Westfield

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

Dear Sirs

Westfield America Trust

Review of International Taxation Arrangements

On behalf of Westfield America 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 America Management Limited

Per:

Marlon Teperson
Group Chief Financial Officer

Westfield America Trust

(“WAT”)

Submission to the Board of Taxation

Review of International Taxation Arrangements

November 2002

1 Executive Summary

WAT 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.

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

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

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

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.

Foreign exchange gains and losses

- Treat foreign exchange gains and losses in relation to capital assets on capital account.

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 WAT 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 WAT, 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 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 invest in BELCs which will bring wealth to Australia.

2.1 Westfield America Trust - Background Information

The following is a brief overview of WAT:

- WAT is Australia's second-largest listed property trust with a portfolio of 61 Westfield Shoppingtowns across the United States.
- The portfolio comprises5.8 million square metres of retail space and around 8,100 retailers and generates in excess of US$13.5 billion (A$24.0 billion) in annual retail sales.
- WAT has total assets of A$16.4 billion and a market capitalisation of A$6.4 billion as of 30 June 2002.
- For the year ended 31 December 2001 WAT distributed A$212m to its unitholders
- WAT has over 21,000 unitholders. Over 90% of the issued capital of WAT is held by Australian residents.
- WAT allows Australian residents to invest in US real estate. This brings wealth and income to Australian residents.

3 Removing Barriers to Outbound Investment in Broad Exemption Listed Countries

Currently WAT's sole investment is shares in Westfield America Inc, ("WEA") a US resident company which has elected Real Estate Investment Trust ("REIT") status. WEA holds the interests in the 61 shopping centres located across the United States of America.

WAT 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 WAT 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. WAT submits that removing barriers to investment in these jurisdictions is therefore critical to the competitiveness of Australian entities seeking to expand offshore.

3.1 Limiting the Scope of the CFC / FIF Rules

3.1.1 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 complementary system to the CFC rules and apply in non-controlled situations.

3.1.2 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, WAT 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.

3.1.3 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.

3.1.4 Other Technical CFC Issues

In addition to the suggested solution above, the existing CFC rules contain a number of anomalies which should be rectified. Some specific anomalies are:

(a) Treatment of limited partnerships established in broad exemption listed countries.

Limited partnerships are often the preferred ownership vehicle for commercial real property located in foreign countries, including the UK and the US.

Under Australian tax law, limited partnerships are treated as a companies for Australian tax purposes. Thus, a foreign limited partnership is treated as a company for the purposes of the CFC rules. However, according to draft Taxation Determination TD2001/D14, a UK or US limited partnership will be treated as a resident of no particular unlisted country unless the limited partnership itself is subject to tax in the UK or the US as appropriate. As UK and US limited partnerships are generally treated as "look through" entities in their home jurisdiction, they do not satisfy the ATO's "subject to tax" requirement.

In the Consultation Paper it is stated that consideration is being given to amending the Australian tax law in relation to the treatment of limited partnerships. It is possible that the amendments may be to treat Limited Partnerships as "look through" entities for Australian tax purposes. This "solution" will be based on the current law.

If the outcome of the current review of Australia's international taxation arrangements provides a more favourable outcome for the treatment of entities established and carrying out activities in BELCs, taxpayers should be able to avail themselves of this outcome.

(b) Flow through of exempt dividends - Section 23AJ

It is current policy that certain non-portfolio dividends paid to companies are treated as exempt income for Australian tax purposes. Under s.23AJ, a non-portfolio dividend paid directly to an Australian resident company by a company that is a resident of a listed country is exempt from Australian income tax.

However, the exemption in s.23AJ does not apply where the non-portfolio interest is held indirectly through a trust. In other words, the interposition of a trust disentitles a corporate beneficial recipient of a non-portfolio dividend to the exemption notwithstanding that the corporate beneficiary indirectly holds a non-portfolio interest in the underlying company.

This positions potentially applies in bare trust or nominee situations as well as for holdings in unit trusts.

We submit that the dividend should retain its character as an exempt dividend on distribution by the interposed trust regardless of whether the trust is a bare trust or a unit trust.

(c) 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.

(d) 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.

3.1.5 Links

The solutions 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".

3.1.6 Priority

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

3.2 Narrowing the Scope of the Public Trading Trust Provisions

3.2.1 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.

3.2.2 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 controlled foreign company, the income would not be 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.

3.2.3 The Solution

We suggest that the problem could be solved by 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.

3.2.4 Links

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

3.2.5 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.

