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4 November 2002

The International Taxation Project
Board of Taxation Secretariat
C/- The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sirs

Westfield Holdings Limited

Review of International Taxation Arrangements

We appreciate the opportunity to express our views on reforming the present international tax system to make it internationally competitive and enclose our Submission.

After your consideration of the matters raised, we would appreciate the opportunity to provide further input prior to your final recommendations to the Treasurer.

We look forward to discussing the Submission with you in the immediate future.

Yours sincerely
Westfield Holdings Limited

Per:

Marlon Teperson
Group Chief Financial Officer

Appendix

The Westfield Holdings Group

WHL is one of Australia's most successful companies. In the year to 30 June 2002, the Group announced its 42nd consecutive increase in profit with an after tax profit of A$234.2 million for the year.

Now in its 43rd year as a listed company, WHL is a fully integrated international developer, architect, builder, property manager and funds manager with A$31.5 billion of assets under management.

The Group currently operates in Australia, the United States, New Zealand and the United Kingdom and manages a portfolio of 109 shopping centres representing more than 8 million square metres of retail space and 16,500 retailers. By geographic location, over 50% of the Group's trading revenues are now derived outside of Australia.

The Group's portfolio of assets under management is split as follows (based on value):

Location	***Assets under management***	***Percentage***
Australia	A$10.3 billion	32.7%
United States	A$17.9 billion	56.8%
New Zealand	A$1.2 billion	3.8%
United Kingdom	A$2.1 billion	6.7%

WHL has over 33,000 shareholders. Its shareholder base is predominantly Australian with less than 15% of WHL's shares held by non-Australian residents.

The Group's principal source of income is from the development, construction and management of assets under its management, i.e. the shopping centres. The Group also derives income through funds management activities and equity investments. The Group's Australian income is derived from these activities as well as dividends and royalties paid from overseas.

For the year ended 30 June 2002, of the Group's profit after tax of A$234.2 million approximately A$118.6 million has been distributed to its shareholders by way of dividend payments (approximately 50%).

WESTFIELD HOLDINGS LIMITED

SUBMISSION

AN INTERNATIONALLY COMPETITIVE TAX SYSTEM FOR AUSTRALIA

1. Executive Summary

1.1 An internationally competitive tax system

The Australian Government has taken the first steps to make the Australian tax system internationally competitive; lowering the corporate tax rate, modifying the CFC and FIF rules for USA investments and negotiating a protocol to the double tax treaty with the USA.

In carrying out the present review the Government has indicated that these initial steps are to become part of a general policy commitment to provide Australia with an internationally competitive tax system.

The central theme for the new system is to be an internationally competitive holding company regime to foster Australians carrying on business overseas and to encourage foreign based businesses in locating their regional headquarters and other activities in Australia. This involves ensuring that the Australian tax system will not add to the risks of Australians carrying on business overseas by inefficient barriers, costs or taxes.

This submission is in response to an invitation from the Government for interested parties to comment on the design and content of the new system.

1.2 The competitors

In our view to be competitive Australia's new system must compete favourably with the systems of its competitors. Realistic benchmarks of competition exist in the systems of Germany, Ireland, Netherlands, Singapore, Sweden and the United Kingdom.

A unique system for Australia is required which in total compares favourably with those of its competitors. Headline corporate tax rates are not the only measure of competition. Rather than pursue nominal lower rates the system in our view first needs to be streamlined having regard to Australia's position in globalisation; efficiency needs to replace unworkable complexity.

1.3 The priorities

The first priority, in our view, should be to continue the removal of international anti-competitive tax barriers which the Government began in 1999 with a limited exclusion of investments in the USA. The second priority should be to facilitate Australian companies paying in total taxes a competitive global tax rate – with a bias to paying in the mix more, rather than less, Australian tax. The third priority should be to examine the alternatives for reducing the present tax disadvantage to shareholders of investing overseas.

1.4 The first priority – removing anti-competitive tax barriers

(1) The CFC rules

The CFC rules were originally anti-avoidance rules; over time the rules have become "anti-focussed".

To be competitive Australia must, in our view, abolish the rules or focus them on where there is an unacceptable risk of tax avoidance or deferral when the total costs (including tax) of carrying on business overseas are taken into account.

We suggest the CFC rules should be refocussed so that initially the rules have no application to CFCs resident in Canada, France, Germany, Japan, New Zealand, UK or USA where certain conditions are met or to a CFC resident elsewhere where the CFC pays an average tax rate of at least that nominated by the Government. Then, after a period determined by the Government, the rules should have no application to each of the other white countries listed by competitors (unless the Treasury is satisfied by then, that any particular country has an unacceptably high risk of tax avoidance).

