

# **Business Coalition for Tax Reform**

## **Review of International Tax Arrangements**

### **Submission to the Board of Taxation**

**October 2002**

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## **Executive Summary**

The Business Coalition for Tax Reform (BCTR) welcomes this opportunity to provide a submission to the Board of Taxation on the Review of International Tax Arrangements.

The BCTR supports this review being conducted by the Board of Taxation, and fully endorses the open and participative consultation process being followed.

As Australian business continues to become more and more internationalised, it is imperative that our international tax arrangements do not act as a barrier to investment flows and economic activity. These arrangements are as relevant to trade and investment decisions as they are to taxation.

A number of aspects of Australia's international tax arrangements inhibit the ability of Australian companies to expand their operations beyond the domestic environment, and discourage investment by non-residents into, and through Australia.

The development and implementation of a program of reforms to modernise Australia's international taxation arrangements is therefore a pressing area of business tax reform that requires immediate attention.

### **Dividend Imputation**

The BCTR considers that the bias between the tax treatment of foreign and domestic source income of resident investors has an adverse impact on the cost of equity capital for Australian companies and should be addressed. Even if the bias is not eliminated completely, the BCTR strongly supports the retention of the imputation system.

We therefore recommend that:

- either a shareholder credit or a partial exemption should be considered as the best way of addressing the bias;
- if the shareholder credit option is chosen, the level of the credit should be greater than 1/9<sup>th</sup>
- dividend streaming should be pursued, in conjunction with either a shareholder credit or a partial exemption;
- any policy measures in this area should operate side by side with dividend imputation; and
- policy measures are not supported that favour the tax treatment of foreign income over domestic income.

## **Controlled foreign company (CFC) rules**

The foreign source income system imposes unnecessary compliance costs on foreign investors and domestic investors with offshore investments. It is detrimental to the international competitiveness of Australian companies and should be addressed.

The BCTR recommends:

- a general exemption from the CFC rules for broad exemption listed countries;
- extensions to the rollover relief to remove CGT constraints;
- the implementation of a transparent and ongoing process to examine the basis for countries on both the broad exemption and limited exemption lists; and
- the implementation of an open and transparent process for resolving outstanding foreign source income issues on an individual basis.

The BCTR considers there should be a comprehensive review of the basic policy drivers behind Australia's foreign source income rules. Such a review should take into account the increased level of globalisation, the development of transfer pricing rules in many developed countries (including Australia), the recent reductions in Australia's corporate tax rate and other factors.

## **Tax treaties**

The BCTR recommends that Australia should seek to establish a competitive and non-discriminatory network of tax treaties under which Australia would collect its fair share of tax revenue on international business. In particular, there is a need to continue down the path of bilateral renegotiations to drive down withholding taxes, which would help reduce the cost of doing business. The BCTR supports focussing on re-negotiation of the double tax agreements with our major trading partners coupled with a prioritisation of countries with which we negotiate new agreements.

## **Conduit Income**

Australia's tax system imposes a layer of Australian tax on foreign income flowing through to foreign shareholders. This is out of step with most other developed countries, and has led to Australia not being used as a regional holding location. In relation to conduit income, the BCTR:

- supports a broad flow-through regime for all foreign profits and gains to foreign investors in Australian companies;
- considers such relief should apply equally to dividends and capital gains;
- considers that flow-through relief should extend well below the 100% ownership level, with an eligibility threshold to be the subject of further consultation;
- would support extending capital gains tax relief in respect of the disposal of foreign subsidiaries to Australian owned companies; and
- does not support the introduction of special incentives and benefits that are not available to resident taxpayers.

## **Residency**

To address the practical difficulties with the current residency test, which create a further impediment to Australia's suitability as a location for international companies, the BCTR recommends clarification of the test to improve certainty for business and encourage participation by Australian management in foreign businesses.

## **Foreign investment fund (FIF) rules**

The BCTR recommends a fundamental review of Australia's foreign investment fund (FIF) rules in the medium term, while an urgent process should be implemented now to address the numerous technical problems associated with this regime.