4 Taxation Treatment of Foreign Exchange Gains and Losses in Respect of Capital Transactions

4.1 The Current Law

There is significant uncertainty as to the current taxation treatment of many foreign exchange gains and losses. This arises as the High Court decision in the ERA case in 1996 cast significant doubt on the operation on the taxation rules on the treatment of foreign exchange gains and losses contained in Division 3B of Part III of the Tax Act.

Notwithstanding that the High Court decision was handed down in 1996 there has still not been any legislative amendment to clarify the operation of the law. In May 2002 the Assistant Treasurer announced that consultation (including the release of exposure draft legislation) would be undertaken in relation to this issue with a view to introducing legislation in the spring sittings of Parliament (by the end of 2002). Subsequently the Australian Taxation Office and Treasury undertook consultation in relation to this area. However, there has been no announcement as to the result of that consultation process. We urge The Board of Taxation to press the Government on this issue.

One policy issue of particular importance to WAT in relation to the taxation of foreign exchange gains and losses is whether such gains and losses should all be treated on revenue account for taxation purposes or whether in some circumstances the taxation treatment should follow the commerce and accounting and gains and losses should be included in the cost of assets.

4.2 The Problem

Any assessable income derived by WAT from foreign exchange gains in relation to capital transactions would be included in the taxable income of unitholders of WAT who are presently entitled to the trust's income for an income year notwithstanding that WAT has not generated any corresponding net cash receipt to include in the distribution.

The problem arises in two main areas:

- Under the CGT rules where there is a delay between entering a contract and settlement of the contact; and

- Where there is a foreign currency hedge entered into in relation to the obligations or receivables under another contract.

WAT submits that there should be a matching of such gains and losses with the character of the underlying transaction. Character matching will avoid situations where, for example, an exchange gain would be immediately assessable but a capital loss from the underlying transaction would be quarantined under the CGT rules.

Example 1:

Assume a resident entity purchases a commercial property in the United States on 1 September for a price of US$100m, payable in 91 days. The exchange rate is USD0.52:AUD1 on the day the contract is signed. Under the CGT rules the cost base of the property would be A$192.3m. The entity sells AUD/buys USD to discharge the liability on 30 November when the exchange rate is USD0.57:AUD1, ie A$175.4m. The current policy is that the reduction in the amount payable in A$ would be treated as a revenue account exchange gain of A$16.9m.

The suggested treatment would be to incorporate the exchange gain into the cost base of the asset, such that its cost base would be A$175.4m and no gain realised for tax purposes. This matches the accounting for the transaction.

WAT submits that similar rules should apply for foreign currency hedging essentially in connection with capital transactions (ie an acquisition or a disposal of an item on capital account). This approach would also generally coincide with normal commercial practice and accepted accounting treatment.

Example 2:

Continue the assumptions as in example 1 above, and further assume the entity wishes to minimise the impact of exchange rate fluctuations so it forward purchases the US dollar payable at USD0.53:AUD1. On settlement of the property, the entity buys the US$ for A$188.7m (under the hedge) and disposes of these US$ for a property now worth A$175.4m (at 0.57) resulting in a loss on disposal of the US$ of A$13.3m. The *current policy intention could result in a cost base in the property of A$192.3m, a revenue gain on delayed settlement of A$16.9m and a revenue loss on disposal of US$ acquired under the hedge of A$13.3m.*

For commercial and accounting purposes, the entity acquired the property for net proceeds of A$188.9m. The suggested treatment would match the commercial outcome and the taxation outcome.

4.3 The Solution

WAT submits that any foreign currency gain or loss arising in respect of capital transactions should be treated as part of the cost base of the capital asset or part of capital proceeds on disposal of the asset as applicable.

The proposal treatment would align the taxation treatment of such foreign exchange gains and losses with the accounting treatment and commercial reality.

WAT suggests the following amendments to the CGT rules:

1. Insert a cost base adjustment for:

   (a) A foreign currency gain or loss arising for an asset purchased under a contract where the consideration is denominated in a foreign currency and there is a delay between date of contract and of the amount due under the contract payment; and

   (b) A gain or loss arising on the disposal of foreign currency acquired under a contract entered into to acquire foreign currency to hedge an obligation to acquire an asset under a separate contract.

2. Insert an adjustment to the capital proceeds on disposal for:

   (a) A foreign currency gain or loss arising on the disposal of an asset under a contract where the disposal consideration is denominated in a foreign currency and there is a delay between the date of contract and receipt of the due under the contract; and

(b) A gain or loss arising on the disposal of foreign currency received as consideration for the disposal of an asset where the foreign currency is disposed under a contract entered into to hedge the receipt of foreign currency on disposal of the asset.

4.4 Links

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

4.5 Priority

High. There is a pressing need for the rules on the taxation of foreign exchange gains and losses to be clarified.