consultation paper *Review of International Taxation Arrangements* (RITA), released by the Department of Treasury in 2002, reported the outcomes of the Government's review into international taxation which included a number of issues in relation to CGT and non-residents. Subsequently, the Board of Taxation released its publication *Internal Taxation – A Report to the Treasurer,* examining the matters raised in RITA and providing recommendations. On 13 May 2003 the Australian Government responded to the Board of Taxation's report, announcing that it would consider the recommendations[2] and on 10 May 2005 the Government announced that it would implement a suite of reforms to the treatment of CGT for foreign residents.[3]

1.12 The current package will deliver significant benefits to foreign investors holding shares in Australian companies and interests in certain trusts because these interests will not attract CGT. This will more closely align Australia's CGT laws with standards of the Organisation for Economic Co-operation and Development (OECD). The Hon. Peter Dutton, MP described the reforms as 'enhanc[ing] Australia's status as an attractive place for business and investment' by removing the disincentives to foreign investors that currently exist within the taxation system.[4]

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1 Explanatory Memorandum, pp 7, 21, 25, 33.

2 The Hon. Peter Costello, MP, Treasurer, 'Review of International Taxation Arrangements', Press Release 032, 13 May 2003.

3 The Hon. Peter Costello, MP, Treasurer, 'International Tax Reforms', Press Release 044, 10 May 2005.

4 The Hon. Peter Dutton, MP, Minister for Revenue and the Assistant Treasurer, 'Government Introduces Further Improvements to the Tax System', Press Release 039, 22 June 2006.

1.13 As outlined in the Explanatory Memorandum, Schedule 4 contains two key changes to the CGT regime for non-residents:

- reducing the categories of taxable Australian assets held by a foreign resident which attract CGT from nine categories to five; and
- applying CGT to non-portfolio interests held by foreign residents in interposed entities under certain conditions, thereby introducing an additional integrity measure into the taxation system.[5]

1.14 The measures contained within Schedule 4 also apply to rights or options in relation to assets. The changes are applicable to all foreign residents (individuals, companies, trusts or trustees of foreign trusts, holding interests in Australian assets or resident entities).[6]

1.15 Key issues examined below in relation to Schedule 4 are: the narrowing of the tax base; the reduction in the categories of assets attracting CGT; and, the proposed integrity measure.

Narrowing of the tax base

1.16 The cost to revenue of the CGT reforms for foreign residents is expected to be $50 million per annum in 2006-07 and $65 million per annum thereafter. This is because a reduction in the range of taxable assets to essentially land-rich assets will mean that some foreign investors will no longer be required to pay CGT when engaging in certain transactions. This exemption appears to form the basis of the expected loss to Government revenue per annum.[7]

1.17 The Explanatory Memorandum outlined a number of measures that are likely to counter-balance the negative impact on revenue including:

- longer term economic benefits because Australia will become a more attractive regional hub for business and investment;
- a further reduction in constraints on foreign investment into and out of Australia; and
- decreased risks to revenue from the introduction of the integrity measure by targeting foreign residents who may be using alternative structures to change their Australian tax obligations.[8]

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5 Explanatory Memorandum, p. 33.

6 Explanatory Memorandum, p. 5.

7 For an outline of the costs to revenue of these reforms, see Explanatory Memorandum, p. 65. However, a breakdown of the costs to revenue of $50 million for 2006-07 and $65 million per annum thereafter has not been provided in the Explanatory Memorandum.

8 Explanatory Memorandum, p. 68.

1.18 In terms of compliance costs, it is anticipated that the new provisions are unlikely to have a significant impact. The impact on compliance costs are anticipated as:

- an increase for foreign investors with indirect holdings in taxable Australian real property;
- a decrease for foreign investors as a result of the narrowing of the assets which will attract Australian CGT and the broadening of the non-portfolio interest requirement; and
- nil effect on Australian taxpayers as the proposed provisions only apply to foreign residents.[9]

Narrowing the range of taxable assets

1.19 Under the current CGT base a foreign resident makes a capital gain or loss whenever a CGT event occurs for any asset that has a 'necessary connection with Australia' including:

- land and buildings located in Australia;
- shares or units in Australian resident companies or trusts;
- a 10% or greater shareholding in an Australian public company;
- a 10% or greater unitholding in an Australian unit trust;
- business assets of an Australian permanent resident; and
- an option or right to acquire one of the above.