## **Expatriates**

The BCTR recommends the removal of current tax impediments to the ability of Australian employers to recruit appropriately experienced expatriate employees, which in some instances include double taxation. Without advocating the establishment of tax incentives that are not available to all Australians, the BCTR supports proposals to remove these impediments.

## **Section 1. Introduction**

The BCTR is an apolitical organisation whose members are industry and professional associations from all sectors of the economy representing small, medium and large businesses. A list of BCTR members is attached at Appendix A.

The BCTR members have a common desire to provide a unified approach to building a better tax system that enhances both international and domestic business competitiveness and fairness and which helps create a business climate conducive to investment, growth, job creation and private saving.

Australia's international taxation arrangements are an important factor in relation to Australia's ability to compete for internationally mobile capital, business, technology and labour. Similarly, our international taxation arrangements are critical to the ability of Australian investors and businesses to participate in commercial opportunities abroad.

The international business environment has changed markedly over the past 15 years. This has resulted from the freeing-up of financial markets, the opening up of many economies to foreign investment and trade, and significant trade liberalisation. Global communication, project financing, business coordination and transport have changed significantly due to the advent of new business practices and technologies.

Australia remains a major capital importing country. However, over the past two decades it has also become a major overseas investor with Australian investment abroad now accounting for over 60 per cent of the level of foreign investment in Australia.

The clear trend is for the gap to continue to narrow with capital outflows eventually outstripping inflows. This has important implications for policy setting, including Australia's international tax arrangements.

It is important to recognise that Australia benefits from investment overseas because of the flow-back of profits, interest and dividends, the development of markets for Australian business (including related services inputs) and the technical, managerial and market know-how which is obtained.

Australia's imputation system penalises Australian companies' attempts to allocate foreign income to foreign investors and franked Australian-source income to Australian investors. This is because Australia effectively double-taxes the foreign income of Australian companies and promotes a tax bias which impacts on the cost of capital.

Australia's foreign source income rules place undue emphasis on anti-avoidance, create inflexible structures for Australian companies expanding offshore, and impose unnecessary compliance costs. Our tax system imposes high costs on domestic companies that need to encourage skilled employees to relocate to Australia.

These shortcomings in Australia's tax system inhibit our capacity for employment growth and wealth creation.

Other developed countries have been proactive in ensuring their tax systems have kept pace with the demands of the global economy. As a small country already handicapped by its geographic isolation, Australia should be making every effort not to be left behind. The BCTR has been closely involved in taxation reform since its inception in 1997. Our approach to tax reform is based on clearly stated principles, and is guided by our desire to build a better tax system that meets our objectives and principles for taxation reform. The BCTR's general principles for tax reform are attached at Appendix B.

We acknowledge that it may not always be possible to meet all of these principles simultaneously, and therefore judgements will need to be made in relation to the trade-offs between competing principles.

In the context of international tax, the BCTR's general principles governing tax reform can be translated into the following key objectives:

1. Domestic disincentives for foreign investors to invest in Australia should be minimised, while the ability of foreign investors to access tax credits in their home countries for Australian tax paid should be enhanced.
2. Differences between the tax treatment of all classes of foreign source income, gains and losses of Australian investors and similar income, and gains and losses derived by Australian investors on domestic activities should be minimised.
3. Australian tax levied on non-Australian source income or gains attributable to non-residents should be minimised.
4. Disincentives in Australia's international taxation regime for parent companies to either remain Australian resident companies or to become Australian resident companies (including in relation to conduit income) should be minimised.
5. Impediments in Australia's international taxation regime to Australian employers recruiting appropriately experienced expatriate employees should be minimised.
6. Australia's international taxation arrangements should be clear and inexpensive to comply with and there should be certainty over tax obligations.
7. Australia's international taxation arrangements should be designed to secure the integrity of the revenue base and the role of the tax system in meeting domestic equity objectives.
8. Australia should seek to establish a competitive and non-discriminatory network of tax treaties under which Australia would collect its fair share of tax revenue on international business.