(2) The FIF rules

The FIF rules were also originally anti avoidance rules; these too have become "anti-focussed".

To be competitive Australia must, in our view, abolish its FIF rules or focus them where there is unacceptable risk of tax avoidance.

We suggest the FIF rules should be refocussed so that they have no application to investments by listed companies or trusts, managed investment schemes or other collective investment vehicles. In this submission we raise other alternatives for consideration by the Government.

(3) Miscellaneous provisions

We detail in this submission a number of other existing provisions which we consider are anti-competitive and should be removed.

1.5 The second priority – facilitating Australian companies paying in total a competitive global tax rate

We suggest that the Government should have the objective of facilitating Australian companies paying in total taxes a competitive global tax rate, whilst maximising the Australian tax share of total worldwide taxes paid. It is the total taxes which is important - not a particular nominal tax rate on part of the income.

Most Australian double tax treaties have become uncompetitive and we suggest that the active, determined and targeted approach taken by the Government in negotiating the protocol to the double tax treaty with the USA should now be taken with the other treaties.

In this submission we list other areas for improvement. In addition we suggest Treasury should establish a formal procedure to carry out an ongoing review to ensure that everything is being done to achieve the Government's objective.

1.6 The third priority – examining the alternatives for reducing the present tax disadvantage to shareholders of investing offshore

Imputation of Australian paid taxes is embedded in the Australian tax system and we consider that adjusting for the lack of imputation on foreign paid taxes requires the cost to revenue of alternatives to be first determined.

Once the practical alternatives are known consultation can take place on the most suitable alternative for Australia. We see this as an Australia wide issue, rather than what is good for one particular company which carries on business outside of Australia.

2. An internationally competitive tax system for Australia

In October 2001 the Government in its paper "Securing Australia's Prosperity" committed itself to the reform of Australia's international tax regime.

The white paper "Removing Tax Barriers to International Growth" ("White Paper") made the following comment on the Government's paper:

> "That paper represents a major commitment by Government, potentially of strategic importance for Australia's direction, to realign Australia's tax laws to Australia's long-term objectives and desired position. This commitment should not be underestimated. With the focus of the Prime Minister and Federal Treasurer squarely on these issues, there is potential for major much-needed reform."

Subsequently, the Treasurer, Peter Costello said:

> "I want Australian companies to grow and remain headquartered in Australia. I want them to be internationally competitive and that is a big part of driving the review of international tax arrangements."

On 22 August 2002 in releasing the consultation paper "Review of International Taxation Arrangements" the Treasurer said:

> **"The review will build on the Government's achievements to date to give Australia an internationally competitive system."**

The Consultation Paper issued by the Commonwealth Department of Treasury ("Consultation Paper") provides:

> "To maintain Australia's status as an attractive place for business and investment, the tax system needs to continually adapt to the increasingly integrated global business environment.

> Australia also needs to be responsive to international trends and developments in other countries' tax systems, particularly those countries – such as the United States, Japan, certain European countries and New Zealand – which are a major source or destination of capital, and those countries which compete with Australia for investment and business."

This submission is in response to the Government's invitation to be part of providing Australia with an internationally competitive tax system.

3. The central theme – an internationally competitive holding company regime

The Government's central theme for Australia's new international tax system is a tax environment which:

- Fosters the international growth of Australian companies.
- Encourages the establishment of regional or segment headquarters in Australia for foreign controlled companies.

The first recommendation of the White Paper was:

> "Recommendation 1: An internationally competitive holding company regime
>
> The Australian Government should focus urgently on creating internationally attractive holding company tax regimes for:
>
> - Parent holding companies – an environment to encourage the parent holding companies of Australian-based international businesses to remain centred in Australia; and
> - Conduit holding companies – an environment to attract foreign-owned businesses to locate their regional headquarters and other activities in Australia."

The White Paper in commenting on the theme stated:

> **"The fundamental issue remains – how to sustain Australia's growth path by attracting and retaining high growth dynamic companies. That growth is needed to create employment and economic development."**
>
> "These issues are not just "big end of town" issues. They affect the formation of new and emerging businesses in Australia, and whether these remain in Australia or

whether their headquarters and commercial centres shift overseas to other commercial centres."

Many Australian companies, large and small, well established or just established carry on business overseas. An internationally competitive tax system is important for each of them. Carrying on business overseas has commercial risks not faced domestically. It is fundamental that these risks are not increased by an Australian tax system which imposes inefficient barriers, costs or taxes.

4. The priorities in designing a new system

In designing an internationally competitive tax system for Australia we suggest that it is first necessary to prioritise the areas for change.

