"REVIEW OF INTERNATIONAL TAXATION ARRANGEMENTS"

SUBMISSION TO THE BOARD OF TAXATION ON THE COMMONWEALTH DEPARTMENT OF TREASURY'S CONSULTATION PAPER OF AUGUST 2002

By

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN AUSTRALIA

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Table of Contents

Executive Summary

The Institute of Chartered Accountants in Australia ("ICAA") welcomes the opportunity to provide this submission to the Board of Taxation on the Department of Treasury's consultation paper, "Review of International Taxation Arrangements", August 2002 ("the Consultation Paper").

The ICAA recognises that there is need for urgent change to the existing Australian business tax system due to the increasing globalisation of business and the desire for Australia to take a role in the globalised business environment of the future.

Attracting Equity Capital for Offshore Expansion

The ICAA recognizes and supports the position of the Consultation Paper that the dividend imputation system ought to remain as a feature of Australia's tax landscape in the near term, pending a more considered review.

The ICAA submits that the provision of domestic shareholder relief for unfranked dividends out of foreign source income (Option 2.1A) should be considered in conjunction with allowing dividend streaming of foreign source income (Option 2.1B). The provision of franking credits for foreign dividend withholding taxes (Option 2.1C) is no longer attractive.

The ICAA believes that there are other factors which are also important in setting an attractive capital raising environment that need attention. Enhanced venture capital concessions are required as a matter of urgency. In addition, the tax treatment of intangibles and intellectual property deserves consideration both in terms of reducing withholding tax on royalties paid to Australian companies and also by expanding the business intangibles eligible for amortisation under the uniform capital allowances provisions.

Promoting Australia as a Location for Internationally Focused Companies

The ICAA considers that the design underpinnings of the CFC rules are obsolete, with an inappropriate policy direction for Australian-held groups with international activities. The ICAA is further concerned about the excessive nature of the CFC rules, being a complex and poorly maintained set of rules. However, the ICAA recognises that core rewriting of the CFC rules would be a massively complex exercise with a span of years required to implement the rules.

Therefore, the ICAA recommends an approach of addressing the measures which remove the worst features of the CFC rules, and therefore prioritises the measures as follows:

A. Treatment of lower-level offshore reorganisations within CFC groups;
B. Treatment of comparable tax countries;
C. Refinement of the tainted services/income rules;
D. Exemption for non-portfolio dividends.

The ICAA considers that the key policy setting required is for Australia not to impose capital gains tax on reorganisations of lower-tier subsidiaries. This could be achieved by way of a participation exemption or using some mechanism of CGT rollover.

The ICAA considers that a revision of the definition of tainted services income is required and that it is not appropriate for the concept of tainted services or passive income to be overlaid over the existing concept of Broad Exemption Listed Country (BELC). Furthermore, the ICAA is of the view that there should be an exemption from the CFC rules for CFCs that operate in BELCs. The expansion of the list of BELCs would be welcome but this should not go hand in hand with additional measures designed to attribute specified income. A durable process for determining what "comparably taxed" means should also be established. Such a process should include external stakeholders, possibly through a liaison group. This process should be on-going and transparent.

In order to address the technical and policy issues in the existing CFC legislation, the ICAA strongly encourages the establishment of a permanent International Working Group (IWG) with a mandate to make specific recommendations for all of the items coming to attention (from the current lists and from future input).

The ICAA recommends that there should be a carve-out from the application of the complex CFC rules where the value of the transaction or the business revenue is below an indexed amount as the current de minimis exemption is inadequate.

The ICAA does not support the Review of Business Taxation's proposal to apply CGT to the sale by non-residents of non-resident interposed entities with underlying Australian assets, due to serious concerns with appropriate targeting and enforceability.

Although the ICAA supports the overall reduction in withholdings as being a very desirable outcome of the recent protocol to the Australia-United States tax treaty, it does not support protocol amendment itself as a model for future treaty negotiation whereby taxpayers are left to deal with ongoing inadequacies of old treaties. The ICAA sees tax treaty negotiations with Australia's leading trade partners as being of high priority but also recognizes that the prioritizing of tax treaty negotiations needs to be a continuous process.
The ICAA supports a consultation process on negotiating tax treaties and recommends that a newly constituted Treasury Treaties Working Group be formed.

The ICAA is supportive of a process to consider providing conduit relief (conditional on the establishment of significant scale activities in Australia) but considers that the conduit concession would require coverage of more than merely the CGT treatment of foreign investments. The ICAA would be interested in participating in the process leading to development of the relevant criteria.

The ICAA supports the amendment of the central management and control rules to provide that the mere conduct of Board meetings in Australia, the mere involvement of Australian directors in Board meetings of foreign subsidiaries, and the involvement of Australians in Australia in supervisory or oversight activities in relation to foreign subsidiaries should not constitute the foreign subsidiaries to be carrying on business in Australia.

The ICAA supports a harmonisation of the residency rules in Australia's tax treaties with the residency rules for domestic law purposes. That is, if a treaty provides for non-resident status for a company, we support - as a compliance streamlining process - the non-resident status being applicable for domestic law purposes

Promoting Australia as a Global Financial Services Centre

The ICAA supports measures that will promote Australia as a global financial services centre. The ICAA believes that the foreign investment fund ("FIF") rules go beyond the original intent of the measures and create a significant and costly compliance burden. As such, a fundamental review of the FIF rules in the medium term is recommended combined with a review to address the more pressing concerns of the existing legislation, including trusts, as covered in the Consultation Paper.

Improving Australia's Tax Treatment of Expatriates

The ICAA considers that it is important for Australia to be able to attract highly educated and skilled labour from overseas. However, the current tax treatment of expatriates can be prohibitively expensive to Australian businesses. (The ICAA notes that this issue does not just concern foreigners coming to Australia to fill top executive positions but applies across the board to engineers, scientists, academics and middle management to name but a few). The ICAA therefore supports the position taken by Government in regard to the foreign income exemption for "temporary" residents (as reflected in Taxation Laws Amendment (No.7) Bill 2002) and supports the reform of other areas such as superannuation arrangements for temporary residents.

The ICAA is not supportive of the proposal that departing residents should provide security for a deferred CGT liability.

The ICAA considers that the potential for the double taxation of employee share options needs to be addressed but believes that this should be done first by a re-writing of the domestic law as a matter of very high priority, rather than through bilateral tax treaty negotiations.

The ICAA supports the establishment of a specialist cell of the Australian Taxation Office to deal with the administrative concerns of foreign expatriate employees.

Other Matters

The ICAA would welcome the opportunity to participate in further consultation with the Board over the next couple of months prior to the Board finalizing its report to the Government by the end of this year.

As the delivery of the international tax reforms proposed in the Consultation Paper will require strong project management, the ICAA recommends that a standing committee/Board is needed to push ahead with the international tax reforms to ensure that momentum is not lost. The ICAA would be a willing participant in such a process.

The ICAA urges that, whatever may be the changes in policy or "clarification" of the law as it applies to international taxation that come out of this review, on-going attention must be given to the care and maintenance of the law. In this respect, the ICAA submits that there is a role for the Board of Taxation to establish a process for escalating all interpretive and policy issues for consideration by a panel of experts from the Treasury, the ATO and externals with a mandate to make recommendations for legislative amendments and changes to administrative practices. Such amendments (if acceptable to Government) could for instance be implemented by way of an "Annual Technical Corrections Bill".

1. Introduction and Overriding Principles

1.1 Introduction

The Institute of Chartered Accountants in Australia ("ICAA") welcomes the review and the recognition that there is need for urgent change to the existing Australian business tax system due to the increasing globalisation of business and the desire for Australia to take a role in the globalised business environment of the future. The ICAA is of the view that it is not possible for us to remain as "Fortress Australia" with an inefficient international tax system adding significantly to cost structures, and still stay competitive in the global arena.

The Ralph Report concluded that there were major practical problems with the current taxation system of international transactions, both for foreign controlled groups operating in Australia and Australian controlled groups operating internationally.

The ICAA recognises the importance of the Government now taking action in announcing the review of aspects of Australia's international tax arrangements and the release of the consultation paper on the "Review of International Taxation Arrangements" by the Federal Treasury in August 2002 ("the Consultation Paper").

The ICAA is a participant in the Business Coalition for Tax Reform (BCTR) which is producing a submission itself, and members of the ICAA are also involved in other business bodies' submissions to the review. The ICAA is supportive of other submissions and draws from these in this document.

The ICAA believes it will be useful also to provide to the Board of Taxation and to the Government input in relation to international tax issues particularly as they affect emerging businesses and small to medium sized enterprises ("SMEs"), to supplement other submissions.

The ICAA acknowledges the valuable contributions made by its members and, in particular, a number of the members of the ICAA's Tax Technical Panel chaired by Tony Stolarek.

1.2 Overriding Principles

The ICAA recognises that it is important for Australia to be integrated and connected into global business networks and activities.

Australia is a substantial economy, with significant natural resources and primary and secondary industries. However Australia needs to grow, to ensure that we are:

- Not merely a primary production location – a farm;
- Not merely a resource producer – a mine or oil and gas source;
- Not merely a domestic market of almost 20 million people – a downstream market;
- Not merely a clever country providing contract research to international companies without ownership of the intellectual property here.

Instead Australia must continue to develop as a vibrant commercial centre for international activity centred in Australia.

The ICAA considers that:

1. As Australian based companies grow and operate internationally, this creates opportunities for the development of headquarters activities in Australia, as well as export-oriented activities, which add to employment and the pace of economic activity.

