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Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
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By email: economics.sen@aph.gov.au

23 August 2007
Our Ref: NW:AK

Dear Sir / Madam

Re: Division 250 draft legislation

We welcome the opportunity to comment on Tax Laws Amendment (2007 Measures No. 5) Bill 2007 ("the Bill"), in particular the provisions contained in Schedule 1 for Tax preferred entities. On the whole, we welcome the introduction of Division 250, which removes the draconian impacts of section 51AD from the Income Tax Assessment Act 1936 (ITAA 1936). Furthermore, we are pleased that Treasury have taken into account many of the significant issues raised during the earlier consultation process, and that there a substantial number of appropriate carve outs from the application of the Division.

While we support the introduction of the proposed Division 250, we highlight in the attachment some important technical issues that we believe need to be corrected in the Bill. In highlighting these issues, however, it is not our intention that introduction of the proposed legislation be in any way delayed.

Should you have any queries, or wish to discuss any aspect of this submission, please contact me on (03) 9208 7444.

Yours sincerely,

Neil Ward
Director
Deloitte Touche Tohmatsu Ltd

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ATTACHMENT

1. Definition of "end user"

The definition of "end-user" in section 250-50 for the purpose of determining the 'tax-preferred use of an asset' in Division 250 appears to be considerably wider than the equivalent section 51AD(4) of the Income Tax Assessment Act 1936 (ITAA 1936).

Under section 51AD(4), the tests of "use" and the "control of use" were mutually exclusive tests. Specifically, the "use" test applied only to leases of property while the "control of use" test applied only to the provision of goods and services. In addition, the use test in paragraph 51AD(4)(a) applied only during the time when the taxpayer owned the property and the lease "was in force". Similarly, the "control of use" test in paragraph 51AD(4)(b) applied in respect of the provision of goods and services only during the time when the property was owned by the taxpayer.

The definition of "end-user" in section 250-50 appears to combine the "use" and the "control of use" tests such that both equally apply to leases and the provision of goods or services. Furthermore, unlike the tests in section 51AD(4), there appears to be no restriction on when the test applies in determining when an entity is an end user.

For example, consider the case where a taxpayer builds, owns and operates property under an arrangement , which is eventually transferred to the tax-exempt entity at the end of the arrangement. In this example, and assuming that the arrangement is with an entity that is a section 51AD exempt entity only (and not an entity within Division 16D), the "use" of the property or the "control of the use" test was restricted to the arrangement period under section 51AD. The "end user" test in section 51AD did not examine the use or control of the asset post the transfer. For Division 250 purposes, however, it appears that the use or control of the property by the tax-exempt entity post transfer will fall within section 250-50 particularly given the words "will use, or effectively control the use" in paragraph 250-50(1)(b) or, alternatively, the words "will be able to use, or effectively control the use" in paragraph 250-50(1)(d). The definition of the end user test in subsection 250-50(1) is not restricted to the "arrangement period".

We believe that the current definition of "end-user" needs to be consistent with that contained in the current provisions. Accordingly, we would seek a technical amendment to the definition of "end user" in section 250-50(1) to the effect of including the words "during the arrangement period" as per the amendment below:

> "(1) An entity (other than you) is an end user of an asset if, [during the arrangement period] the entity (or a *connected entity):"

2. Controlled foreign companies and Foreign Investment Funds

Under the controlled foreign companies (CFC) regime, the attributable income of a CFC is calculated on the basis that the CFC is a resident Australian company under section 383. Accordingly, unless there is a specific exclusion to disregard the operation of Division 250, we believe it is possible that Division 250 will apply inappropriately to a CFC where, for example, a CFC leases property located outside Australia to another non-resident entity or provides goods or services in respect of that property to another non-resident. As section 383 does not assume that the other non-resident entity is to be treated as a resident for the purpose of Division 250, this may result in an inappropriate application of Division 250 where there are non-resident to non-resident arrangements.

We note that in the public version of Division 230 (i.e. TOFA) released on 8 May 2007[1], Treasury has proposed to exclude Division 230 from the CFC and Foreign Investment Fund (FIF) provisions by amending section 389 and 557A of the ITAA 1936.

Likewise, where Treasury has not considered the Division 250 interaction provisions properly, we would request that Division 250 be excluded until such time that proper consultation has occurred in respect of this interaction provision. We believe that a technical correction should be made to section 389 and 557A to achieve this result. It would also be necessary for section 51AD and Division 16D to be similarly excluded from the CFC and FIF provisions to overcome the inappropriate application of these provisions, given their continued operation post Division 250.

3. Transitional arrangements

The Explanatory Memorandum (EM) states, at paragraph 1.287, that the transitional rule "will effectively switch off the adverse consequences of section 51AD with effect from 1 July 2003". However, we note that the transitional rule, contained at Schedule 1, Part 3, subitem 71(11) only has application from 1 July 2007. We believe that this is not consistent with the first public exposure draft of Division 250, which effectively turned off the application of section 51AD (and applied Division 250) from 1 July 2003. Under the current drafting, this means that section 51AD still applies for the four years from 1 July 2003 to 30 June 2007, and denies all deductions in respect of the arrangement during this period. We believe a technical amendment is required to change the reference from 1 July 2007 to 1 July 2003, and that Division 250 apply retrospectively for such arrangements.

In addition, we believe that Division 250 should have an unrestricted option so that taxpayers can elect into Division 250 for all transitional arrangements. The transitional options provided are somewhat restricted and do not allow pre-commencement Division 16D arrangements to be elected into Division 250.

[1] http://tofa.treasury.gov.au/content/downloads/TOFA_Draft_Bill_2007.rtf