

Document 6
Mallesons Stephen Jaques
S O L I C I T O R S

Messrs and
Commonwealth Treasury
Computer Associates House
Corner National Circuit and Brisbane Avenue
BARTON ACT 2600

5 June 2001

Dear and

Debt Equity Rules - Consultation on Draft Legislation

Thank you for the opportunity of participating in the consultation process for the debt/equity rules. The comments which follow include observations made by Section 22. Given the nature of the process, the views expressed are personal and do not reflect the views of Mallesons Stephen Jaques or Deutsche Bank AG.

We have taken as the starting point the description of the policy in paragraph 2.8 of the Explanatory Memorandum which accompanied the Exposure Draft *New Business Tax System (Thin Capitalisation and Other Measures) Bill 2000*. Given the time frame our focus has been on structure and linkage. We provide no substantive comments in relation to the proposed capital gains regime at this time. Doubtless, with more time, we may have been able to provide more practical comments.

We are supportive of the proposed legislative changes. However, we are uncomfortable with the **approach** to the proposed changes in a number of key areas.

Given your time frame, and in order to be of assistance, we have summarised:

- 1 the key issues in the Executive Summary below
- 2 substantive comments in Appendix A
- 3 points requiring clarification in Appendix B; and
- 4 suggested drafting changes in Appendix C

Executive Summary

- 1 A distinction between debt and equity interests is both appropriate and desirable. The distinction should be drawn so that "excluded interests"

LEVEL 60
GOVERNOR PHILLIP
TOWER
1 FARRER PLACE
SYDNEY NSW 2000
AUSTRALIA
DX 113 SYDNEY
ABN 22 041 424 954

TELEPHONE
(61 2) 9296 2000

FAX
(61 2) 9296 3999
EMAIL
syd@msj.com.au
www.msj.com.au

SYDNEY
MELBOURNE
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should be identified, with the remaining interests in a company being distinguished between debt and equity.

- 2 Instead of attempting to apply general application rules for each particular Division, it would be preferable to treat all returns on equity interests as dividends and all returns on debt interests as interest. This suggestion requires a definition of return (see Appendix C) and overcomes the numerous challenges posed by inclusion/exclusion analyses currently required by the draft provisions. It also avoids gaps in the framework which seem to arise in relation to withholding tax and dividend rebates (see Appendix A).
- 3 In order to promote certainty, the provisions should rely on regulation making powers or upon determination making powers vested in the Commissioner of Taxation, not both. There is a risk that the line between the exercise of a delegated legislative power and an administrative function could become blurred, leading to challenge and a lack of certainty. We would prefer the Commissioner to have determination making powers only, so that any legislative changes follow the usual Parliamentary process.

We note that the legislation is drafted to have a commencement date of 1 July 2001. If our input has utility, we would be grateful for the opportunity of participating further in the consultative process.

Should you require clarification of comments in this letter, please do not hesitate to contact Section 22 or me. If you would consider it to be of value, we shall be pleased to meet with you in Canberra or Sydney to discuss any of the matters described in this letter prior to the introduction of the legislation into Parliament.

Yours sincerely

Partner
Direct Line (61 2)
Direct Fax (61 2) 9296 3999
Email @msj.com.au

APPENDIX A
SUBSTANTIVE MATTERS

Section 22

- 5 There is no requirement for a benchmark rate in proposed section 25-85. If the benchmark rate is designed to reflect the ratio of *Fletcher v Federal Commissioner of Taxation* 91 ATC 4950, it should be included as an exception to section 8-1 of the *Income Tax Assessment Act 1997* (the 1997 Act). The reliance upon an “equivalence” and “comparable” regime in the definition of benchmark rate promotes uncertainty. Indeed, the Commissioner through administration of the legislation regularly distinguishes between taxpayers as a result of their attributes, status, activities and level of activity.

Section 22

Pages 4-10 section 22

APPENDIX C

DRAFTING SUGGESTIONS

1. Replace proposed section 25-85 with:

*A *return paid on a *debt interest shall be allowed as a deduction to the payer under section 8-1 when that *return is incurred.*

Section 22

Pages 12-14 section 22