INTERNATIONAL
BANKS AND SECURITIES
ASSOCIATION OF AUSTRALIA

9 December 2005

Gary Banks
Chairman
Taskforce on Reducing the Regulatory Burden on Business
PO Box 80
BELCONNEN ACT 2616

Dear Mr Banks

Review of Business Regulation – Supplementary Information

Thank you for the opportunity to comment on the Commonwealth Government's initiative to reduce regulatory business costs for business and to meet with the Taskforce. We hope that the comments provided in our submission of 25 November are helpful to you.

Since we prepared the submission a number of issues have emerged that we believe are worth bringing to your attention (notably in regard to the operation of the Foreign Acquisitions and Takeovers Act). These are contained in the attachment to this letter.

This highlights the need for a long-term process to identify and deal with inefficient regulation on an ongoing basis.

Please do not hesitate to contact me if you have any queries regarding our comments in this letter.

Yours sincerely

Duncan Fairweather
Executive Director

Attachment

1. Foreign Acquisitions and Takeovers Act

Area of Concern

The Foreign Acquisitions and Takeovers Act (FATA) definition of a foreign person.

Way in which Regulation is Inappropriate

FATA [section 11(1)] considers both beneficial shareholdings and "legal" shareholdings (ie the registered shareholder) when determining if a substantial or an aggregate substantial foreign interest is held for the purpose of the Act.[1]

The implications of this include that all shares in a company held by a foreign-owned custodian are treated as foreign, even if the shares are held on behalf of Australian residents. Similarly, shares held by fund managers that are foreign owned but hold the shares on behalf of Australian residents are treated as foreign owned.[2] As a result, companies that are clearly controlled by Australians may be required to notify the Foreign Investment Review Board (FIRB) of certain acquisitions (set out in FATA) that they intend to make. For example, if they wish to participate in a project tender, they may have to include FIRB approval as a condition of their proposal.

This result seems contrary to both the Government's policy intention and it imposes practical constraints and a cost burden on Australian businesses participating in projects covered by the Act, company takeovers and investing in shares more generally.

Solution

An efficient short-term solution would be for the Government to make a regulation under s.39 of the FATA to prescribe for the purpose of s.11(5)(c) the interests in shares of persons who act in the capacity of a custodian or fund manager that is authorised to operate in Australia – that is, shares held by these persons would not be treated as foreign for the purpose of the test. A similar approach has been adopted in other parts of the law.[3]

A long-term solution would be to amend the FATA to bring it into line with commercial practice, so that only the beneficial owner of a share, and not the legal owner, is treated as holding the share. This would provide a truer picture of the foreign ownership of a corporation. This would also provide an opportunity to review a number of other matters, like reporting thresholds, given increasing globalisation of securities markets and in particular fund management.

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[1] In broad terms, if a person holds a substantial interest of 15% or more shares in a company, or if 2 or more persons hold an aggregate substantial interest of 40% or more shares in a company, then they will be taken to hold a controlling interest or an aggregate controlling interest in the company.

[2] FIRB has provided a partial solution by introducing regulations (effective June 2004) to allow for foreign custodians with an Australian Financial Services licence to apply for a certificate of exemption, which would allow companies to 'look through' the custodian to the underlying holders of the shares. However, this solution is outside the control of affected companies and, as far as we are aware, custodians typically have not used the exemption.

[3] The associates test in the s.128F interest withholding tax exemption recognises the non-beneficial capacity in which a custodian and fund manager will hold debentures.

2. Corporations Act – Recording of Resolutions

Area of Concern

Section 251A(3) of the Corporations Act requires a company to ensure that minutes of the passing of a resolution without a meeting are signed by a director within a reasonable time after the resolution is passed.

Way in which Regulation is Inappropriate

The practical effect of this section is that where a company passes a resolution of:

(i) The directors by circular resolution signed by some or all of the directors (in accordance with the company's constitution), the company is also required to prepare a separate minute repeating the same resolution wording and arrange for this minute to also be signed by one of the directors. This minute is then kept in the minute book together with the signed circular resolution;

(ii) A sole shareholder or multiple shareholders in writing, the company must include the wording "Signed as a minute in accordance with section 251A(3) Corporations Act 2001 (Cwth)" on the bottom of the written resolution and arrange for it to be signed by a director.