The BCTR considers that any specific proposals emerging from the current review should be evaluated against the BCTR's general tax principles, and should avoid the creation of further distortions. The BCTR supports a neutral tax outcome that avoids any bias in favour of either foreign or domestic investment.

## **Section 2. Attracting Equity Capital for Offshore Expansion**

To expand offshore, Australian multinationals need to access both domestic and foreign sources of equity capital. The dividend imputation system favours, at the shareholder level, domestic investment. This increases the cost of capital for Australian business undertaking direct investments offshore.

### **Recommendations**

The BCTR recommends that:

- either a shareholder credit or a partial exemption should be considered as the best way of addressing the bias;
- if the shareholder credit option is chosen, the level of the credit should be greater than 1/9<sup>th</sup>
- dividend streaming should be pursued, in conjunction with either a shareholder credit or a partial exemption;
- any policy measures in this area should operate side by side with dividend imputation; and
- the Board of Taxation and the Government should examine options preferred by business against the costs to the revenue to most efficiently address the bias.

Even if the bias is not eliminated completely, the BCTR strongly supports the retention of the imputation system. Any measures that are implemented in respect of foreign dividends should operate in conjunction with imputation.

BCTR principles require equivalent treatment of distributed profits, irrespective of their source. Accordingly, we would not support policy measures that favour foreign income over domestic income.

### **The imputation system**

The introduction of imputation in 1987 was an important aspect of the tax reforms at that time. Over the fifteen years or so that has elapsed since then, the Australian economy has changed significantly. The growth in outward investment by Australian companies and more generally the process of globalisation have led some to argue for the imputation system to be modified so that it does not unnecessarily impede Australian companies competing in a globalised world.

Australia's imputation system has proved to be fundamentally sound – both in practice and in principle - and is strongly supported by the BCTR. However, the current

Australian international tax system interface inhibits the ability of Australian companies to compete internationally. This is because the imputation system and dividend withholding tax arrangements are biased against Australian companies with global shareholders and global investments. This bias was not a concern when imputation was first brought in. It has evolved in recent years as a consequence of the evolution of the Australian economy.

Under dividend imputation, Australian resident shareholders receive franking credits on dividends paid by resident Australian companies only for Australian tax paid. Australian residents do not receive credits for foregone company tax paid by a branch or offshore subsidiary of an Australian company. Accordingly, resident individuals or funds investing equity offshore via an Australian resident company will face an additional layer of taxation when that company's foreign earnings are distributed as unfranked dividends.

Dividend imputation has undoubtedly been a key factor in raising the overall level of direct and indirect share ownership in Australia. However, this type of system suffers the disadvantage of encouraging domestic expansion in preference to international development. To the extent that resident investors respond to this bias by demanding higher pre-tax returns from foreign investments undertaken by Australian based groups, this can distort investment decisions.

### **The cost of capital**

A bias clearly exists at the shareholder level due to the higher effective tax rates on distributed foreign earnings. However, the BCTR agrees the key issue should not be the bias itself, but rather its impact on the cost of capital of Australian based corporate groups. That is not to say that addressing the bias at the shareholder level would not be worthwhile on equity grounds – only that doing so may amount to no more than providing targeted tax relief (however deserving), without at the same time making a broader impact on economic activity, wealth creation, jobs and the like.

The significant gap between the respective proportions of foreign earnings and foreign shareholders of most Australian based multinational enterprises suggests that resident investors are more likely than not to be a substantial source of new equity capital. Anecdotal evidence suggests that even Australian companies with significant foreign operations look to Australian investors as a substantial source of new equity funds. This is largely due to the difficulties Australian companies face in attracting the attention of investors and financial advisors in foreign equity markets.

Recent published work prepared for the Australian Competition and Consumer Commission supports the view that the imputation system has an adverse impact on the cost of capital for Australian businesses. This work suggests that foreign investors should be disregarded, and that franking credits clearly have a value, with the recognition

that most investors would be able to fully utilise imputation credits.<sup>1</sup> We are also aware of economic modelling work in this area that is being commissioned by the BCA and other organisations. The BCTR's view is that the bias is likely to have an adverse impact on the cost of funds of Australian companies.

