AFMA

31 October 2013

Manager
Resource Tax Unit
Indirect, Philanthropy and Resource Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attention: James O'Toole

Via Email: MRRTRepeal@treasury.gov.au

Dear Sir,

Minerals Resource Rent Tax Repeal
Repeal and Rephrasing of MRRT Repeal Measures

The Australian Financial Markets Association (**AFMA**) represents the interests of over 130 participants in Australia's wholesale banking and financial markets. Our members include banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers.

We write in respect of the open consultation regarding the repeal and rephrasing of certain measures in consequence of the repeal of the Minerals Resource Rent Tax (**MRRT**). In particular, we are concerned that a measure that is not currently legislated has been linked by the Treasurer to the MRRT and accordingly will not proceed. This measure is the phasing down of interest withholding tax for financial institutions.

Given the measure is not legislated, it is not specifically referred to in the Exposure Draft or accompanying draft Explanatory Memorandum. However AFMA is concerned that the repeal of the MRRT may cause the Government to discontinue the phasing down of interest withholding tax for financial institutions which, for the reasons articulated below, would be a retrograde step.

Background to the Phasing Down of Interest Withholding Tax for Financial Institutions

The Johnson Report

In November 2009, the Australian Financial Centre Forum (**AFCF**) released its report entitled "Australia as a Financial Centre: Building on our Strengths" (the **Johnson**

report). This report contained a number of recommendations to promote Australia as a financial services centre.

In the Johnson Report, the AFCF expressed the view that "the application of interest withholding tax to offshore borrowings by Australian based banks is inconsistent with Australia's need, as a capital importing country, to access a diversity of offshore sources of funding." The AFCF went on to state that:

> "the continuing application of interest withholding tax on financial institutions' borrowing offshore sits uneasily with the Government's desire to develop Australia as a leading financial centre and is putting Australia at a competitive disadvantage with respect to overseas financial centres."

Accordingly, the Johnson Report recommended that interest withholding tax be removed on interest paid:

- on foreign-raised funding by Australian banks;
- to foreign banks by Australian branches; and
- on related party borrowings by financial institutions.

The Henry Tax Review

The Henry Tax Review, in its Final Report entitled "Australia's Future Tax System" and released in May 2010, recommended that "financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to non-residents." It is noted that the recommendation reflected AFMA's submission to the Henry Tax Review, which stated that "the cost of this reform would be small in the context of the tax system and would be more than offset by the economic benefits it would generate."

Government Response

In the 2010-11 Federal Budget, the Government announced that, pursuant to the recommendations in both the Johnson Report and the Henry Tax Review, it would phase down the interest withholding tax paid:

- by foreign bank branches to head office to 2.5% from 2013-14 and 0% from 2014-15;
- by other financial institutions/borrowings to 7.5% from 2013-14 and 5% from 2014-15.

On 23 November 2011, the then Assistant Treasurer announced that the phasing down of interest withholding tax would be deferred by one year.

Current Government Comments

On 28 August 2013, the then Shadow Treasurer and Shadow Minister for Finance, Deregulation and Debt Reduction issued a media release entitled "Coalition's Responsible Budget Savings." In this media release, the savings that would be made as a consequence of the abolition of the MRRT were announced; these included "discontinuing the phasing down of interest withholding tax on financial institutions." The media release did not articulate the basis for the discontinuance of the phase down from a policy perspective, except for the assumption that the phasing down was part of a spending package funded by the MRRT.

AFMA's concern, therefore, is that the repeal of the MRRT will confirm the Government's policy perspective to not introduce the phasing down of interest withholding tax, just as the repeal of the MRRT is the catalyst for the repeal of other measures, such as loss carry-back, capital allowance deductions for small business entities and the upfront deduction for geothermal energy exploration.

Generally, AFMA does not advocate the specific linkage of revenue and expenditure measures. Whether the phasing down of interest withholding tax for financial institutions is an appropriate and laudable policy response to promoting banking competition and access to offshore funding should be considered autonomously, not purely based on a purported link to a revenue source that is to be repealed.

Policy Position

AFMA strongly supports the recommendation in the Johnson Report regarding interest withholding tax for financial institutions, given the benefits that will arise to the broader economy. AFMA believes that a reduction and ultimately elimination of interest withholding tax on interest paid by financial institutions would improve banks' access to cost effective funding from overseas and contain the rise of cost in financial intermediation, which is increasing due to, in part, the increasing regulatory burden.

It is AFMA's view that the discontinuance of the phasing down of interest withholding tax will hinder competition in the banking sector and therefore have an adverse impact on Australian business and borrowers. The discontinuance of the phase down of interest withholding tax would appear contrary to the Government's stated policy objectives of improving banking competition.

Indeed, the Government has made repeated comments endorsing and prioritising the recommendations of the Johnson Report. The Coalition's "Our Plan for Real Action" document states at page 30 that the Coalition would "give priority to the recommendations of the Johnson Report into Australia as a Financial Centre." This was consistent with comments made by the then Shadow Assistant Treasurer, now Minister for Finance at the 2012 Financial Services Council conference, namely:

> "The Johnson Report outlined a number of policy setting changes that would help Australia become a regional financial centre. The key recommendations focused on regulatory and tax changes to make investment easier and more attractive. The recommendations included…reforms to the interest withholding tax regime…The Coalition continues to support the principles of the Johnson Report recommendations."

In addition to the Johnson recommendations, it is AFMA's view that continuity of policy will assist in promoting Australia as a financial services centre and attract foreign investment. Resiling from a recommendation that is articulated in the Johnson Report and embraced by prior Governments will not enhance the confidence of foreign investors into Australia.

Request

Given the Exposure Draft and accompanying draft Explanatory Memorandum do not mention the Government's stance with respect to the phasing down of interest withholding tax and the recommendations from both the Johnson Report and the Henry Tax Review, AFMA requests that the Government confirm its commitment to the recommendations and articulate a plan to phase down, and ultimately eliminate, interest withholding tax for financial institutions.

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Please contact me on (02) 9776 7996 if you would like to discuss any aspects of the foregoing.

Yours sincerely

Rob Colquhoun
Director, Policy (Taxation)