2. The involvement of Australia in the activities of global companies (even if they are foreign-owned) creates significant opportunities for Australia, for business in general, and for our members participating in and serving those businesses. It is in Australia's interests for Australian subsidiaries of global companies to be recognised as centres of excellence, or global service centres and to have other global activities.

3. It is important that Australia has an attractive international tax environment which helps Australian emerging companies to grow **and to retain those growing companies, their business activities and their employees in Australia**.

The ICAA wants to ensure that Australia's international tax environment makes Australia an attractive location for emerging and growing companies to raise capital while remaining headquartered or largely based in Australia. We recognise that companies need to have bases overseas, in overseas markets and capital markets. However we believe it is important that the Australian locations of emerging companies and publicly-listed companies remain vibrant and dynamic – rather than being lower-tier subsidiaries with limited roles.

4. It is imperative for the review to accept Australia's position as part of the Asia-Pacific region and also to recognise that by itself, it is a small economy which businesses may end up avoiding if the tax system remains out of step and costly in regard to its neighbours. Comparisons of tax systems need to be made with our near neighbours in mind, rather than merely with our OECD counterparts (which typically are "high tax" countries).

5. An underlying goal of the review should be to reduce complexity and the administrative burden of the international tax system, particularly for SMEs. It is imperative to minimise compliance costs in respect of international transactions such that start-up enterprises, SMEs and large businesses generally can be competitive. Many of the current rules are extremely complex and can actually act as a disincentive for SMEs to expand offshore.

6. The ICAA supports the development of Australia as a financial hub, recognising the substantial skills of Australians in the funds management industry, and the well-developed regulatory environment which we offer, which is more advanced than many other countries. In this context, the ICAA believes Australia should build on these advantages and therefore there must be changes to our tax system which currently repels international funds management activities.

2. Comments on Chapter 2 – Attracting Equity Capital for Offshore Expansion

2.1 Dividend imputation should remain, but bias should be addressed

The ICAA recognises and supports the position of the Consultation Paper that the dividend imputation system ought to remain as a feature of Australia's tax landscape in the near term, pending a more considered review:

(a) Australia is almost unique in the world in taxing superannuation funds. When Australia commenced taxing superannuation funds, the dividend imputation system was represented by the Federal Treasurer of the day, Mr Paul Keating, as an important tax benefit to superannuation funds, an important counter-balance to the tax cost imposed on Australian savings.

The ICAA believes that the imputation system should not be adjusted (other than to remove the defects in relation to international business and international investment, discussed below) other than in the context of a detailed review of our savings policy and the taxation of savings. The ICAA supports escalation of this review, given the aging of Australia and given the large growth in savings in superannuation funds.

(b) The ICAA considers that the core features of the imputation system have been one of the factors which have encouraged Australian investors to participate in the stock markets and have globally quite high share investment percentages.

(c) The imputation system has generated signals which have made it attractive for Australian investors to acquire shares in Australian-based and Australian-focused companies. The ICAA believes that no action should be taken without some thought as to the long-term impact on the attractiveness of such companies.

Making significant core changes to the imputation system would create tax confusion. The ICAA has been a leader in pointing to the need for Australia's tax administration and tax policy to be focused on key national objectives, without creating excessive tax changes where these can be avoided.

The real area for focus is the other more urgent changes to the imputation rules in relation to the taxation of international business and international transactions discussed below. We support the focus of the Consultation Paper on removing various well-known tax inefficiencies and signals in relation to Australia's taxation of international transactions. This is the key immediate priority for focus.

Option 2.1 seeks input on the impact on Australian companies of the dividend imputation bias at the shareholder level, and considers three options for dealing with this bias, the options being stated as alternative options.

2.2 Is the issue the cost of capital or is the issue the attractiveness of Australian companies?

The ICAA is not in possession of detailed capital markets data which can be used to precisely calibrate cost of capital for Australian companies. However there are various references on the impact of imputation, including research commissioned by the ACCC and State regulators, such as " The cost of capital under dividend imputation" prepared for the ACCC by Associate Professor Martin Lally, in June 2002.

The ICAA would support the Board of Taxation undertaking such research as needed.

2.2.1 Franked dividends are attractive

However the ICAA can make the following comments:

(a) Franked dividends are attractive to:

- (i) Australian resident individuals; and
- (ii) Australian resident superannuation funds.

The attraction of franked dividends for individuals arises for:

- (i) retirees looking for a high quality of earnings;
- (ii) investors who are working; and
- (iii) higher-income investors, who might be attracted to leveraged investments in franked-dividend-producing shares.

Superannuation funds are highly attracted to franked dividend producing shares, because the franking credits, which are now refundable under the recent changes to the imputation measures, mitigate the tax imposed in relation to contributions to the superannuation funds. That is, superannuation funds pay tax at 15% (or more) on contributions, income and capital gains (capital gains are taxable at reduced rates). The surplus franking credits available in relation to franked dividends are an important mechanism for superannuation funds to control their overall tax liability.

Superannuation funds' asset consultants, and our members as tax advisers to superannuation funds, draw this fact to the attention of superannuation funds.

The impact of franked dividends is therefore an element in the asset allocation process for superannuation funds, Given the expected lower overall returns available for equity markets now, the dividend imputation advantage might be more significant for superannuation funds.

We suggest that the Board might conduct research in this area as part of its research around the Options, discussed below.

(b) Since the introduction of the 50% discount for capital gains in relation to assets held for more than 12 months (and the one-third discount for superannuation funds), there are signals which encourage Australian investors to invest more readily in capital growth assets.

However, investors have learned from recent stock market corrections that it is dangerous to pin all their hopes on capital growth, and investors must look to the underlying business fundamentals of the investment.

More importantly, growth investments are recognised as being only a part of a balanced portfolio approach for investors. A balanced portfolio needs to contain a mix of income producing assets and growth assets, appropriately tailored to the risk profile of the investor.

So, it would be misleading to consider that the CGT discount introduced as a result of the Ralph Review of Business Taxation (RBT), which is welcomed by the ICAA, has any great impact on the cost of capital issues.

(d) The ICAA recognises that franked dividends may be of less significance in privately-owned companies. However the franked dividend is an important signal when unrelated investors are introduced.

2.2.2 Unfranked or Low Franked Dividends reduce attractiveness of widely-held Australian companies

Given the attraction of franking credits and their grossing-up of the net after-tax yield, the ICAA submits that actions which reduce the franking credits available for Australian investors must reduce the attraction of investing in Australian companies.

The ICAA is not able to provide detailed cost of capital statistics and as noted above would suggest that the Board of Taxation might seek its own input on such issues, potentially from international investment banks.

However, we observe that a company paying franked dividends will clearly be more attractive to an Australian resident investor than a company whose dividends are not franked, all other things being equal.

So the ICAA sees the dividend imputation system, or more correctly the supply of franked dividends to Australian investors, as being an attractive factor to encourage Australian investors in invest Australian companies.

2.2.3 Foreign earnings affect franking and thus the attractiveness of widely-held Australian companies

The current settings of the imputation system mean that when Australian companies invest into overseas activities, their franking outcomes are impaired. This must affect their attractiveness, as discussed above.

As a result, the ICAA recommends that the after-tax outcomes for Australian investors need to be adjusted, so that the franking benefits can be preserved for Australian investors to the greatest possible extent where an Australian resident company:

(a) invests into international activities; and
(b) has foreign shareholders.

2.3 Dual Listed Companies ("DLCs") Are Not the Solution

The ICAA notes the comments in the Consultation Paper that "the form of dividend streaming already available to DLCs is similar to a stapled stock arrangement".

However the ICAA believes that DLCs do not provide the solution to this problem of shortage of imputation credits in relation to international activities. DLCs require:

(a) a company which is listed in an international stock market; and
(b) that foreign listed company to have a significant presence, headquarters and scale in the foreign capital market (that is, a sharing of the headquarters activity with Australia, which reduces the relative significance of the Australian company).

As recognised in the recent Reserve Bank article "Dual Listed Companies" in the Reserve Bank of Australia Bulletin of October 2002, DLC's are issued for a combination of reasons including market attractiveness, and not just for purposes of solving franking shortfall issues.

2.4.1 Potential Evidence of Impact of Imputation for DLCs

Significantly, the same Reserve Bank Bulletin, while looking to the difficulties in establishing the precise cost of capital outcomes for DLCs, noted that:

> "the fact that two of the three DLCs involving Australian companies have persistently traded at a significant premium in the Australian market relative to the UK market tends to refute claims that Australian companies can increase shareholder value by shifting their listing to larger overseas exchanges".

The ICAA sees this as confirming that DLCs trade at premiums in the Australian market, and the ICAA suggests that at least one reason for this would be the availability of the franking credits in relation to the Australian company in the DLC structure, which enhances the attractiveness of such a company to Australian investors.

This underpins our comments above, that Australia should carefully protect the attractiveness of Australian globally-oriented companies to Australian investors.

2.4 Considering the Three Alternative Options

2.4.1 Option C is not attractive

Option C proposed is to provide franking credits for foreign dividend withholding taxes paid by Australian groups in relation to their subsidiaries' offshore activities.

With respect to the Ralph Review of Business Taxation ("RBT"), the ICAA believes this is no longer a viable long-term solution.

This is because:

(a) this proposal provides no benefits or credits in relation to the underlying basic corporate income taxes paid overseas;
(b) various countries impose no dividend withholding taxes (for example, the UK); and
(c) even where foreign countries impose dividend withholding taxes, the trend of treaties, as typified in the recently negotiated protocol to the US-Australia double-tax agreement, is to reduce dividend withholding taxes in various circumstances.

In any event, Option C, if implemented, would still not reduce the impact of foreign dividend withholding taxes on the reported profits of Australian public companies, thus continuing to provide a disadvantage to those companies repatriating profits to Australian parent companies.

