



3 February 2012

Business Tax Working
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Dear Sir/Madam

Submission on the Business Tax Working Group's interim report on the tax treatment of business losses

Australand Property Group (**APG**) welcomes the opportunity to provide a submission on the issues and ideas raised in the interim report.

APG is one of Australia's leading diversified property groups.

APG's activities span across Australia and include development of residential land, housing and apartments, development of and investment in income producing commercial and industrial properties, and property management.

APG commends the Working Group on the four possible reforms provided in the report that could be pursued individually or as elements of a suite of reforms to improve the treatment of losses:

1. Element A – remove the continuity of ownership (**COT**) and same business (**SBT**) tests and introduce an alternative integrity test.
2. Element B – allow losses to be refunded.
3. Element C – introduce a time limited form of loss carry back.
4. Element D – apply an uplift factor to losses.

However, APG also notes the BTWG's terms of reference that the costs of any reform options will need to be offset by savings from business taxation measures to achieve a revenue neutral package. Against this background further consultation should be held prior to the implementation of any proposals relating to tax losses to ensure that any counter balance measures are acceptable.

Summary

Whilst we will comment on each of the proposals set out in the report, the primary focus will be on Element C as set out in the report which proposes the introduction of a time limited form of loss carry back.

APG generally supports this proposal but subject to:

- the comments set out below regarding the time frame of the carry back; and
- the measures introduced to counter balance the cost to the Revenue of introducing the measure.



Background

By way of background, the property industry's business is a cyclical one as evidenced by the booms and busts of the 1980s, 1990s and recent times. It is indeed a very rare scenario where a company in the property industry would have a symmetrical pattern of having one year of profits followed by a loss year and then a reversion to profits in the next and so forth.

Further, large property businesses are truly entrenched in the property industry as a whole. Whilst these businesses may be carrying on a number of different operations e.g. developments, construction project management and/or investments, such operations are still entrenched in a property business as a whole. When there is a downturn in the property market all of these different operations within a business will be affected.

This cyclical characteristic must also be the case for other industries as well the property industry (eg retail industry).

It is against this background that APG wishes to put into context its analysis of the four elements proposed by the Working Group.

Submission

We set out below our comments and analysis on each of the four elements of the proposals relating to tax losses with a particular focus on Element C.

1. Element C – Introduction of a Time Limited form of Loss Carry Back

As set out in paragraph 103 of the report a Loss Carry Back allows companies to carry current year tax losses back to be offset against previous year's profits, resulting in a refund of tax previously paid. On this basis the report states that a loss carry back is limited to the taxes paid in previous income years.

It is also noted that paragraph 108 of the report makes the point that the Australia's Future Tax System Review recommended a one year carry back for company revenue losses, with the amount of any refund limited to a company's franking account balance.

Furthermore at paragraphs 114 and 115 of the report it is stated that this reform element assumes that loss carry back would be limited to a period of one to three years. Moreover, this is cited to be consistent with international practice as set out in Appendix B to the report.

APG generally supports the loss carry back proposal and wishes to submit the following in relation to its implementation:

- a. The period of carry back should be three (3) years.

From the property industry's perspective, the proposal of limiting the carry back to one year will not provide a notable incentive to change behaviour in relation to decision making.

As set out earlier, the property industry's business is a cyclical one as evidenced by the booms and busts of the 1980s, 1990s and recent times. It is indeed a very rare scenario where a company in the property industry would have a symmetrical pattern of having one year of profits followed by a loss year and then a reversion to profits in the next and so forth.

Moreover, most businesses in the property industry would experience "multiple loss years or volatility of tax profile over a number of years rather than moving regularly from profit to loss (and back again)" to quote the Working Group's own comments at paragraph 115 of the report.



APG strongly endorses the Group's proposition that a three year carry back period would provide greater opportunities for carry back to occur and a better smoothing impact on the tax treatment of companies. Such a period should also have the effect of influencing decision making in respect of new projects/developments.

