



16 January 2009

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

2009/10 PRE-BUDGET SUBMISSION

The Institute of Chartered Accountants in Australia ("the Institute") is pleased to provide the enclosed 2009/10 Pre-Budget submission.

The Institute is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 58,000 of today's and tomorrow's business leaders, representing some 46,000 Chartered Accountants and 12,000 of Australia's best accounting graduates who are currently enrolled in our world-class post-graduate program.

Should you wish to discuss any aspect of this submission, please do not hesitate to contact the Institute's Tax Counsel, Mr Yasser El-Ansary, on (02) 9290 5623.

Yours faithfully

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The Institute of Chartered Accountants in Australia

**PRE-BUDGET SUBMISSION 2009/10
TO FEDERAL GOVERNMENT**

16 January 2009



**The Institute of
Chartered Accountants
in Australia**

EXECUTIVE SUMMARY

Economic conditions

The Institute is very mindful of the challenges faced by the government in the current economic climate and recognises that there may be a need for further fiscal stimulus in the coming months. Such stimulus could potentially be delivered via the tax system.

In this context, we believe that the government needs to be willing and prepared to examine specific tax measures that may require prompt policy and/or legislative amendments in the coming months such as matters associated with debt/equity swaps, liquidations, losses, write-downs, certain reorganisations, etc that might not have been identified or given high priority in a prosperous economic climate.

Australia's future tax system (AFTS) review

At this point in time, a number of current major tax issues fall within the ambit of AFTS review therefore the Institute has not raised these again in this submission. However, the Institute does once again re-state our disappointment at the exclusion of the GST from the AFTS review.

Company loss and bad debt rules

Although arguably under the umbrella of the AFTS review, addressing the shortcomings of the company loss and bad debt rules has become even more pressing due to the prevailing economic climate.

The Institute therefore recommends that enhancement of the Same Business Test (SBT) should be considered in the context of the 2009/10 Budget. We also recommend that consideration be given to such things as allowing losses on start-up expenses for large scale infrastructure projects to be refundable, allowing consortium companies to flow through losses to their shareholders and introducing loss carry-back rules.

International tax

The Institute is eagerly awaiting the release of Board of Taxation's report on the foreign source income anti-tax-deferral regimes. We anticipate that the government response to the Board's recommendations will form part of the 2009/10 Budget process.

Carbon Pollution Reduction Scheme (CPRS)

There are aspects of the proposed taxation treatment of emissions permits in the government's White Paper that, in the view of the Institute, deserve further attention. We therefore look forward to participating in consultation on the exposure draft legislation for the CPRS due to be released in late February 2009.

Initiatives are required to encourage business take-up of green technologies and also R&D measures such as increasing the deduction on eligible "green" technology R&D expenditure to 200%. Other incentives could take the form of changes to existing capital allowance provisions, or via the introduction of specific provisions.

Managed investment trusts (MIT)

The Institute is concerned that the current MIT review by the Board of Taxation may not have the necessary time and resources to address all of the relevant trust issues for non-MITs, especially as they impact small to medium sized entities (SMEs). Therefore, the Institute believes that the government should devote resources towards working to correct the uncertainty which currently exists for SMEs around the use of trusts.

Small business specific issues

Small business specific issues are also within the ambit of the AFTS review. However, the Institute considers that some on-going small business issues should be considered in the context of the 2009/10 Budget. In particular, the government needs to consider the existing rules relating to trust losses, employee share schemes and non-commercial losses.

GST

The Institute looks forward to the finalisation of the review of the legal framework for the administration of the GST by the Board of Taxation. The Institute anticipates that the government will consider the recommendations of the Board as part of the 2009/10 Budget process, if not before.



Research & development (R&D) tax concession

The Institute is anticipating the release of the final report from the review of the national innovation system, which is considering, *inter alia*, the R&D tax concession. The Institute would welcome the government's response to those recommendations as part of the 2009/10 Budget process, if not before.