So, Option C is not attractive.

2.4.2 Option B, streaming of domestic profits, is an important element

Option B calls for allowing dividend streaming of foreign-source income.

The ICAA suggests it is somewhat misleading to talk of streaming of foreign source income. Rather, the **key aspect which must be protected is the ability to stream Australian-sourced profits, with resulting franking credits, to Australian shareholders. This is the key issue which needs to be recognised as a fundamental design element of the dividend streaming measures**.

This proposal involves, as noted in the Consultation Paper:

> "Australian companies to pay franked dividends to shareholders who benefit most from franking (for example, resident shareholders such as superannuation funds) and unfranked dividends to those who benefit least or not at all (for example, non-resident shareholders). Streaming could be limited to a company's foreign-sourced income (however measured)".

We agree with the comment in the Consultation Paper that "legislating to allow dividend streaming could be the simplest option to implement. Current efforts to prevent streaming create legislative complexity and increase administrative and compliance costs".

The ICAA supports the introduction of dividend streaming of foreign source income, in ways which will preserve the franking entitlements to the greatest possible extent for Australian resident shareholders. The ICAA supports **both**:

(a) streaming of foreign source income from an Australian parent company to foreign shareholders, and
(b) streaming of foreign source income from a foreign subsidiary to foreign shareholders using stapled stock streaming.

Both measures are needed. In some cases, foreign stapled stock will be desirable, particularly where foreign investors in a particular foreign country might benefit from receiving income sourced from underlying profits in their own country. The ICAA notes specific measures which applied in the UK for some years.

However the dividend streaming measures ought not to be limited to foreign stapled stock subsidiaries, and should enable an Australian parent company to direct foreign-sourced income together with an associated Foreign Dividend Account (FDA) credits, to foreign shareholders. The ICAA believes that every possible step should be taken to make Australian parent companies attractive to foreign investors.

2.4.3 Dividend Streaming in Itself is Not Sufficient

While the ICAA supports the dividend streaming measure, this is not the entire solution. The reason is simple:

(a) dividend streaming allows the conservation of Australian franking credits for Australian shareholders;
(b) however, if an Australian company expands offshore, and pays foreign taxes, then over time its franking credits may be insufficient to provide fully franked dividends to its Australian shareholders.

The ICAA notes, and the Board can research, the experience of various Australian companies which expanded overseas, which had reduced franking percentages, and which created a reduced attractiveness to Australian investors, particularly where the franking percentage started to fluctuate.

The ICAA suggests also that volatility in franking percentages is relevant in the investment attractiveness of Australian companies. Shareholders will tend, from the viewpoint of prudence and planning their long-term financial affairs, to assume the lowest likely or lowest possible franking percentage. For this reason, the ICAA believes that the capital raising measures need to introduce an imputation advantage for Australian investors in relation to their companies' international activities – as proposed in Option A.

Dividend streaming of domestic and foreign profits to those shareholders who can benefit the most would appear to be an attractive alternative to those companies whose shareholder mix is appropriate and proportional to the mix of domestic and foreign sourced profits. It does not operate quite as beneficially for those companies (especially emerging Australian SMEs) where the foreign profits are not yet significant or where there are minimal foreign shareholders, such as prior to international listing.

2.4.4 Option A - Providing Domestic Shareholder Relief for Unfranked Dividends Out of Foreign Source Income

The ICAA submits that Option A should be investigated in conjunction with Option B, to provide some economic and psychological signal to Australian investors which will continue to attract them to investing in Australian companies which operate globally.

The Consultation Paper looks to a credit of 1/9th. The ICAA is supportive of submissions seeking provision of a greater credit. From the viewpoint of neutrality to Australian investors between Australian-sourced profits and foreign-sourced profits, it appears *prima facie* that the neutral level of credit would need to be no more than 3/7. We recognise also that an increased credit level would involve some decision process about:

- Which investors would be eligible, and
- Whether the credit could be offset against other income.

This measure could provide an equitable solution for the emerging SME companies with a low foreign shareholding percentage, where they are unable to use an effective dividend streaming arrangement. Absent such an incentive, closely held SME companies and their economic owners can effectively suffer a combined tax rate in excess of 70% in many cases in respect of fully distributed foreign taxed profits. This discourages such companies from expanding into foreign jurisdictions while retaining ultimate ownership in Australia. (The ICAA made detailed comments on this disincentive in some of its early submissions to the RBT).

The ICAA recognises that this measure would need to be costed. However the ICAA believes that the following behavioural and economic issues would flow from this measure:

(a) The provision of a credit to Australian shareholders in relation to unfranked dividends from foreign income would amount to a form of tax incentive. This is recognised.
(b) However the net effect of the tax incentive would be to retain an attractive environment for emerging Australian companies, growing on the global markets, to raise their capital in Australia.
(c) For Australian global companies to retain Australian bases, and raise capital in Australian markets, is an important element in protecting the relationship of those companies with their Australian investors, and their ongoing activity in Australia.

Again, while the ICAA has not commissioned economic research precisely on this issue, it appears to the ICAA that, without change in this area, once Australian companies "go global" and lose the relationship with Australian investors and Australian capital raising, they will be more likely to migrate, or to have relatively lower share prices resulting in takeovers by non-Australian companies, and in various ways to reduce their connection with Australia.

<u>Priority</u>
High

2.5 Other Measures to Attract Equity Capital for Offshore Expansion

The ICAA believes that there are other factors that are also relevant in setting the attractiveness of Australian companies.

2.5.1 Venture Capital Concessions

One of the unattractive features of the Australian tax environment is the lack of truly viable venture capital concessions, notwithstanding the measures proposed in the RBT report and introduced in 1999.

The ICAA recognises here the Press Release of the Assistant Treasurer, Senator Helen Coonan, foreshadowing enhanced treatment of venture capital effective 1 July 2002, delivering on the Budget announcement in the May 2002 budget. The ICAA urges the Government to proceed with this measure with the greatest urgency.

The ICAA would like to stress the significance of the venture capital concession in the equity raising behaviour of Australian companies. We make the following points:

1. Australia is recognised internationally for the quality of its knowledge and research skills.

2. However, it is unattractive for foreign private capital (which emanates largely nowadays from major foreign pension funds, educational funds and endowments such as charitable foundations and US university foundations) to invest in Australia, because Australia imposes capital gains tax on investments by foreigners in Australian private companies

   This taxation impost can be contrasted with carefully designed venture capital concessions which apply in many other countries, which are specifically tailored to enable long-term patient venture capital to be attracted into the local jurisdiction and used to grow local companies.

   Because of Australia's capital gains tax regime and the very severe controlled foreign corporations legislation, Asian and US venture capital providers sometimes encourage Australian emerging companies to effectively relocate to an international jurisdiction before they will introduce their venture capital. The venture capital concessions must be made to work in conjunction with reform of the CGT rollover and CFC provisions of Australia's tax legislation.

3. This issue was recognised in the RBT, in the venture capital concession recommended by the RBT, and in the concession introduced in 1999 by the Government in *New Business Tax System (Capital Gains Tax) Act* 1999.

4. Unfortunately, however, the venture capital concession then introduced was flawed in a number of critical respects:

(i) The venture capital concession was limited only to investments by foreign superannuation funds, and investments by foreign educational endowments (such as those of the major US universities) and major charitable endowments (such as the Ford Foundation) were ineligible for the concession.

(ii) More importantly, the concession in relation to intermediaries was restricted so that only a foreign collector partnership which was owned exclusively by superannuation funds exempt in their country of taxation was eligible. Again, this meant that if any foreign collector vehicle had any investment in it from a foreign charitable endowment educational foundation, or wealthy foreign individual, then – even if these investments were limited in extent – the foreign collective investment vehicle was ineligible for the Australian venture capital concessions.

The ICAA notes that, unlike the optimistic times of 1999, when NASDAQ was booming, and global stock markets were strong, we now have a very muted international economic environment.

Further, the ICAA notes that since 1999 Singapore has expressly targeted the venture capital market with a concession designed to capture Singapore as a hub for venture capital investment.

As a result it is disappointing that the initiative of the RBT, and the well-meaning initiative of the Government in 1999, has not been achieved due to flawed legislation which has not been remedied in the interval.

The ICAA believes that Australia needs a strong, active and vibrant venture capital industry, bringing in foreign equity funds into Australian companies, and that the venture capital concessions provide a significant element of this attraction, particularly in relation to unlisted companies such as:

(a) early stage investments – in industries such as biotechnology, computer technology, but also engineering and other innovative production processes; and
(b) later stage venture capital investments such as leveraged buy-outs, and other mechanisms where existing Australian businesses can be acquired by new financial owners, with the involvement of foreign venture capital monies, and invigorated and grown to a global scale.

Priority
Immediate

2.5.2 Australian Treatment of Intangibles and Intellectual Property

The ICAA considers that, as well as the dividend imputation measures and the venture capital measures, the Government should identify the significance of the treatment of intangibles and intellectual property in making for an attractive capital raising environment.

The ICAA notes in particular the need for Australia to focus on two aspects which would make Australia more attractive as a location for the capital raising and holding of global intellectual property in Australia. As discussed in more detail below, the two factors are:

(a) the withholding tax environment which applies to royalties under Australia's double-tax agreements. Specifically, the ICAA suggests that Australia should adopt a preference for negligible or nil royalty withholding tax rates in its double-tax agreements; and

(b) an enhanced process of amortising or achieving an appropriate tax recognition or tax write-off for the cost of intellectual property. In other words, the ICAA believes that the existing limited categories of intangible property which are eligible for write-off under the uniform capital allowance (UCA) rules should be expanded.

