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

Dear Sirs

Westfield Trust

Review of International Taxation Arrangements

On behalf of Westfield Trust, we appreciate the opportunity to express our views on reforming the present international tax system to make it internationally competitive and enclose our Submission.

After your consideration of the matters raised, we would appreciate the opportunity to provide further input prior to your final recommendations to the Treasurer.

We look forward to discussing the Submission with you in the immediate future.

Yours sincerely
Westfield Management Limited

Per:

Marlon Teperson
Group Chief Financial Officer

Westfield Trust

(“WT”)

Submission to the Board of Taxation

Review of International Taxation Arrangements

November 2002

1 Executive Summary

WT welcomes the release of the consultation paper "Review of International Taxation Arrangements" prepared by the Department of the Treasury ("The Consultation Paper") and appreciates the opportunity to provide comments on Australia's international taxation arrangements.

WT submits that the review of Australia's international tax arrangements should not be limited to the options set out in the Consultation Paper.

WT broadly endorses the submissions prepared by Westfield Holdings Limited and by the Investment and Financial Services Association ("IFSA"). In this submission, WT wishes to emphasise the importance of certain aspects of those submissions and include certain additional points.

WT considers that the following reforms should be made to ensure that Australia has a more competitive international tax system:

Removing barriers to the access of debt capital.

- Extend the interest withholding tax exemption for publicly offered debentures to debentures issued by unit trusts.

Removing barriers to outbound investment in broad exemption listed countries (BELCs).

- Exclude BELC CFCs / FIFs from the CFC / FIF rules.
- Exclude activities in BELCs from the public trading trust rules.

2 Introduction

The Government is to be commended for its commitment to ongoing taxation reform in Australia. In particular, there appears to be an appreciation from the Government that if Australia is to be competitive in an increasingly globally orientated environment, its domestic and international tax rules cannot be allowed to inhibit Australian enterprises from pursuing offshore business opportunities and attracting foreign capital.

Consistent with the Government's commitment to ensuring that Australian tax rules do not place Australia at a competitive disadvantage, while also protecting Australia's revenue and integrity needs, the WT submission makes a series of recommendations that we consider should satisfy the Government's objectives. While the submission focuses on issues that are of principal relevance to the activities of WT, the recommendations, and the principles underpinning these recommendations, have broader application.

The objectives of this submission, and the principles underpinning the submission's recommendations, are as follows:

- That the Australian tax system should be underpinned by the principles of simplicity and certainty.
- That Australian unit trusts should have the same access to debt capital markets as Australian corporates.
- That the Australian tax system should not impose unwarranted additional compliance burdens on Australian entities investing into jurisdictions with comparable tax systems.

We have detailed in the submission how and why these principles should be given practical effect. These recommendations should make it easier for Australian unit trusts to raise debt capital and to invest in BELCs which will bring wealth to Australia.

2.1 Westfield Trust - Background Information

The following is a brief overview of WT:

- WT is Australia's largest listed property trust with a portfolio of 40 shopping centres (29 in Australia and 11 in New Zealand).
- WT's portfolio comprises 2.3 million square metres of retail space, has over 7,300 retailers and generates A$10.0 billion of retail sales.
- WT had total assets of A$9.2 billion and a market capitalisation of A$6.8 billion at June 2002.
- For the 12 months to 31 December 2001 WT distributed A$433m to unitholders.
- WT has over 40,000 unitholders. Over 80% of the issued capital of WT is held by Australian residents.

3 Extension of Interest Withholding Tax Exemption for Publicly Offered Debentures to Debentures Issued by Unit Trusts

3.1 The Current Law

Section 128F exempts from interest withholding tax interest paid or payable on certain publicly offered debentures issued by companies.

3.2 The Problem

Under current law a unit trust cannot access the interest withholding tax exemption. WT submits that the interest withholding tax exemption currently available for publicly offered debentures issued by companies should be extended to include publicly offered debentures issued by unit trusts, such as WT.

WT submits that unit trusts should have access to all debt capital markets on the same basis as Australian corporates. It is illogical that a unit trust should have restrictions applying to its debt funding that do not apply to companies.

It is understood that the policy objective of the present section 128F as outlined in the Explanatory Memorandum to the existing section 128F was to improve and streamline the operation of the previous section 128F regime introduced in 1971 in the context of modern overseas capital markets, in order to facilitate increased competition in the Australian financial market and the home lending market. Additional changes to section 128F have further sought to encourage the development of the domestic corporate debt market and to further integrate that market with offshore corporate debt markets in order to increase competitive pressures in domestic lending, including an extension of the exemption to Australian branches of foreign banks.