Solution

Section 251A(3) should be deleted as it is an administrative step that adds no value to the process of passing or recording a written resolution and is not seen to have any practical benefit, especially as most written resolutions are in respect of wholly-owned subsidiaries within a corporate group.

This amendment would not relieve a company from the requirements in s.251A (1) to keep in the company's minute book, a record of resolutions passed without a meeting, within a month.

3. Fringe Benefits Tax

Area of Concern

The fringe benefits tax (FBT) lodgement date for taxpayers with substituted accounting periods (SAPs).

Way in which Regulation is Inappropriate

The FBT year-end is 31 March for all entities and FBT returns must be lodged accordingly. This works well for taxpayers with an income tax year that ends on 30 June, as it allows three months to prepare the FBT return. However, for SAP taxpayers (eg with a December year-end), it can mean having to simultaneously manage both the FBT return and the income tax returns, which is a problem as only very large organisations have a separate FBT and income tax compliance team.[4] As a result, staff in some institutions must work very long hours for about six months of the year and then have a much lighter workload for the remaining six months.

A substituted accounting period is the standard arrangement for many US and European company groups, which must align their income tax year globally.

[4] The tax system is so complex for financial institutions that it takes the best part of 5 months to complete tax returns.

Solution

Provide SAPs with the option of a substituted accounting period for FBT purposes to spread the intra-year compliance burden on affected taxpaying entities. This would reduce operational risks arising from compressed schedules and would increase the potential to hire and maintain staff.

4. Taxation of Controlled Foreign Companies

Area of Concern

The controlled foreign company rules in the foreign accruals taxation system that taxes Australian residents on an accruals basis on their share of relevant income derived by foreign entities that has not been comparably taxed offshore.

Issue 1 *- Acquisition Timing and Profit Apportionment*

Under the controlled foreign company rules, Australian controllers of foreign companies may be attributed their share of the foreign company's annual profit. In broad terms the foreign company's profits are allocated to the Australian controller on the last day of the foreign company's accounting period (per s.456 of the Income Tax Assessment Act 1936). Where such attribution arises the amount attributed is based on the whole year's profits of the foreign company without any reference to the ownership period of the Australian controller. Thus, even if the Australian controller acquired the foreign company near its year-end, the amount on which the Australian controller will be taxed is calculated by reference to the whole year's profits of the foreign company.[5]

Solution

Australian controllers of foreign companies should be permitted to adopt some form of apportionment of the foreign companies profits in the year of acquisition.

Issue 2 *- "Control" and Profit Apportionment*

The amount taxed under the controlled foreign company provisions is generally determined on an Australian controller's ownership interest. The proportion of the profits that are attributed to the Australian controller is the higher of the percentage interest in capital or voting power or rights to distribution or capital (on winding up or otherwise).[6] However, where the Australian controller is treated as exercising "control" over the foreign company (eg control over decision making) then the Australian controller could be taxed on an amount greater than the ownership interest. Therefore, even if the Australian controller only has a minority economic interest, the Australian controller could be exposed to attribution of up to 100% of the CFC's profits.

Solution

The amount to be attributed to an Australian controller should be limited to the Australian's controller's economic interest in the foreign company.

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[5] Not all income is subject to such attribution. Income that is subject to such attribution is mainly passive income such as rent, royalties or interest income, and certain income from related parties.

[6] Section 356 of the Income Tax Assessment Act 1936.

Issue 3 *- Share Trading Profits as Passive Income*

Income that is subject to attribution under the controlled foreign company rules includes passive income such as rent, royalties and interest income, and also the buying and selling of "tainted assets". The definition of "tainted assets" in s.317 contains an extensive list of items, but specifically excludes trading stock. However, the trading stock exclusion does not extend to trading of shares in a company and units in a trust. Therefore the profits/losses arising for controlled entities offshore conducting a business of trading equities and equity derivatives are attributable to an Australian controller.

Solution

The legislation should be redrafted to extend the trading stock exemption included in the definition of tainted assets to cover trading in shares in companies and units in trusts (and related equity derivatives).

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