2.5.2(a) Withholding tax

The withholding tax environment in relation to royalties and charges for intellectual property is important.

Australia in the past was a net payer of royalties to residents of other countries. However, with the talent of Australia's business people and researchers, Australia is recognised as a viable research location. Unfortunately however, Australia's double-tax agreements do not strive for any advantageous treatment in relation to royalty withholding taxes, other than typically the generic 10% limitation on royalty withholding taxes.

As a result, Australia is not seen as an attractive location to use as a licensing hub for international business.

The ICAA and its members have seen Australian technology move to ownership in other countries which have better treaty networks, from which the technology is licensed. Unfortunately, the other countries' treaty networks and licensing activities mean that there are flow-on activities which are then undertaken in those other countries – activities involving the intangibles management, professional services, and licensing headquarters activities of the relevant companies.

The ICAA understands that there will no doubt be a concern about potential revenue costs in this regard. But the ICAA believes that the opportunity cost of such a measure may be low. That is, Australia is missing out on international licensing activity by virtue of Australian intellectual property being sold overseas. If Australia had a more attractive withholding tax environment fostering licensing through Australia, then Australia would be able to generate a higher level of licensing activity through Australia.

And, more importantly, if international intangibles were owned through Australia, and managed through Australia, the ICAA submits that the intangibles would then be more likely to remain in Australia within the Australian companies affiliated with global organisations.

<u>Priority</u>
Significant

2.5.2(b) Amortisation of Intangibles and Intellectual Property

The ICAA notes that various specific elements of intangible property are currently eligible for amortisation under the Uniform Capital Allowances (UCA) rules.

However these amortisations are limited to:

(a) Certain items of intellectual property as defined in the legislation, broadly as being rights under a Commonwealth law – i.e. standard patent, petty patent, registered design, copyright, and licences of these rights.
(b) Mining, quarrying or prospecting rights/information;
(c) In-house software;
(d) IRUs, and
(e) Spectrum licences and data transmitter licences.

The ICAA notes that other countries such as the US and more recently, in 2002, the UK, have mechanisms whereby a broader range of business intangibles is eligible for amortisation. The ICAA observes that these amortisation techniques make it more attractive for acquisitions of intangibles to be made by companies located in those countries.

The ICAA believes that, as a medium-term objective, Australia should consider an enhanced process for amortisation of business intangibles in the context of acquisitions. It might be argued that this amortisation will create a revenue cost. But the ICAA submits that the marginal revenue cost might be in fact quite low. Factors in determining the marginal revenue cost will include:

(a) increased attractiveness of Australian takeovers for Australian companies (that is, the economics for an Australian acquiror will improve, perhaps to the same level as the after-tax economics for a US acquiror or now a UK acquiror of an Australian company); and
(b) the fact that there will be a higher propensity for Australian-based acquisitions rather than foreign takeovers might enhance the volume of headquarters activity in Australia, and the flow-on benefits for Australian businesses.

The ICAA recognises that while this is a priority this measure would require some analysis and revenue costing.

For that reason the ICAA believes that this should be itemised by the Board and by the Government as a medium term measure of significance for Australia's growth.

<u>Priority</u>
Significant

2.5.3 Addressing "black hole" assets and expenditure

With the abandoning of the Tax Value Method, the ICAA urges the Government to proceed towards the systematic treatment of rights and black hole expenditures, with a view to implementing these changes as soon as possible. The time that the current case-by-case approach is adopted should be limited. The measures in the UCA provisions are limited to a handful of specific costs and are insufficient. Having expenditure not being recognized by the tax system, for instance need to make payments for exclusive rights to a sales territory or a product, adds to cost structures of Australian-based companies and makes Australia unattractive for international companies.

<u>Priority</u>
Significant

3. Comments on Chapter 3 – Promoting Australia as a Location for Internationally Focused Companies

The ICAA supports measures that will make the Australian tax environment friendlier to Australian-based multinationals and more attractive as a location for regional holding companies and headquarters of global segments of company groups.

Evidence

The ICAA members see a recurring pattern of behaviour:

(a) Australian-owned or listed companies operating globally have tax problems in operating their international activities, and
(b) Global companies, which might be thinking of establishing regional headquarters in Australia or global headquarters of particular segments ("segment headquarters") bypass Australia and establish these activities elsewhere. In international business, location decisions are very flexible.

Australia's tax rules, especially those relating to location of internationally focused companies, are just not competitive. This affects incremental investment decisions and Australia's potential. These issues are receiving continued attention in other countries, our competitors, and must be addressed in Australia.

The ICAA's views are shared by others, as illustrated by the following statement by a resent visitor:

> "The focus should be on being tax neutral, to allow commercial considerations to drive investment decisions rather than have some sort of tariff-type taxation system which tries to keep investment within Australia… The comparison has to be with near neighbours, and Australia is getting out of step . . . the tax taken from corporation tax is just too high in Australia compared to other competitors in Asia…
>
> Australia has a huge number of opportunities which they need to capture. The government needs to be proactive and needs to make sure it doesn't get bogged down in dogma of trying to retain the status quo as far as it sees in terms of tax tariffs… multinational and global organisations can shift income and capital anywhere they want and the bottom line is that Australia is a small economy and if it doesn't get the tax regime right, multinationals will just avoid it."[1]

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[1] Head of Taxation for the UK-based Association of Chartered Certified Accountants, Chas Roy-Chowdhury quoted in "Get tax reform right or lose business: warning" Australian Financial Review, Oct 31 2002, by Allesandra Fabro

The ICAA considers that the design underpinnings of the controlled foreign company ("CFC") rules are obsolete, with an inappropriate policy direction for Australian-held groups with international activities. The ICAA is further concerned about the excessive nature of the CFC rules, as a complex and poorly-maintained set of rules, which cause significant limitation on legitimate commercial activities.

Equally the ICAA recognises that core rewriting of the CFC rules would be a massively complex exercise with a span of years required to implement the rules.

Key Priorities

For this reason the ICAA recommends an approach of addressing the measures which remove the worst features of the CFC rules, and therefore prioritises the measures as follows:

A. Treatment of lower-level offshore reorganisations within CFC groups (option 3.1)
B. Treatment of comparable tax countries (options 3.2 and 3.3)
C. Refinement of the tainted services rules (option 3.2)
D. Exemption for non-portfolio dividends (option 3.9)

Detailed analysis

Option3.1:
To consider options to expand rollover relief under the controlled foreign company rules, while maintaining the integrity of those rules.

The ICAA supports expansion of rollover relief under the CFC rules, as currently the rollovers allowed under the CFC regime are extremely restrictive. This issue has been a problem since the commencement of the CFC regime in 1990 and has been one of the major reasons why foreign investors have considered Australia to be an unattractive place to form regional holding companies (see option 3.10 below).

<u>The problem</u>

The limited rollover relief provided for under the CFC regime is a major issue for Australian-based companies that may be unable to efficiently restructure. This can leave them trapped in inefficient and uncompetitive structures (both commercially – i.e. from a managerial and administrative perspective - and for tax purposes e.g. higher foreign withholding taxes). This is because they may be unable to change an inefficient structure without having current Australian tax payable on unrealised profits.

Where transfers are at book value, the deemed market value disposal rules in Australia's CGT provisions will apply such that the unrealized profit will be determined on this basis. The result can be that the inefficient structures are left in place and no tax is attributed to Australia in any event.

This is an important issue. It means that Australian companies with international operations are:

(a) unable to restructure or streamline their groups without major costs and
(b) as a result enduring higher compliance costs in maintaining their structures.

It results in a tendency to inefficient international operations solely because of outdated and inflexible Australian tax law.

Further, this current lack of restructure relief acts as a disincentive for basing international activities through Australia.

The solution

Australian based companies need to be able to have the flexibility to restructure on a go-forward basis due to the fact that business conditions change over time – so company structures must be able to as well. This is an important issue in ensuring that Australian-based companies remain competitive in the global arena.

The ICAA considers that the key policy setting required is for Australia not to impose capital gains tax on reorganisations of lower-tier subsidiaries in CFC chains. The ICAA is open to whether this is implemented:

(a) using participation exemptions (i.e. total exemption from CGT in some cases) or
(b) using some mechanism of rollovers as discussed below.

The ICAA considers that a key criterion for this decision should be the ease of drafting the measure, and the convenience of its administration.

The ICAA believes that consideration also needs to be given to extending rollover relief in scrip-for-scrip cases but agrees that this needs to be explored further.

In summary, the types of measures envisaged by the ICAA to expand roll-over relief in the context of CFCs include those as recommended in the Business Council of Australia's paper on "Removing Tax Barriers to International Growth" of 11 December 2001, i.e.:

- Allowing tax deferred rollover of assets between CFCs that are members of the same wholly-owned group, irrespective of the residence of the CFCs;

- Allowing relief for a CFC in a Broad Exemption Listed Country (BELC) where the relief is consistent with relief provided by the BELC;
- Allowing scrip for scrip transactions in certain circumstances.

The ICAA appreciates the Treasury's concern that the integrity of the CFC rules needs to be maintained. This issue needs to be dealt with as part of the review of the proposed expansion of CGT roll-over relief in the context of CFCs.

Priority
Immediate

Option 3.2:
To consider options to appropriately target the tainted services income rules, while maintaining the integrity of the controlled foreign company rules.

The ICAA supports this proposal, as currently the rules do not reflect the increase of and significance of international services in the economy. They also represent another reason why Australia is unattractive as a conduit/holding company location.

