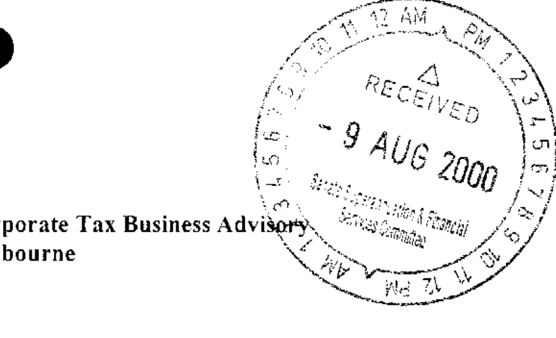
Senate Select Committee on Superannuation and Financial Services

Main Inquiry
Reference (b)

Submission No. 26

Submittor: Mr Ian C Edney
Vice President Taxes
Broken Hill Proprietary Company Ltd
GPO Box 86A
MELBOURNE VIC 3001
☎ - (03) 9609 3333
🖹 - (03) 9609 3015



Corporate Tax Business Advisory
Melbourne

4 August 2000

The Secretary
Senate Select Committee on Superannuation and Financial Services
Department of The Senate
Parliament House
CANBERRA ACT 2600

Dear Sir

SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

I refer to the Public Hearing by the Senate Committee on Superannuation and Financial Services held on 14 July 2000 in relation to establishing Australia as a regional centre for the provision of financial services. Further to the evidence provided by phone on 14 July 2000, BHP is pleased to now provide a written submission.

As noted at the time, in addition to expatriate remuneration issues, the existing income tax law contains structural problems that affect the taxation treatment of companies establishing Australia as a regional base.

A summary of our submission is set out below with the more detailed submission attached.

Corporate Tax Issues

BHP submits that for Australia to provide an internationally competitive tax regime that will attract regional investment the existing tax framework requires modification. In order to attract foreign investment to establish Australia as a regional base, BHP submits;

- foreign profits should be able to be distributed to foreign shareholders without Australian franking implications;
- Australian multinationals should be able to invest offshore via joint venture companies without double tax, local and Australian, on profits;

The Broken Hill Proprietary Company Limited ACN 004 028 077
BHP Tower 600 Bourke Street Melbourne Victoria 3000 Australia
(GPO Box 86A Melbourne Victoria 3001 Australia)
Telephone 61 3 9609 3333 Telex AA30408 Facsimile 61 3 9609 3015

- Australia should continue to push for renegotiation of Double Tax Agreements in order to reduce the level of dividend withholding tax on profit repatriation to Australia;
- the current transfer pricing in regard to the provision of intercompany non core services should amended to allow cost recovery with no mark up;
- foreign exploration expenditure of Australian companies should be deductible against Australian income, with appropriate claw-back rules for successful exploration.

I have also had the benefit of reviewing the comments made by Mr Jim Killaly on page 622 of the transcript in relation to Australian joint venture companies facing double taxation of profits derived from an overseas investment. BHP has provided further comments in the attached detailed submission that expand on the issue. It appears Mr Killaly has misinterpreted the question in providing his response which we believe does not correctly reflect the position.

Expatriate Employment Issues

The tax regime for both arriving and departing international executives must be internationally competitive to both attract and retain the best international executives. The existing rules and some of the proposed amendments in A Tax System Redesigned are/will be a disincentive for attracting international executives. The tax system should not adversely influence Australia's ability to attract international executives. Therefore, BHP submits;

- the Superannuation rules should allow for the withdrawal of benefits or the transfer of accumulated benefits in Australian funds to foreign superannuation funds with appropriate safeguards;
- Australian employers should be allowed to contribute to genuine foreign retirements plans without penalty;
- the Federal Government should pursue the negotiation of reciprocal retirement agreements to allow for the rollover of benefits between jurisdictions;
- the proposal to impose Australian taxation upon the cessation residency by a participant in an Australian employee share plan is not appropriate and employees should have the option of deferring the taxing point until the relevant cessation time;
- the proposal to deem a disposal of assets held at the time of cessation of residency should be modified to allow for deferral until ultimate realisation of the assets.

Should you have any questions in regard to the this submission, please contact me on 03 9609 3997.