In our view the priorities are:

Priority 1 – Removing anti-competitive tax barriers

The first priority should be the removal of those tax barriers which make Australia uncompetitive. These are largely anti-avoidance provisions which over time have become "anti-focused".

Priority 2 – Facilitating Australian companies paying in total taxes a competitive global tax rate

The second priority should be the provision of measures which facilitate Australian companies paying in total taxes a competitive global tax rate, whilst maximising the Australian tax share of total worldwide taxes paid.

Priority 3 – Examining the alternatives for reducing the present tax disadvantage to shareholders of investing overseas

The third priority should be to examine the alternatives for reducing the tax disadvantage to shareholders of investing overseas and then, to establish a timeframe for implementation of the most suitable alternative.

This priorisation accords with the following statements made by the Treasurer, Peter Costello:

July 2001 - "If you sit around a table of the developed countries of the world and the British and the French and the Germans and the Japanese and us, you would find that most of those countries are seeking to reduce their company taxes, their capital taxes and to some degree their income taxes."

"So if you think there is global competition going on in tax, and there is, and you think that Australia has to be competitive, what you will be doing…would be re-weighting, as I said, from direct to indirect."

August 2002 - After the Treasurer strongly defended dividend imputation, saying it was too entrenched in Australian society to be removed he said: "I don't see Australia moving away from that. It's so firmly fixed in our landscape," and "I think it is very much one of the reasons why Australian investors like equities."

The priorisation also accords with the White Paper:

> "In short, to encourage international businesses to locate in Australia, and to ensure that the international and regional headquarters of businesses are retained in Australia, we need to remove the uncompetitive barriers imposed by our international tax rules."

5. The timing for introducing the new system

The Government has already taken the first successful steps to make Australia's international tax system more competitive, including lowering the corporate tax rate, modifying the CFC and FIF rules in regard to investments in the USA and negotiating a protocol to the double tax treaty with the USA.

In carrying out the present review the government is ensuring that there is established a comprehensive policy commitment to make the Australian system competitive.

In our view the Priority 1 changes: removing anti-competitive tax barriers, should occur as soon as practical. These changes are within the powers of the Australian Government.

The Priority 2 changes: Australian companies paying in total taxes a competitive global tax rate, is an ongoing process and should commence as soon as practical. Some of these are matters within, and others without, the sole power of the Australian Government.

The Priority 3 changes: examining the alternatives for reducing the present tax disadvantage to shareholders of investing overseas, should first be the subject of detailed revenue costing and then the realistic options should be the subject of consultation. In this way the practically realistic alternatives are on the table. The time for introducing the change may be over several tax years.

6. Government revenue constraints

In designing a new system reference must be had to revenue constraints of the Government.

We consider that the constraints should not be barriers to the first priority: removing anti-competitive tax barriers. Any tax collected from the uncompetitive provisions is tax which should not be collected. There is no meaningful loss to revenue in not collecting tax from provisions which should not exist.

There are revenue considerations in implementing the second priority: facilitating Australian companies paying in total taxes a competitive global tax rate. It needs to be recognised in weighing up the costs and benefits, however, that this priority is about gaining revenue which might otherwise be lost by relocations or failure to locate in Australia and in increasing the tax base from the entities concerned. As has been demonstrated in Australia, a drop in the primary corporate tax rate, may produce the same or greater revenue.

The third priority: examining the alternatives for reducing the tax disadvantage to shareholders of investing overseas, involves dividend imputation which is well entrenched in the Australian system. Costing of options to remove the present tax disadvantage are necessary before a rational debate can occur on alternatives. The revenue achievable alternatives need to be first detailed so that the best realistic alternative is selected.

7. Providing Australia with an internationally competitive tax system

We suggest that there are three steps to take in providing Australia with an internationally competitive tax system.

- First, examine what the relevant Australian competitors are doing.

- Second, select the competitive features of the competitor's systems as are most suitable for Australia.

- Finally, improve on the selected features in fine tuning the provisions for the new system.

The White Paper contains this on the subject:

> "Throughout this paper, we compare our tax system with those of other countries. At the same time, we recognise that we need a solution tailored uniquely to Australia's position in the world. This is important to enhance Australia's growth opportunities and Australia's business influence internationally."

A competitive tax system is of necessity measured against the tax systems of relevant competitors. No two systems are the same and some aspects of one system may be more favourable to taxpayers than others. It is the total tax system which is judged against that of competitors and the priorities of the Australian Government.