The problem

The definition of "tainted services income" has remained essentially unchanged since the introduction of the CFC measures in 1990 even though there has been increased activity in the services sector. The list of BELCs was reduced to just 7 in 1997 such that tainted services income derived by a CFC in all other countries will lead to attributable income, potentially subject to Australian tax on a current basis. There are few exceptions.

Many companies' operations involve service activities. The international focus of business is to add services and added value on top of the supply of goods and basic products. So for many businesses their service provision actually constitutes "active services" – i.e. the business carried out is a service, rather than being product based.

These services and added value activities are, in a global context, provided from various appropriate business locations, in various countries.

These services are not activities designed to shift income from one jurisdiction to another (which was the major fear that motivated introduction of the measures). Often such operations cannot be easily moved due to the need to be near customers and the necessary infrastructure.

Australia's CFC rules as they currently stand are also detrimental to:

- Multinational groups with shared service centers in limited-exemption listed or non-listed countries;
- Companies with installation and maintenance service agreements where the goods are sold from Australia (with associated installation and maintenance paid for under such agreements), but the installation and maintenance services are provided locally.
- Companies with service and support facilities provided to customers from in limited-exemption listed or non-listed countries.

Australia now has a very robust transfer pricing regime to deal with the matters such as related party transactions in an international context. The transfer pricing measures already impose a significant administrative burden on companies operating cross-border. The tainted services income rules add another layer of complexity and an additional compliance burden which becomes particularly onerous for SMEs.

<u>The solution</u>

The ICAA supports the following approach:

(a) the revision of the definition of tainted services income to exclude the operations of a CFC where it is undertaking an active business of providing those services to non-associates and limiting its operation to services provided to Australian resident associates.

(b) there is no place for the concept of tainted services or passive income to be overlaid over the existing concept of a BELC. There should be no application of the passive income rules to BELC CFCs. This would make for an easier compliance task for Australian business. For Australia to impose the existing overlay of complex, unclear and costly rules onto subsidiaries in BELCs is unwarranted, distrustful of the foreign countries concerned and inconsistent with the whole concept of BELC CFCs. Therefore, the ICAA supports a total exemption from the CFC rules for CFCs that operate in BELCs.

(c) the concept of a BELC should be broadened to include comparable taxed countries, discussed in our views relating to option 3.3.

<u>Priority</u>
Immediate

Option 3.3:
To consider whether additional countries should be included in the broad exemption country list, and to clarify the criteria for inclusion (or exclusion).

We support an expansion of the broad exemption country list but we wish to emphasise that this should not go hand in hand with additional measures designed to attribute specified income.

The trend should be to fully exempt income and capital gains arising in the BELC without the exceptions which presently over-complicate the rules. For example, it should not matter that the income receives a specific concession in the foreign country. Only income from non arms-length transactions and passive income arising from transactions which are not related to the core business should be potentially attributable and then, only if not "comparably taxed" outside Australia. To restate, Australia should not in our CFC rules attempt to "second guess" the US rules, for example. A US subsidiary of an Australian group operates in a tax environment of sufficient integrity not to need complex and costly CFC compliance overlaid onto it.

A durable process for determining what "comparably taxed" means should be established. Such a process should include external stakeholders such as the Board or a Treasury Liaison Group which might be established. That is, the criteria and the listing of countries should be transparent. The process of identifying additional countries to be included on the broad exemption list, or even the limited exemption list, should be an ongoing one and not haphazard or *ad hoc*.

The ICAA considers that the revenue effect of this proposal would not be great.

We note that where an exemption applies, the value of the exemption will accrue to the shareholders. For widely held enterprises, this value will be subject to CGT as it is realised (that is, the exempt income nevertheless increases the value of the Australian head entity, and when shareholders sell investments in the head entity, the vendor shareholders will be taxed here if they are Australian residents.) So, the exemption is then little more than a short-term time shift in revenue.

Whilst this may not be the case for privately owned enterprises, the value of the transactions would be significantly smaller with a correspondingly smaller impact on revenue. In any event, the potential for increased trade flows with Australia should provide a basis for encouraging smaller enterprises to derive foreign source income without the disincentive and compliance costs of working out how much is assessable in Australia.

<u>Priority</u>
High

Option 3.4:
To identify technical and other remaining policy issues regarding the controlled foreign company rules, and consider options to resolve them either on a case-by-case basis or as part of a major re-write of the provisions.

<u>The problem</u>

After 12 years, the CFC and related rules remain riddled with errors, ambiguities and unintended consequences notwithstanding the establishment of a number of consultative forums to discuss the issues. Only the glaringly obvious mistakes or those threatening the revenue have received any priority for amendment. Whilst there have been some amendments which favour taxpayers, the list of outstanding items is very long and the ATO has had to "manage its way around" the issue – often in a way which discourages transactions and often in a way which favours the revenue.

Examples of the outstanding issues can be found in the "CFC National Issues Register" which contains more than 80 recognised issues and the "TLIP – FSI rewrite" list which contains more than 120 line items logged when the rewrite of the foreign source income rules was a live project. Whilst there are some duplications on these lists, none of the items are trivial. For example, these lists include the call for a review of the meaning of the word "associate" – a term originally designed to link taxpayers with a potentially common purpose in relation to the control test. Not only does the meaning operate in unintended ways for that test, but the word "associate" now pervades the Income Tax Law for many other purposes with further unintended outcomes. These lists also call for a wider range of rollovers – especially to enable a group including offshore subsidiaries to reorganise (now an even more pressing need in light of the Consolidation regime) and the lists make the point that royalties can be a part of the core business but are nevertheless treated as tainted thereby separating the income from the foreign tax credits they create.

Another important item on the lists is the very inappropriate way in which changes in the value of foreign currency and the relationship between a particular currency and the "functional currency" can give rise to assessable income.

The control test, rollovers, the division between active and passive income and FX / functional currency conversions are high priority items from a very long list of issues which demand review to provide certainty and sensible outcomes for taxpayers.

The ICAA is committed to a consultative model with Government, and has taken the lead in providing input to government about many problematical administrative issues in the tax law, before and after the Tax Reform process.

The ICAA applauds the willingness of Government to modernize Australia's tax law, but emphasize that this modernisation carries with it a responsibility to maintain and keep under repair any new rules, and to test that they are meeting their objectives from the viewpoint of Government and the community in terms of adequate compliance models and economic outcomes.

The solution

The ICAA does not recommend at this stage a rewrite of the entire CFC rules, with another law of many pages. Instead, the ICAA recommends action to resolve the gross and long-standing problems. Accordingly, the ICAA:

(a) Strongly encourage a review of the technical and policy issues.
(b) Recommends that a permanent International Working Group (IWG) comprising ATO/Treasury and external stakeholders be established with a mandate to make specific recommendations for all of the items coming to attention (e.g. from the current lists and from future input and experience with the rules as constituted from time to time). The meetings of the IWG need to be held regularly.
(c) Stresses that Government must be committed to ensuring that the recommendations for legislative change are supported with OPC resources and a slot in the Parliamentary program.
(d) Recommends a process of "shortcuts" or "carve outs" for SMEs. Complex rules discourage business activity, and are very inappropriate to apply to small and emerging businesses (SME). The ICAA therefore recommends that there should be a carve-out from the application of all complex rules where the value of the transaction or the business revenue is below an indexed amount.
(e) Recommends an updating of the de minimis exemption e undertaken as the current de minimis exemption from the CFC rules is inadequate.

All of these issues can be considered by the proposed IWG.

Priority
Immediate for the establishment of the IWG. The outcome of the IWG will take longer and can be assigned a longer time line for achievement.

Option 3.5:
To consider whether the recently negotiated protocol to the Australia-United States tax treaty provides an appropriate basis for future treaty negotiations or whether alternative approaches are preferable.

At the outset, the ICAA notes the significance of a strong and continuous process to renegotiate and keep relevant Australia's Double Tax Treaties.

A protocol amendment should be no more than an ambulatory change intended to recognise faults or changes in the environment in which the Treaty is applied.

Whilst the overall reduction in withholdings is a very desirable outcome, the US Treaty is 20 years old and it is unfortunate that it was not **fully** re-negotiated at least 10 years ago.

The ICAA notes also that there are many issues under the US Treaty which were not dealt with in the Protocol. This means that taxpayers will need to deal with ongoing inadequacies in that Treaty. For these reasons, we are definitely of the view that the US Protocol amendment must not be a model for future Treaty negotiations.

<u>The solution</u>

However, as mentioned above, the reduced withholdings on dividends and royalties are a very desirable outcome and should be a significant aim for all future Treaty negotiations as should be the separation of specified types of income from the withholding categories into the general business income basket. Nevertheless, the US Treaty is not generally a good model as it is so old and outdated in many respects. In this regard, future Treaty negotiations should have regard to early input from external stakeholders and specialists with significant experience in the impact or likely impact of the particular Treaty on taxpayers.

The ICAA recommends that Australia's negotiating position should be to minimise royalty withholding taxes wherever possible, in order to maximise the potential of Australia as a base for licensing of technology internationally. Australia is currently seen as having a treaty network with little concessions in relation to royalty withholding taxes in its treaties – i.e. The typical rate is limited to 10%.

Australia should strive for treaty limitations on royalty withholding tax of zero with as many countries as possible, to enable Australian firms to extract licensing revenues and bring them efficiently into Australia without being forced to manage licensing through offshore countries which have better treaty arrangements.

Finally, tax treaties are an adjunct to trade and the early input of the Department of Foreign Affairs and Trade should be mandated.

<u>Priority</u>
High

Option 3.6
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.

The ICAA recognises the Treasury's concern that a non-resident holding Australian assets through a non-resident company can dispose of that non-resident company, thus avoiding Australian CGT on non-portfolio assets.