1.20 Broadly, the new categories to be introduced restrict the range of taxable assets to Australian real property assets and interests, notably:

- taxable Australian real property assets, including interests in Australian real property regardless of whether the interest is held directly or indirectly; and
- CGT assets used by non-residents in carrying on a business through a permanent establishment in Australia.

1.21 The interpretation of taxable Australian real property also extends to include a mining, quarrying or prospecting right (to the extent that right is not real property), if the minerals, petroleum or quarry materials are situated in Australia.

1.22 This amendment removes the requirement for introducing a CGT conduit regime, as described in Recommendation 3.10(1) of RITA, and 'extended it to all capital gains tax except for the land-rich entities'.[10]

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9 Explanatory Memorandum, p. 5.

10 Mr Mark Hadassin, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, p. 3.

Submissions and other commentary

1.23 All submissions, as well as commentary on the Bill from legal firms which did not provide submissions to the inquiry, supported the narrowing of the categories of assets attracting CGT. While this inquiry attracted limited submissions, it has been the subject of considerable commentary in legal newsletters and the press.

1.24 The Institute of Chartered Accountants in Australia stated their support for the proposed provisions, describing some of the benefits as:

> …streamline[ing] and simplify[ing] the operation of the law. The revised rules focuses Australia's CGT regime on a more limited range of assets which promotes efficiency and will reduce business compliance costs.[11]

1.25 In the publication 'Legal Update', Corrs, Chambers and Westgarth commented that the current categories of assets attracting CGT by foreign investors is too wide and inconsistent with international practice.[12] The Taxation Institute of Australia submitted that the changes align Australia's taxation system with that of our key trading partners, namely, the United States of America and Canada and remove unnecessary complexity in the taxation system by:

- concentrating on the major enforceable gains rather than making an ambit claim for tax which is rarely collected; and
- mirroring Australia's current jurisdiction claim under tax treaties.[13]

1.26 Under the proposed changes foreign investments in sectors that are traditionally not land-rich (such as retail, financial services or information technology sectors) will avoid CGT. However, mining, real estate and infrastructure sectors will continue to attract the CGT. KPMG partner, Mr David Watkins was reported in the Australian Financial Review as saying that:

> Other developed countries like the United Kingdom typically only are interested in applying capital gains tax to non-residents investing in land and building. The fact that [Australia] had a longer list, including shares in companies, made us uncompetitive.[14]

1.27 Others have suggested that the narrowing of the asset categories will increase the incentives for foreign entities to invest in Australia and may potentially lead to a wave of merger and acquisition activity.[15] As an example, a recent media report

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11 The Institute of Chartered Accountants in Australia, *Submission 2,* p. 2.

12 Corrs, Chambers and Westgarth Lawyers, 'Capital Gains Tax and Foreign Residents', Legal Update, 30 June 2006.

13 Taxation Institute of Australia, *Submission 3,* p. 1.

14 Elizabeth Kazi, 'CGT change to spur mergers', *Australian Financial Review,* 23 June 2006, p. 15.

15 KPMG, 'Capital gains tax changes a catalyst for M&A wave', Media Release, 22 June 2006.

speculated that the changes to the CGT regime will reap an 'enormous capital gains tax advantage' to foreign investors bidding in the sale of Coles Myer because the entity is not land-rich, leasing most of its retail outlets.[16] Furthermore, the report commented that 'any foreign group has a significant advantage over an Australian group' as the disposal of shares by foreign investors would not attract CGT.

1.28 In a media release, KPMG said that the prospect of reforms to the CGT regime is already resulting in foreign investors reviewing their strategies for investing in Australia and is expected to increase transactions in the market.[17] In the publication 'Legal Update', Minter Ellison described some of the key outcomes that could be expected from the new CGT regime including:

> - increased activity by non-residents in Australian unlisted companies and unit trusts, and in interests of 10% or more in Australian listed companies, where the underlying assets do not comprise predominantly Australian real property;
> - [that] Australia will become a more desirable holding company location;
> - [that] non-residents will be more likely to structure the carrying on of a business in Australia via an Australian subsidiary entity rather than an Australian branch; and
> - an increase in Australian investment by non-residents.[18]

1.29 The main beneficiaries of the changes to non-resident CGT were described by the Institute of Chartered Accountant in Australia in evidence to the Committee as both pension and superannuation funds and foreign multinationals establishing regional headquarters in Australia.[19] The Investment and Financial Services Association Ltd 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.[20]

Additional integrity measure

1.30 The Bill proposes the introduction of an integrity measure to ensure that foreign investors do not avoid Australian CGT by holding their assets in interposed

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16 Simon Evans, 'CGT windfall for overseas Coles bidders', *Australian Financial Review,* 28 August 2006, p. 10.

