



**AUSTRALIAN BANKERS' ASSOCIATION INC.**

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16 February 2007

Mr Peter Hallahan  
Committee Secretary  
Senate Economics Committee  
Department of the Senate  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

Dear Mr Hallahan,

**Tax Laws Amendment (2006 Measures No. 7) Bill 2006**  
**Amendments to Interest Withholding Tax exemptions**

The Australian Bankers' Association ("ABA") writes in response to the invitation from the Committee for submissions on *Tax Laws Amendment (2006 Measures No. 7) Bill 2006* ("Bill"). The ABA is the peak body for the Australian banking industry – its 26 members include all of Australia's major banks.

**1. Key issues**

The ABA has grave concerns about the content of Schedule 2 of the Bill, which contains proposed amendments to the interest withholding tax ("IWT") exemption in section 128F and related provisions of the Income Tax Assessment Act 1936.

Among other issues, if enacted in its current form, the Bill will be retrospective and will effectively impose cost (via interest withholding tax "gross up" clauses) on Australian borrowers who negotiated loan arrangements in good faith based on current law.

For the future, the Bill will unreasonably impede access by borrowers to international debt markets. For example, the proposed amendments will prejudice the ability of Australian firms to participate in the syndicated loan market, which is growing rapidly and was worth \$68.4 billion in 2004/05, according to the Reserve Bank Bulletin of September 2005. Following the 2005 amendments to s.128F, this market has been able to adopt international documentation standards which no longer require the cumbersome use of "debentures". There is evidence

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that the Bill has already caused some disruption and disunity in the syndicated loans market.

The ABA considers it essential that the Bill be amended prior to its passage through Parliament. The nature of the ABA's proposed solution (set out below) to the problem which the Bill seeks to remedy would not be adequately addressed via regulations as an alternative to amending the legislation.

## **2. Background – the problem being addressed**

The s.128F IWT exemption was broadened in 2005 so as to now be available for all publicly offered "debt interests" as well as "debentures". Prior to the 2005 amendment, only debentures qualified for the exemption. The explanatory memorandum to the 2005 amendments noted that:

*"While the concept of interest in the IWT provisions was partially aligned with the new debt/equity rules in 2001, the concepts of 'debenture' and 'offshore borrowing' need to be similarly updated to make the IWT provisions work as intended."*

We understand that the Australian Taxation Office (ATO) received requests to consider whether a broad interpretation of 'debt interests' could arise that would include such items as standard term deposits and other standard bank accounts, and that Treasury concluded that it would be preferable to amend existing law to avoid any ambiguity in this area.

The ABA understands why the Government wishes to ensure that items such as standard term deposits and other standard bank accounts should not benefit from the s.128F exemption.

## **3. Proposed solution**

To this end, the ABA's response to Treasury's Paper, dated 26 June 2006, recommended that s.128F (and s.128FA) be amended to specifically exclude unacceptable forms of debt interests. Such amendments should be in the legislation itself and not the regulations.

That is, the IWT exemptions would continue to apply to any "debentures" (as has always been the case) and to any "debt interest" that is not a debenture, except for debt interests of a type specified in a "negative list".

The ABA continues to believe that the approach it set out in June 2006:

- is feasible from a drafting/administration perspective;
- is specifically targeted to the identified problem areas noted above, and will thus protect Government revenue; and
- will enable Australian borrowers to appropriately raise finance from international financial markets through publicly offered instruments and

transactions which are debt interests, but which do not meet the somewhat ill-defined and archaic description of a "debenture".

The ABA considers that enactment of the Bill as it stands, with accompanying regulations in due course, would not achieve the appropriate outcome, for the following reasons:

- the current structure of the Bill is not designed to accommodate a "negative list" approach;
- the matters in question go to the heart of the operation of s.128F and such substantive issues must be included in the primary legislation; and
- as a practical matter, the development and promulgation of tax regulations is often a drawn out exercise. It would not be reasonable to subject Australian and foreign market participants to the possibly lengthy delays and uncertainty that could arise from a regulation process.

*Proposed regulation making power to disallow the IWT exemptions*

A further concern which the ABA has with the Bill relates to new s.128F(1C) and s.128FA(2A) which provide for a regulation to disallow the IWT exemption "in prescribed circumstances". These provisions should be deleted, as they will cause significant and unreasonable uncertainty for borrowers and lenders.

Measures of this nature can have effectively retrospective operation. The proper application of the rule of law, and the protection of Australia's reputation in international financial markets, demands that any withdrawal of a tax concession should occur via amendment to the primary legislation, with full Parliamentary consideration.

#### **4. Process issues**

The ABA notes that a breakdown occurred in the consultation process in relation to the proposed IWT amendments. The ABA lodged submissions with Treasury in June and December 2006, but was not engaged in formal consultation until after the introduction of the Bill on 7 December 2006.

The ABA met with the Minister on 7 February and Treasury on 15 February, and we are currently working on a further elaboration of how we envisage the amendments to s.128F and s.128FA might be drafted. In particular, the ABA will be forwarding to Treasury, in the near future, a suggested means of drafting the "negative list" of debt interests to be excluded from the IWT exemptions.

The ABA would welcome an opportunity to appear before the Committee, and we look forward to further and close consultation with Treasury and the Minister on the IWT aspects of the Bill.

Yours faithfully

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**Tony Burke**

**Cc:** Phil Lindsay, Office of the Minister

Michael Rawstron, Treasury