Ms Teresa Dyson  
Board of Taxation  
c/ The Treasury  
Langton Crescent  
CANBERRA ACT 2600

By email: taxboard@treasury.gov.au

23 May 2014

Dear Ms Dyson

Review of Debt and Equity Tax Rules

PricewaterhouseCoopers (PwC) welcomes the opportunity to make a submission in response to the Board of Taxation (the Board) Discussion Paper (the Discussion Paper) in relation to its review of the debt and equity tax rules, released for stakeholder consultation on 25 March 2014.

All references are to the Income Tax Assessment Act 1997, unless specified.

Executive Summary

In view of the significant size and complexities involved in this review, we have limited our comments to two broad areas that we see as causing significant practical difficulties, red tape and costs for business, being the operation of the integrity rule in s974-80 and international taxation.

In our view it is imperative that urgent remedial action be taken to address the uncertainties surrounding the operation of s974-80 as a result of the significant compliance costs that arise for taxpayers in dealing with this uncertainty. To that end, we recommend that the Board expedite the review of s974-80 by separating it from the larger debt and equity tax review, with a view to recommending that the Government repeal the provision as soon as possible.

Due to the ongoing work of the Organisation of Economic Cooperation and Development (OECD) on base erosion and profit shifting (BEPS), including consideration of hybrid mismatch arrangements, we recommend that the Board disband any further work on the international aspects of the review.

Our comments and recommendations are informed by the Government’s red tape reduction program (cuttingredtape.gov.au) which aims to reduce unnecessary red tape costs on individuals, business and community organisations. In our view, the two recommendations above will dramatically reduce red tape costs on Australian businesses and be consistent with the Australian Government Guide to Regulation released in March 2014.
Comments on specific issues

Chapter 5 - Integrity rule in s974-80

PwC has significant concerns about the application of section 974-80, and has been involved in consultations in the past regarding its operation. While we commend the Government for recognising the importance of this issue by including this in the terms of reference for the Board’s review of the debt equity tax rules, we are disappointed that this been “on the radar” for many years, with no resolution in sight given that the Board is not due to report to the Assistant Treasurer until March 2015. Although we acknowledge that the terms of reference of the Board’s review may be limiting, we recommend that the Board seek to expedite the review of the s974-80 by separating it from the larger debt and equity tax review and addressing it in priority to other issues raised in the Discussion Paper.

The uncertainty relating to the application of this provision has caused significant compliance and administration costs for taxpayers for well over a decade. This issue has become even more pressing in recent years as the Australian Taxation Office (ATO) has stepped up its compliance activity in this area, despite the acknowledgment by the former Government that the section as currently worded goes beyond its original intention. The 2011-12 Federal Budget, which contained the originally announced changes to s974-80 to restore its intended purposes (now over three years ago), stated that “the changes will ensure that this provision will only apply to arrangements where both the purpose and effect is that the ultimate investor has, in substance, an equity interest in the issuer company”\(^1\), with the amendment to apply from the commencement of the debt / equity tax rules (in most cases, 1 July 2001).

It appears that the ATO has no current plan to cease compliance action on this issue while a legislative fix is developed, which serves to emphasise the need for a resolution of this issue as soon as possible.

Stapled groups

In July 2012, the ATO issued draft Taxation Ruling TR 2012/D5 Income tax: debt and equity interests: when is a public unit trust in a stapled group a connected entity of a company for the purposes of paragraph 974-80(1)(b) of the Income Tax Assessment Act 1997. The draft Ruling was subsequently withdrawn following industry consultation and the ATO indicated at that time that it would be replaced by a Law Administration Practice Statement. We understand that drafting of this Practice Statement is significantly advanced, with the ATO aiming to release the draft Practice Statement before 30 June 2014.

Stapled groups have often been a target of the ATO in its compliance action regarding s974-80, and as the Board stated in its Discussion Paper “stapled structures are a commercial reality and are a significant subset of the investment population”\(^2\). We commend the Board for recognising this, and in particular, for highlighting that the uncertainties regarding the application of s974-80 to stapled structure arrangements should be removed. As we have been heavily involved in consultation with Treasury and the ATO regarding the application of s974-80 to stapled groups in the past, we would be happy to provide further assistance to the Board in relation to the difficulties that arise in this area.

