

**Business  
Coalition for  
Tax  
Reform**

Level 11, 455 Bourke Street  
Melbourne Vic 3000  
Telephone (03) 9600 4411  
Facsimile: (03) 9600 4055

13 July, 2007

Board of Taxation Secretariat  
C/- The Treasury  
Langton Crescent  
PARKES ACT 2600

**Email: [taxboard@treasury.gov.au](mailto:taxboard@treasury.gov.au)**

Dear Mr Warburton,

**FOREIGN SOURCE INCOME ANTI-TAX DEFERRAL REVIEW**

The Business Coalition for Tax Reform (BCTR) welcomes this opportunity to respond to the Board of Taxation's May 2007 discussion paper on this important topic.

The BCTR is Australia's peak business tax group, comprising a range of industry associations drawn from all sectors of the economy and representing small, medium and large businesses. BCTR members share the common objectives of creating and implementing a better tax system that enhances both international and domestic business competitiveness and fairness, and which assists in creating a business climate which is conducive to investment, growth, job creation and private saving.

In the BCTR's view, the current review represents a worthwhile opportunity to revisit a regime that was designed some twenty years ago, at a time when the policy approach in relation to foreign income was based on capital export neutrality – i.e. the tax system at that time set out to tax the foreign income derived by Australian residents on an Australian tax equivalent basis, with only limited deferral opportunities.

The various international tax policy changes implemented since 2003 have moved our system closer to a capital import neutrality framework, particularly with the broadening of the exemption for foreign dividends and the participation exemption for the disposal of shares in entities with underlying active businesses.

While the BCTR supports and encourages the notion of achieving greater simplicity in our tax laws through the harmonisation of the four existing anti-tax deferral regimes, we believe the key outcome of this review will be the modernisation, simplification and better targeting of our anti-tax deferral rules. This will reduce uncertainty and compliance costs, and help make Australian companies more internationally competitive.

The discussion paper rightly points to the need to strike an appropriate balance between protecting Australia's revenue base and promoting competitiveness for Australian business. In the BCTR's view, the existing anti-tax deferral rules do not get this balance right. The vast majority of international business arrangements have not been put in place with tax deferral in mind, and even where the incidental effect of a particular structure or arrangement involves a degree of deferral, Australian tax on the underlying profits will eventually be paid when they are distributed to Australian shareholders.

The current exemptions are not sufficiently broad, and the system imposes unnecessary compliance costs on Australian businesses, both large and small. The regime should be more precisely targeted so that it catches arrangements and transactions that are reasonably likely to involve a material deferral of Australian tax.

A number of member organisations will be making more detailed submissions, which we commend to the Board. The BCTR would like to outline hereunder a number of key ideas by way of amplification:

- The BCTR would support collapsing the CFC and FIF rules into a single, simplified regime, with broadened exemptions and a degree of flexibility in calculating attributable amounts. Our membership does not have strong views about the best way of dealing with the two other attribution regimes (transferor trusts and deemed present entitlement). We do have some concerns, however, that a harmonised regime incorporating all four sets of rules might be more complex than one which includes just CFCs and FIFs.
- Taxpayers that are subject to attribution should be able to choose the method of attribution that best suits their circumstances, subject to appropriate rules to prevent cherry picking.

- The branch equivalent rules for calculating attributable income should be modified to exclude sections of the Australian tax law that are inappropriate from a policy perspective (e.g. sec 51AD or its forthcoming replacement). Taxpayers should also have the option of using the audited accounts of the foreign entity, subject to adjustments such as write-downs and provisions.
- There should be part-year attribution rules where ownership of an attributable entity changes hands during a year of income.
- The base company rules should only be retained in respect of activities that lack a proper commercial basis.
- Income currently treated as passive should not be attributable where it is an integral part of an active business being conducted either by the relevant entity or its associates. This includes rental and leasing income, royalties, licence fees and tolling income.
- Interest income derived as an incident of an active business, say at the start-up phase or the winding down phase, should not be treated as passive income.
- The tainted sales and service income rules should be abolished. Where there are transactions involving associates, one of which is an Australian resident, the transfer pricing rules should apply.
- Transactions between non-resident associates should not be caught under the anti-tax deferral rules at all.
- The listed country approach should be retained and expanded where possible.
- There should be a “push-down” exemption in respect of entities that are subject to the attribution rules of listed countries (that is, if a CFC resident in a listed country has a controlling interest in an entity resident in a non listed country, the income of the entity resident in the non listed country should not form part of attributable income in Australia).
- Depending on the way in which other proposals are dealt with, consideration should be given to a purpose based exemption for transactions or arrangements which are caught up under the anti-tax deferral rules, but where it can be objectively demonstrated that deferral was no more than an incidental purpose.
- There should be an exemption for widely-held managed funds, including wholesale funds that have such funds as members.

4.

- There should be an exemption for publicly listed Australian companies, justified in our submission, on the basis that shareholder expectations and governance arrangements would make it highly improbable that such companies would put arrangements in place that are driven by tax deferral considerations.
- There should be an exemption for widely-held publicly listed foreign companies.

A number of the points we have raised are inter-related, and some of our recommendations could fall away if others are adopted. For example, a public company exemption would largely negate a number of more specific recommendations, at least in respect of that sector. Likewise, the abolition of the base company rules, except in cases where an arrangement lacks a clear commercial basis, would obviate the need for some of the exemptions sought.

Please do not hesitate to contact the undersigned should the Board require any further clarification.

Yours Faithfully,

A handwritten signature in black ink, appearing to read 'John Stanhope', with a stylized flourish at the end.

(John Stanhope)

Chairman  
Business Coalition for Tax Reform