Announced but unenacted measures

The Institute considers that the government, while making good progress, needs to address some very important measures that remain unenacted, such as ones relating to foreign currency, consolidation and losses.

We believe that the government should once again complete a 'stock take' of tax measures at the upcoming Budget time. This process could include other issues that we believe have not been closed off in consultations that may need revisiting. The Institute also recommends that resources be specifically made available – as part of an on-going commitment by government – to ensure that tax changes are enacted as soon as practicable after announcement in order to provide greater certainty for businesses and taxpayers more generally.

Care and maintenance of the law

The Institute welcomed the recommendations of the Tax Law Design Panel, including giving greater priority to the ongoing care and maintenance of the tax system and the piloting of the Tax Issues Entry System (TIES).

However, over the coming months the government needs to be mindful and open to the possible need to urgently adjust aspects of recently introduced legislation.

Board of Taxation reviews

The Institute believes that the government should task the Board of Taxation with responsibility to undertake major post-implementation reviews on the both the debt/equity provisions and tax consolidation.



A. CONTEXT OF THE SUBMISSION

The Institute of Chartered Accountants in Australia (the Institute) is the professional body representing Chartered Accountants in Australia. Our reach extends to more than 60,500 of today's and tomorrow's business leaders, representing over 48,500 Chartered Accountants and 12,000 of Australia's best accounting graduates who are currently enrolled in our world class Chartered Accountants postgraduate program.

Our members work in diverse roles across commerce and industry, academia, government, and public practice throughout Australia and in 119 countries around the world.

We aim to lead the profession by delivering visionary leadership projects, setting the benchmark for the highest ethical, professional and educational standards, and enhancing and promoting the Chartered Accountant brand. We also represent the interests of members to government, industry, academia and the general public by actively engaging our membership and local and international bodies on public policy, government legislation and regulatory issues.

The Institute can leverage advantages for its members as a founding member of the Global Accounting Alliance (GAA), an international accounting coalition formed by the world's premier accounting bodies. With a membership of approximately 750,000, the GAA promotes quality professional services, shares information, and collaborates on international accounting issues.

The Institute has developed its public policy framework and conducts its engagement with, and advocacy to, government in the context of this framework. The Institute's policy position can be summarised as:

- Support for and advocacy of measures that enhance Australia's economic position as robust and globally competitive, fostering innovation, choice and flexibility;
- Advocacy of continuous improvement in the efficiency of Australia's taxation, superannuation and regulatory regimes and the elimination of regulatory duplication between Federal and State governments;
- Commitment to working with government in a pro-active way, not only to identify problems but also to propose solutions.

We strive to put forward thoughtful and rigorous views, which, whilst responsive to the immediate concerns of our members, are in the national interest as well as our own.

It is against this backdrop that the Institute's 2009/10 pre-Budget submission is presented to government.



B. TAXATION

1 Prevailing economic conditions

The Institute is mindful of the challenges faced by the government in the prevailing economic climate.

We recognise that there may be a need for the government to initiate further fiscal stimulus in the coming months, which could include further incentives delivered through the tax system (such as the recently announced temporary 10% investment allowance and the deferral of 20% of the upcoming PAYG liability for small businesses). The Institute welcomes those initiatives that encourage capital investment by business and ease the current cash flow burdens on small business.

In this submission, the Institute will not be seeking to pre-empt any further fiscal stimulus measures that may be contemplated by the government other than to say that other measures could include:

- Extension of the time period for the availability of the 10% temporary investment allowance announced on 12 December 2008 – broadly, the allowance is scheduled to run to 30 June 2009 and the assets have to be installed ready for use a year later, which rules out many major projects. In addition, many businesses may be in the position that they cannot bring expenditure forward to take advantage of the allowance at such short notice, particularly in light of the challenging economic times, including a shortage of credit (especially for small businesses).
- Extension of time for other businesses with turnover of >\$2m to make tax payments.
- Extension of the PAYG reduction for small business to the next quarter (March 2009).