### **Addressing the bias**

Addressing the bias would lead to improved economic performance at a broader level, and the various options canvassed in the Treasury paper (and possibly others) should therefore be explored.

That said, it may not be necessary to eliminate completely the bias that exists at the shareholder level. It is possible that only partially eliminating the bias would have a sufficiently beneficial impact on the cost of capital. What level of shareholder relief is appropriate should become clearer as a result of the above studies being undertaken.

### **Shareholder credit**

The BCTR considers it is unlikely the 1/9<sup>th</sup> shareholder credit canvassed in the Treasury consultation paper would be sufficient to change investment behaviour. We consider that if this option is chosen, the level of the credit should be greater than 1/9<sup>th</sup>. Nevertheless, this mechanism represents a positive approach, in that it has the result of reducing the effective tax on foreign dividends.

### **Partial exemption**

An alternative approach, which appears to have broadly the same effect, is a partial exemption for unfranked dividends that are paid out of foreign earnings. We understand that some of the modelling work being undertaken will compare the likely behavioural responses of both the shareholder credit and the partial exemption options. In the meantime, the BCTR considers that both the shareholder credit and partial exemption approaches have merit.

### **Dividend streaming**

The streaming of foreign dividends to foreign shareholders is unlikely, by itself, to represent a comprehensive response to the bias, since few Australian companies at present have the right balance between foreign earnings and foreign shareholders. That position is expected to change in the years ahead, however, as more Australian companies experience growth in their foreign earnings and expand their non-resident

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<sup>1</sup> Lally, M. June 2002, 'The Cost of Capital Under Dividend Imputation', Victoria University of Wellington, page 3.

shareholder base. Accordingly, the BCTR considers that streaming should be actively pursued as an option, in tandem with either the shareholder credit mechanism or a partial exemption.

### **Other options**

The current global trend to reducing withholding taxes suggests the option of providing imputation credits for foreign dividend withholding tax is unlikely to represent the best policy fix. We do note, however, that the revenue implications of this measure have already been factored into the Government's forward estimates.

### **Section 3. Promoting Australia as a Location for Internationally Focussed Companies**

Promoting Australia as a location for internationally focussed companies requires examination of the following issues:

- Controlled foreign company (CFC) rules
- Tax treaties
- Conduit income
- Place of residency

#### **Controlled Foreign Company (CFC) Rules**

Australia's attractiveness as a location for Australian companies expanding offshore is adversely affected by the scope and complexity of the CFC rules. Even where Australian based companies have no choice but to expand their operations offshore, they are faced with significant compliance costs and direct tax costs through attribution. They also enjoy far less flexibility than their competitors in restructuring their foreign operations.

The CFC rules are overly complex, were designed in a different business era and are now out of step with modern business practices. Changes to the CFC rules would improve the competitiveness of Australian businesses in the international arena by increasing their capacity to periodically restructure, reduce exposure to unnecessary international tax costs and reduce the cost of managing international tax planning and compliance.

#### **Recommendations**

The BCTR recommends:

- a general exemption from the CFC rules for broad exemption listed countries;
- extensions to the rollover relief to remove CGT constraints;
- the implementation of a transparent and ongoing process to examine the basis for countries on both the broad exemption and limited exemption lists; and
- the implementation of an open and transparent process for resolving outstanding foreign source income issues on an individual basis.

## **General exemption**

The BCTR recommends a general exemption from the CFC rules for broad exemption listed countries. These countries have a comparable tax system to the Australian system, resulting in a low amount of revenue being collected, but with high compliance costs. Adopting this single measure would significantly reduce compliance costs for Australian businesses.

