QUESTIONS TO TREASURY OFFICIALS IN RELATION TO TAX LAWS AMENDMENT (2006 MEASURES NO. 4) BILL 2006, SCHEDULE 4

WRITTEN QUESTIONS

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.

Disaggregate the cost to revenue from the first measure and the gain if any to revenue from the second measure.

Treasury response

The cost of the measure as announced is as follows:

2006-07	2007-08	2008-09	2009-10
-$50 million	-$65 million	-$65 million	-$65 million

The cost of the amendment to allow a cost base for Australian real property as at 10 May 2005 is as follows:

2006-07	2007-08	2008-09	2009-10
-	-$20 million	-$15 million	-$10 million

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?*

Treasury response

Consistent with international practice, most developed countries have foreign income attribution rules that subject their residents to taxation of foreign income. These rules aim to limit the avoidance or long term deferral of tax obligations by residents using no or low tax countries to structure their investments for tax advantage.

Usually these rules distinguish between investments made through comparably taxing countries or through low or no tax countries. Investments made through comparable taxing countries usually derive little or no taxation advantage for the resident investor, and therefore are not subject to the full effect of foreign income attribution rules. Investments made through low or no tax countries could derive significant tax advantages, and are therefore generally subject to stricter attribution rules.

The extent to which a foreign investor would be subject to tax in their country of residence will depend on the operation of the foreign income attribution rules and domestic tax laws of that country.

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?*

Treasury response:

The extent to which a foreign investor would be subject to tax in their country of residence will depend on the operation of the foreign income attribution rules and the domestic tax laws of that country.

Foreign investors will generally be subject to tax on such gains in their country of residence, with a credit provided for any Australian tax paid.

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?*

Treasury response:

See response to questions 2 and 3.

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?

Treasury response:

See response to questions 2 and 3.

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.

Treasury response:

Treasury cannot comment on the taxation affairs of individual taxpayers. Nor does the costing take account of events that have not yet occurred and which may not come to pass.

In general, however, the takeover of any Australian owned company would initially involve the disposal of shares by the current owners which would increase capital gains tax revenue for the period concerned.

The impact of the eventual disposal of the shares by the new foreign owner would depend upon how much the shares had appreciated in value following the takeover and the timing of the disposal. For instance, if there were no increase in value of the shares in the entity taken over after a takeover, the impact on revenue from the legislation would be zero.

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.

Treasury response:

See response to question 6.

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 are expected to relate to real property.

Treasury response:

The test for whether a company is land-rich (more than 50 per cent of its assets relate to Australian real property) is relevant at the time a foreign resident makes a capital gain on shares in the company.

Whether Coles will be a land-rich company in the future is a question of fact. The balance sheet of Coles may change significantly from the current balance sheet depending on how the business is conducted in the intervening years.

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.

Treasury response:

The impact of a foreign takeover of an Australian owned company would result in an increase in CGT revenue as a result of the realisation of the capital gains of the current owners. Any CGT implications from the bill will arise from any subsequent disposal of the shares in the company by the new foreign owners at some future date.

It is difficult to predict the CGT consequences of a theoretical application of the current foreign resident CGT regime to investment decisions made under a reformed foreign resident CGT regime.

For example, foreign investors may currently structure their investments into Australia through a foreign interposed entity to minimise Australian CGT obligations. If the existing CGT regime continued unchanged, then these structures would likely continue to be used. Under the proposed reformed foreign resident CGT regime, foreign investors might instead choose to directly hold and sell shares in Australian companies.

Moreover, foreign investors with portfolio interests (less than 10%) in Australian public companies are unlikely to have changed tax obligations as a result of the proposed measure, as disposals of portfolio interests in public companies are already exempt from Australian CGT under the current tax laws.

Foreign investors will generally be subject to tax on such gains in their country of residence, with a credit provided for any Australian tax paid. This may also influence investment decisions and structures used.

The following hypothetical case studies outline the possible broader CGT consequences for Australian and foreign investors of the eventual sale of shareholdings in Australian companies.

CURRENT CGT AND FOREIGN RESIDENT RULES

(a) Australian company takes over an Australian company

The Australian company will be subject to domestic CGT rules on capital gains or capital losses made on the shares in the takeover company.

(b) Foreign company takes over an Australian company

The foreign investor may be subject to the foreign resident CGT rules on capital gains or capital losses made on the shares in the takeover company:

- If the shares directly held in the Australian company are later sold, the foreign investor is subject to Australian CGT.
- If the foreign investor holds the shares in the Australian company through an interposed foreign company, and that foreign interposed company is instead sold, the foreign investor is not subject to Australian CGT.
- Foreign investors will generally be subject to tax on gains in their country of residence, with a credit provided for any Australian tax paid (or for foreign tax paid in the case of a foreign interposed entity being used).

REFORMED CGT AND FOREIGN RESIDENT RULES

(a) Australian company takes over an Australian company.

Australian company will be subject to domestic CGT rules on capital gains or capital losses made on the shares in the takeover company.

(b) Foreign company takes over an Australian company

The foreign investor may be subject to the foreign resident CGT rules on capital gains or capital losses made on the shares in the Australian company if the Australian company is land-rich:

- If the shares directly held in the Australian company are later sold, and the Australian company is land-rich, the foreign investor will be subject to Australian CGT.
- If the foreign investor holds the shares in the Australian company through an interposed foreign company, and that foreign interposed company is instead sold, the foreign investor will be subject to Australian CGT where the foreign interposed company is land-rich.
- Foreign investors will generally be subject to tax on such gains in their country of residence, with a credit provided for any Australian tax paid.

While a foreign investor will not be subject to Australian CGT on the shares in an Australian company that is not land-rich, foreign investors will generally be subject to tax on such gains in their country of residence.

QUESTION ON NOTICE

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Senator BERNARDI—*It was in relation to non-resident firms and Australian firms if they invest in the same asset, effectively, in Australia. I understand it would be dependent upon where they are resident as to their taxation obligations in that country. Could you explain the likely disparities between the taxation regimes that may appear for an Australian resident and Australian non-resident firm?*

Answer

The International Comparison of Australia's Taxes (3 April 2005), chapter 6, provides a comprehensive overview of capital income taxation. The report is available at http://www.comparativetaxation.treasury.gov.au/content/default.asp

Appendix 6.1 to the report provides details on the integration of company and individual taxation in ten OECD countries. This is relevant for assessing the extent to which foreign residents at the company and individual shareholder level are subject to tax in their country of residence.

Appendix 6.2 to the report outlines details of the taxation of capital gains in ten OECD countries.