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20 December 2012

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cc: hector.thompson@treasury.gov.au
cc: Office of the Hon David Bradbury MP
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Dear Mr Reid

Exposure Draft - Tax laws Amendment (2013 Measures No. 1) Bill 2012: General anti-avoidance rules

Thank you for the opportunity of making a submission on the Exposure Draft legislation and Explanatory Memorandum to amend Part IVA of the 1936 Tax Act - which we refer to as the ED and the EM in this submission

For the purposes of this submission Pitcher Partners comprises five independent firms operating in Adelaide, Brisbane, Melbourne, Perth and Sydney - collectively we are one of the largest accounting associations outside the Big Four. Our specialisation is advising smaller public companies, large family businesses and small to medium enterprises - which we refer to as "the middle market" in this submission.

Executive summary

We understand that there are a number of submissions that have outlined some of the technical and practical issues associated with the proposed amendments. We have not sought to reiterate those issues and concerns.

Instead, this submission outlines the clear implications this legislation will have on the middle market, especially in relation to internal restructure transactions, and our significant concern on the effect that this will have on compliance costs for taxpayers in the middle market.

The nature of taxpayers in the middle market is that their businesses will grow over time and thus will (eventually) be required to evolve. However, going forward there will be real uncertainty as to whether Part IVA will be applied to various internal restructure transactions involving taxpayers in the middle market.

We believe that this uncertainty as to whether Part IVA will apply to internal restructures will pose a significant impediment to taxpayers in the middle market appropriately restructuring their groups. In our view such restructures should not warrant the time, effort and compliance costs of considering the complex effect of the proposed new legislation.

We further highlight that even a simple transaction, involving a decision to either sell the assets of a business or the shares of the company, may well be one that falls foul of the proposed Part IVA amendments. Thus prudent taxpayers will be required to consider the full extent of the new legislation on even basic plain vanilla transactions.

In our view, requiring taxpayers in the middle market to consider Part IVA in these circumstances demonstrates a lack of consideration and empathy towards the middle market. This will not only create real impediments for middle market taxpayers looking to grow and evolve but will result in significant compliance costs for even the most simple and plain vanilla of transactions in the middle market.

We believe that this issue could be addressed by considering a simple amendment. That is, we believe that Part IVA should make it clear that a tax benefit cannot arise if a taxpayer uses taxation concessions and/or tax rollovers to facilitate either:

1. an internal restructure; or
2. a transaction involving ordinary family or commercial dealings.

We believe it is imperative that this be considered as part of the amendments to Part IVA.

The middle market

There is no doubt that small businesses are a critical part of our Australian economy. Small businesses make a significant contribution to the Australian economy, accounting for almost half of industry employment (47.2%) and contributing over a third of industry value added in 2009-10 (35.3%)[1].

Over the course of their business lifecycles taxpayers in the middle market will ordinarily go through a number of distinct phases, including: start-up; expansion; contraction; external acquisitions; divestments; and succession planning.

[1] The Department of Innovation Industry, Science and Research "Key Statistics – Australian Small Business", 31 October 2011, page 3.

The evolution of a business will also often require a middle market taxpayer to consider: amalgamating existing businesses; corporatising existing structures; bringing businesses within a wholly owned group structure; demerging business entities; and obtaining additional finance (both debt and equity) from third parties.

This means that a business structure that has been put in place at a certain point in time will quite often not be suitable at a later point in the business cycle. As a result, taxpayers in the middle market will often need to restructure their business to suit their changed circumstances.

More often than not, a number of tax concessions and rollovers will be used to facilitate these internal transactions. These concessions and rollovers have been specifically inserted into the Tax Act in order to prevent taxation from being an impediment to internal restructures. Without access to these concessions, the tax cost of internally restructuring the business would far outweigh the commercial benefits of doing so.

We (and no doubt most other advisers) would regard the use of these concessions and rollovers to facilitate internal restructures as no more than ordinary family or commercial dealings to which there should be no question of Part IVA applying.

The application of Part IVA is notoriously fact specific however, and the draft amendments will add even more uncertainty as to whether Part IVA will apply in any given case. This increased uncertainty will only make it more difficult for taxpayers to structure / restructure their operations with any great degree of confidence that Part IVA will not be invoked by the ATO.

In particular, the removal of the “do nothing” argument in such cases and the requirement to look at all of the “non-tax effects” of a transaction to determine the alternative postulate will simply increase the risk that Part IVA will apply to even a simple internal restructure transaction that should not (in our view) fall within the realm of Part IVA.

We expect therefore, that if the proposed amendments become law either: (i) middle market taxpayers will not instigate internal restructures; or (ii) there will be a significant increase in the number of middle market taxpayers that will request private binding rulings to confirm that Part IVA will not apply to even ‘plain vanilla’ internal restructures. We highlight that this will be the outcome for taxpayers in the middle market, as they generally lack the resources to undertake a thorough taxation analysis themselves.

In our view either of these outcomes is undesirable from an economic and administrative perspective. We believe accordingly, that the Treasury should seriously consider dealing with this issue when developing the Part IVA amendments.

Recommendation

We submit therefore, that Part IVA should be amended to make it clear that a tax benefit cannot arise if a taxpayer uses taxation concessions and/or rollovers to facilitate an internal restructure. We also request that the legislation make it clear that it is not intended to apply to ordinary family or commercial dealings.

We do not believe that the current concession that is contained for a single rollover is sufficient to deal with this concern under the redrafted legislation[2] - especially given the increased breadth of the legislation. Furthermore, we do not believe that taxpayers in the middle market should be forced through the compliance exercise of considering whether Part IVA will apply to simple internal restructure transactions of this nature.

Alternatively, if such an exemption is unacceptable then we believe that only large taxpayers who have the resources to do such an analysis should be forced to have to work through Part IVA if they are undertaking an internal restructure using taxation concessions or rollovers. For these purposes we would suggest that the thresholds used in the Taxation of Financial Arrangements ("TOFA") rules should be used.

In the event that the Treasury does nevertheless consider that Part IVA should apply to purely internal restructures by all taxpayers, we believe it is imperative that sufficient consultation occurs on the practical implications for taxpayers in the middle market - who will form the majority of taxpayers that will be affected by this measure.

In short, we believe it is crucial that sufficient testing is done using real life case study examples on how the approach proposed in the ED and the EM will apply in practice - i.e. consultation will not advance any thinking around the practical issues with applying this approach if it merely involves very high level discussions of this measure.

Further Details

Should you wish to discuss any aspect of our submission in further detail, please contact me on 03 8610 5170.

Yours faithfully
PITCHER PARTNERS ADVISORS PROPRIETARY LTD

ALEXIS KOKKINOS
Executive Director

[2] Section 177C(2) of the ITAA 1936