## **Rollover relief**

Australian-based multinational groups from time to time need to consider reorganisations of their asset holding structures in order to improve operating efficiency, but can be prevented from doing so by the narrowly confined rollover relief under the current CFC regime. The potential application of CGT may impede the restructuring of the offshore operations of an Australian business. The BCTR therefore supports extensions to the rollover relief to remove these constraints.

## **Broad exemption country list**

The BCTR recommends the implementation of a transparent and ongoing process to examine the basis for countries on both the broad exemption and limited exemption lists. This would ensure the right balance is maintained between the integrity of the regime and the management of tax compliance costs into the future.

## **Addressing outstanding CFC issues**

The BCTR supports the need to identify technical and other policy issues regarding the CFC rules and consideration of options to resolve them. While a major rewrite of the CFC rules is supported in the longer term, specific pressing issues should be resolved in a more timely manner. The BCTR understands that business and the Tax Office have already developed a list of outstanding technical issues that need to be urgently addressed.

The BCTR therefore recommends the implementation of an open and transparent process for resolving outstanding foreign source income issues on an individual basis.

## **Tax Treaties**

Australia has a series of double tax agreements (DTAs) which often produce inequitable results for Australian companies with foreign subsidiaries. The DTAs typically allow foreign jurisdictions to levy withholding tax (WHT) at the rate of 15 per cent on

dividends paid to Australian companies from foreign subsidiaries. The trend in Europe and the United States of America is to reduce WHT to 5 per cent or even 0 per cent, rendering Australia's DTAs (with the notable recent exception of the new Australia-US DTA) uncompetitive. In addition, new DTAs are typically taking over five years to negotiate, yet have a life of twenty or more years.

Australia's new protocol to the Australia-US DTA is scheduled to commence in 2003 in respect of dividends. This is positive for Australia and implements some of the key issues recommended by business groups.

Re-negotiation of DTAs now needs to be accelerated with Australia's major trading partners (notably Germany and Japan).

The BCTR supports modernising Australia's tax treaty network, and recognises that the recent protocol with the US represents a major step in this process. While the Australia-US tax treaty is an improvement to the current treaty process, further consideration needs to be given as to what specific aspects of this treaty should form the basis for future treaty negotiations, and whether certain aspects of other tax treaties should be incorporated (e.g. the Australia-UK tax treaty, which is currently under re-negotiation). As a general principle, the BCTR favours bilateral negotiations that reduce withholding taxes as this reduces costs for business and frees up funds for both Australia and overseas.

The BCTR also believes that a non-discrimination clause that is consistent with tax neutrality and the Government's trade and investment objectives should be included in all Australia's double taxation agreements.

The BCTR supports effective consultation arrangements with business and other parties in achieving successful and timely treaty negotiations, and therefore supports options to improve the transparency and effectiveness of current processes. Australian businesses reported receiving much better information on the recent Australia-US protocol process from US sources than from our own Government officials. This needs to be improved in future treaty work.

## **Conduit income**

Foreign source income that non-residents earn through an Australian entity can be highly sensitive to domestic tax. Currently, Australia is not being used as a regional holding location, due to its taxation treatment of capital gains earned by the foreign subsidiaries of foreign-owned Australian companies.

A broader and more effective conduit relief system would increase the attractiveness of Australia as a destination for investment. This would lead to the increased creation of jobs in Australia as foreign corporations establish and staff regional holding companies in Australia. Further, regional holding companies are likely to increase the flow of funds through Australia, assisting the development of Australian capital markets.

## **Recommendations**

In relation to conduit income, the BCTR:

- supports a broad flow-through regime for all foreign profits and gains to foreign investors in Australian companies;
- considers such relief should apply equally to dividends and capital gains;
- considers that flow-through relief should extend well below the 100% ownership level, with an eligibility threshold to be the subject of further consultation;
- would support extending capital gains tax relief in respect of the disposal of foreign subsidiaries to Australian owned companies; and
- does not support the introduction of special incentives and benefits that are not available to resident taxpayers.

