

20 January 2009

Committee Secretary  
Senate Economics Committee  
Department of the Senate  
PO Box 6100  
Parliament House  
Canberra ACT 2600  
Australia

To the Committee

## **Review of Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008**

This submission from Ernst & Young relates to the referral on 4 December 2008 of the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 ("the Bill") to the Senate Standing Committee on Economics for inquiry and report by 20 February 2009.

Ernst & Young has been extensively involved in the consultation process in relation to this Bill over many years, dating back to the "Taxation of Financial Arrangements: A Consultative Document" announced by the then-Treasurer John Dawkins MP and released in December 1993 by the Australian Taxation Office, with numerous proposals and consultations by successive governments since then.

The Division 230 measures contained in the Bill ("the rules") are, in our view, a highly desirable reform to codify the taxation of financial arrangements, particularly in relation to financial institutions and taxpayers that use financial instruments intensively.

For those taxpayers the rules will replace existing tax laws that lead to problematic outcomes, especially where taxpayers integrate various instruments to develop their financial positions. For example, where a taxpayer might borrow funds in one currency, and then hedge the interest and currency risk by using a mixture of forward rate agreements, interest futures, swaps and options, the current law calls for each instrument to be considered individually, with different tax recognition and timing rules. This leads to complex tax outcomes, with potential tax payments or benefits not reflecting the true financial or economic outcomes or timing of the transaction.

We highlight the following features of the Bill.

The Bill will help taxpayers to align tax, financial and economic outcomes by allowing for a financial arrangement comprising of several instruments to be assessed as a whole, by bringing together the various elements of the financial arrangement (section 230-55).

The Bill will simplify tax compliance by allowing taxpayers the option to recognise financial arrangements and their timing, for tax purposes, in a way more closely aligned to the treatment in audited financial statements. We support the taxpayer choice whether to align their accounting and tax compliance processes.

The Bill improves the application of the tax law for taxpayers who use financial instruments to hedge their underlying exposures. Under the existing tax law, the hedging transactions must be accounted for separately to the underlying exposures, causing variable and volatile tax timing and recognition leading to tax payments or benefits disconnected from the underlying transaction. The elective hedging method (Subdivision 230-E) will allow taxpayers to align the tax treatment of the hedge and the hedged item.

The Bill properly focuses on large taxpayers only, by excluding many small taxpayers, such as those with small turnovers and those who hold non-tax deferral financial instruments. The fact that such excluded taxpayers may optionally choose to adopt the new rules is a further positive aspect of the Bill.

The Bill will permit early adoption on 1 July 2009 by those who will gain tax compliance and other benefits from the new rules. Those who adopt the rules on 1 July 2010 will have an opportunity to learn from the experiences of the early adopters.

This two-stage adoption will provide an opportunity for the legislation to be refined to reflect the real world experience of the early adopters before many of the larger taxpayers adopt the rules.

### **Early passage of the Bill is desirable**

Because of the 16 year progress of this measure from the first discussion paper to date, with many discussion drafts of legislation, many people in business are now unwilling to commit significant effort to preparing for this Bill as there is some concern that this Bill might never be legislated.

As well, given the global financial crisis, businesses generally are unwilling to commit to the time and expense of updating systems until they know that the legislation is finally introduced.

We submit, therefore, that Parliament should enact the Bill expeditiously.

However the Committee and Parliament should recognise that there will inevitably be amendments to improve or adjust the resulting Act in light of practical experiences of the early adopters, as discussed below.

### **Proactive management and updating of the law is necessary**

The Bill represents a major legislative change affecting financial arrangements which are engaged in by taxpayers across Australia and internationally. It will have a wide-ranging effect.

It is inevitable therefore that some of the policy settings in the Bill will, even after the extensive consultation, need attention. Submissions are already being made to Treasury and further changes will be identified after the Bill is enacted.

We submit that the Committee should recognise, in its report on this referral, that:

1. Treasury needs a project management approach with a program to monitor the technical issues and any required amendments, anticipating changes to be developed in 2009 and 2010. This includes sufficient resourcing of this Treasury function to allow efficient maintenance of the legislation

This process should benefit from the lessons learned from previous desirable tax reform measures, where insufficient resourcing and project management to maintain the tax legislation after its enactment detracted from the success of the reform.

As a result, various tax reform measures have numerous loose ends and announcements which have not been legislated, which are listed in Joint Media Release No 052/2008 from The Hon Wayne Swan MP, Treasurer and The Hon Chris Bowen MP, Assistant Treasurer Minister For Competition Policy And Consumer Affairs of 13 May 2008 "Announced But Unenacted Measures Of The Previous Government". These issues continue to frustrate taxpayers and the proper administration of the tax laws. We recognise and support the initiative of The Hon Chris Bowen MP in establishing the Tax Design Review Panel of 2008 and signalling adoption of its recommendations to enhance management of tax laws and their ongoing maintenance.

2. Parliament should anticipate amending legislation after enactment of the Bill, including issues arising from experiences of early adopters and their advisors after commencement of the rules. This recognises the need to build on experiences when any wide-ranging legislation becomes operational.
3. Amending legislation should be targeted for speedy introduction, in late 2009 or early 2010. The larger group of taxpayers adopting the rules from 1 July 2010 must have a stable, certain and high quality legislative package to underpin their tax compliance, with sufficient advance notice of amendments and lead time to enable taxpayers to amend their systems and procedures leading up to the 1 July 2010 "hard start date."

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Yours sincerely



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