



AUSTRALIAN BANKERS' ASSOCIATION INC.

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The Hon Peter Dutton MP
Minister for Revenue and the Assistant Treasurer
Room M1.22
Parliament House
CANBERRA ACT 2600

Dear Minister,

**Taxation of Financial Arrangements
Positive impact on the Revenue**

I refer to my letter to you of 1 March 2006, which enclosed the submission ("**Submission**") by the Australian Bankers' Association Inc. (the "**ABA**") on exposure draft legislation which contains proposed reforms to the taxation of financial arrangements ("**TOFA**").

The purpose of this letter is to provide you with further information in relation to the Revenue impact of the TOFA reforms.

As noted in Appendix 1 to the Submission, the TOFA reforms should be revenue-positive for the Government. That is, on an overall basis, taxpayers will return taxable income from financial transactions earlier as a result of TOFA than would otherwise have been the case. The ABA does not take issue with this outcome.

In footnote 3 to the Submission (page 33) the ABA noted that, given the size of the economy and the volume of interest/discount bearing instruments held by non-accruals taxpayers, the revenue-positive nature of TOFA may be considerably higher than the 1999 estimates produced by the Ralph Review of Business Taxation, i.e. potentially multiples of those estimates.

We now wish to advise you of another revenue-positive aspect of TOFA, which does not appear to have been taken into account in the 1999 estimates at all.

Under current law, in relation to derivatives and various foreign currency denominated transactions, banks and other taxpayers use "realisation" or "accrual" methods (rather than a fair value method), to recognise assessable income and allowable deductions for tax purposes.

Two of the proposed TOFA reforms, which the ABA supports, are the use of fair value and retranslation elections for tax purposes, which will achieve consistency with financial accounting rules. In addition, it is expected that the new TOFA rules, for ease of compliance reasons, will allow taxpayers to elect to apply the new rules to pre-existing transactions.

Four leading members of the ABA have indicated to the ABA that they propose to make the fair value and retranslation elections, and that they intend to make the transitional election to include pre-existing transactions within the new system. (This assumes that the "direct link" approach – see below – is not introduced).

In aggregate, these four members have indicated that they currently have a deferred tax liability in relation to such pre-existing transactions of approximately \$1 billion. In other words, *if* fair value and retranslation methods currently applied for tax purposes, they would have paid \$1 billion more in tax than they have in fact paid. That is, the current absence of these rules has allowed tax to be legitimately deferred until a future time.

For these four members, the consequence of adopting the transitional election is that, indicatively, \$1 billion of tax will be brought forward by them over a 4 year period (being the proposed period over which an elective transitional balancing adjustment will be spread), i.e. approximately \$250 million per annum.

Again, the banks do not take issue with this acceleration of tax payments: it is a consequence of a more rational set of tax rules.

However, in light of this major acceleration of tax payable, the banks seek your further consideration of the "direct link" approach to TOFA reform as set out in the Submission, so as to ensure that TOFA is implemented in the most efficient and "compliance cost friendly" manner possible. We stress that the revenue-positive "dividend" described above will also arise under the "direct link" approach.

We look forward to ongoing close consultation with you, your advisers and Treasury in relation to the TOFA reforms.

Yours sincerely,

Tony Burke

Cc: Mr Philip Lindsay, Senior Taxation Adviser, Office of the Minister for Revenue and the Assistant Treasurer