However, the ICAA queries how such a proposal could be implemented and its enforceability. The consultation paper itself states at page 40 that "this measure is complex to target appropriately, and its implementation was deferred pending a review of the tax treaty policy."

If not appropriately targeted and implemented, unintended results and significant uncertainty for other resident shareholders could arise. Collection of tax would present problems where both the vendor and the purchaser were non-residents. To address these, it would most likely be necessary to deem the liability to rest with the Australian resident entity. Given such rules would be necessarily complex, yet another layer of complexity would be added to the Australian tax system. There may also be resistance from treaty partners regarding the imposition of such measures.

Most of these issues were discussed in the first and only consultative meeting on the issue in early 2000. In that meeting, a number of situations were proposed which would, if implemented, impose some hugely anomalous outcomes, massive compliance difficulties and practical problems for every-day companies where there is no hint of tax avoidance. In many cases, there is no overall tax avoidance since any gains are already taxed in home country jurisdictions. To write law to impose tax in such situations and then exempt the gain where the gain is already taxed elsewhere would be unduly complex and would most likely cost more to enforce than could possibly be recovered.

It should be noted that many Australian companies also sell their interests in foreign operating companies by way of sale of interposed companies, with a resulting tax liability in Australia or in another overseas location. For example, an Australian company with several subsidiaries in Europe might, these days, sell the shares of a UK holding company, which would not give rise to CGT in Germany, France, etc. The same occurs in South-East Asia with the sale of Singapore regional holding companies.

For these reasons, the ICAA recommends that the measure not be proceeded with.

Option 3.7:
To consider which countries should be given priority for tax treaty negotiations, taking into account negotiations underway with the United Kingdom and Germany, the need to update pre-CGT treaties, and countries that Australia may be obliged to approach because of most favoured nation clauses in existing treaties.

The ICAA supports priority being given for tax treaty negotiations with Australia's leading trade partners such as the United Kingdom and Germany. However, the ICAA also recognises the need for prioritising to be a continuous process and recommends that this be addressed by the National Tax Liaison Group - Tax Treaties Advisory Panel (of which it is a participant) on a much more frequent basis (see below under Option 3.8). This should permit consideration to be given to the priorities of a diverse range of businesses through this representation, including SMEs.

The ICAA believes that consideration should also be given to increasing the resources in the Treasury in the area of tax treaty negotiation in order to be able to take on more projects such that opportunities are not forgone whilst obligations under most favoured nations clauses in existing treaties are adhered to.

Option 3.8
To consider options to improve consultation processes on negotiating tax treaties.

The ICAA supports a consultation process on negotiating tax treaties. It is disappointing that the National Tax Liaison Group – Tax Treaties Advisory Panel has not met more frequently since its inception in 1997.

With the Treasury now responsible for tax legislative processes and the International Policy Group we recommend a newly constituted Treasury Treaties Working Group be formed. This Working Group should meet more frequently – particularly as developments unfold in regard to each treaty's negotiation/re-negotiation. This consultation process should be as transparent as permitted under any relevant confidentiality constraints.

Priority
High

Option 3.9
To consider abolishing the limited exemption country list and provide a general exemption for foreign non-portfolio dividends Australian companies receive and (subject to some existing exceptions) foreign branch profits.

The ICAA supports this proposal.

This proposal has the potential to significantly reduce the complexity of the rules and the barriers preventing Australian companies from bringing foreign-generated profits back to Australia.

The ICAA considers that if a CFC has income which is to be attributed then the dividend therefore should be exempt. Alternatively if there is no attribution, then

Australia should not impose further tax on the resulting dividend to Australia. Otherwise companies will merely continue retaining pools of profits offshore, because of current disincentives to remit profits back to Australia.

It might be asked how this proposal interacts with Option 2.1A, B and C. The ICAA sees the exemption applying at the corporate level, that is, when the Australian company holding the non-portfolio interests in foreign companies receives the dividends. When the Australian company then pays the dividends on to its shareholders, then Option 2.1 and the treatment of the foreign dividends becomes relevant, together with the additional tax imposts on Australian shareholders. So the policy proposals are well integrated.

<u>Priority</u>
High

Option 3.10
To consider options to provide conduit relief for Australian regional holding and joint-venture companies, including consideration of the benefits and costs of introducing a general conduit holding company regime; providing an exemption for the sale of a non-portfolio interest in a foreign company with an underlying active business; and providing conduit restructure relief.

The ICAA supports the proposal in principle, subject to not making the eligibility conditions too complex.

<u>The problem</u>

Australia should take the position of somehow seeking to take a “small piece of the action” rather than being too greedy, as is presently the position, in order to attract regional holding companies and becoming regionally competitive.

Australia remains attractive as a research location, or as an import market, or as an export market of goods and services manufactured in Australia, but Australia misses out on the level of interaction and relevance which could arise from a stronger involvement in headquarters activity in relation to international activities.

<u>Understanding the problem</u>

A foreign-owned global organisation might often see that its Australian subsidiary of an international group is operating at world’s best practice or has talented managers and researchers.

The global group might then consider giving the Australian company a regional or global role in some sector. So the potential is for the Australian subsidiary to be a regional headquarters company or a regional holding company, or a regional management company, regional service company or other significant global interaction. But the global group finds on analysis that:

(a) Australia imposes capital gains tax in relation to the disposal of subsidiary companies located overseas, if these are owned directly by the Australian company.
(b) Australian CFC rules (mentioned elsewhere in this submission) impose various tax liabilities if lower-tier disposals or re-organisations occur.
(c) Australia attributes the income of lower-tier CFCs where their income is considered to be tainted service income or tainted sales income (which categories include many legitimate offshore service and sales activities, as discussed above).
(d) The income of foreign branches or other foreign income is taxed in Australia.

Three outcomes arise:

(a) The Australian tax environment cuts off the potential for the Australian company's enhanced responsibilities, ownership of overseas activities, and managerial involvement.

    Thus Australia has limited international management, headquarters, co-ordination and other similar activities. The bulk of activities provided out of Australian subsidiaries of global groups are limited to downstream processing, manufacture, export and sales activities in Australia, with little involvement of the Australian companies and Australian management directly in the higher levels of an organisation.

(b) If a global group takes over an Australian company which had developed to a certain stage with overseas subsidiaries, overseas activities etc, the Australian tax factors make it **unattractive to continue to retain those international management, holding and co-ordination activities in and below the Australian company**.
    The global company will then transfer out from the Australian company all of its international subsidiaries, and have these held by a company located in a more favourable international location such as The Netherlands, or Singapore, or the UK, etc.

(c) Australian individuals may be involved in the higher levels of organisations, but the model is typically for those Australian individuals to perform those functions in overseas locations, as employees of overseas companies, with the avoidance of excessive Australian taxation being a significant driver in such re-location decisions.

So the ICAA notes that there are at least 4 measures requiring attention for the retention and attraction of such activity:

(a) Capital gains tax in relation to foreign subsidiary companies;
(b) CFC rules applying to lower-tier disposals or re-organisations;
(c) Attributing the income of lower-tier CFCs;
(d) Treatment of foreign branch and non-branch income of overseas subsidiaries.

Some might argue that such concessions might constitute “harmful international tax competition” which might be challenged by the OECD.

However, the ICAA believes that these issues do not represent harmful tax competition. Rather they recognise the need for action in relation to the uncompetitive international tax regime has for Australia. These indicators confirm that Australia is not, from a tax viewpoint, an attractive location for higher level management or licensing or administration activities.

The solution

The ICAA is for this reason supportive of conduit rules that are based around the involvement of Australian companies that are wholly foreign owned in relation to their foreign income and gains. However the ICAA considers that:

(a) The conduit concession requires more than merely the CGT treatment of foreign investments. In particular, the ICAA considers that the conduit concession ought to flow through to an enhanced CFC environment, without application of CFC rules to foreign subsidiaries.

    That is, there is little point in attributing the income of CFCs international activities to Australian designated conduit companies when these are in turn owned by global companies. To introduce a CGT concession without CFC concessions is incomplete and would have no real impact.

(b) Conduit benefits must be conditional on the establishment of a significant scale of activities in Australia by the global groups. That is, the ICAA considers that Australia has no need to deliver conduit tax concessions to mere shell companies or “post box” companies. Conduit concessions can be restricted to substantial activities in Australia or associated with substantial activities of global companies in Australia.

    For convenience of the Board, the ICAA does not discuss the detail and eligibility criteria at length in this submission. The ICAA emphasizes however that:

(i) the conditions should <u>not</u> be severe, otherwise the concession will be a waste of effort. The ICAA notes the 1999 initiative of the Federal government in relation to foreign venture capital investment, which was neutralized by excessive conditions to the concession.
(ii) a process for registration of the conduit companies would mean much less eligibility and anti-avoidance rules would be needed.

The ICAA would be interested in participating in the process leading to development of the criteria, because we consider that these have a significant potential to enhance the commercial environment in Australia, to the great advantage of Australians in business, Australians in the professions, and Australians in support activities generally.
<u>Priority</u>
Medium

Option 3.11
To consider whether to proceed with the foreign income account rules recommended by the Review of Business Taxation and whether to allow the tax-free flow-through of foreign income account amounts along a chain of Australian companies, subject to Option 2.1.

The ICAA recommends that this option be considered in conjunction with other proposals, in particular options 3.10 (conduit relief) and 2.1 (dividend imputation / streaming) to encourage rather than hinder Australian multi-nationals in the flow through of foreign source income to non-resident shareholders is required.

The ICAA notes that the existing Foreign Dividend Account ("FDA") provisions, and it seems the proposed Foreign Income Account ("FIA") provisions under the RBT, have limitations.