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\(^1\) 2011-12 Federal Budget, Budget Paper No. 2, Part 1: Revenue Measures, page 20
\(^2\) Discussion Paper, paragraph 5.46
General

In relation to the General Question posed in Chapter 5 of the Discussion Paper, we make the following observations:

- the 2011-12 Budget announcement to amend s974-80 appears to go some way to addressing the concerns relating to its application. However, without seeing the detail of the legislative amendments, it is difficult to conclude on whether the amendments will address all of our concerns. We welcome the proposed addition of a legislated discretion for the Commissioner to not apply s974-80 where he considers it would be unreasonable for it to apply. However, the delays in progressing this announcement, in conjunction with the ATO’s aggressive position on s974-80 in recent years, have heightened our concerns around the operation of this provision.

- In our view, there is no need for a specific integrity provision in Division 974, as the general anti-avoidance provision in Part IVA of the Income Tax Assessment Act 1936 can be applied in situations where there has been a scheme to obtain a tax benefit, being the deductions otherwise claimed by the issuer of the debt interest. As noted in the Discussion Paper, “section 974-80 is intended to apply only where these is a deliberate design and purpose that the deductible return to the connected entity is used to fund, either directly or indirectly, a return to the ultimate recipient”, and in our view, such deliberate actions to obtain a tax deduction should typically fall within the ambit of Part IVA.

The delay in resolving issues regarding s974-80 has resulted in taxpayers being effectively “caught in the crosshairs” between the ATO and Government. While the Government acknowledges that the provision needs to be rewritten, the ATO is continuing to pursue taxpayers who it sees as falling foul of the provision as currently drafted. We therefore recommend that urgent remedial action be taken, either:

- by the repeal of the existing provision while an alternative is drafted (if it is concluded that a specific integrity measure in Division 974 is warranted – however, see our comments above regarding potential application of Part IVA); or

- via an ATO administrative concession which would provide that the ATO will not undertake further compliance action on this issue while the 2011-12 Federal Budget measure is being developed and enacted. An administrative concession such as this would be consistent with the ATO’s approach to many other significant tax announcements – see, for example, the ATO’s administrative treatment in relation to CGT look-through treatment for earnout arrangements.

Chapter 10 - International taxation

There are clear linkages between this review and the work of the OECD in its Action Plan to address BEPS. For example, the work of the OECD on hybrid mismatch arrangements is likely to be highly relevant and inform the recommendations of the Board at the completion of this review.

The Hybrids Report concludes that the collective tax base of countries is put at risk through the operation of hybrid mismatch arrangements even though it is often difficult to determine

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3 Discussion Paper, paragraph 5.15
5 Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues (5 March 2012) OECD
unequivocally which individual country has lost tax revenue under the arrangement. Apart from impacting on tax revenues, the report also concludes that hybrid mismatch arrangements have a negative impact on competition, efficiency, transparency and fairness. However, these conclusions are based on anecdotal evidence and have not been qualified or quantified.

As highlighted by the OECD and noted in your Discussion Paper, “uncoordinated, unilateral or limited responses by governments to BEPS would replace that framework [of bilateral treaties] with competing sets of international standards that could result in the risk of double or even multiple taxation for business, with negative global consequences for investment, growth and unemployment”\(^6\).

In addition, the outcomes and success of the BEPS project are far from certain, especially given the need for some level of consensus between the G20 countries. There is a risk of inconsistencies emerging as countries push back on proposed changes which are inconsistent with their national interests. There is also a real danger of increased instances of double taxation and disputes with revenue authorities across the globe. This could hamper international trade and investment.

Given these uncertainties and risks, we recommend caution in dealing with these issues, particularly with respect to any unilateral actions before the completion of the OECD’s work. As a consequence, we recommend that the Board disband any further work on the international aspect of the review. This is because the OECD Action Plan is moving to address hybrid mismatch arrangements and, in the meantime, Australia’s comprehensive tax regime, which includes a general anti-avoidance rule, sufficiently deals with hybrid mismatch arrangement concerns. Moving ahead of the OECD Action Plan would be inconsistent with the Government’s red tape reduction program.

We commend the Board for the thoroughness of its work to date in relation to the review of the debt and equity tax rules and would be happy to assist further and are willing to engage in separate dialogue with you and your team to canvass these issues in detail.

Should you have any questions, or wish to discuss any of the comments in our submission further, please do not hesitate to contact Mike Davidson on (02) 8266 8803 or Peter Collins on (03) 8603 6347.

Yours sincerely

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\(^6\) Discussion Paper, paragraph 10.51