An internationally competitive tax system is not a mediocre one but one which in some material aspects provides a competitive advantage over the systems of other competing countries. The advantage may not necessarily be measured in the head line primary tax rate being lower than the competitors, but in terms of a tax environment which is "friendly" to Australian companies carrying on business outside of Australia or foreign companies wishing to carry on business or invest in Australia. In this respect "friendliness" may be measured in a host of ways: minimum and efficient compliance requirements – certainty – simplicity – focused anti-avoidance provisions –

commercially realistic ATO rulings – prompt commercial legislature changes to meet global trends.

8. What are Australia's competitors doing

We reviewed six competitors of Australia, which we considered were relevant, to examine how they compete or plan to compete with Australia: Germany, Ireland , Netherlands, Singapore, Sweden and the United Kingdom.

Each of these countries have or are presently examining their systems to retain and attract international tax business.

- **Germany has recently announced international tax reforms to make it more internationally competitive.**

- **Ireland has announced that its corporate tax rate for 2003 will drop to 12.5%.**

- **Netherlands - In July 2001 James Hardie a long established Australian group, announced that it would establish a new parent company in the Netherlands. It was stated that this would allow the group to maintain a global tax rate of 25%-30% over the long term, as compared to a rate of 40%-50% should it remain in Australia (after Australia negotiated a protocol to the USA double tax treaty the 40%-50% rate was revised down to 36%-37%).**

- **Singapore has announced that its corporate tax rate for 2003 will drop to 22% and by 2005 to 20%.**

- **Sweden has recently introduced a series of measures designed to make it a more attractive headquarters location.**

- **The UK Government recently stated publicly that it wishes to make Britain the best place in the world for multinationals to locate.**

We have not in this submission set out the details of our review of the six competitors. Rather we have drawn upon the review in preparing this submission and refer to particular features of a competitor's system where we considered it helpful.

9. The first priority – removing anti-competitive tax barriers

Anti-competitive tax barriers include tax rules that are not competitive with Australia's competitors, and rules that impose unwarranted and undue compliance cost and burden on Australian taxpayers.

9.1 The CFC rules

(1) History of CFC rules

In the USA prior to 1963 the earnings of foreign companies generally were not subject to tax until remitted to USA shareholders. This changed with the introduction of CFC rules in Subpart F of Chapter N of the Internal Revenue Code.

Germany followed in 1972 with its CFC rules and the UK in 1984.

Australia adopted CFC rules in 1991.

Since then a number of countries have adopted CFC rules in one form or another. There are, however, a large number of European countries that have no such rules eg Austria, Belgium, Greece and Italy.

Even in those countries with CFC rules there is a substantial variation in the content of the rules, the exemptions and practical enforcement. For example, the UK in the period from 1984-1999 had very strict CFC rules but in practice they were only invoked in limited circumstances determined by the Inland Revenue.

(2) The CFC rules in the six competitors

Ireland and Singapore do not have CFC rules.

Netherlands has CFC rules but these are generally not applicable to foreign holding companies or to companies that have a function in the company group and are not merely investors in unrelated passive investments.

Accordingly each of those three countries tax system provides a material competitive advantage over Australia.

Germany, Sweden and the UK have CFC rules. But each has a large number of exclusions or qualifications so that the rules have limited operation, if any, for most companies carrying on business outside the country's borders.

For example in the UK the CFC provisions **do not apply** if any of the following tests are satisfied:

- The CFC is liable to tax in its country of residence which is at least equal to 75% of the tax that would have been payable in the UK under UK law (eg 22.5%).
- The CFC remits by way of dividend a certain proportion of its profits to UK residents.
- The CFC carries on business of an approved nature in the foreign country in which it is resident.
- Shares in the CFC are listed on a recognised stock exchange.
- The profits of the CFC for a 12 month period do not exceed a specified de minimis amount.
- The existence of the CFC, and the transactions which it undertook were not designed to avoid UK tax by diversion of profits out of the UK.
- The CFC is resident and carries on business in any of 74 listed countries (subject to certain conditions).

The UK tests have the effect of focusing the application of its CFC rules on unacceptable tax avoidance risks.

Sweden

In Sweden a Swedish resident company that owns an interest in a foreign entity is subject to Swedish tax on its share of the foreign entity's worldwide profit if, at the end of the calendar year, the Swedish company alone, or together with related companies, holds at least 10% of the capital or voting rights in the foreign entity and Swedish residents control directly or indirectly at least 50% of the capital or voting rights of the foreign entity. This legislation has no application if the foreign entity satisfies either of the following conditions:

- It is subject to an income tax imposed by its home country that is similar to the Swedish corporate tax. An income tax rate of 10%-15% computed in accordance with Swedish accounting and tax rules, will be similar to the Swedish corporate tax.