17 KPMG, 'Capital gains tax changes a catalyst for M&A wave', Media Release, 22 June 2006.

18 Minter Ellison Lawyers, 'Australian Capital Gains Tax and foreign residents', Legal Update, 20 July 2006.

19 Mr Mark Hadassin, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, pp 2–3.

20 Investment and Financial Services Association Ltd, *Submission 4,* pp 1–2.

entities. The Explanatory Memorandum explained that this measure will strengthen Australia's CGT base:

> This ensures that the disposal of an interest in Australian real property is subject to Australian CGT regardless of whether the interest is held directly or indirectly.[21]

1.31 The following example illustrated this point:

> …the foreign resident may establish a foreign company that then invests in the Australian assets. But for special rules, the sale of that company by the foreign resident would not be subject to Australian CGT consequences, whereas the direct sale of the Australian assets would. This overcomes a tax anomaly that would otherwise arise between foreign residents who invest directly in Australia versus those who invest indirectly.[22]

1.32 The additional integrity measure would apply to the disposal of non-portfolio interests in interposed entities (including foreign entities) where more than 50 per cent of the value of such an interest is derived from taxable Australian real property. An indirect Australian real property interest will be established to exist where the foreign resident has a membership interest in an entity which passes both the non-portfolio interest test and a principal asset test. This aligns with Recommendation 3.6 of RITA 'as it applies to protect the narrower CGT tax base for foreign residents.'[23]

Introducing and enforcing the integrity measure

1.33 The Board of Taxation did not support implementation of Recommendation 3.6 of RITA:

> The Board recommended against proceeding with the Review of Business taxation proposal to apply capital gains tax to the sale by non-residents of non-resident interposed entities with underlying Australian assets'.[24]

1.34 The Institute of Chartered Accountants in Australia commented:

> We note that the Board recommended that Australia would gain little from CGT expansion measures to tax non-residents disposing of equity interests in foreign entities…This recommendation was driven, at least in part, by an appreciation that the revenue to be collected would be outweighed by the inefficiency of and discouragement for foreign investment in Australia.[25]

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21 Explanatory Memorandum, p. 38.

22 Explanatory Memorandum, p. 32.

23 Explanatory Memorandum, p. 61.

24 See publication: Board of Taxation, 'Review of International Taxation Arrangements. A Report to the Treasurer', February 2003, p. 94.

25 The Institute of Chartered Accountants in Australia, *Submission 2,* p. 5

1.35 In responding to the Board's recommendation, the Government had previously explained that:

> A non resident holding Australian assets through a non resident company can dispose of that company, avoiding Australian tax on any capital gain - even though the gain relates to Australian assets. The Review of Business Taxation recommended addressing this issue but its implementation was deferred pending a review of tax treaty policy by this review.
>
> As the Board proposed giving up relevant capital gains taxing rights (Recommendation 3.11(2)) in tax treaty negotiations it did not support this measure proceeding. It also noted the possible adverse effect upon foreign investors' perception of Australia as a place to invest, and perceived administration concerns.
>
> However, as the Government has decided to continue taxing these capital gains, it may be appropriate to reinforce Australia's ability to tax non residents disposing of Australian assets. Accordingly, in consultation with the business community, the Government will give further consideration to the Review of Business Taxation recommendation, recognising that any proposal will need to address concerns regarding a possible adverse effect upon foreign investors' perception of Australia as a place to invest, administration and compliance issues.[26]

1.36 The Explanatory Memorandum noted that the inclusion of this integrity measure in Australian taxation law is consistent with Australia's tax treaty practice and the *OECD Model Tax Convention on Income and on Capital*.[27]

1.37 Concern has been expressed about the inclusion of the concept of 'indirect Australian real property interests' into the categories of assets. Difficulties in enforcing this provision were flagged in a *Taxation in Australia* article by Mr Peter Norman:

> The expectation that a non-resident will simply file a tax return and pay the tax due on its disposition of an interest in an interposed foreign company that is an 'indirect real property interest' may be somewhat optimistic.[28]

1.38 In addition, Mr Norman said that whilst the Bill confines the application of this provision to interposed entities holding Australian real property, 'the status quo of relying on the non-resident to file a tax return remains'.[29]

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26 The Hon. Peter Costello, MP, Treasurer, 'Review of International Taxation Arrangements', Press Release 032, 13 May 2003.

