Level 2
95 Pitt Street Sydney, NSW 2000
Telephone 02 8223 0000
Facsimile 02 8223 0077
Email tia@taxinstitute.com.au
Website www.taxinstitute.com.au
ABN 45 008 392 372

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Manager
Company Tax Unit
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: companylosses@treasury.gov.au

Dear Sir

Company Losses amendments

The Taxation Institute of Australia (**Taxation Institute**) welcomes the opportunity to provide comments on the exposure draft of the *Tax Laws Amendment (2009 Measures No. 6) Bill* 2009 and the related explanatory memorandum (**Exposure Draft Material**). The Exposure Draft Material concerns changes to permit company losses to be deducted where the current rules may deny loss deductions in situations where not all of the shares carry the same rights to dividends, return of capital or voting.

The Taxation Institute has some significant concerns in relation to the Exposure Draft Material. These concerns are outlined below.

Definition of "unfixed share structure" - s167-10(2)

Where the directors of a company can declare discretionary dividends in respect of a share to the exclusion of any other share, the shares still have the same rights to dividends. Therefore, the Taxation Institute considers that those companies do not have an "unfixed share structure" as defined in section 167-10(2). Accordingly, such companies cannot avail themselves of the modified continuity of ownership test (**COT**) in proposed Division 167.

The Taxation Institute considers that such companies should be able to avail themselves of the modified COT in Division 167. Therefore, the Taxation institute recommends amending section 167-10(2) so that such companies would be considered to have an "unfixed share structure".

If, contrary to the Taxation Institute's view, the proposed provisions are intended to apply to such companies, then this should be clarified either in the legislation or the explanatory memorandum (**EM**).

Fundamental reliance on market value of shares

Section 167-20 proceeds on the basis that it is possible to efficiently and inexpensively work out the market value of the relevant shares.

It is acknowledged that the provisions may apply to companies which have shares that are listed. In the case of listed companies, it is possible to have a market value determined at a particular point in time (or to determine a value range at a point in time given that while trading proceeds the market value is potentially moving up and down).
However, many of the companies to which these provisions will have application (and indeed, on at least one view, most of the companies to which these provisions will have application) will not be companies with listed shares.

In the absence of listed shares there is a history of disputes over the market value of shares. This is illustrated by the recent referral of valuation aspects of the employee share plan provisions to the Board of Taxation for further consideration.

The Taxation Institute considers that it would be preferable from a compliance cost perspective to permit a company to elect to adopt a different approach to that required under section 167-20(c) and (d). The alternative approach might be a right to estimate market value using the method outlined in section 167-25(4) or some other form of indicative market value. The appropriate alternative method would require further consideration.

If there is a concern about inappropriate application of such a provision, an integrity measure could be included.

Reconsideration under section 167-20

Example 1.3 on page 20 of the EM considers a situation which, on its face, would appear to be resolved by the application of section 167-15.

After disregarding the debt interests the subject company is left with:

(a) Lisel & Oliver holding 1,000 ordinary shares (ie 100%) continuously through the ownership test period; and
(b) Mark holding 300 ordinary shares (ie in excess of 50%) continuously through the ownership test period.

The Taxation Institute would have expected that there would be no need to consider section 167-20 and then section 167-25. However, the EM states:

> "However, as different classes of shares with unequal dividend rights continue to exist, Kommissar Co is still unable to satisfy the dividend and capital distribution conditions of the continuity of ownership test."

The Taxation Institute considers that this example needs to be fixed.

Reconsideration under section 167-25

Section 167-25 proceeds on the basis that the COT is not satisfied after being reconsidered under section 167-20 or under section 167-15 (if COT could not have been reconsidered under section 167-20).

Under section 167-15, it is not clear that COT can be reconsidered if there are no debt interests in existence at the time.

In the EM at para 1.51, example 1.4 on page 25 it is stated:

> "The unsatisfied conditions cannot be reconsidered under section 167-15 (because none of the shares are debt interests) or …."

The Taxation Institute considers that it should be clarified that the COT can be reconsidered under section 167-25 even if neither the subject company nor the holding company, have debt interests. This is important to the structural stability of the provisions. If it does not operate in this manner, there will be many companies which do not have debt interests and which do not satisfy the conditions of section 167-20 such that COT will not be able to be reconsidered.

"Determine if it is reasonably practicable for the company to work out the relative market value of each remaining share"

The Taxation Institute considers that further consideration needs to be given to whether it is reasonably practicable for the company to work out the relative market value of each remaining share. The Taxation Institute considers that this is a vitally important factor in the design of the legislation. Further, it is the critical point of the method statement in section 167-25(2) (refer to Step 2).

It is not clear whether it is intended that this is an objective test or a subjective test. Further, it is not clear who is to make the determination (ie the Commissioner or the Company).

Further, it is not clear what matters must or can be taken into account in making such a determination. In particular, it is always possible to engage a share valuer to value the relevant shares. However, as partly recognised in para 1.41 of the Exposure Draft Material, this is a compliance cost that is not always justified.

There mere ability to seek a share valuation should not automatically mean that it is "reasonably practicable" to have to do so.