- It is resident in a tax treaty country that is included on a Swedish legislative "white list", and it derives its income in that country, or in other white list countries. The white list includes all of Sweden's tax treaty countries, except Australia, Cyprus, Malaysia, Spain and Thailand.

Germany

In Germany the Foreign Tax Law provides for a deemed distribution of certain retained profits derived by "intermediate companies" (Zwischengesellschaften) in low-tax countries (Secs. 7-14 AstG).

The provisions apply if:

- One or more German residents hold in total directly or indirectly more than 50% of the share capital in the foreign company. (Sec. 14 AStG);

- The intermediate company yields passive income; and

- The passive income is subject to a foreign tax rate of less than 25% (30% before 2001).

Passive income comprises mainly interest and royalties. It can also include income from leasing under certain circumstances, especially if the activities are carried out with the assistance of German related companies and if the foreign intermediate company does not have sufficient economic substance.

Since 1 January 2002 dividends are generally classified as active income, and therefore exempt from CFC attribution. Previously dividend income was active where it was derived from active subsidiaries resident in the same country as a holding company CFC.

The rules do not apply to some CFCs deriving passive income if the actual dividend paid by the CFC is exempt from tax to the German parent under the relevant double tax treaty.

The deemed dividend rules do not apply if the passive income does not exceed EUR 62,000 or 10% of the total gross income of the intermediate company (Sec. 9 AstG).

Passive income that is treated as a deemed dividend must be determined according to German tax and accounting rules. The taxpayer can choose between an income calculation on a cash basis or on an accrual basis. Foreign taxes are deductible (Sec. 10 AStG).

(3) UK is the least competitive of the six competitors

From our review of the CFC provisions of Germany, Sweden and UK - the UK has the most draconian CFC rules.

It must be noted, as mentioned earlier, that unlike Australia the CFC rules of a foreign country may not be applied in practice. The position in the UK from the introduction of the rules in 1984 to 1999 has been summarised as follows:

> "Although the (UK) legislation was draconian and subject to various exemptions potentially applicable to all non-UK companies "controlled" by persons resident in the United Kingdom, in practice its application was severely restricted because it applied only upon direction being made by the Board of Inland Revenue."

5 June 2000 Tax Notes International at 2527

In 1999 the position in the UK changed with the introduction of self assessment.

Given that three of the competitors have no CFC rules for foreign multinationals, of the remaining three, the UK has the least competitive CFC rules.

(4) The USA exemption from Australian CFC rules

In 1999, as a step to make Australia more competitive, the Government amended its CFC rules to provide a qualified exemption for investments in real estate investment trusts in the USA which met certain conditions; s356(4A) ITAA 1936. This Government initiative has proven successful.

(5) Australia is even less competitive than the UK

The Australian rules have a wider scope than the UK rules and a more limited list of exemptions.

Of the UK exemptions listed at 9.1(2) the following are particularly noted:

(a) The white countries exemption

Two conditions must be satisfied for this exemption to apply.

First, the CFC must be resident in one of the 74 listed white countries and satisfy certain conditions. A company is treated as a resident in a country if, under local law, it is liable to tax there by reason of domicile, residence or place of management. Failing that, where a country does not impose tax by reason of one of those criteria, a company is treated as resident where it is incorporated.

Second, 90% of the income of the CFC determined according to generally accepted commercial accounting standards (but disregarding any profit or loss of a capital nature) must be locally sourced income. For this purpose locally sourced means income which is treated under a country's own laws as accruing in, arising in or being derived from the country and which is within its charge to tax (actually chargeable there or covered by a specific exemption from the general charge).

(b) Acceptable dividend policy exemption

A CFC is exempt from the CFC rules if within the relevant accounting period or 18 months thereafter it pays at least 90% of its chargeable profits to UK residents.

(c) The anti-avoidance exemption

If a CFC fails to satisfy any of the other exemptions there is a catch all exemption if it was not a main reason for the CFC's existence or transaction in question to achieve a reduction in UK tax by diverting profits from the UK.

(6) How should the Australian CFC rules be amended

We suggest that the Australian CFC rules should be amended in two stages.

The first amendment should commence as soon as practical and provide an exemption from the CFC rules in respect of the following entities:

(i) An entity resident in any of Canada, France, Germany, Japan, New Zealand, UK or USA where not less than 90% of its income determined according to generally accepted commercial accounting standards (but disregarding any profits or loss of a capital nature) is local source income or foreign source income subject to tax at an average rate of tax nominated by the Australian Government or the average worldwide tax rate on its local and foreign sourced income is not less than such average rate.

For these purposes:

(a) "Local source income" means income which is treated under a country's own laws as accruing in, arising in, or being derived from that country and which is within its charged tax ie is actually chargeable there or covered by a specific exemption from the general charge.