27 Explanatory Memorandum, p. 32.

28 Peter Norman, 'Capital gains tax reforms for non-residents', *Taxation in Australia,* issue 41, no. 2, August 2006, p. 84.

29 Peter Norman, 'Capital gains tax reforms for non-residents', *Taxation in Australia,* issue 41, no. 2, August 2006, p. 84.

1.39 In 'Legal Update', Corrs, Chambers and Westgarth Lawyers also reported that applying indirect Australia real property interests as an asset category 'raises interesting enforcement issues' but noted that it will be the subject of amendments included in the International Tax Agreements Amendment (No. 1) Bill 2006.[30]

1.40 KPMG has argued that the introduction of the this concept will mean that some foreign investors will now be liable to pay CGT whereas they had previously been exempt:

> As a result, a foreign company selling shares in another foreign company may find themselves exposed to Australian tax.[31]

Transitional measures

1.41 The lack of transitional measures for introducing the provisions of Schedule 4 was the foremost concern presented in evidence to the inquiry.[32] The Institute of Chartered Accountants in Australia argued:

> The CGT expansion measure has no transitional measures, which means that Australia has effectively subjected to Australian CGT a large range of foreign investors selling their interests in foreign companies which ultimately have Australian assets. Those investors, newly taxable, are potentially taxable on unrealised gains accrued over past decades.[33]

1.42 Furthermore, the Institute commented:

> This expansion has been handled in an inequitable manner, from a transitional viewpoint, as it creates new CGT exposures for foreign residents previously not exposed to Australian CGT, in circumstances not resulting from any tax avoidance activity, including for example because:
>
> - foreign residents subject to the measures are not given any enhanced cost base at the commencement of the new rules; and
> - the rules may potentially subject to Australian taxation foreign residents' underlying gains on non-Australian assets and non-Australian real property assets.[34]

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30 Corrs, Chambers and Westgarth Lawyers, 'Capital Gains Tax and Foreign Residents', Legal Update, 30 June 2006.

31 KPMG, 'Capital gains tax changes a catalyst for M&A wave', Media Release, 22 June 2006.

32 See for example, Mr Ali Noroozi, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, p. 2; Mr David Rynne, Minerals Council of Australia, *Committee Hansard*, 14 September 2006, p.9.

33 The Institute of Chartered Accountants in Australia, *Submission 2,* p. 5.

34 The Institute of Chartered Accountants in Australia, *Submission 2,* p. 5; The Minerals Council of Australia, The Australian Petroleum Production and Exploration Association Ltd and The Corporate Tax Association, *Submission 1,* p. 3.

1.43 Similar concerns were also expressed in a joint submission by the Minerals Council of Australia, Australian Petroleum Production and Exploration Association Ltd and Corporate Tax Association. To address these matters it was recommended that either a market value cost base be introduced, or that interests acquired prior to the Royal Assent of the Bill be excluded from the CGT base.[35]

1.44 However, at the inquiry's public hearing, the Institute told the Committee that the absence of transitional measures in the Bill will be addressed by the Government in an amendment to be 'introduce[d] into Parliament shortly I believe'.[36] This point was reiterated by Minerals Council of Australia representative, Mr David Rynne, who said:

> It was formally brought to our attention only yesterday that the government will proceed with an amendment that will address this principal concern—that is, non-resident entities will obtain a 10 May 2005 market value cost base. This was our foremost concern, and this amendment is very much welcomed by the joint submission parties.[37]

1.45 Mr John Nagle from the Department of the Treasury provided further information to the Committee on the nature of the proposed amendments:

> There are two amendments in the legislation…The first one is what we call resetting the cost of these assets being brought into Australia's tax base for the first time. The second one we consider a consequential amendment that removes an inappropriate demerger provision that was picked up only after consultations had ceased on the measure and industry came to us with a live case that showed there was a need to make another consequential amendment to a demerger provision.[38]

1.46 The Committee notes that the financial impact of implementing either of these measures would be an additional cost to revenue, over and above the $50 million per annum in 2006-07 and $65 million per annum detailed in the Explanatory Memorandum.