One area that the Institute is currently focused on is the identification of tax issues that have been put on the 'backburner' during the recent 'boom years' but which may now become more urgent and important as a direct result of the altered economic climate. The Institute believes that the government will need to remain both willing and prepared to address specific issues that may emerge as requiring prompt policy and/or legislative attention in the short to medium term. For instance, matters associated with debt/equity swaps, liquidations, losses, write-downs and certain reorganisations etc might not have been identified or given high priority in a prosperous economic climate, but in the prevailing economic climate such issues may naturally become more significant to certain businesses.

We understand that the ATO is cognisant of this issue from a tax administration and advice perspective and in that spirit has invited National Tax Liaison Group members to communicate potential issues requiring close attention as they are identified.

2 Australia's future tax system (AFTS) review

At this point in time, a number of current tax issues fall within the ambit of AFTS review. The review panel is not expected to report back to government on this comprehensive review until the end of calendar year 2009.

The Institute and KPMG lodged a detailed joint submission to the review panel on 17 October 2008 entitled '*Thinking beyond borders - tax reform for the 21st century*'. In that submission the Institute focused principally on options associated with reforms to the taxation of capital and, in particular, reforms to the Australian corporate tax system.

As you will be aware, the AFTS review panel issued a consultation paper on 10 December 2008 and the Institute looks forward to continuing actively participating in the review, including the next round of consultation over the coming months.

Given the AFTS review is currently underway the Institute has not raised in this submission other specific tax issues which are considered to fall within the ambit of that review. Those specific tax issues include for instance, the [comparably high] corporate tax rate in Australia, the need for more generous capital allowances, the high level of taxes on capital, personal income tax rates, FBT and various state taxes. The Institute is hopeful that numerous issues such as these will be addressed as part of the AFTS review.



The Institute will however take this opportunity to once again re-iterate its disappointment at the exclusion of the GST from the scope of the AFTS review.

The Institute's comments on that part of the AFTS review that is focussed on the retirement income system will be contained in our forthcoming February 2009 submission to the review panel.

3 Company loss and bad debt rules

Although arguably under the umbrella of the AFTS review, addressing the shortcomings of the company loss and bad debt rules has become even more pressing in the current economic climate.

Firstly, the Institute considers that enhancement of the Same Business Test (SBT) rules cannot be delayed any further.

By way of reminder, in response to an invitation by the previous government, the Institute (together with a number of other bodies) lodged a submission on 31 January 2006 suggesting various ways in which the SBT could be improved. Although the \$100m cap was subsequently abolished, other important issues relating to the SBT are yet to be addressed.

The current global financial crisis has now led to the re-popularisation of equity financing over debt financing which thereby has put pressure on the ability of some businesses to satisfy the continuity of ownership (COT) provisions in some instances. In addition, as the SBT provisions require almost an identical business to be carried on, it is difficult for companies deriving losses to reorganise their business and attempt to trade out of a loss position back into a profitable position without potentially triggering some adverse tax implications.

It could be said therefore that the SBT operates in some instances as an impediment to helping business navigate their way through the difficult economic climate we currently face.

For these reasons, as well as those set out in our January 2006 submission, the Institute recommends that enhancement of the SBT be considered in the context of the 2009/10 Budget process.

The Institute also recommends that, in addition to those measures, consideration should be given to:

- Allowing losses on start-up expenses for large scale infrastructure projects to be refundable. Currently, many large scale infrastructure projects are carried-out through special purpose vehicles (SPVs) that often cannot be consolidated with profit-making companies in order to realise the value of the losses immediately (ie. the losses are trapped and realisation is delayed until the SPV generates taxable income at some point in the future). Alternatively, in other cases complicated – and expensive to setup and administer – structures such as operating companies and asset holding trusts are employed in order to create the ability to pass through losses to investors (even then investors may not have sufficient profits against which to apply the losses).
- Allowing consortium companies to flow-through losses to their shareholders, similar to the United Kingdom.
- Introducing loss carry-back rules.

