THE TAX INSTITUTE

THE MARK OF EXPERTISE

12 June 2014

Mr Peter Peters
Senior Adviser
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ForeignResidentCGT@treasury.gov.au

Dear Mr Peters,

Improving the Integrity of the Foreign Residents CGT Regime

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the *Tax and Superannuation Laws Amendment (2014 Measures No. 3) Bill 2014: foreign resident CGT integrity measures Exposure Draft* (**Exposure Draft**).

Summary

Our submission below addresses our main concern in relation to the Exposure Draft which is that the draft provision in the Exposure Draft has potentially much broader reach than the policy intent of the measure to create an integrity rule that prevents the double-counting of assets when applying the capital gains tax (**CGT**) rules to foreign residents.

Discussion

Background

The purpose of the amendment is to ensure that the foreign residents CGT regime operates as intended and prevents double-counting of assets when the "principal asset test" contained in Division 855 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**) is applied to determine the amount of capital gain or loss a foreign resident has made.

The previous government identified that transactions between entities within a consolidated or 'multiple-entry consolidation' (**MEC**) group could give rise to duplication of assets that impact on the application of the principal asset test. For example, non-

TARP[1] assets might be created to dilute the TARP assets and potentially ensure that no capital gain arises to a foreign resident on disposal of a CGT asset[2].

The current Government has identified that the same risk of duplication can occur in the context of group companies that are not necessarily in a consolidated or MEC group and, as such, seeks to further extend the application of the amendment.

Issue

The Tax Institute's key concern with the proposed amendment in the Exposure Draft is that the amendment extends to certain arrangements beyond what may be intended to have been captured and which otherwise fall outside the intended scope of the amendment.

Draft section 855-30(4A) refers to an 'arrangement', a term which is broadly defined for the purpose of the 1997 Act. Though the policy intent is to prevent double-counting of assets created by way of transactions occurring between two related parties, given the breadth of the meaning of the term 'arrangement', the provision could potentially apply to arrangements that involve not only two related parties, but unrelated 3rd parties as well. For example, if a subsidiary company obtains a loan from an unrelated financier (eg a bank) and the parent company provides a guarantee for the loan, an asset would be created between the parent and subsidiary companies as a result of the 'arrangement' that would involve an independent 3rd party. Assuming that the loan transaction is on a commercial footing, we question whether such a transaction should be captured by the draft provision.

Discussions with Treasury indicate that the amendment is not intended to capture commercial transactions similar to that described above.

The Tax Institute is also concerned that assets may be captured by the draft provision that have arisen from transactions that may have been entered into a long time before the current CGT asset disposal occurs. We are concerned that these transactions would have taken place without regard to potentially circumventing the CGT rules that apply to foreign residents, particularly if they occurred well before Division 855 began to apply in December 2006. For example, in Year One, a company may place surplus funds on deposit with an arm's length financial institution. In Year Five, a related company borrows an amount, which could be more, less or the same, from the financial institution. The amount on deposit may or may not be given as security.

Again, discussions with Treasury indicate that the amendment is not intended to capture such a transaction, assuming that the original deposit and the subsequent loan are not part of an arrangement.

[1] Taxable Australian Real Property.

[2] Where the asset is a direct or indirect interest in Australian real property.

Suggested Solution

To ensure that the scope of the application of draft section 855-30(4A) is properly defined, we suggest inclusion of a purpose clause to ensure that it is clear on the face of the legislation that this integrity measure is directed at preventing the double-counting of assets arising from transactions between two related party entities. Where the purpose and scope of the provision is clear on its face, this will prevent taxpayers needing to rely on the explanatory memorandum and other extraneous material to determine the scope and application of the provision.

We suggest the following amendments (noted in red) to the proposed provision below that could be considered by Treasury:

> Section 855-30 (4A) This provision applies to prevent the double-counting of the market value of assets that arise from an *arrangement described in this provision. For the purposes of subsections (2) and (4), disregard the *market value of an asset that is not *taxable Australian real property if:
>
> (a) the parties to an *arrangement included the first entity and the other entity, or included:
>
> (i) the first entity or the other entity; and
>
> (ii) an entity that is a first entity or other entity for the purposes of a related application of subsection (3) and table item 2 in subsection (4); and
>
> (b) an effect of the arrangement was to create the asset, as an asset of one of those 2 parties, before the *CGT event happened.
>
> Note: Commercial arrangements involving entities other than the first entity or other entity do not form part of an arrangement for the purpose of this provision.

In addition, we suggest that a limitation be imposed regarding the timing of transactions that have given rise to assets that may be double-counted. It could apply to assets arising from transactions that have occurred after the commencement date of the integrity measure (see Item 2 of the Exposure Draft).

This limitation would ensure that earlier transactions that are unlikely to have been entered into for the purpose of circumventing the CGT rules that apply to foreign residents would be appropriately excluded from the reach of the draft provision.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

Michael Flynn
President