

# Business Coalition for Tax Reform

2 March 2007

The Hon Peter Costello  
The Federal Treasurer  
Room MG 47  
Parliament House  
CANBERRA ACT 2600

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Dear Mr Costello

## **Submission – Recoupment of company tax losses using the same business test**

The purpose of this letter is to convey the Business Coalition for Tax Reform's strong view that the review of the same business test (SBT) announced in the former Minister for Revenue and Assistant Treasurer's press release of 7 December 2005 should proceed as a matter of urgency, for the 2007/08 Budget at the latest.

As part of that review, the BCTR strongly recommends that access to the SBT be reinstated for all companies whose total income exceeds \$100 million (the SBT ceiling). The SBT ceiling currently denies tax recognition of legitimate losses in circumstances where there is no relevant loss trafficking. Indeed, it is likely that its principal effect will be in relation to companies' legitimate losses. It is an unjustified deadweight on Australian companies with start-up or major losses from, for example, major infrastructure projects, energy and resources projects or major early-stage research or capital expenditure.

We also recommend that consideration be given to:

- Allowing consortium companies to flow through losses to their shareholders, similar to the UK; and
- Introducing loss carry back rules. We note that the Warburton-Hendy Report indicated that half of the OECD-10 countries permit loss carry back.

The BCTR is of the view that these measures are a necessary part of the Government's continuing reform to enhance Australia's international competitiveness and will more closely align its tax rules with international tax practice.

The BCTR is a forum for bringing together the views of the business community on tax reform issues. 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 conducive to investment, growth, job creation and private saving. A list of BCTR members is provided in Attachment A.

## **Policy considerations**

The BCTR notes that companies incur tax losses from commercial transactions that, most often, cause **another** taxpayer to earn assessable income, realise a capital gain or suffer a reduction in the cost base of an asset. Cancelling a company's tax loss biases the tax system against the loss company and, ultimately, increases the effective tax rate on company profits above the legislated level of 30%.

The tax system is already biased against capital losses. Taxpayers can only deduct capital losses from capital gains. So, the "stock" of capital losses in the tax system mainly consists of losses that taxpayers have incurred, but which they could not deduct from their other income. Deferring companies' deductions for their capital losses again increases the effective tax rate on company profits above the legislated level of 30%. Tax policy should therefore be doubly cautious about cancelling a company's capital loss under the company loss rules and the SBT ceiling.

Some commentators suggest that the company loss rules ensure that only the shareholders who actually “bore” the burden of a company’s tax loss can benefit from it. This is simplistic and incorrect and, for widely held entities, it is the business that is adversely affected:

- The company loss rules effectively discourage the purchaser of a loss company from attributing any value to its losses. These rules, therefore, have the perverse effect of preventing the shareholders who bore the burden of the company’s loss from benefiting from it by selling the company for a price that includes the discounted value of its losses.
- Majority interests in companies can have their value adversely affected by tax losses. However, a majority shareholder in a company will be subject to the loss duplication rules (Subdiv.165-CD), which **prevent** them from realising any benefit from the company’s losses.

The BCTR accepts the need for rules against loss trafficking. We emphasise that there is no policy basis for extending them beyond what is strictly necessary to discourage loss trafficking.

### **Reinstating access to the SBT for all companies**

The BCTR strongly supports the modifications made to the continuity of ownership test (COT) to address the practical difficulties faced by listed public companies and “eligible Division 166 companies” (referred to collectively as widely held entities). Business sought such changes to restore the operation of the COT in relation to widely held entities as various governments always intended, as it operated prior to the 1997 rewrite of the rules under the so-called Tax Laws Improvement Project.

The BCTR does not support the simultaneous removal of the SBT for companies whose total income exceeds \$100 million. In our view, the SBT was always intended to operate as a “saving provision” in relation to the COT so that takeovers, mergers and other commercial transactions do not affect a company’s access to its losses, in the absence of indicators of loss trafficking.

The introduction of the ceiling is against the clear policy of the original introduction of the SBT rules. It is against the Ralph Review of Business Taxation recommendation to retain the SBT. It is an unnecessary and unexplained deadweight on Australian business.

The SBT ceiling is not justified by the improvements to the COT (particularly for larger companies which do not benefit from the COT improvements). It appears to be based on some unknown concern about loss trafficking in larger companies. No policy has been provided to support the SBT ceiling. There is no costing for the combined SBT/COT changes and there is no policy discussion or justification underpinning the SBT ceiling. This is clear from the Senate Economics Legislation Committee report on the measures.

### **Improving operation of the SBT, including loss carry back, consortium company loss flow-through**

In the abovementioned press release, the Government invited submissions on options for improving the operation of the SBT as it applies to claims by companies for carry forward losses and bad debt deductions for consideration in the then forthcoming 2006-07 budget context.

We urge the Government to consider, in the context of the forthcoming budget, the various options for improving the SBT made in submissions lodged, including (as a priority) the removal of the SBT ceiling.

The BCTR supports the joint submission lodged on 31 January 2006 by various professional and other organisations, including the Corporate Tax Association, the Institute of Chartered Accountants in Australia and the Minerals Council of Australia (refer attached). This makes a number of recommendations to overcome the harshness of the SBT, particular problems for income tax consolidated companies and the “all or nothing” consequences of failing the test.

Amongst the recommendations made in the joint submission is:

- introduction of loss carry back rules as recommended by the Asprey Report and in the 2006 Warburton-Hendy Report and
- consortium company flow-through loss relief, in a manner similar to the UK relief.

The BCTR supports the recommendation that such rules be developed in consultation with affected stakeholders

In the event you have any questions regarding the above matters please contact me on 03 9634 9901.

Yours faithfully

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

John Stanhope  
Chairman

cc. The Honourable Peter Dutton, Minister For Revenue and the Assistant Treasurer

## **Attachment A**

### **Business Coalition for Tax Reform members**

Australian Financial Markets Association

Australian Institute of Company Directors

Business Council of Australia

Corporate Tax Association of Australia

CPA Australia

Council of Small Business Organisations of Australia

Institute of Chartered Accountants in Australia

Insurance Council of Australia

Investment and Financial Services Association Ltd

Minerals Council of Australia

National Institute of Accountants

Property Council of Australia

Real Estate Institute of Australia