4 International tax

The Institute is eagerly awaiting the release of the report of the Board of Taxation on the foreign source income anti-tax-deferral regimes, which we understand was delivered to the Treasurer in September 2008.

We lodged a substantial submission with the Board on 13 July 2007 and then a subsequent submission in response to the Board's position papers on 4 July 2008.

When announced by the previous treasurer on 10 October 2006, the objectives of the review were broadly stated to be focussed on reducing compliance costs for Australian businesses operating overseas, whilst also aiming to remove obstacles to their international competitiveness and continuing to counter tax deferral. Now, more than ever, this goal is crucial to Australian outbound investment businesses.



The Institute would welcome the release of the report and the government's response to the Board's recommendations as part of the 2009/10 Budget, if not before. Further resources should be made available by government to progress its objectives in implementing any recommendations emanating from this review (assuming of course that such recommendations will appropriately address the objectives of the review).

5 Carbon Pollution Reduction Scheme (CPRS)

On 10 September 2008, the Institute lodged a detailed submission on the tax issues of the proposed CPRS in response to the government's Green Paper that was released on 16 July 2008. This submission followed an earlier joint report by the Institute and Ernst & Young released in April 2008 entitled '*Australia's Proposed Emission Trading Scheme - The Tax Policy Dimension*', where it was stressed that the impact of such a scheme needed to be appropriately addressed by the Australian tax system.

As you will be aware, the White Paper was released by the government on 15 December 2008. In terms of that White Paper, there are still aspects that, in the view of the Institute, require greater attention. In the area of the taxation of emissions permits, we understand that further consultation is planned once exposure draft legislation for the CPRS is released in February 2009. Therefore, we will at this point just flag the importance of getting the tax treatment 'right' so as to avoid tax being viewed as an impediment to business take-up and participation.

One important issue in relation to which the White Paper is silent relates to initiatives aimed at encouraging business take-up of so-called "green" technologies. As detailed in the Institute's September 2008 submission on the Green Paper, we recommended that consideration be given to appropriate climate change tax incentives as part of the design and implementation of the CPRS.

The Institute also submitted that R&D measures that will support the large scale private investment required to meet carbon pollution reduction targets ought to be considered. Such measures could include increasing the deduction on eligible "green" technology R&D expenditure to 200% and either amending (or alternatively, removing altogether) thresholds applying to R&D Tax Offsets for companies developing green technologies.

Other incentives that could be considered by the government as part of its 2009/10 Budget deliberations include:

- Changes to existing capital allowance provisions.
- Introduction of specific provisions such as increased depreciation rates (either through asset-class specific rates or via a flat loading rate) applicable to emissions-reducing capital expenditure; such measures would need to specifically include expenditure relating to "add-on" or refitting of existing plant and equipment.
- Introduction of a targeted investment allowance.
- Amending the concept of 'taxable purpose' in the context of various provisions in the income tax legislation to expressly encompass activities that have the purpose of emissions abatement by a business.

The Institute believes that the introduction of such incentives should be considered as part of the 2009/10 Budget process given that the CPRS is scheduled to commence on 1 July 2010.

6 Managed investment trusts (MIT) review

The Institute welcomes the Board of Taxation's review of managed investment trusts and the interim changes made to Division 6B and 6C of the *Income Tax Assessment Act 1936*.

The Institute lodged a submission on 18 December 2008 in response to the Board's discussion paper entitled '*Review of the tax arrangements applying to managed investment trusts*'.

In its submission, the Institute noted the desirability of the Board exploring whether its recommendations can also be rolled-out across all Division 6 trusts, which are not MITs, given the current legislative uncertainty surrounding the taxation of the net income of trusts. However, whilst this would be desirable, the Institute is concerned that the MIT review may not have the necessary time and resources that will allow it to address all of the relevant trust issues for non-MITs, especially as they impact SMEs.