(b) "Residence" means if under local law the entity is liable to tax there by reason of domicile, residence or place of management. Failing that, where a country does not impose tax by reason of one of those criterion, a company would be treated as resident where it is incorporated. Any other entity would be treated as resident where it is created or established.

(ii) An entity where:

(a) Not less than 90% of its income is derived directly or indirectly from an entity referred to in (i) and is paid as a distribution to Australian shareholders within 12 months of year end; or

(b) Not less than 90% of its income is locally sourced in Canada, France, Germany, Japan, New Zealand, UK or USA and is paid as a distribution to Australian shareholders within 12 months of year end.

(iii) An entity which pays worldwide tax at an average rate of not less than the average rate of tax nominated by the Australian Government.

The second amendment should commence as soon as practical after the first change and extend the countries named in (i) above to each of the other countries on the white list of competitors (unless Treasury has in the meantime satisfied itself in respect of a particular country that the opportunities to engage in material international tax avoidance or deferral are unacceptably high when the total cost (including tax) of carrying on business overseas is taken into account).

(7) Consequential amendments to branch profits exemptions

The branch profits exemption in s23AH and in the CFC provisions (s403) should be extended to all profits derived from carrying on activities in an exempted country.

9.2 The FIF rules

(1) History of FIF rules

The FIF rules were introduced in Australia in 1992 after the CFC rules, following a series of Information Papers released by the Government. The Information Papers discussed systems in other countries for attributing foreign source income to prevent perceived tax advantages in residents deriving passive income offshore.

The genesis of the FIF system was the Canadian offshore investment fund rules. The Canadian rules were designed to prevent the accumulation of passive income in low tax foreign jurisdictions. These rules apply only to interests in offshore entities where:

> "One of the main reasons for the taxpayer acquiring, holding or having the interest in the entity is to derive a benefit from investments such that the taxes, on the income, profits and gains from the fund are significantly less than the tax that would have been applicable if such income, profits and gains had been earned directly by the Canadian taxpayer", s94(1) Income Tax Act (Canada).

The Canadian Department of Finance has recently announced amendments to the FIF rules by replacing the deemed rate of return attribution method (formerly the sole attribution method) and motive test with a rule that assesses an investor's share of the profits and gains of the offshore entity, with credit allowed for foreign taxes paid by the entity. A fallback market value method has also been adopted.

Unlike the CFC rules – similar FIF rules have only been adopted in a small number of countries.

(2) The FIF rules of the six competitors

Ireland, Netherlands, Singapore and Sweden do not have FIF rules.

Germany has a set of rules in limited form for attributing income from low-taxed passive foreign investment companies to German resident shareholders.

UK has only a modified form of FIF rules.

(3) The UK rules

The UK is presently reviewing its system which was introduced in 1984. The British Government now believes that system may no longer be the best way to achieve the aim of preventing investors using offshore funds to reduce the tax they would otherwise pay on their savings. The system was designed primarily to prevent investors disposing of the investment (with the inbuilt accumulated income) and paying a lower capital gains tax rate. It introduced the concept of "qualifying" and "non-qualifying" offshore funds. Corporate taxpayers apart, investors in qualifying funds are subject to income tax on income arising from the fund; and to capital gains tax on any gain they realise when they dispose of their interest in the fund. However, investors in "non-qualifying" offshore funds are subject to income tax when they make a disposal. No distinction is made between the income and capital accumulated in the fund.

(4) The USA exemption from Australian FIF rules

The Australian Government in 1999 began the modernisation of the FIF rules with an exemption from the Australian FIF rules enacted in respect of the USA; s513 ITAA 1936. This provided an exemption for investments in an entity that is treated as a corporation subject to tax on worldwide income under the USA Internal Revenue Code or a regulated investment company or real investment estate trust.

This Government initiative began the movement for removing anti-competitive tax barriers from Australia's international tax system.

(5) The Australian FIF rules are uncompetitive

Even with the USA exemption and other exemptions the Australian FIF rules are uncompetitive when compared with the six competitors reviewed.

(6) How should the Australian FIF rules be amended

We suggest that as soon as practical the FIF rules should be amended so that they have no application to Australian listed companies or trusts, managed investment schemes or other collective investment vehicles.

We also suggest that if the FIF rules apply, a taxpayer should be free to choose a deemed rate of return method calculated by reference to 13 week Treasury Note rate and not the present deemed rate. In considering other alternatives consideration could be given to a taxpayer being free to elect in the year of investment whether to be subject to the FIF rules or not. If the taxpayer elected to be subject to the FIF rules the taxpayer would be entitled to the discount capital gain.