Yours faithfully,

Ian C Edney
Vice President Taxes

Q:\AM\Senate Review.doc

BHP SUBMISSION
SENATE SELECT ON SUPERANNUATION AND FINANCIAL SERVICES

CORPORATE TAX ISSUES

1. Dividend Matters

(a) Dividend Flow through Australia

BHP submits that foreign profits should be able to be distributed to foreign shareholders without adverse Australian franking implications. The current anti-dividend streaming rules are a major impediment for Australian multinationals which are seeking to become internationally competitive.

Foreign shareholders of Australian multinationals should be allowed to receive dividends direct from foreign subsidiaries located in foreign comparable tax countries, without the imposition of Australian franking penalties and Australian dividend withholding tax.

The Review of Business Taxation considered both these options in A Tax System Redesigned ("ATSR") at Recommendations 20.2 and 20.3. The first option of streaming foreign profits to foreign shareholders was considered as sound in principle but was rejected on revenue grounds. The second options was rejected for the same reason.

(b) Offshore Joint Venture Companies

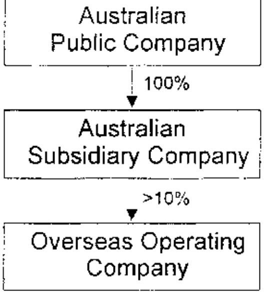
Following recent changes to Australia's tax laws, Australian public companies which invest overseas through an Australian joint venture company face effective double taxation on profits derived from the overseas investment. This anomaly stems from the recent removal of the inter-company dividend rebate for unfranked dividend distributions between non-wholly owned resident entities. Such double taxation at a company level, materially and adversely impacts the economics and viability of overseas investments, and it is likely that many projects may now prove to be uneconomic. Companies are judged by investment markets on the basis of the after-tax profits which they are able to report to shareholders, and a similar basis is applied by companies in the evaluation of project investments.

The effective double taxing of overseas income where the Australian public company investment is held through a joint Australian company, will impede the growth and international competitiveness of Australian multinationals, and in particular the ability of Australian public companies to take a lead on overseas investment and seek investment partners. We believe this to be inconsistent with the objectives of the Review of Business Taxation regarding a compatible system of taxation for business entities, and an internationally competitive taxation environment for Australian business investment.

Our submission to address this anomaly, is that the existing foreign dividend account ("FDA") and the proposed foreign income account ("FIA") should be amended to prevent the imposition of Australian income tax on non-portfolio unfranked dividends received by an Australian resident company from another Australian resident company out of overseas profits which have already borne foreign tax.

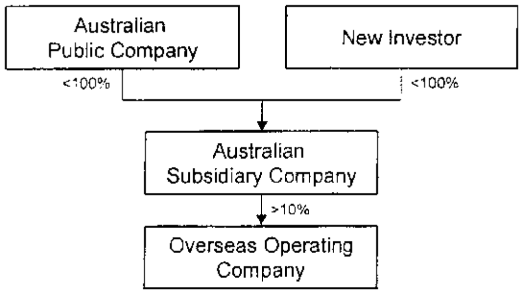
The issue is illustrated below.

An Australian public company group may originally invest in a project overseas under a structure such as:



When the Australian Subsidiary Company seeks to pass the income on, as a distribution, to its 100% parent company, the distribution is likely to be unfranked. In this case, the unfranked status of the distribution does not result in a tax liability because of the 100% ownership relationship between the payor and payee

However if there is not a 100% ownership relationship between the parent company and the Australian subsidiary company, the result is quite different. It is not uncommon for a new investor to be admitted to the investment, above the Australian Subsidiary Company, as follows;



The flow of distributions of foreign taxed income from the new jointly held Australian company to the Australian public company, as illustrated in the above diagram, is materially affected by the removal of the intercompany dividend rebate. Even if the new investor takes only a nominal shareholding in the Australian Subsidiary Company, the Australian Public Company will now be fully taxable in respect of any unfranked dividend which it receives from the Australian Subsidiary Company. No such problem arose prior to 1 July 2000.

Therefore, we reiterate that such double taxation at a company level materially and adversely impacts the economics and viability of overseas investments and it is likely many projects may now prove to be uneconomic.