General conduit relief is a feature of the tax systems of most other developed countries (not just tax haven locations). The adoption by Australia of similar arrangements (combined with other measures) would represent a significant step in removing a major impediment to the development of the Australian subsidiaries of foreign investors into local and regional hubs, and facilitate the growth of this important segment of Australian business.

The BCTR supports a system under which all foreign income and gains of the foreign subsidiaries of Australian companies would be able to flow through to the non-resident shareholders of those companies without being subject to Australian tax. This approach should apply equally to dividend flows and capital gains, and should not be restricted to companies that are 100% foreign owned. However, we would not support measures that would provide additional special incentives that are not generally available to Australian residents.

The BCTR considers there would also be merit in extending capital gains tax relief to Australian based companies disposing of their interests in foreign subsidiaries by way of a UK-style participation exemption. Tax relief already exists where active business assets are disposed of directly by a foreign subsidiary. The absence of similar CGT relief for the disposal of shares in the foreign subsidiary itself can create costs and inefficiencies in structuring disposals. Extending CGT relief in this fashion would enable Australian-based companies to compete more effectively with foreign companies.

## **Residency**

Australia taxes all Australian resident companies on their worldwide income. If a company is not incorporated in Australia it is still considered to be a resident if it carries on a business in Australia and either has its central management and control in Australia, or Australian resident shareholders control its voting power.

The scope of the central management and control test is very broad, involves a high degree of uncertainty, and imposes a limitation on companies which are genuinely carrying on business outside Australia.

With the use of modern technology such as video conferencing, e-mail, and internet, it is increasingly possible to participate in management from anywhere in the world. It is unreasonable for the use of these technologies alone to give rise to central management and control problems.

The BCTR agrees that there are practical difficulties with the current residency test and this is creating an impediment to Australia's attractiveness as a location for international companies. The BCTR believes that the current arrangements are uncertain and inhibit Australian management from participating in the supervision of foreign subsidiaries.

### **Recommendation**

The BCTR recommends clarification of the current residency test to provide certainty for business and remove impediments to the involvement of Australian management in the business of foreign subsidiaries.

## **Section 4. Promoting Australia as a Global Financial Services Centre**

Australia's foreign investment fund (FIF) provisions and the CGT treatment of investments by non-residents in Australian managed funds restrict Australia's future as a global financial centre. The current FIF rules are complex, and impose high compliance costs for those taxpayers and managed funds affected.

The BCTR supports measures aimed at providing a better balance between maintaining the integrity of the tax system, while minimising compliance and other costs for taxpayers.

Branches (permanent establishments) are a legal structure through which international investment can take place. The Treasury consultation paper puts forward an option to consider specific tax issues outside the Government's current tax reform program, where the lack of separate entity treatment inappropriately impedes the use of branch structures.

Domestic tax law provides an uncertain and inconsistent approach to the taxation of permanent establishments, which fails to deliver a tax neutral outcome. The BCTR believes that permanent establishments should be neither advantaged nor disadvantaged under Australia's tax system, and supports movement towards the separate entity treatment of branches.

### **Recommendation**

The BCTR recommends that consideration be given to fundamental reform of the current foreign investment fund rules in the medium term, and believes that a transparent process should be implemented forthwith to address the numerous technical problems with this regime identified by the funds management industry.

## **Section 5. Improving Australia’s Tax Treatment of Foreign Expatriates**

In a global economy, skilled labour is becoming increasingly mobile. To compete internationally, Australia needs to be able to attract skilled workers to fill shortages and to access new ideas and skills.

Countries around the world are boosting their efforts to attract highly educated and skilled workers and to compete internationally. Australian businesses must also be able to attract such skilled workers. The influx of skilled workers will lead to the introduction of new ideas and skills and consequently should lead to improved productivity and international competitiveness of Australian businesses.

The current tax treatment of foreign expatriates who become temporarily residents, and the high costs this imposes on business, discourages many businesses from locating in Australia or bringing skilled people here.

Australia has always been considered a high tax country for individuals due to high marginal tax rates that apply at low thresholds. This makes it difficult to convince overseas expatriates to accept employment here. Australian companies either have to offer higher salaries to attract those individuals, or compensate them in some way for the increased tax burden. Generally this is highly expensive, and can disadvantage Australian business.

