



10 February 2012

Business Tax Working Group Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: BTWG@treasury.gov.au

Dear Sir/Madam

Interim Report on the Tax Treatment of Losses

The Australian Financial Markets Association (AFMA) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. We appreciate the opportunity to comment on the positions put in the interim report on the tax treatment of business losses.

Tax Treatment of Losses

The asymmetric tax treatment of losses is a significant matter for businesses, especially those who experience financial stress and need to adjust to changing economic conditions. While entities in the financial sector are generally profitable, there is great diversity in both scale and scope of businesses within the sector and some individual entities may experience losses during dislocations like the global financial crisis or during significant cyclical downturns. Tax law has a bearing on the decisions made by companies in this situation about how to best preserve and grow the value in their business.

In our view, there is benefit to more balanced tax loss rules that ameliorate the current tax bias against innovative investment and that help affected business entities achieve a smoother adjustment to changing economic conditions. The reform would assist individual businesses by providing cash flow relief (for example, who otherwise may not have to borrow working capital at high interest rates) and would benefit the economy by an automatic stabilisation mechanism to help preserve capital, amongst other things. Thus, we support the mandate given to the Working Group by the Government and the thrust of the analysis in the Report.

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We expect that some individual companies will make submissions in response to the consultation questions about the impact of potential reforms on their business. Therefore, we are limiting our comments to signal our broad support for removal of the continuity of ownership test and same business test which would reduce the tax bias against some risky investments (subject to an acceptable integrity check), as well as the loss carry back/carry forward uplift.

Tax Black Hole Provisions – Staff Termination Payments

Section 4 of the Interim Report recognises the potential for tax black holes to exist in relation to the changing or closure of a business. In this context, there is a specific matter in relation to staff termination payments that we would like the Working Group to take up in its final report.

The ability of a company to effectively manage change in its business in a manner that assists affected employees in a reasonable manner will support staff commitment and assist productivity. Moreover, the Government and the community expect companies to look after the welfare of their staff. The closure of a business unit can be a distressing time for employees and companies in this situation may endeavour to make redundancy payments in excess of minimum statutory entitlements to assist affected employees. The tax law should not inhibit employers who wish to help their staff in this way. However, staff termination payments made to employees may not always be tax deductible to the employer, creating a tax expenditure black hole.

In technical terms, the problem arises from the interaction of s.40-880 and s.25-50 with s.26-55 of the Income Tax Assessment Act 1997; the latter limits the tax deductibility of a pension, gratuity or retiring allowance paid to an employee. A recent tax ruling, TR 2011/6 includes an example that explains ATO's view of the law:

Example 34

Company T made a payment to an employee in the form of a retiring allowance which meets the conditions for a deduction under section 25-50. However, the payment resulted in the company making a loss for income tax purposes. Paragraph 26-55(1)(a) limits the deduction otherwise available under section 25-50 if the deduction creates or increases a loss for income tax purposes.

As a result, the part of the payment to the employee that created the loss is not deductible under section 25-50. As paragraph 26-55(1)(a) expressly prevents part of the payment being deductible under section 25-50, paragraph 40-880(5)(h) excludes that part of the payment from deductibility under section 40-880.

We believe this outcome conflicts with good tax and social policy. The Ralph Review of Business Taxation considered the tax policy issues and recommended that business closure costs should be made deductible to eliminate a tax expenditure black hole.¹ Staff termination costs may be a significant component of the cost of winding-up a business unit and they

¹ *A Tax System Redesigned*; recommendation 4.14.

should be fully tax deductible. This outcome is also anomalous given the treatment of related expenditures (eg legal advice on a termination payment is tax deductible).

Staff termination payments arising in the normal course of winding up a business unit should be fully deductible. The Working Group should recommend that all *bona fide* staff termination payments should be tax deductible and the law should be amended to provide the desired certainty in this regard. If there is any concern about tax avoidance, then this should be dealt with separately.

Tax Reform Priorities

The Consultation Guide asks how we would rank reforms to the tax treatment of losses against other changes to the business tax system.

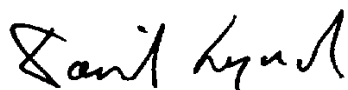
Both the Henry tax review and the Johnson Report on Australia as a financial centre recommended the abolition of interest withholding tax (IWT) for financial institutions because this would benefit the Australian economy. Amongst other things, it would boost competition in banking and support the flow of credit to the private sector.

The Government announced on 23 November 2011 its decision to defer the phasing down of IWT paid by financial institutions by one year, so it will not begin until 2014-15.

AFMA's main tax priority for the Government is for it to proceed with the introduction of legislation to lock-in the announced IWT change. This would enable financial institutions to build in the reform in their forward business planning with greater certainty and enhance Australia's competitiveness as a financial centre, thus protecting jobs.

Thank you for the opportunity to contribute to the Working Group's considerations through the consultation process.

Yours sincerely



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