(c) Dividend Withholding Tax Rates

BHP supports Recommendation 22.21 in ATSR to reduce the level of dividend withholding rates to at least 5% but notes the trend to 0%. However, Australia is lagging behind other jurisdictions in renegotiating the Double Tax Agreements (DTA) and hence the level of withholding taxes are not currently being reduced. The Government should pursue DTA renegotiation with key trading partners to hasten the reduction in dividend withholding tax rates.

2. Transfer Pricing

Under Australia's current transfer pricing rules (Income Tax Ruling TR1999/1), the provision of non-core services by Australian entities to overseas affiliates is required to be charged at cost plus 7.5% profit margin. Such a policy discourages the establishment of an "in house" service centre in Australia for the provision of services to the region. It should noted that both the OECD and the United States accept cost recovery as an acceptable level of charging in relation to non core services.

3. Australian as an Exploration Base

The Australian tax system currently does not permit deductions for foreign exploration expenditure, thereby reducing the international competitiveness of our tax system.

We believe that having the ability to deduct foreign exploration costs against Australian income, with appropriate claw back rules for successful exploration, is essential to ensuring Australian companies can compete on equal terms overseas against their US and UK counterparts. Its absence will make it increasingly difficult to explore overseas from Australia, thus foregoing the economic, technical and financial benefits that would otherwise flow back to this country.

EXPATRIATE EMPLOYMENT ISSUES

1. Superannuation and International Executives

The Relevant Issues

The Federal Government has increasingly focussed on the issues regarding the funding of the retirement of an ageing population. Tax concessions and compulsion (via the Superannuation Guarantee Charge) have been used to boost national retirement savings.

These concessions have been structured and have evolved such that retirement savings are not entirely free from tax. Hence, tax is imposed at the time contributions are made, at the time income is earned by the superannuation entity, and at the time when benefits are paid from the superannuation entity.

The system should be able to accommodate foreigners who work in Australia temporarily, and yet ensure that foreigners who retire in Australia have funded for their retirement in the same manner as an Australian citizen.

The Current Law

The taxation laws of Australia currently penalise a company that employs foreign executives to work in Australia where superannuation contributions are made to non complying superannuation funds. The tax penalty consists of either:

- FBT being imposed on the superannuation contribution (where the executive is in Australia on a visa where the visa has a life of greater than 4 years), or
- the contribution not being deductible in Australia (where the executive is in Australia on a temporary visa not exceeding 4 years).

This is the case even if the non complying superannuation fund is a genuine retirement plan that is treated as such by the relevant tax or pension authorities of the jurisdiction in which the plan resides.

Hence, domestic employers are compelled to contribute to Australian complying superannuation funds. Of course, the Superannuation Guarantee Charge legislation also compels Australian employers to contribute to an Australian complying superannuation fund (except in the case of certain senior employees that meet certain conditions).

These Australian complying superannuation funds require all superannuation benefits to be preserved until the executive reaches the age of 55 (the preservation age may be up to 60 years depending on the birth date of the executive).

Potential Solutions

(i) *Permitting the transfer or roll over of benefits to foreign superannuation funds*

Foreign nationals should be permitted to transfer their Australian superannuation benefits to genuine foreign superannuation funds or classes of foreign superannuation funds. These funds may be selected by reference to the laws of other countries or by other criteria established by the Australian Government.

As an example of appropriate genuine foreign superannuation funds, UK approved pension plans have preservation rules which are comparable to Australian preservation rules. A further example is US 401(k) plans.

If a transfer of benefits is permitted, the Australian general revenue may be protected by the imposition of tax on the transfer.

(ii) Permitting foreigners to withdraw benefits subject to a recontribution rule.

Prior to 30 June 1998, the laws which regulated superannuation benefits as embodied in the Superannuation Industry (Supervision) Act and Regulations permitted the early withdrawal of benefits where a person was leaving Australia to reside permanently overseas.

This rule was changed as there was a concern that this concession to the preservation rules, allowed Australian residents to leave Australia for significant periods of time, make the necessary declarations to superannuation fund trustees and withdraw their benefits notwithstanding that these persons may have left open the option to retire to Australia.