### **Recommendations**

The BCTR recommends:

- the removal of inequitable features of the current system, in particular the removal of double taxation and supports the passage of the measures currently before Parliament<sup>2</sup>.
- not proceeding with the Review of Business Taxation recommendation that residents departing Australia should provide security for deferred CGT liabilities.
- the acceleration of negotiations with Australia's major trading partners to finalise bilateral superannuation agreements to eliminate additional layers of cost.
- consideration be given to the establishment of a cell within the Australian Taxation Office establish to work with employers to deal with the tax administration concerns of foreign expatriates.

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<sup>2</sup> Taxation Laws Amendment Bill (No 7) 2002.

The BCTR does not support any proposal to treat ceasing to be an Australian resident as a cessation event for the purposes of Division 13A.

### **Temporary residents**

Changes to the expatriate tax rules were introduced into Parliament earlier this year as part of Taxation Laws Amendment Bill (No. 4) 2002, but were rejected by the Senate. These changes were intended to remove major tax disincentives to the employment of foreign expatriates and have been re-introduced as Taxation Laws Amendment Bill (No. 7) 2002. The BCTR supports the removal of inequitable features of the current system, in particular the removal of double taxation and supports the passage of the measures previously excised from this Bill.

It should be noted that these measures are not about providing tax cuts to highly paid foreign executives. Most of the employees involved are middle managers, nurses, technicians and the like. Moreover, many of the businesses looking to recruit such people are dissuaded from doing so because the very high tax costs, including taxes on taxes, fall on them rather than the foreign employees.

While temporary residents should not be taxed on a more favourable basis than Australian residents, the BCTR does not support the taxing of foreign nationals on gains arising from their foreign assets (whether acquired before or during their assignment in Australia), except to the extent that the acquisition of the asset is effectively connected with services performed in Australia.

### **Security for deferred CGT liabilities**

The BCTR does not support proceeding with the Review of Business Taxation recommendation that residents departing Australia should provide security for deferred CGT liabilities. Such a move is a disincentive to highly skilled workers coming to Australia, and exacerbates current problems with the CGT treatment of foreign expatriates as, in many cases, it will force foreign expatriates to sell their CGT assets to enable them to provide the security.

### **Employee share options**

The potential for double taxation of employee share options can also be a disincentive to highly skilled foreign expatriates working in Australia. Accordingly, the BCTR believes that share options should not be subject to double taxation. We agree that the preferred method is to remove double taxation through bilateral tax treaty negotiations, as it would allow an agreed mechanism to be implemented by both countries and would result in reciprocal treatment for Australians working in the treaty partner country.

## **Cessation event under Division 13A**

Under the current domestic tax law (Division 13A), tax on a discount given to an employee for ‘qualifying’ shares or rights acquired under an employee share scheme may be deferred for up to ten years unless a ‘cessation time’ event occurs. The BCTR does not support any proposal to treat ceasing to be an Australian resident as a cessation event for the purposes of Division 13A. To do so would result in double taxation without relief in instances where the employee doesn’t exercise their options at the time of departure, or it may force them to exercise their options and sell their shares in order to pay their Australian income tax liability.

## **Superannuation**

In some circumstances, compulsory superannuation contributions support for Australian and foreign expatriates can significantly increase the cost of employment for both domestic and foreign employers. Some foreign country social security systems, such as the UK, require continued superannuation support for expatriates to maintain retirement benefits whilst the foreign expatriate seconded to Australia is within the Superannuation Guarantee system. While Australia currently has agreements with Netherlands, Portugal and the US dealing with double superannuation coverage, the BCTR recommends accelerating negotiations with Australia's major trading partners (for example broad listed countries under CFC rules) to finalise bilateral superannuation agreements to eliminate this additional layer of cost.