These provisions do not encourage joint Australian and foreign ownership of Australian companies with foreign subsidiaries. The apparent benefit of the FDA provisions is whittled away to the extent of any Australian shareholders, due to the inability to stream dividends with franking credits to Australian and FDA credits to foreign shareholders. FDA credits are of no value to Australian shareholders, the same as receiving an unfranked dividend. Franking credits are an inefficient means to eliminate dividend withholding tax for foreign shareholders, particularly if FDA credits could have otherwise been used. At present, an Australian company with both Australian and foreign shareholders generating both franking credits and FDA credits must favour the dividend preferences of one shareholder group, resulting in tax inefficiencies for the other.

The ICAA also refers to the example given in the Consultation Paper (Figure .4) of an Australian joint-venture company with an underlying foreign partner. In such situations, the tax-free flow through of foreign income account amounts along a chain of Australian companies should be permitted.

Option 3.12
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.

<u>The problem</u>

The ICAA recognises that, where Australian residents in Australia exercise board roles in relation to foreign-incorporated subsidiaries, or supervisory activities, or top-level management responsibilities consistent with their headquarters responsibility, then the foreign-incorporated subsidiaries might be treated as resident in Australia and subject to the full Australian tax.

<u>Evidence of the problem</u>

ICAA members, when advising companies on the operation of their offshore subsidiaries, regularly advise that:

- Board meetings should be conducted offshore,
- Boards of foreign subsidiaries should have a majority of foreign directors,
- Australians in Australia should limit their involvement in the day to day or supervisory activities of the foreign subsidiaries.

Otherwise the foreign-incorporated companies might be treated as carrying on business in Australia, with central management and control (CM&C) in Australia, and with Australian tax liability. This unquestionably limits Australia's role in such groups. This also unquestionably reduces the scope for global companies to place their regional or segment headquarters into Australia.

<u>The solutions</u>

Amending CM&C is a partial solution

The ICAA supports the amendment of the CM&C rules to provide that the mere conduct of Board meetings in Australia, the mere involvement of Australian directors in Board meetings of foreign subsidiaries, and the involvement of Australians in Australia in supervisory or oversight activities in relation to foreign subsidiaries should not constitute the foreign subsidiaries to be carrying on business in Australia and should not cause there to be CMC in Australia.

But we see problems in this approach. How will CM&C be defined? What involvement will be sufficient and not too extensive? There would be a need for very clear and probably extensive guidance.

A preferable solution would be to enable foreign incorporated subsidiaries not to be residents of Australia, along US lines.

The ICAA notes the discussion in the Consultation paper about the risk of "corporate inversions" which might arise from a pure incorporation test. That is, Australian companies might convert themselves into foreign companies by being acquired by foreign incorporated companies which are managed from Australia but which are not resident in Australia.

But the ICAA considers that this risk is not great, and is reduced by virtue of:

(a) the dividend imputation requirements which require an Australian resident company to pay franked dividends;
(b) capital gains tax which would arise on any disposal of Australian shares by Australian holders;
(c) transfer pricing rules which apply to any services provided from Australia to foreign affiliates;
(d) Australia's CFC rules which apply to foreign companies controlled by Australians;
(e) Australia's extensive recently-modernised thin capitalisation laws.

The ICAA does note a potential concern about incorporation of a start-up outside Australia being facilitated under a place of incorporation test. This risk should be mitigated by an attractive international tax environment in Australia, in the various ways discussed in this submission. In other words, companies seek to avoid Australian residence principally because the Australian international tax environment is unattractive.

If this was considered to be insufficient protection then the International Working Group could consider additional integrity measures limited to companies incorporated in countries **not being comparable taxed countries.** We consider that such integrity measures would need to be clear and easily administered, and not unclear such as the concept of "place of effective management."

<u>Priority</u>
High

Option 3.13
To consider whether a company that is a non-resident for tax treaty purposes should be treated as a non-resident for all purposes of the income tax law, as an alternative to the current dual resident company provisions.

The ICAA agrees to the proposal to consider this issue.

The ICAA supports a harmonisation of the residency rules in Australia's tax treaties with the residency rules for domestic law purposes. That is, if a treaty provides for non-resident status for a company, we support - as a compliance streamlining process - the non-resident status being applicable for domestic law purposes. This would remove the current complex operation of the treaty tie-breaker rules and their domestic effect in Australia.

<u>Priority</u>
Medium

4. Comments on Chapter 4 – Promoting Australia as a Global Financial Services Centre

The ICAA supports measures that will promote Australia as a global financial services centre. Increasing the funds management sector would be expected to have desirable flow on effects for the Australian economy, and directly to our members, being those involved in the funds management sector and those providing support services to a global financial services industry.

The ICAA refers to the Senate Select Committee on Superannuation and Financial Services report on "The Opportunities and Constraints for Australia to become a Centre for the Provision of Global Financial Services" which remarked that "Australia's tax regime would appear to be the most active restraint on Australia's competitiveness in the international market place".

The ICAA considers that all of the options for consultation need to be explored further in conjunction with representatives of the funds management industry.

The ICAA considers that the foreign investment fund ("FIF") rules go beyond the original intent of these measures, which was to prevent the avoidance of Australian tax on the accumulation of passive income in offshore entities (i.e. deferral of taxation). The FIF rules as they currently stand are far reaching, operating not just as anti-avoidance measures. The ICAA considers that the FIF rules create a significant and costly compliance burden. The ICAA submits that an appropriate balance between meeting integrity concerns whilst not hindering investment activities needs to be established.

The ICAA also believes that consideration should be given to extending the exemption from the FIF rules to include investments in other comparably taxed jurisdictions, as well as those currently existing for US companies.

The ICAA supports investigation into increasing the 5 per cent balanced portfolio exemption threshold in the foreign investment fund rules to see whether this should be increased. Currently, funds may sell down to get themselves within the 5% balanced portfolio exemption before year-end, which can leas to additional costs for investors due to transaction costs and market movements.

The ICAA supports consideration being given to exempting from the FIF rules:
(a) Australian managed funds that follow widely recognised indices, and
(b) complying superannuation funds.

The ICAA is of the view that consideration should be given to funds management services being included as an eligible activity under the FIF rules as such operations result in active business income and not income from the holding of passive assets.

The ICAA supports consideration of measures that will remove the impediment to non-residents investing in Australian unit trusts as currently it is preferable for such investors to either invest directly or through an offshore managed fund.

The ICAA considers that a review of the fundamentals of the tax treatment of foreign trusts together with the exemptions and other changes proposed for the FIF rules is also required.

The ICAA supports consideration of specific tax issues where the lack of separate entity treatment impedes the use of branch structures. As a general principle, the ICAA believes that permanent establishments should be neither advantaged nor disadvantaged under Australia's tax regime.

5. Comments on Chapter 5 – Improving Australia's Tax Treatment of Foreign Expatriates

The ICAA considers that it is important for Australia to be able to attract highly educated and skilled labour from overseas. This results in information and knowledge exchange, the introduction of new skills and can fill gaps where for instance there are skill shortages in the local market - all of which are highly beneficial to business and the economy whilst maintaining Australia's competitiveness from an international perspective.

Furthermore, consistent with our comments above in relation to promoting Australia as an attractive place to conduct international business activities, the entire objective would be defeated if our laws in relation to the taxation of expatriate personnel remained so onerous and prohibitive as to make the labour costs of operating such international activities too expensive.

The current tax treatment of expatriates can be prohibitively expensive to Australian businesses (such as when a full or partial tax equalisation or tax protection policy applies) or it can deter valuable labour resources from coming to Australia in favour of a less expensive jurisdiction where, for example, they can be deemed to be non-residents. Additionally, the high Australian tax costs of locating expatriates in Australia can deter foreign businesses from locating their regional headquarters in Australia.

The ICAA stresses that this issue does not just concern foreigners coming to Australia to fill top executive positions. It applies across the board to engineers, scientists, academics and middle management to name but a few.

Australia is essentially competing with the rest of the world to attract scarce labour resources. Therefore, when determining the appropriate taxation treatment of expatriates in Australia, the treatment in other jurisdiction competing for those scarce resources needs to be considered.

The ICAA supports the position taken by the Government as reflected in Taxation Law Amendment (No. 7) Bill 2002 concerning the foreign source investment income exemption for "temporary" residents as these measures will reduce the cost burden on employers and employees, with the employees continuing in most cases to pay their 'home' country taxation. However, the ICAA also supports consideration of additional measures such as:

- Possible extension of the 4 year limit in appropriate cases;
- Exemption of foreign workdays from Australian tax;
- Review of superannuation arrangements for temporary residents.

Option 5.1:
To consider whether to proceed with the Review of Business Taxation recommendation that residents departing Australia provide security for deferred CGT liability

The problem

When for example an expatriate returns to his/her home country or moves to another assignment outside Australia after having been a tax resident of Australia, the CGT rules apply to deem disposal of every asset at market value. An exception is provided for those assets having the necessary connection with Australia. For those who have been a tax resident for less than five out of the last ten years, the deemed disposal rules will not apply to assets held on arrival to Australia or acquired because of someone's death. The deemed disposal rules apply to all Australian tax residents ceasing to be tax residents of Australia, not just expatriates.

To address the issue of there having been no realisation of a gain at the time of departure, the person ceasing to be an Australian tax resident can opt to defer payment of the Australian CGT liability until actual disposal of the asset. This raises concern with collection of tax as at the time of a later disposal, the person in question may not be Australian resident - e.g.. in the case where the person departed Australia permanently. In response to this concern, the RBT(recommendation 22.20) put forward the proposal that an Australian resident departing Australia be required to give appropriate security to the Australian Taxation Office.