Pro-rated assessment of real property holdings

1.47 The Institute of Chartered Accountants in Australia and the joint submission from the Minerals Council of Australia, Australian Petroleum Production and Exploration Association Ltd and Corporate Tax Association described a further alleged deficiency with the Bill as that the assessment of CGT for companies with substantial real property holdings is not pro-rated. Mr Noroozi illustrated this concern:

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35 The Institute of Chartered Accountants in Australia, *Submission 2,* p. 5.

36 Mr Ali Noroozi, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, p. 2.

37 Mr David Rynne, Minerals Council of Australia, *Committee Hansard*, 14 September 2006, p. 9.

38 Mr John Nagle, Analyst, International Tax and Treaties Division, Department of the Treasury, *Committee Hansard,* 14 September 2006, p. 13.

> Let us say that a non-resident has shares in an Australian company whose assets are 60 per cent Australian real property. In that scenario if the foreign resident sells the shares in that Australian company then they have to pay tax on 100 per cent of the value of those shares as opposed to the 60 per cent that is referable to Australian real property.[39]

1.48 The joint submission outlined the impact of the assessment of CGT not being pro-rated, including that the use of Australia as a regional headquarters would be discouraged under certain circumstances.[40] The submission argued that taxable CGT gains or losses on Australian real property need to be more precisely focussed by specifying that only a proportion of the gain on the sale of interests in a resident or non-resident entity that is land-rich should be subject to CGT, equal to the Australian land-rich proportion. To address the problem, the submission proposed:

> …all that would be needed would be the introduction of provisions somewhat similar to subsections 768-505(2) and 768-505(4) which similarly pro-rate a total CGT gain or loss in the context of the participation exemption provisions of subdivision 768-G (albeit while only applying in the context of the range 50% to 100%).[41]

1.49 Representatives from the Institute of Chartered Accountants in Australia stated that any action to address this concern should not delay the passage of the Bill, commenting:

> …we would not want to delay this measure any further because of this one issue that we have. So we fully support the immediate passage of this through parliament.[42]

Other concerns

1.50 The joint submission by the Minerals Council of Australia, Australian Petroleum Production and Exploration Association Ltd and Corporate Tax Association also outlined a number of other amendments for inclusion in the Bill, including:

- addressing impediments to upstream corporate restructures by:
    - amending the CGT event J1 anomalies; and
    - dealing with other CGT restructuring impediments.

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39 Mr Ali Noroozi, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, p. 2.

40 The Minerals Council of Australia, The Australian Petroleum Production and Exploration Association Ltd and The Corporate Tax Association, *Submission 1a,* pp 5–6.

41 The Minerals Council of Australia, The Australian Petroleum Production and Exploration Association Ltd and The Corporate Tax Association, *Submission 1a,* p. 6.

42 Mr Ali Noroozi, Institute of Chartered Accountants in Australia, *Committee Hansard,* 14 September 2006, p. 2.

- allowing taxpayers to choose to utilise book values in all 'indirect Australian real property interest' calculations;
- introducing a mechanism to avoid potential double taxation exposures where an Australian tax impost against the proposed changes to the CGT regime is not creditable against the equivalent gain taxed in a foreign jurisdiction; and
- allowing grouping access to CGT losses and tax losses of wholly-owned companies.[43]

Committee's view

1.51 The Committee considers that the Bill adequately addresses anomalies in Australia's international taxation system as it relates to the treatment of CGT and non-residents. The Committee is convinced that the amendments to the taxation system will reap important benefits to the Australian economy and to the people of Australia.

Recommendation

The Committee recommends that the Senate pass the Bill.

Senator George Brandis
Chair

43 The Minerals Council of Australia, The Australian Petroleum Production and Exploration Association Ltd and The Corporate Tax Association, *Submission 1,* pp 3–4.

ADDITIONAL REMARKS: LABOR SENATORS

Labor Senators comments relate to schedule 2 and schedule 4.

Schedule Two

Labor Senators believe that Schedule Two should be amended to provide for tax exempt status of the asbestos compensation fund for victims of asbestos related disorders resulting from the operations of James Hardie.

The government has already provided a billion dollars in a company tax break to James Hardie through changes to the black hole provisions of the tax act.