## **ATO specialist cell**

The BCTR supports the suggestion that the Australian Taxation Office establish a specialist cell to work with employers to deal with the tax administration concerns of foreign expatriates. This would provide integrated administrative support for foreign expatriates and employers and is worth considering.

## **Conclusion**

Australia's international taxation arrangements are central to the ability of Australia to compete for internationally mobile capital, business, technology and labour. Our international tax arrangements are critical to the ability of Australian investors and businesses to participate in commercial opportunities abroad.

The BCTR believes that it is imperative that reform of our international tax arrangements is undertaken now to ensure that Australian businesses can expand and grow.

The BCTR's approach to tax reform is based on clearly stated principles, and is guided by our desire to build a better tax system that meets our objectives and principles for taxation reform.

The BCTR submits that proposals contained in the Review of International Taxation Arrangements should be evaluated in the context of these BCTR objectives and principles.

The BCTR supports this review being conducted by the Board of Taxation, and fully endorses the open and participative consultation process being followed.

The BCTR firmly supports ongoing reforms to reduce the complexity, uncertainty and the costs of compliance associated with Australia's income tax system. We recommend that ongoing maintenance and review of the system is essential and that a formal process, such as a Committee or Reference Group, must be implemented to undertake this.

## **APPENDIX A**

### **Members of the Business Coalition for Tax Reform**

Association of Consulting Engineers  
Association of Superannuation Funds of Australia  
Australian Bankers Association  
Australian Business Limited  
Australian Chamber of Commerce and Industry  
Australian Constructors Association  
Australian Food and Grocery Council  
Australian Gas Association  
Australian Hotels Association  
Australian Industry Group  
Australian Institute of Company Directors  
Australian Retailers Association  
Australian Stock Exchange  
Business Council of Australia  
Business SA  
Corporate Tax Association of Australia  
Council of Small Business Organisations of Australia  
CPA Australia  
Electricity Supply Association of Australia  
Employers First  
Federal Chamber of Automotive Industries  
ICC Australia  
Institute of Chartered Accountants in Australia  
Insurance Council of Australia  
International Banks and Securities Association of Australia  
Investment & Financial Services Association  
Master Builders Australia  
Meetings Industry Association of Australia  
Minerals Council of Australia  
National Association of Forest Industries  
Property Council of Australia  
Restaurant & Catering Australia  
State Chamber of Commerce NSW  
Tasmanian Chamber of Commerce and Industry  
Urban Development Institute of Australia  
Victorian Automobile Chamber of Commerce  
Victorian Employers' Chamber of Commerce & Industry

## **APPENDIX B**

### **Business Coalition for Tax Reform Objectives and Principles**

#### **BCTR Objectives**

The BCTR is an apolitical organisation of business and professional associations from all sectors of the economy representing all businesses in Australia, irrespective of their size, nature of operation or ownership.

The members of the BCTR have a common desire to provide a unified approach to building a better tax system that enhances both international and domestic business competitiveness and fairness and which assists in creating a business climate conducive to investment, growth, job creation and private saving.

#### **BCTR Principles**

1. The tax system should be simple, transparent and should minimise uncertainty.
2. The design, administration and operation of the tax system should be undertaken with full and effective consultation with relevant stakeholders including the business community.
3. The tax system should fairly balance the need to protect the taxation revenue base with the principles of a good tax system, i.e. efficiency, fairness (horizontal and vertical equity), simplicity, clarity, certainty and low compliance costs.
4. The tax system should enhance competitiveness by providing a climate conducive to improved investment in Australia and from Australia for Australian-based entities and individuals.
5. Indirect taxation at the State and Territory level should be more efficient and competitive.
6. The pattern of Federal/State financial relations should be transparent, efficient and sustainable.
7. The tax treatment for savings should be consistent with an overall savings policy that encourages the sustainability of strong, ongoing growth.
8. The tax, and social security, treatment of personal income and fringe benefits should conform to the principles of fairness, efficiency and simplicity.
9. The tax system should avoid the double taxation of business income and provide relief for all business expenses.
10. The tax system should not impede organisational restructuring.