CORPORATE TAX
ASSOCIATION
of Australia Incorporated

9 February 2012

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

By Email: BTWG@treasury.gov.au

Dear Sir/Madam

**Business Tax Working Group (BTWG) Interim Report on the Tax Treatment of Losses**

The Corporate Tax Association (CTA) welcomes the opportunity to comment on the Interim Report on the tax treatment of losses (Report).

Before addressing the various options canvassed in the Report, we'd like to make a few points about the BTWG's terms of reference.

In making its recommendations to government on how the Australian business tax system can be improved, the BTWG must do so within the confines of revenue neutrality. Given this limitation, it is understood that choices will need to be made between various reform options.

Given the need to make these choices, it is difficult to be definitive about what we'd prefer by way of improvements to the tax treatment of losses without more information about the costings associated with each of the proposals set out in the Report. Other reform options, such as reducing the corporate rate, might be more highly valued by taxpayers. Or what we are asked to give up might not warrant making any change. To allow the CTA and others to make informed decisions, the BTWG has to be more forthcoming with this information. The timing constraints on the BTWG (as set out on page 34 of the Report) make this request all the more urgent.

**Decision Making and Tax**

As a general comment, the perceived bias against risk taking created by the current tax treatment of losses may be more theoretical than real. The headline tax rate is certainly factored into any financial modelling undertaken in respect of potential new investment, but businesses are expected to eventually return a profit. Most business analysis is predicated on success. The main exception to this general rule might be certain infrastructure projects that have long lead times and which typically experience changes in ownership as the risk profile of the project matures. Specific measures to modify the COT/SBT for these businesses were announced in the 2010 Budget.

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That being said, there is certainty significant scope to improve the existing tax treatment of losses.

**Element A – Removing the COT and SBT and introducing an alternative integrity test**

In our view, the COT rules have never been appropriate for publicly listed companies. Large businesses do not make acquisitions in order to access tax losses and nobody pays anything for the losses. Through the available fraction, consolidation represents a systemic integrity measure to prevent loss trafficking – if the acquired entity has a large balance of unutilised losses but a low market value, the acquirer will not enjoy the benefit of the tax losses for many years. The COT/SBT regime could therefore be safely done away with for 100 per cent acquisitions for consolidated groups.

To prevent inappropriate outcomes in the case of less than 100 per cent acquisitions, an available fraction style integrity measure could be designed or, alternatively, we could move to an arbitrary drip feed of 10 years (or some other period). For the sake of simplicity, and keeping in mind the costs and complexities associated with the consolidation available fraction rules, we would prefer a drip feed rule.

In our view, the introduction of either an available fraction or drip feed mechanism would remove the need for any kind of dominant purpose test, with all its attendant uncertainty.

Finally, any changes to the COT/SBT regime should be extended to the tax treatment of bad debts.

**Element B – Loss Refundability**

The CTA does not support the idea of allowing tax refunds for losses. No other country in the world has gone down this path and in our view such a policy would be open to serious abuse.

**Element C – Time limited loss carry back**

The CTA would support the introduction of some form of loss carry-backs, although the bulk of CTA members would not be prepared to give up much for it. This is because large companies, with only a few exceptions, do not regard the refund of tax paid in earlier years as critical to their financial survival. Accordingly, we would support loss carry-backs, but with a modest cap of, say $5 million all up. This would have the practical effect of limiting the cost of the measure (and reduce whatever large companies and others would have to give up) and focus the benefits on the SME segment, at least proportionally.

We think the carry-back period should be up to two years. One year may not be enough – particularly where a group moves from a taxable position to a small loss the following year and a much larger loss the year after that.

We consider the capacity to carry back losses ought to be limited by the company's franking account. With a two-year loss carry-back, we do not see the need to allow further time to amend prior year returns.

As a final point, although we note the BTWG has focused solely on companies, we consider it would be appropriate to broaden any loss carry-back measures to other legal forms in which business, particularly small business, is conducted. This would include trusts and sole traders.

**Element D – Applying an Uplift Factor**

The CTA supports an uplift in losses carried forward to preserve at least their nominal value over time. The uplift rate should be higher than the suggested risk-free government bond rate as the cost of capital for companies is higher than that.

**Scope of tax losses to which the new rules would apply**

Although we note that the Report proposes to limit any changes to new losses, to avoid the significant cost and complexities associated with having to manage two taxation systems, we urge the BTWG to consider the feasibility of allowing taxpayers to utilise existing losses via a drip feed mechanism over a period of 10 to 20 years.

At the very least, consideration should be given to simplifying the existing tax system so as to minimise compliance costs for those having to comply with two separate systems. Relaxing the SBT would be an obvious starting point.

**Black hole provisions**

On black holes, there should be immediate deductibility of closing down costs and the cost of unsuccessful ventures that have come to an end. In combination with a two-year loss carry-back rule, that might enable some taxpayers to get some economic benefit from those deductions, whereas a 5-year write-off is likely to put most of the tax benefit out of reach where a business is closing down.

Please feel free to contact either myself or Frank Drenth should you wish to discuss any aspect of this submission further.

Yours sincerely,

Michelle de Niese
(Assistant Director)