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Deloitte & Touche

September 4, 2002

The Secretary
The International Taxation Project
Board of Taxation Secretariat
c/- The Treasury
Langton Crescent
PARKES ACT 2600
AUSTRALIA

Dear Sir/Madam:

SUBMISSION
REVIEW OF INTERNATIONAL TAXATION ARRANGEMENTS

We wish to submit on the discussion paper *Review of International Taxation Arrangements*.

About Deloitte & Touche LLP

Deloitte & Touche LLP is one of the largest professional firms in the United States of America with more than 30,000 people and serving 3000 SEC clients.

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Specific points submitted on

1. **Option 3.6 for consultation:** to consider whether or not to proceed with the Review of Business Taxation proposal to apply CGT to the sale by non-residents of non-resident interposed entities with underlying Australian assets.

2. **Option 3.12 for consultation:** to consider options to clarify the test of company residency so that exercising central management and control alone does not constitute the carrying on of a business.

3. **Option 4.6 for consultation:** to consider exempting from CGT gains to which non-resident beneficiaries are presently entitled that relate to assets without the necessary connection with Australia. Whether an asset has the necessary connection with Australia could be determined as if the trustee of the resident trust was a non-resident.

Option 3.6: Applying CGT to interposed entities with underlying Australian assets

We are strongly opposed to this proposal. We consider that it is flawed from a policy perspective, would be difficult to comply with in a practical sense and would harm Australia's international competitiveness.

It is inherent in any entity-based taxation system that the sale of the entity has different tax consequences to the sale of the assets of the entity. The sale of shares in a company owning trading stock is not treated in the same manner as the sale by the company of that trading stock. Despite economic equivalence arguments, the tax treatments of the different legal forms are different in almost all jurisdictions. (We note that in the US, the use of "check-the-box" rules to disregard certain entities is largely elective by the taxpayer).

We see the main objections to this proposal being based on policy issues, increased compliance costs and economic issues.

Policy issues

We consider that any such proposal would be inherently difficult to target and would be complex. Issues include:

1. Defining the threshold test for seeking to tax the sale of an interposed entity.

   What level of Australian assets would have to be held? Only Australian assets? Predominantly Australian assets? Any Australian assets?

2. Dealing with apportionment issues for non-Australian assets held directly or indirectly by an interposed entity.

   Apart from valuation issues where the interposed entity owned both Australian and non-Australian assets directly, there would be no policy basis for seeking to tax a non-resident on the sale of an interposed entity which held non-Australian assets even where those non-Australian assets were held through an Australian entity (this point is apparently recognized in the discussion document).

3. Dealing with tax treaty issues.

   Where an interposed entity is resident in a country which has a favorable tax treaty with Australia, seeking to tax the sale of that entity could put Australia in breach of its treaty obligations.

4. Risks of economic double taxation.

   Many countries impose some form of capital gains tax. If Australia seeks to impose CGT on the sale of an interposed entity then there is an increased risk that the vendor will be subject to double taxation. This is particularly likely in circumstances where, for compliance or other reasons, the Australian tax is imposed on an entity other than the entity actually selling the interposed entity (e.g. by imposing the tax directly on the Australian assets). Many countries would deny a credit for Australian tax paid in these circumstances.

Compliance issues

It seems likely that the implementation of this proposal in any form would require complex legislation. Inevitably this will increase compliance costs for foreign investors into Australia. At a time when many countries are seeking to reduce compliance costs as well as make themselves more attractive to foreign investors this would seem to be a significantly retrograde step.

Economic issues

There does not appear to have been any analysis done in any of the published material in which this idea is proposed to link any (presumed) revenue losses to either negative economic impact of the proposal or the increased compliance costs which will be faced, in varying degrees by all investors into Australia. In particular we would have expected to see some analysis of the impact of raising the cost of (foreign) investment into Australia on the national well-being of Australia.

We note that the US does not impose capital gains tax on the sale of shares in US companies held by non-US residents (other than the limited case of land owning companies). Rather than seeking to extend the Australian CGT model to tax indirect sales of Australian assets by non-residents we consider Australia should give serious consideration to exempting even direct sales of (at least) shares in Australian companies (we note the existing partial exemption for portfolio investments in listed companies).

Option 3.12: Clarifying the residency test for companies

We support a move to either an exclusive use of place incorporation for determining residency or greater emphasis on place of incorporation. This would align with the US treatment of corporate residency and would therefore simplify the resolution of residency issues between the US and Australia.

Moving to a more objective test will also serve to reduce uncertainty and therefore compliance costs.

The discussion document notes concerns about the US and the possibility of companies "expatriating" to foreign jurisdictions for tax purposes. It needs to be recognized that a significant contributing factor to the (relatively small) number of these changes is the impact of the US CFC rules and certain aspects of the US's position in the world economy. It is not clear that the same factors would apply in Australia. In addition, as noted in the discussion paper, the existence of an imputation system in Australia creates a strong incentive to remain resident (at least for companies with significant Australian shareholdings). As you will be aware the US has no such system.

Option 4.6: Exempt non-resident beneficiaries from Australian CGT on the sale of non-Australian assets

We believe that this approach is consistent with both residency-based and source-based taxation. The basic approach should be to tax residents on their world wide income and non-residents only on their Australian sourced income (although for a capital importing country even this later point is debatable). It is incorrect from a policy perspective to seek to tax non-residents on income which is not sourced in Australia.

We note that if (despite our submission above) Australia did proceed to try and tax the sale of interposed companies with Australian assets it would be necessary to extend this principal to ensure that no tax was levied in relation to the proportion of the assets of the interposed entity which were not Australian based. This might require looking through a number of tiers of companies.

If you wish to discuss this submission please contact Greg Cole on +1 202 220 2090.

Yours sincerely,

Deloitte & Touche