In our view, the changes to the law requiring all benefits to be preserved (but for some minor transitional rules) are too harsh and do not cater for foreigners who are working temporarily in Australia.

We recommend that the concession be reintroduced with modifications to minimise the potential for the early withdrawal of benefits where the person then subsequently retires to Australia. These modifications could include:

- only allowing early withdrawals by persons who are not Australian citizens or holders of Permanent Resident Visas, and
- requiring a recontribution of the withdrawn benefit to a complying superannuation entity (increased by an appropriate amount to reflect earnings if the benefit had remained in the superannuation system) where the foreign national applies for Australian citizenship or a Permanent Residents Visa. If appropriate, the recontribution requirement may be limited so that it is only imposed if the foreigner makes such an application within a period of time after the person departs Australia (say 10 years). This recontribution concept is used by the Singaporean Government.

(iii) Removing the barriers to contributions to genuine foreign retirement plans

Contributions to genuine foreign retirement plans should be permitted without any penalty being imposed on Australian employers.

Hence, FBT should not be imposed on such contributions and deductions should be allowed. Further, there should be no compulsion for Australian employers to make contributions to an Australian complying superannuation fund where contributions are made to genuine foreign superannuation.

The law has developed to stem the use of foreign superannuation funds as tax deferral mechanisms. The law has gone too far in this regard and a relaxation of the law to allow contributions to approved plans, or classes of plans would ensure that the objective of having contributions made for the retirement of an employee are met. We have previously provided examples of approved funds that will ensure that the funds are genuine retirement vehicles.

To ensure that the integrity of the Australian revenue is not compromised, safeguards may be introduced. These may include:

- only exempting from FBT, contributions made for the benefit of non Australian citizens and foreigners who do not hold a Permanent Resident Visa; and
- treating the contributions as assessable income of the foreigner, but only imposing tax at a rate representative of the rate that would be borne by the foreigner if the contribution were made to an Australian complying superannuation fund. The concessional rate may apply only in respect of contributions not exceeding an indexed reasonable level. Contributions in excess of this level would assessed at the foreigner's marginal rate of tax.

(iv) Reciprocal agreements with Foreign Governments

In addition to the unilateral changes to the law, the Federal Government can pursue the announcements that it made in respect of negotiating for reciprocal agreements with foreign governments for the rollover of benefits between pension plans. No action has been taken in this regard and we are not aware of any plans for these negotiations to commence. These should commence immediately.

2. Employee Share Plans

BHP submits that it is not appropriate to impose tax upon share value discounts under an Employee Share Plan at the time an employee ceases to be resident, as at this time:

- the employee is most likely prevented by the rules of the ESP from disposing of the ESP shares or options to pay any deemed tax liability. (This position is contrasted with Recommendation 22.20 of A TSR - under which an employee can dispose of the CGT asset to fund any tax liability); and
- the deemed income may be too contingent at this stage to be included in assessable income. For example many ESPs require performance hurdles or specified periods of time to be satisfied before the shares or options vest.

Notwithstanding our submission in the preceding paragraph, if the Government decides to proceed with Recommendation 22.19(a) of ATSR, BHP contends that employees ceasing Australian residency should have the option of:

- being taxed on ESP discount upon ceasing residency; or
- electing to defer tax on the ESP discount until the cessation time (ie 10 years) by providing appropriate security to the ATO.

This provides consistency with the proposed treatment outlined by Recommendation 22.20 for individuals who cease residency. Such a proposal is also more likely to align the Australian taxing point with that of the home country (eg; United States).

3. Deemed Disposal of Assets upon Cessation of Residency.

Recommendation 22.20 of ATSR recommends that a resident who departs Australia be deemed to have disposed of assets held at that time for their then market value or elect to defer the tax liability until realisation of the asset but provide a security deposit. It was recommended in ATSR that the rules be based upon those to be introduced in Canada. The Canadian rules treat departing residents as having disposed of property that could end up treaty protected. However, tax collection is deferred until ultimate sale provided adequate security is provided. Hence the taxing point will always be the point of departure and cannot be deferred until ultimate sale.

Fixing the taxing point as the cessation of residency will impose tax on gains that may never be realised.

Therefore, BHP submits the existing rules that allow departing residents to defer the taxing until ultimate sale be maintained.