The Taxation Institute considers that, as currently drafted, these words will result in disputes around the meaning of these words, their application in relation to the method statement and the selection between section 167-25(3) and section 167-25(4). In particular, there is a concern that the ATO will adopt a position that their share valuers have carried out a valuation and that therefore it is reasonably practicable to do so. As such section 167-25(3) should apply and therefore the company does not satisfy the test under section 167-25(3).

The Taxation Institute considers that safe harbour rules should be included in the legislation so that a company can elect to go straight to section 167-25(4), rather than having to reach a view on a potentially contentious point as to whether the determination is "correct". If there are concerns about integrity issues, then limits could be set and a discretion to exceed those limits given to the Commissioner to ensure that matters can be addressed in a speedy and efficient manner without resort to expensive share valuations.

Treatment of death duty minimisation companies

Companies which were established for death duty minimisation purposes were characterised by the existence of multiple classes of shares. In such circumstances, it may be difficult to establish a principal class of shares.

It would follow that such a company would be unable to make a reconsideration under section 167-20 because it would be unable to satisfy section 167-20(c) and (d). However, it would be able to carry out reconsideration under section 167-25(2)(b). The Taxation Institute considers that this should be expressly stated in the EM for clarity.

Inability to reconsider if failed in a prior year

At para 1.51 of the EM it is explained that section 167-30 is an integrity measure. However, there is no explanation of what the rationale for its existence is.

Example 1.4 relates to a specific situation. However, the provision would also apply to a situation where in the original articles of a company established in 1960 include a provision that rights attaching to a particular share or class of shares impacting on the market value of that share/those shares would cease to exist on 1 July 2012.

Such a situation should not be within the integrity measure as it clearly was not intended to impact on the ability of the company to claim a loss deduction. The integrity measure needs to be reconsidered so that it is restricted only to those acts/events which warrant its application.

Difference in approach under Subdivision 167-A & Subdivision 167-B

There is a significant difference in the approach under Subdivision 167-B when compared with Subdivision 167-A. There is no obvious explanation for not adopting a similar multi-layered approach in both subdivisions.

For instance, there may well be shares which are debt interests and which have voting rights (eg to ensure that they are entitled in their home jurisdiction to tax credits for underlying foreign taxes). In such circumstances, it seems reasonable that they should be permitted to be excluded in a manner similar to Subdivision 167-A.

There is also a significant difference in the approach under Subdivision 167-B when compared with Subdivision 167-A in relation to the treatment of holding companies. Subdivision 167-B applies at the level of the loss company. It fails to redress differential voting positions at a level higher in the ownership chain (ie in a holding company of the loss company). The Taxation Institute considers that this should be covered by the provisions of Subdivision 167-B.

The application date for Subdivision 167-B should be 1 July 2002 in line with the application date for Subdivision 167-A.

Choice

There may also be a scenario where a taxpayer could be disadvantaged if the amendments on voting rights go back to 1 July 2002. For example, where a company owns 90% of a sub and subsequently acquires the remaining 10%, the transferred losses there may have been classified as SBT losses on the basis there were multiple classes of shares. If the amendments go back from 1 July 2002, all SBT losses may be unwound to become COT losses. For taxpayers in this situation, they should be given the choice to leave things as is. Therefore, it may be appropriate to make section 167-B a choice like 167-A.

The reforms – too narrow

It appears where there are “non-share equity” securities on issue which have rights to capital distributions, the COT tests cannot be satisfied. This is because the ordinary shares also have rights to capital distributions, but the 50% test cannot be satisfied by reference to the ordinary shares alone. The Taxation Institute considers that this is a fairly common situation.

The Exposure Draft Material does not apply in this situation. The Exposure Draft Material will only apply under section 167-10(1) if both of the following apply:

- a condition in the table cannot be satisfied; and
- the company has an "unfixed share structure".

An "unfixed share structure" is defined in section 167-10(2) as "its *shares do not all have the same rights to any dividends, or capital distributions, of the company". If the entity has one class of ordinary shares, its shares will have the same rights, therefore the Exposure Draft provisions cannot apply. The non-share equity interests which have rights to capital distributions will not be “shares” and therefore can not be taken into account.

In order to fall within the Exposure Draft legislation it would be necessary to amend the legislation to specifically include non-share equity in "unfixed share structure". This could be achieved in a number of ways. For example, "A company will also have an unfixed share structure at a particular time if, at that time, it has on issue securities other than shares which also have rights to capital distributions of the company.”

There may also need to be “flow on” amendments all the way through the COT legislation, as the COT tests seem to only look at the rights attaching to “shares”, and ignore non-share equity.

Modification of the same business test

At para 1.59 of the EM in line 4 it would be helpful to substitute “the head company” for “it” (assuming that is what is intended).

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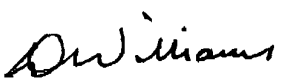
If you would like to meet with representatives from the Taxation Institute or require any further information or assistance in respect of our submission, please contact David Williams on 02 9958 3332.

Yours faithfully



David Williams
Vice President