However, the whole scheme has been put into jeopardy by failing to ensure that payments from James Hardie to the fund are deductible in the hands of the fund and fund earnings are tax free. By denying this the Government is effectively trying to claw it back the $1m of concession it has already granted.

This hard-hearted approach imposes a tax on both the payments the fund receives from the Company and on its earnings. It could mean ripping up to $1.4 billion out of the pockets of asbestos victims and their families.

This amendment to the bill is needed urgently to give certainty to the victims and their families.

Schedule 4

This schedule involves a major reduction in the capital gains tax base for non-residents. In evaluating this measure there is of course the initial consideration of cost. The Explanatory Memorandum posits a cost of $65m per annum. This in itself is significant, but Labor Senators note that this cost could be expected to increase substantially, either as a result of proposed Government amendments or as result of prospective mergers, especially the hostile takeover bid for Coles.

Such costs have to be weighed judiciously against the suggested economic benefits of increasing the attractiveness of Australia as a source of international capital. It is regrettable that this judgement has not been assisted by adequate argument or modelling from the Government or Treasury in the hearing. Decisions of this nature by the Parliament require the highest levels of analysis this country can afford. In this case, the Government has not put its argument with sufficient economic rigour.

This may be the fault of the political process or perhaps of officials. Whatever the case, it must be corrected and Labor Senators call upon the Government to devote more resources to make its argument to the people through the Parliament.

Why does the Government not provide the Parliament with the best analysis available? Why should this nation settle for second best in making difficult decisions of this nature?

Treasury officials have indicated that two amendments will be made to the Bill. While this in itself is justification for Labor's reference of the Bill to the Committee it also reveals a dangerous trend in tax legislation. Time and again imperfect bills are put to the Parliament. How many times has the Parliament been forced to consider amendments to consolidation measures, and the international tax measures (for example the International Tax: Participation Exemption Bill 2004). The debacle of the TLAB (Loss Recoupment and Other Measures) Bill 2005 is still unresolved. Labor's amendments were rejected in the morning and the Bill made subject to review in the afternoon, a review that is now eight months overdue! The legislative error rate is becoming appallingly high in taxation matters.

Schedule 4 seeks to align Australian international tax arrangements with the model OECD treaty in relation to taxation of capital gains for non residents. Labor supports the policy intent in principle but is concerned that the reduction in the capital gains tax base for non-residents is very significant. An additional major concern of Labor Senators relates to whether this Bill will actually disadvantage resident CGT taxpayers compared to non-resident CGT taxpayers.

With this in mind, Labor asked the following questions to officials in advance of the hearing:

1. The Explanatory Memorandum to the Bill contains two principal measures as outlined in 4.12 p33:

    - narrows the range of assets which may be subject to Australian CGT to Australian real property directly held by a foreign resident and any CGT asset (other than Australian real property) used by the foreign resident at any time in carrying on a business through a permanent establishment in Australia; and
    - strengthens the application of CGT to foreign residents in Australia's domestic law by applying CGT to non-portfolio interests in interposed entities (including foreign interposed entities), where more than 50 per cent of the value of the interposed entities' assets is attributable, whether directly, or indirectly through one or more other interposed entities, to Australian real property.

The stated cost of the measures in the EM is \$50m in 2006/7 and \$65m thereafter.

To Treasury: Disaggregate the cost to revenue from the first measure and the gain, if any, to revenue from the second measure.

2 To what extent will non-resident companies who will now be able to avoid CGT as result of this Bill be able to structure their affairs from tax havens or other low tax jurisdictions to avoid paying CGT altogether?

3 What proportion of the revenue forgone as a result of this measure is likely to be captured by CGT or similar tax arrangements in other countries?

4 To what extent will these measures disadvantage an Australian firm, investing in shares that will remain captured by the current CGT net relative to a non-resident firm that invests in Australians shares?

5 Will non-resident firms and Australian firms investing in the same Australian shares be likely to have different tax rates on these investments? If so, please outlined the likely disparities?

6 The Bill was drafted before the announced takeover bid for Coles by a consortium of non-resident investors. Has the impact of this bid been factored into the costings explicitly. If so, what is the impact of this bid in the costings in the EM.

7 If the impact of this bid has not been included in the costings in the current Bill, identify the likely additional cost to revenue from the Bill if the foreign takeover is successful, and the firm is subsequently sold by the new non-residents owners within 4 years.

8 To what extent will the assets of Coles be defined as real property for the purposes of CGT law? What proportion of the income producing assets of Coles is expected to relate to real property?

