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From: @ato.gov.au]
Sent: Thursday, 9 August 2001 4:20
To: (Treasury)
Subject: FW: Debt and Equity/Thin Cap - some queries

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KPMG Submission (Part 1)

Regards

-----Original Message-----

From: @kpmg.com.au]
Sent: Thursday, 19 July 2001 11:47
To: @ato.gov.au'; @ato.gov.au'
Cc: @ato.gov.au';
Subject: Debt and Equity/Thin Cap - some queries

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- > We refer to recent discussions between yourselves and of KPMG
- > Sydney in relation to the New Business Tax System (Debt and Equity) Bill
- > 2001 ("the debt/equity Bill") and the New Business Tax System (Thin
- > Capitalisation) Bill 2001 ("the thin cap Bill"). At the request of
- > , we have outlined below some of our observations/questions in writing
- > in relation to the two Bills. We note that there are other issues we
- > would also like to raise with you for clarification. We will forward
- > these other issues to you as soon as possible.
- >
- > Specifically, this note deals with the following:
- >
- > * Treatment of leases;
- > * Income received in advance;
- > * The application of the new Section 25-85 of the Income Tax
- > Assessment Act 1997 ("the 1997 Act");
- > * Related schemes; and
- > * Losses and debt deductions
- >

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> New Section 25-85

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> We note that the wording of new Section 25-85 of the debt/equity Bill has
> changed from the Exposure Draft. Would it be possible for you to provide
> us some insight as to the rationale for the change? Further, what is the
> ATO's view on dividends paid on preference shares. For example, are
> dividends paid, (where, firstly, the dividend is linked to an interest
> rate or secondly, is at the discretion of the directors of the company) in
> respect of preference shares with a term of say less than 10 years (i.e.
> the debt interest definition appears to be satisfied), deductible under
> Section 8-1 of the 1997 Act with the assistance of the new Section 25-85
> inserted by the debt/equity Bill?

>

> We have significant concerns on whether a deduction may be claimed for the
> dividend paid on the preference share (refer above) as the reasons
> mentioned in Section 25-85(2) might not be the sole reasons that preclude
> a "dividend" from a deduction under the general provision of Section 8-1
> of the 1997 Act.

>

> Generally, the new Section 25-85 of the 1997 Act provides that a return on
> a debt interest is not prevented from being a general deduction merely
> because of two reasons:

>

> * the return is contingent on the economic performance of an entity;

> or

> * the return secures a permanent or enduring benefit.

>

> However, if there are reasons, other than the abovementioned two, why the

- > return on a debt interest is not deductible under the general provision
- > of Section 8-1, then the return on a debt interest cannot be deducted.
- >
- > Could it be argued that the dividend paid on the preference share is not
- > incurred in gaining or producing assessable income as the payment was
- > incurred too late in the process of income production (this being
- > different to a return made that is contingent on profits or securing an
- > enduring benefit) and therefore is still not deductible under Section 8-1?
- >
- >
- > It seemed clear that the original intention was that the dividend on a
- > redeemable preference share (that is a debt interest under the new rules)
- > should generally be tax deductible. Given the change to Section 25 -85
- > from the Exposure Draft, does the ATO believe that a deduction is still
- > available for a dividend in respect of a non-equity share such as a
- > redeemable preference share?
- >

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