There does not appear to be any explicit or specific policy reason in the Explanatory Memorandum or other supporting material arguing why the exemption is limited to companies and cannot be extended to unit trusts. It is suggested that the exemption did not

originally include unit trusts as they are a form of investment vehicle was not common when the legislation that was first introduced in 1971.

Therefore from a policy perspective, it would not seem to matter whether widely held debentures are issued by companies or unit trusts. Provided the tests for the widely held debentures exemption under section 128F are met, the policy objectives will be achieved and would allow entities such as unit trusts to access overseas funding at a competitive rate. It is also anomalous that a subsidiary company of a unit trust could access the exemption but the holding trust could not.

3.3 The Solution

WT submits that the solution is to extend the exemption in s.128F to unit trusts.

3.4 Links

This item links to chapter 4 of The Consultation Paper regarding promoting Australia as a global financial services centre.

3.5 Priority

High.

4 Removing Barriers to International Investment in Broad Exemption Listed Countries

Currently WT holds interest in 11 shopping centres in New Zealand.

WT submits that Australia should not discourage investment offshore where the investment is in a jurisdiction that has a comparable tax system. In these circumstances the Australian taxation system should not impose unwarranted additional burdens on taxpayers in respect of their activities in the other jurisdiction.

In light of this WT submits that the scope of the Australian CFC/FIF rules and the public trading trust rules should be limited to exclude from their operation investments and activities in Broad Exemption Listed Countries (BELCs). That is, Countries that have been accepted as having highly comparable tax systems to Australia. The current BELCs are United States, United Kingdom, New Zealand, Canada, France, Japan and Germany. The first three countries are major locations for outbound investment from Australia. WT submits that removing barriers to investment in these jurisdictions is therefore critical to the competitiveness of Australian entities seeking to expand offshore.

4.1 Limiting the Scope of the CFC / FIF Rules

4.1.1 The Current Law

The broad purpose of the CFC / FIF provisions is to prevent the accumulation of income in low tax jurisdictions and thereby defer the incidence of Australian tax.

Under the CFC rules Australian residents are taxed on an accrual basis on their share on certain income earned by CFCs. For CFCs resident in BELCs the income that is attributed is generally limited to income that is subject to concessionary tax treatment.

The FIF rules provide a complimentary system to the CFC rules and apply in non-controlled situations.

4.1.2 The Problem

As noted by Treasury in the Consultation Paper, the current Australian CFC regime is overly complex. This complexity imposes a substantial and burdensome compliance cost on Australian taxpayers with interests in CFCs.

In addition to the compliance costs the CFC rules are an impediment to conducting business. Of particular concern is the attribution of capital gains which are subject to concessionary treatment in a BELC, or indeed deemed capital gains which only arise due to the application of Australia's CGT rules to the CFC. This aspect is partially acknowledged in Option 3.1 in the Consultation Paper dealing with extending rollover relief under the CFC rules.

The effect of the CFC measures places Australian investors in CFCs resident in BELCs at a competitive disadvantage to local entities and to other foreign investors who are not limited by the rules.

In relation to CFCs located in BELCs, WT submits that the comparable tax regimes means there is little if any benefit to the Australian revenue derived from the CFC measures which might justify the compliance costs and the commercial fetters placed on Australian taxpayers.

Similar compliance issues arise in relation to FIFs in BELCs.

4.1.3 The Solution

We recommend that there be a total exclusion from the CFC rules for certain CFCs. The criteria for the excluded CFC could be as follows – the CFC must:

a) be resident or created under the laws of a BELC; and
b) derive substantially all of its income (say 90%) from operations or assets located in a BELC.

Similar amendments should also be made to the FIF rules.

Alternative suggestions are contained in the Westfield Holdings Limited submission. We also endorse these suggestions.

4.1.4 Other Technical CFC Issues

If the exemption for investments in BELC CFCs cannot be achieved then as a minimum functional currency rules must be introduced into the CFC provisions in relation to the treatment of capital gains derived by CFCs. In addition bare trust / nominee arrangements should be ignored for purposes of the CFC rules.

(a) Functional currency rules for CFC attribution calculations

Where a CGT event has occurred in relation to a CFC, the calculation of a capital gain to be included as attributable income picks up the foreign currency conversion rules in the CGT Provisions. That is, the disposal proceeds for an asset is converted to Australian dollars at the disposal time and the calculation of the cost base of the asset converts the purchase price to Australian dollars at the acquisition time.