9 How much CGT would be saved if:

- The sale of Coles to foreign interests proceeded;
- The assets were sold by the non-residents according to normal commercial patterns;
- The Bill was not passed and the current CGT provisions of non residents remained.

Labor Senators were not granted an answer to these questions at the hearing. This is not acceptable and is a significant breach of process by officials.

Moreover, Labor Senators are of the view that the questions were dealt with in a dismissive fashion by officials. This is deeply disturbing. Furthermore, officials had to be pressed to take the questions on notice! Salt was added to the wound by failing to answer these questions in time for consideration of the Senate report. Labor Senators now call for an explanation for this unacceptable conduct. Labor Senators need to remind officials of the seriousness of their obligations to this Parliamentary process. It is open to the Minister to make good this defect in the ensuing Parliamentary debate.

Labor Senators believe that Senators Murray is making additional comments in relation to this Bill. Labor supports concerns of Senator Murray in relation to Schedule 4 of the Bill.

While Labor supports in principle comments made in relation to proposed amendments to the Bill, Labor reserves its position on these amendments until they are made available to the Parliament.

1.1 Labor Senators also indicate their in principle support of other amendments proposed by the joint submission of the Minerals Council of Australia, Australian Petroleum Production and Exploration Association Ltd and Corporate Tax Association, and the comments of the Institute of Chartered Accountants in Australia. This joint submission argued that taxable CGT gains or losses on Australian real property need to be more precisely focussed by specifying that only a proportion of the gain on the sale of interests in a resident or non-resident entity that is land-rich should be subject to CGT, equal to the Australian land-rich proportion.

1.2 To address the problem, the submission proposed:

> …all that would be needed would be the introduction of provisions somewhat similar to subsections 768-505(2) and 768-505(4) which similarly pro-rate a total CGT gain or loss in the context of the participation exemption provisions of subdivision 768-G (albeit while only applying in the context of the range 50% to 100%).[1]

Labor Senators believe this proposal warrants further consideration and regrets that the matter was not further developed in the Government Senators report.

Labor Senators reiterate their concerns in relation to manifest failures of process in relation to the conduct of this piece of legislation by the Government.

Senator Ursula Stephens	Senaror Ruth Webber	Senator Kate Lundy
Senator for NSW	Senator for WA	Senator for the ACT

1 The Minerals Council of Australia, The Australian Petroleum Production and Exploration Association Ltd and The Corporate Tax Association, *Submission 1a,* p. 6.

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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[1] Committee Hansard Thursday 14 September 2006 Page E15

- 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.

[4] Committee Hansard Thursday 14 September 2006 Page E14

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*

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

[6] Committee Hansard Thursday 14 September 2006 Page E6

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

[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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[13] Committee Hansard Thursday 14 September 2006 Page E4

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.

Senator Andrew Murray

Appendix 1
Submissions Received

Submission Number	Submitter
1	The Minerals Council of Australia (MCA) The Australian Petroleum Production and Exploration Association Ltd (APPEA) and The Corporate Tax Association (CTA)
1a	The Minerals Council of Australia (MCA) The Australian Petroleum Production and Exploration Association Ltd (APPEA) and The Corporate Tax Association (CTA)
2	The Institute of Chartered Accountants in Australia
3	Taxation Institute of Australia
4	Investment & Financial Services Association Ltd (IFSA)

Appendix 2

Public hearing and witnesses

Thursday, 14 September 2006 – Canberra

BROWN, Mr Colin Leslie, Manager
Costing and Quantitative Analysis Unit, Tax Analysis Division
Department of the Treasury

DAW, Mr Haydn, Manager, International Tax and Treaties Division
Department of the Treasury

DRENTH, Mr Frank, Executive Director
Corporate Tax Association of Australia Inc

HADASSIN, Mr Mark, Member
Institute of Chartered Accountants in Australia

NAGLE, Mr John, Analyst, International Tax and Treaties Division
Department of the Treasury

NOROOZI, Mr Ali, Tax Counsel
Institute of Chartered Accountants in Australia

PETERS, Mr Peter, Analyst, International Tax and Treaties Division
Department of the Treasury

PORTAS, Mr Anthony Sean, Member, Tax Committee
Minerals Council of Australia

RYNNE, Mr David, Assistant Director, Economic Policy
Minerals Council of Australia