9.3 Miscellaneous anti-competitive provisions

(1) Treatment of limited partnerships established in broad exemption listed countries.

Limited partnerships are often the preferred ownership vehicle for commercial real property located in foreign countries, including the UK and the USA.

Under Australian tax law, limited partnerships are treated as a companies for Australian tax purposes. Thus, a foreign limited partnership is treated as a company for the purposes of the CFC rules. However, according to draft Taxation Determination TD2001/D14, a UK or USA limited partnership will be treated as a resident of no particular unlisted country unless the limited partnership itself is subject to tax in the UK or the USA as appropriate. As UK and USA limited partnerships are generally treated as "look through" entities in their home jurisdiction, they do not satisfy the ATO's "subject to tax" requirement.

In the Consultation Paper it is stated that consideration is being given to amending the Australian tax law in relation to the treatment of limited partnerships. It is possible that the amendments may be to treat Limited Partnerships as "look through" entities for Australian tax purposes. This "solution" will be based on the current law.

If the outcome of the current review of Australia's international taxation arrangements provides a more favourable outcome for the treatment of entities established and carrying out activities overseas, taxpayers should be able to avail themselves of this outcome.

(2) Flow through of Exempt Dividends

It is current policy that certain non-portfolio dividends paid to companies are treated as exempt income for Australian tax purposes. Under s.23AJ, a non-portfolio dividend paid directly to an Australian resident company by a company that is a resident of a listed country is exempt from Australian income tax.

Similarly, under s403 a non-portfolio dividend paid to a CFC resident in a listed country by a company that is also resident in a listed country is not attributable income of the CFC.

However, the exemption in s.23AJ and s403 does not apply where the non-portfolio interest is held indirectly through a trust. In other words, the interposition of a trust disentitles a corporate beneficial recipient of a non-portfolio dividend to the exemption notwithstanding that the corporate beneficiary indirectly holds a non-portfolio interest in the underlying company.

This positions potentially applies in bare trust or nominee situations as well as for holdings in unit trusts.

We suggest that the dividend should retain its character as an exempt dividend on distribution by the interposed trust regardless of whether the trust is a bare trust or a unit trust.

(3) Functional currency rules for CFC attribution calculations

Where a CGT event has occurred in relation to a CFC, the calculation of a capital gain to be included as attributable income picks up the foreign currency conversion rules in the CGT provisions. That is, the disposal proceeds for an asset is converted to Australian dollars at the disposal time and the calculation of the cost base of the asset converts the purchase price to Australian dollars at the acquisition time.

As a result, there can be capital gains (and thus attributable income) on transactions entered into by a CFC which are due solely to exchange rate movements (ie there is no gain in the functional currency) and no economic gain to the CFC.

Moreover, because CGT assets include assets such as loans and other receivables, capital gains can arise by reason of the mere receipt of such amounts by a CFC where they are denominated in the functional currency of the CFC.

We suggest that CFC rules should be amended such that all capital gains and capital loss calculations are done in the functional currency of the CFC and only the net capital gain is converted to A$.

(4) Bare trusts and nominee arrangements

For the purposes of the FIF measures, s484 provides that the existence of nominee arrangements or bare trusts are to be disregarded such that the beneficial owner of the relevant FIF interest is the entity to which the FIF rules apply.

There is no comparable provision in the CFC rules. Accordingly, there is a technical risk that the existence of the nominee or bare trust should be recognised in applying the CFC measures. The resulting complexity and attendant compliance costs are not justified by any Australian revenue benefit.

We suggest that nominee or bare trust arrangements be ignored for the purposes of the CFC rules.

(5) Division 6C

At present Division 6C of Part III of ITAA 1936 provides an anti-competitive tax barrier to Australian listed property trusts investing offshore.

For example where the Trust controls a REIT in the USA the REIT must observe its own REIT requirements and also those of Division 6C. This causes unnecessary overlapping.

If an Australian investor chooses to invest directly in a REIT and not through an Australian listed property trust the Division is not relevant.

We suggest this anti-competitive barrier should be removed.

(6) Residence of overseas corporations

We suggest that the residence of an overseas corporation should be determined by reference to its place of incorporation.

10. The second priority – facilitating Australian companies paying in total taxes a competitive global tax rate

10.1 In total - a competitive global tax rate

Australia at present has a corporate tax rate of 30% compared to the rate in 2003 for the six competitors.

Germany	25%
Ireland	12.5%
Singapore	22%
Sweden	28%
UK	30%

We have not included Netherlands in the list because the rate for foreign holding companies is effectively substantially less than 20%. USA has a federal tax corporate rate of 35%; in addition there are state taxes.