As a result, there can be capital gains (and thus attributable income) on transactions entered into by a CFC which are due solely to exchange rate movements (ie there is no gain in the functional currency) and no economic gain to the CFC.

Moreover, because CGT assets include assets such as loans and other receivables, capital gains can arise by reason of the mere receipt of such amounts by a CFC where they are denominated in the functional currency of the CFC.

We recommend that CFC rules should be amended such that all capital gains and capital loss calculations are done in the functional currency of the CFC and only the net capital gain is converted to A$. This recommendation links to the current review of the taxation treatment of foreign exchange gains and losses.

(b) Provisions to ignore bare trusts / nominee arrangements

For the purposes of the foreign investment fund (”FIF”) measures in Part XI, s.484 provides that the existence of nominee arrangements or bare trusts are to be

disregarded such that the beneficial owner of the relevant FIF interest is the entity to which the FIF rules apply.

There is no comparable provision in the CFC rules. Accordingly, there is a technical risk that the existence of the nominee or bare trust should be recognised in applying the CFC measures. The resulting complexity and attendant compliance costs are not justified by any Australian revenue benefit.

We recommend that nominee or bare trust arrangements be ignored for the purposes of the CFC rules. Indeed we would recommend that the Review of Business Taxation recommendation (16.11) to ignore bare trusts for all taxation purposes be implemented.

4.1.5 Links

The solution outlined above links to Option 3.4 in the Consultation Paper – "to identify technical and other remaining policy issues regarding the controlled foreign company rules, and consider options to resolve them on a case-by-case basis or as part of a major rewrite of the provisions".

4.1.6 Priority

High. There is a pressing need to address the unwarranted impact of the CFC provisions on investments in BELCs. Further, the solution is easy to legislate.

4.2 Narrowing the Scope of the Public Trading Trust Provisions

4.2.1 The Current Law

Under the current law a unit trust which is a "public trading trust" is taxed as if it were a company (the rules are included in Division 6C of Part III of the 1936 Act). A unit trust will be a public trading trust in relation to an income year if, inter alia, it is a public trust (which includes listed trusts) and is a trading trust in relation to the income year.

A unit trust will be a trading trust if the trustee:

(a) carries on a trading business; or

(b) controls, or is able to control, directly or indirectly, the affairs or operations of another person in respect of the carrying on by that other person of a trading business."

A trading business is defined to mean "a business that does not consist wholly of "eligible investment business". "Eligible investment business" is defined to mean "investing in land for the purposes, or primarily for the purpose, of deriving rent" and/or investing or trading in certain specified securities and financial instruments.

4.2.2 The Problem

The public trading trust rules are an impediment to Australian unit trusts investing in real property owning vehicles in BELCs. The rules impose significant compliance costs on the Australian unit trust. The imposition of these compliance costs does not make sense as Australia should be encouraging unit trusts to expand their operations offshore.

Further, the mischief at which Division 6C was directed was the avoidance of Australian corporate tax through the use of public trading trusts and the consequent erosion of the tax base.

We submit that this mischief does not arise in relation to investments in foreign property or foreign property vehicles controlled by a public unit trust where the property or vehicle is in a broad-exemption listed country. The Australian tax base is not eroded in any way from the use of public unit trusts in these circumstances because Australian corporate tax on the income would not have been payable even if the trust were a company.

If the trust were treated as a company, any property income derived directly by the company would be exempt under the provisions of section 23AH. If the property was held indirectly

through an interposed foreign controlled company, the income would not have been attributable under the CFC rules because the income would not be eligible designated concession income. Any dividends paid by the CFC would be exempt from Australian tax in the hands of the Australian company under s.23AJ. Further, if the recommendation to exclude foreign entities resident in BELCs from the CFC rules is accepted there would be no attribution from these entities.

4.2.3 The Solution

We suggest that the problem could be solved excluding from the operation of Division 6C controlling interests in foreign property owning vehicles in BELCs.

In this way, the provisions of Division 6C can be targeted at unit trust structures which erode the Australian corporate tax base without imposing significant compliance costs on the operations of unit trusts that invest in BELCs.

4.2.4 Links

This item links to the options in chapter 4 of the Consultation Paper regarding promoting Australia as a global financial services centre.

4.2.5 Priority

High. There are significant compliance costs involved. Further given the simplicity of the solution it is submitted that the problem should be resolved to apply for the 2004 year of income.