The ICAA notes the comment in the Consultation Paper that if individual elects to defer CGT until disposal, they also face CGT on any post-departure gains. This results in a risk of double taxation because (once the individual has, after departure from Australia, settled in another country then those post-Australian-departure gains are also taxable in the new country of residence. So this proposal is inequitable as well as being unworkable.

The solution proposed in the Ralph Report

The ICAA has serious concerns with the requirement for security deposits to be given when opting to defer tax on deemed capital gains when ceasing to be a tax resident of Australia for the following reasons:

(a) assuming that it would apply to any person ceasing to be an Australian tax resident, this would appear to be a very costly measure from an administrative point of view, in terms of arranging and maintaining the "appropriate" security to be given, tracking assets and subsequent administration requirements on disposal of the asset.

(b) It may act to make Australia an even less attractive location for foreign expatriates if they are required to provide security when they depart.
(c) Depending on how the system operated, it is possible that Australian businesses would effectively have to "provide" the security.
(d) To provide security would mean that departing residents would have to obtain approval prior to departure so that they could arrange the appropriate security. This could unduly delay departure in a great number of cases and could also encourage non-compliance.

Priority

The ICAA recommends that a very low priority be given to any further consideration of this issue, unless the consideration is to dispose of the proposal once and for all.

Option 5.2:
To consider addressing the double taxation of employee share options through bilateral tax treaty negotiations and possible consequential changes to Australia's domestic tax law treatment.

Many foreign expatriate employees visit Australia for varying assignment periods, just as many Australian employees move overseas as part of their career development. Many such expatriate employees will have some sort of employee share or option plan entitlement when they arrive in or depart from Australia, or even both. Share and option plans are a reality in most international corporate groups these days, which should be recognized and not ignored by our taxation laws.

The problem

A foreign employee may have been granted options prior to arriving to work in Australia. He/she would usually not have needed to file an Australian tax return for the year the options were granted. Therefore, he/she would be unlikely to have made a Section 139E election. Upon arrival in Australia to commence residence, he/she will be deemed to have acquired those options at market value at that date, for CGT purposes. When and if the options are ever exercised, there would normally be a taxing point, so the employee may be taxable in Australia on the entire gain under Division 13A and not under the CGT provisions.

Some part of the gain may have already been taxed, or may now become taxable, in the employee's former country of residence/employment and there would be no Australian tax relief available for the double tax imposed. Division 13A fails in this case because it does not contain any source rules. It merely states that a certain amount will be taxable in Australia at a certain time. For Division 13A purposes, the deemed market value acquisition cost at the date of arrival (for CGT purposes) becomes irrelevant.

If the expatriate had been able to make the Section 139E election before arriving in Australia, there would be no tax at the time of exercise of the options. Any resulting gain on disposal of the shares would be subject to capital gains tax with a deemed cost base equal to the market value of the options at the date of arrival plus the exercise price. If the shares are held for the required 12 months, then the discount capital gains tax rules could apply.

If an expatriate employee working in Australia is granted options, makes a Section 139E election and then ceases residence before they are exercised there would be a deemed disposal of the CGT asset at market value. On the other hand, if a Section 139E election was not made when the options were granted, the options would be assessable under Division 13A and not under the CGT provisions. Therefore, if the expatriate left Australia before the options were exercised, the deemed disposal rules would not operate and there would be no taxing point until the expatriate exercised the options while resident outside Australia.

The problem appears to be that Division 13A was developed purely in a domestic Australian tax law context and there was insufficient attention given to the international aspects. There are no source rules and no apportionment rules where the option period straddles periods of employment in more than one country.

There are also technical problems. One example is that a foreign entity cannot technically be an "employer" as defined for Division 13A purposes because they do not pay "salary or wages" as defined. Accordingly, options granted by a foreign entity (employer or holding company) cannot be qualifying under Division 13A.

<u>The solution</u>

The solution does not lie in amendments to the tax treaty network first, followed by consequential amendments to the domestic tax law.

Division 13A needs to be rewritten first, as a matter of very high priority, to include specific source rules and therefore to take into account situations which involve changes in tax residence, thus avoiding situations that can result in double taxation. Changes to tax treaties can then be considered, if necessary, to relieve any possible double tax problems that may still exist. But we submit that it is first necessary to get our domestic law in order, then to deal with relief situations by way of treaties, not the reverse, as proposed.

We submit that the source and apportionment rules in Division 13A should seek to tax any gain proportionately over the period during which the options are held before exercise, apportioned to source in Australia based on a "days of physical presence" basis or on a "days worked" basis. The alternative of using market values at time of entry and departure can be significantly inaccurate and could lead to gains that are never realised being taxed or nothing at all being taxed when a substantial gain is realised.

Priority
High

Option 5.3:
To consider whether to proceed with the Review of Business Taxation recommendation to treat ceasing to be a resident as cessation event for the purposes of Division 13A.

The ICAA submits that this issue raises similar concerns to those set out above under Option 5.1 (provision of security for deferred CGT liabilities).

The ICAA considers that the issue of the taxation of employee share options should be first addressed by a review of Division 13A and also addressed in bilateral treaty negotiations, although the latter would be a very lengthy process.

Treating termination of residence as a cessation event could lead to a fictitious amount being taxed when no amount is ever realised. With wildly fluctuating share prices, as we have seen in recent years, deeming disposals at market value when such amounts can not yet be realised can be exceedingly dangerous and inequitable.

<u>Priority</u>
The ICAA recommends that a very low priority be given to any further consideration of this issue, especially pending a review of the taxation of share and option plans for expatriates generally.

Option 5.4:
To consider the Australian Taxation Office establishing a specialist cell to work with employers to deal with the tax administration concerns of foreign expatriate employees.

The ICAA supports a specialist cell of the Australian Taxation Office being established to work with employers to deal with the tax administration concerns of foreign expatriates. However, the ICAA is of the view that a service should also be available to individuals.

Many Australian tax issues arising in respect of expatriates can be complex - spanning issues from CGT, income taxation and foreign tax credits to superannuation and FBT - with an additional layer of complexity being added by residency and cross-jurisdictional issues. The large accounting firms each have specialist expatriate tax teams who focus on these complex issues for senior expatriate executives of their multinational corporate clients and to handle the corporate remuneration issues that arise for the employers. This can include tax equalization and tax reimbursement calculations and advice on structuring such remuneration arrangements. The ATO would do well to mirror the sort of expertise that exists within these large accounting firms. Having a “one stop shop” to address such issues would streamline procedures.

<u>Priority</u>
High

6. Other Matters

6.1 Further Consultation by the Board

The ICAA would welcome the opportunity to participate in further consultation with the Board over the next couple of months prior to the Board finalizing its report to the Government by the end of this year.

6.2 Delivery of Reform

The ICAA believes that the delivery of the international tax reform proposed in the Consultation Paper needs strong project management due for instance to the magnitude of the reform proposals, the complexity of the issues involved and the need to move ahead with the reforms as a matter of priority, given that the issues have now been in the pipeline for quite some time.

The ICAA has been a continued proponent of high quality transparent and consultative processes for the delivery of major and multi-year programs such as this international tax reform.

The ICAA submits that a standing committee/Board is needed to push ahead with the international tax reforms to ensure that the issues do not lose momentum. The ICAA would be a willing participant in such a process given the initiatives that it has already undertaken in relation to tax reform, including its focus on administrability of the law and SMEs.

6.3 Care and Maintenance of the Law

Whatever may be the outcome of changes in policy or "clarification" of the law, in the long term, the changes will be largely judged by the extent to which attention is given to on-going care and maintenance of the law.

The ICAA notes that the review of international tax arrangements will be a very big task and may take some years to come to fruition. However, as Option 3.4 of the Treasury paper recognises, the review is not only about policy issues but will also involve a review of the rules from a "technical" standpoint. Assuming this means "clarity" versus "ambiguity" and identification of areas where the outcome may not be intended then there is a great deal of work to be done and ICAA strongly supports appropriate work in this much neglected area.

The fact that we have bad law in many taxation areas is regrettable. The rules around foreign source income are labyrinthine, very complex, ambiguous and result in many unintended outcomes. The lack of clarity in these rules has provided fertile ground for both adventurous taxpayers and overly revenue protective ATO officers whose views on what was intended, leave the "rule of law" struggling for its life. On the other hand, the ATO is often forced to provide an interpretation that makes commercial sense but is not strictly in accordance with the law. **Bad law wastes valuable resources and encourages inappropriate behaviour.**

The ICAA submits there is a role for the Board of Taxation to establish a process for escalating all interpretive and policy issues for consideration by a panel of experts including externals. That is, a standing Committee comprising Treasury / ATO / externals meeting regularly and with a mandate to make recommendations for legislative amendments and changes to administrative practices. Findings and reasons should be published. Issues identified for legislative "repair" should be quickly moved to the legislative design process with consultation before submission to Parliament. The Government should be absolutely committed to providing a slot in the parliamentary program to consider and if thought fit, pass the amending legislation into law. An "Annual Technical Corrections Bill" could be the mechanism for ensuring legislation receives the care and maintenance it deserves. The process of requiring the ATO to "manage its way" around bad law must stop. Recent announcements by the Treasurer and the Board of Taxation give hope for the future but the importance of providing a slot in the parliamentary program for passage of a Bill cannot be over-emphasized.

The ICAA has consistently presented these issues to the Board of Taxation, to Treasury and the ATO and to Government and submits that its members have a very significant interest in processes which can make law and practice robust and clear. Accordingly, ICAA offers its expertise and experience to assist in the design and management of the process which can achieve that outcome.