Lower nominal rates of tax can be misleading. The absence of deductions and the existence of other taxes (eg withholding taxes) may significantly increase the effective tax rate to Australian companies and shareholders.

Rather than concentrating too much on the headline tax rate we suggest that the Government should at this stage take steps to make Australia's international tax system an "internationally friendly environment" for Australian business to carrying on business overseas and foreign businesses wishing to establish regional headquarters or carrying on activities in Australia. By "internationally friendly environment" we mean an environment which compares favourably with the competitors in fostering local companies to carry on business overseas and foreigners to locate business locally. This may be measured in compliance costs, focused anti-avoidance provisions, commercial ATO rulings and a willingness to change to global trends.

10.2 Measures Australia can take to make its system more internationally friendly

There is often a number of reasons why the average tax rate of a corporation may exceed a competitive global tax rate:

- The corporate tax rate of the foreign country where business is carried on.
- Withholding taxes on dividends, royalties and other payments of the foreign country to Australia.
- The non existence or immediate unavailability of foreign tax credits in Australia.
- The operation of transfer pricing provisions.
- The operation of Part IVA.

We suggest that the above be reviewed and steps taken (including the following):

(a) Ongoing review by Treasury

We suggest there should be established an ongoing review by Treasury to identify measures that can make Australia's system more internationally friendly. A formal consultation process should be established to deal with substantive practical matters, not just technical tax defects. In this way action is instigated as soon as possible and a form established for a joint approach to the issue.

(b) Double tax treaties

(1) Withholding tax rates in treaties

Australia's double tax treaties have become uncompetitive.

For example the foreign DWT paid on non portfolio dividends is as follows:

Payer	**Recipient**	**Rate**
US	UK	0%
UK	US	0%
Any EU country	Another EU country	0%
Most EU countries	Australia	10% to 15%

(2) The process in negotiating treaties

The Government's lead in negotiating the protocol to the US double tax treaty should we suggest now be extended to Australia's other tax treaties.

Confidentiality and Government priorities can be maintained whilst consulting with business on changes to double tax treaties which might have an adverse or favourable effect.

We suggest that the consultation process must be real issues and not confined to technical tax issues.

(c) Australian withholding tax

Most Australian withholding taxes on interest and royalties are added to the business expense charged by foreigners.

We suggest that Treasury should consider ways of eliminating these taxes or providing an alternative system.

(d) Transfer pricing

We suggest the objective of the existing transfer pricing provision should be realigned with the objective of facilitating Australian companies paying total taxes at a competitive global tax rate.

In considering the various ways to structure a transaction the transfer pricing provisions should be applied with regard to this objective.

(e) Part IVA

We suggest that in administering the general anti avoidance provisions of Part IVA of ITAA 1936 regard should be had to this objective, so that even if a transaction may result in less Australian tax than an alternative way, there is no tax avoidance if the transaction is structured so as not to pay more than the competitive global tax rate determined by the Australian Government.

11. The third priority – examining the alternatives for reducing the present tax disadvantage to shareholders of investing offshore

We consider that there would be strong resistance to any change to Australia's present imputation system, and if so, the issue is what would be the additional costs to revenue of modifying the tax disadvantage to shareholders of investing overseas.

We suggest that the first step is for Treasury to calculate the likely cost to revenue of the alternatives. When this costing is made available then a consideration of realistic options can take place. In our view the costing and consultation should be part of the present review; which may require the date for reporting on this aspect to be extended to adequately develop and consult on these alternatives.

The most suitable alternative is an Australian wide issue, not just an issue of what is good for a particular company.

We set out below our comments on options A, B and C referred to in the Consultation Paper and their impact on Westfield Holdings Limited.

(a) Option A

Option A applies to give a credit or exemption to a shareholder of a resident company for dividends paid by the company out of foreign source income.

Provided the exemption/credit was at 30%, the Australian shareholder should be in a neutral position as between investment by the resident company in Australia or offshore. However, once one moves from a full credit to a partial credit the bias remains.

Therefore, under the $1/9^{th}$ credit suggested in the Consultation Paper (i.e. 10% of the grossed up dividend), a significant bias remains.

Given Westfield's predominantly Australian shareholder base, Option A would be the most preferrable option.

(b) Option B

Option B allows for streaming of foreign source income to non-resident shareholders. This option is most beneficial where the percentage of foreign income equals the percentage of non-resident shareholders. Westfield is not in this position. While the option would be of benefit as compared to the current system, Option A preferred.

(c) Option C

Option C provides for franking credits for foreign dividend withholding tax. We agree with the Consultation Paper that Option C would be of limited benefit and should not be pursued.

Westfield Holdings Limited
4 November 2002