- b. APG agrees that a company's capacity to carry back a current year loss should be restricted to its franking account balance.
- c. The availability of loss carry back arrangements should be available to all businesses.

It is noted at paragraph 145 of the report that the Working Group observes there may be merit in restricting the availability of the loss carry back proposal to businesses of a certain size, in particular, small and medium sized businesses. Furthermore, examples of the United States and United Kingdom experiences in relation to small and medium sized businesses in this regard are provided at paragraphs 117 and 118 of the report.

One of the rationales for limiting the carry back arrangement to small and medium sized businesses appears to be based on the expectation that larger companies with diversified operations would have an increased ability to utilise losses as profits from certain operations within their business could be offset by losses resulting from other operations in the business structure.

APG submits this expectation does not hold in many circumstances, particularly property, as it fails to recognise that a large property business is truly entrenched in the property industry as a whole. It may have other operations but these are also within the property industry. Take for example the large property groups that are listed on the Australian Securities Exchange. They may be carrying on a number of different operations e.g. developments, construction project management and/or investments, however, such operations are still entrenched in a property business as a whole. When there is a downturn in the property market all of these different operations within a business will be affected. This would also apply in many other industry sectors. Therefore, it does not necessarily follow that the larger companies will have the benefits of diversification and be able to utilise losses better where their businesses are wholly within one industry.

Accordingly, it is submitted that the loss carry back arrangements should be available to all businesses irrespective of size.

2. Element A – Remove COT and SBT

The proposed removal of the COT and SBT coupled with the application of an available fraction rule may be very difficult to apply in practice. Moreover, it may prove to be detrimental in the scenario where a company acquires an interest in another company which has carried forward losses.

Currently where a tax consolidated group of companies acquires a 100% interest in another property company which has losses and joins the consolidated group, the losses transferred to the head company are already subject to an available fraction rule as set out in the report.

However, take for example the scenario where the first company acquires a less than 100% interest in another company which has tax losses (and therefore precluded from forming/joining a tax consolidation group). Currently, notwithstanding that the second company may fail the COT test it is still able to recoup its losses in full without any restriction providing it satisfies the SBT.

If the proposal as currently set out in the report is implemented, that is, remove COT and SBT and apply an available fraction rule to less than 100% acquisitions, this would mean that in the example above, the tax losses may not be able to be utilised at the same rate as under the current rules and therefore any incentives for businesses to expand and/or take additional risks by acquisitions or further joint ventures would be removed.



3. Element B – Loss Refundability

The proposal has appeal and potential benefits in principle. It is also noted that no other jurisdiction offers immediate refundability of tax losses.

However, APG also acknowledges that the potential costs of implementing this proposal will be significant and accordingly, is not a viable option.

4. Element D – Application of an uplift factor to losses

Paragraph 122 of the report notes that an uplift factor set by reference to the ten year government bond rate could be applied to tax losses as they are carried forward.

This proposal has appeal in principle. However, it is submitted that the proposal in its present form would not have any significant impact on business planning decisions having regard to the low benchmark rate to be set as the uplift factor.

APG submits that commercially the uplift factor should be set closer to a company's cost of capital for the proposal to provide any real benefits. In addition, if this measure is introduced we recommend that it be introduced with one or more other proposals.

Conclusion

Again, we commend the Government for undertaking a review on how the business tax system can be improved to enable business to make the most of the challenges and opportunities arising from transactions in the broader economic environment.

We are grateful for the opportunity to provide comments on the issues raised in the report by the Working Group.

However, we reiterate that further consultation should occur prior to the implementation of any of the above tax losses proposals to ensure that any counter balance measures are acceptable.

If you have any queries, please contact me on (02) 9767 2084.

Yours Faithfully

A handwritten signature in black ink, appearing to read "K. Pryke", is written over a light grey circular stamp.

Kieran Pryke
Chief Financial Officer
Australand Property Group