Therefore, the Institute asks that – at a minimum – the government undertakes to address and correct the uncertainty that currently exists for SMEs in respect of the use of trusts. In particular, the meaning of ‘income of a trust’, the treatment of capital gains, and various present entitlement issues should be closely reviewed given ATO practice in these areas is giving rise to significant uncertainty for commonplace family trust scenarios where it is generally accepted there is no mischief.

The Board is to provide a final report around the middle of 2009, therefore the Institute assumes that any recommendations adopted by the government will have to be held over until after the Budget.

7 Specific issues for small businesses

Small business specific issues are also within the ambit of the AFTS review and therefore the Institute will not include detailed discussion of these issues in this submission. That said, the Institute does however wish to make mention here of some on-going small business issues that we believe should be considered by the government as part of the 2009/10 Budget process:

- Trust loss rules – although there have been some positive changes made in response to the Institute’s submission of 16 November 2004, the amendments have only addressed a very limited number of our recommendations.
- Employee share scheme rules – consideration ought to be given to broadening their application to a wider set of circumstances and offering more incentives for employers and employees of small businesses to enter into such arrangements (especially during these difficult economic times given such arrangements do not require the outlay of cash by small businesses).
- Non-commercial loss rules – these rules can operate inappropriately in some circumstances, such as where an individual restructures the manner in which their business activities are carried on.

For completeness, the Institute’s joint study with Deloitte on an elective simplified entity flow-through regime for the taxation of SMEs has already been referred to the AFTS review by the Minister for Small Business. Therefore, we have not raised any specific issues or comments relating to those measures in this submission.

8 GST

The Institute welcomed the Assistant Treasurer’s announcement on 11 June 2008 of a review into the legal framework for the administration of the GST by the Board of Taxation. Having for some time sought a general post-implementation review of the GST legislation to deal with defects, inequitable outcomes and unnecessary complexities, the Institute believes such a review is well overdue. The importance of the Board of Taxation’s GST review has been further heightened by virtue of the fact that GST has been left outside the scope of the terms of reference of the AFTS review.

In response to the Board’s discussion paper, the Institute lodged a detailed GST submission on 15 September 2008 containing our key recommendations covering a number of broad areas including international transactions, going concern exemptions, enterprise and non-enterprise activities, creditable purposes, property, financial services, adjustments, barter transactions, incapacitated entities and general administration and compliance.

The Board was asked to provide a final report to the government by the end of December 2008. The Institute is eagerly anticipating the government’s response to the recommendations made by the Board as part of 2009/10 Budget process, if not before.



9 Research & development (R&D) tax concession

The Institute has welcomed the government's review of the national innovation system, which is considering, *inter alia*, the current R&D tax concession.

In our 3 October 2008 submission on the review panel's report '*Venturous Australia – building strength in innovation*', the Institute argued for simplification of the R&D tax concession and the removal of existing complexities and inefficiencies. The Institute's key recommendations addressed a number of broad issues including the proposed refundable R&D tax credit and its application to SMEs, the "on own behalf" test, the breadth of eligible R&D activities, the scope of eligible entities as well as enhanced incentives for climate change mitigation and/or adaptation technologies (in this respect, please also refer to our comments under section 5 above).

The Institute looks forward to the release of the final report from the expert review panel and the government's response to these recommendations as part of the 2009/10 Budget process, if not before.

10 Announced but unenacted measures

The Institute congratulates the government for some good progress that has been made in addressing announced but unenacted measures as they stood as at 13 May 2008, as set out in the joint press release of the Treasurer and Assistant Treasurer of same date entitled '*The Way Forward on Tax Measures Announced, but not Enacted, by the Previous Government*'.

However, whilst some good work has been done, there remains a number of very important measures that at this point in time are still unenacted. Three measures in particular stand-out to the Institute as requiring urgent attention in order to restore certainty for taxpayers, these are:

- Amendments to the foreign currency provisions announced on 5 August 2004.
- Consolidation amendments announced on 1 December 2005, 27 October 2006, 8 May 2007 and 20 September 2007.
- Losses (which is regrettable given the current economic climate).

There are also items that the government stated would be looked into from 2009, such as announcements in relation to certain aspects of the simplified imputation system and the 45 day rule.

The Institute believes it would be worthwhile for the government to again do a 'stock take' of tax measures at 2009/10 Budget time. Indeed, such a process would be in-line with one of the recommendations of the Tax Design Review Panel in its report entitled '*Better Tax Design and Implementation*' (released in August 2008) that the government should 'periodically review any stock of unlegislated announcements and provide certainty to the community by dealing with any measures that are not to proceed' (recommendation 21). The government has previously stated that it has accepted all of the Panel's recommendations in-principle.

Such a stock take of announced measures could also include other issues that the Institute considers have not been closed-off in consultations that may need revisiting. An example is Treasury's consultation in late 2006 in relation to the thin capitalisation provisions. Although various measures to deal with AIFRS have subsequently been enacted, in its 6 December 2006 submission the Institute made other recommendations such as suggesting a number of ways in which the 'arm's length test' could be improved to more appropriately balance compliance costs with the risk to the revenue.

The Institute also recommends that resources be specifically made available by Treasury, on an on-going basis, to ensure measures are enacted as soon as practicable following Ministerial announcement. Adopting such an approach will assist businesses – and taxpayers more generally – by providing much needed certainty, especially in an already difficult economic environment.



11 Care and maintenance of the law

The Institute welcomed the recommendations of the Tax Law Design Panel, which included giving greater priority to the ongoing care and maintenance of the tax system. As you will be aware, the Institute has long advocated for the government to devote resources to this function.

The government is now in the process of piloting the Tax Issues Entry System (TIES) to identify legislative and administrative issues relating to the care and maintenance of the Australian tax system. The Board of Taxation is to review the operation of the system after 12 months of operation, which the Institute supports.

However, over the coming months the government needs to be willing and prepared for the possibility of needing to urgently adjust certain aspects of recently introduced legislation. For example, *Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008* is a highly complex piece of legislation which introduces a whole new framework for the taxation of financial arrangements for affected taxpayers. In such a complex regime, there are likely to be urgent 'yet to be discovered' amendments that may be progressed in a more expeditious manner, outside the bounds of the new TIES system.

12 Board of Taxation reviews

The Institute believes that the government should task the Board of Taxation with the responsibility of undertaking two major post-implementation reviews on the debt/equity rules and tax consolidation.

We believe the review of debt/equity rules is necessary due to the significant number of interpretive issues that still exist within this area of the taxation law. Such issues should be identified by the Board during consultations and an assessment made as to whether the provisions are regarded as meeting their objective of providing a 'substance over form' approach.

The need for a separate review into tax consolidation emanates because the tax consolidation provisions were written mainly with a focus on formation cases. The passage of time has now revealed that a review is required into whether the consolidation provisions are operating appropriately in acquisition cases, and whether certain structural changes are required. By way of example, the review could potentially explore whether there is a case in support of moving to a full acquisition of assets and liabilities model, rather than an entry history model as is currently the case. Two other potential aspects of the provisions that could be reviewed are whether tax consolidation is interacting with the broader tax law appropriately, and whether the cornerstone principle of the single entity rule requires any amendment.

The Institute's request for these reviews falls in-line with the recommendation of the Tax Design Review Panel that the government should more frequently ask the Board of Taxation to conduct structured post-implementation reviews of major policy initiatives (recommendation 23 of the August 2008 report entitled *'Better Tax Design and Implementation'*). The Panel considered that such reviews by the Board should ideally be undertaken after around two to three years of the new initiatives coming into force. On the basis of that, reviews into the debt/equity rules and the consolidation provisions are already long overdue.

It is therefore the Institute's recommendation that, as part of the 2009/10 Budget process, the government allocate sufficient resources that will enable the Board to commence these new reviews, as well as assist with being able to progress and finalise other crucial reviews (such as that relating to managed investment trusts).