



THE TAX INSTITUTE

THE MARK OF EXPERTISE

23 November 2016

Mr Tom Reid
General Manager
Law Design Practice
The Treasury
Langton Crescent
PARKES ACT 2600

By email: lawdesign@treasury.gov.au

Dear Mr Reid,

Improvements to the debt and equity tax rules

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the *Tax and Superannuation Laws Amendment (debt and equity scheme integrity rules) Bill* Exposure Draft (**Exposure Draft**) and associated documents¹.

The Tax Institute endorses the submission prepared by Greenwoods & Herbert Smith Freehills dated 21 November 2016 which considers in extensive detail the numerous examples included in the draft Legislative Instrument.

Other comments

1. General

The repeal of sections 974-70 and 974-80 is a welcome step towards addressing the uncertainty that both provisions contribute towards the process of classifying certain financing arrangements as debt or equity in accordance with Division 974 of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**). The characterisation is intended to be based on the economic substance of the financing schemes.

The rules are intended to operate to aggregate multiple schemes as one scheme taking into account factors such as the interdependence of the pricing, terms and conditions of the schemes and whether it would be concluded that the schemes have been designed to operate to produce their combined economic effect.

¹ Being the Exposure Draft Explanatory Memorandum (**EM**) and the draft *Income Tax Assessment (Debt and Equity Examples) Declaration)2016 (Legislative Instrument)*.

However, the proposed rules contained in the Exposure Draft to replace the two provisions mentioned above still produce some of the uncertainty that is in the current rules. While we do not believe that sections 974-70 and 974-80 should be retained, we do believe that the rules to replace these provisions should offer a more certain approach to the characterisation of debt and equity interests to provide the integrity that is required.

2. Approach to legislative drafting

We understand that a principles-based approach to the drafting of the proposed provisions in the Exposure Draft has been taken. This has led to the development of the draft Legislative Instrument which contains a number of examples, the purpose of which is to give guidance as to how the new scheme aggregation rules will apply in particular circumstances². We understand the rationale for taking this approach is to cater for financing arrangements that are not yet contemplated and to ensure the law is flexible enough to cater for those in the future.

We acknowledge that the Board of Taxation suggested that a legislative instrument be used to give the force of law to the eight examples they developed³, and this was preferred to inclusion of the examples in the EM given the limitations on the interpretative force of material contained in explanatory material associated with legislation⁴.

Our preference is to see at least some of the examples included in the legislation with the remainder in the EM⁵, thereby capturing the intended application of the amendments as intended by the government of the day. Use of a Legislative Instrument leaves it open to subsequent executive governments to vary the application of the amendments which may result in inconsistent application to that which is intended by the current elected Parliament, including it seems so as to increase tax (e.g. by denying interest deductions) without the normal Parliamentary scrutiny and process followed in imposing tax.

3. Drafting matter

We recommend draft section 974-155(1)(a) be amended to insert the words 'in a material way' as follows:

- (a) The pricing, terms and conditions of one or more of the schemes **in a material way**:

This will show that the connection (ie dependence, link or operation) between the pricing, terms and conditions of two or more schemes is more than just minor or trivial.

² Paragraph 1.15 of the Explanatory Memorandum

³ Refer to paragraph 3.43 onwards in the Board of Taxation's report *Review of the Debt and Equity tax rules – the related scheme and equity override integrity provisions*, December 2014

⁴ Ibid at paragraph 3.44

⁵ If this was to be adopted, proposed section 974-155(3) would no longer be required.

It also makes this provision consistent with draft section 974-155(2) which confirms subsection 974-155(1) does not apply **merely** because the dependence, link or operation happens as a result of one of the factors in subsection 974-155(2)(a).

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'A. Athanasiou', with a horizontal line extending to the right.

Arthur Athanasiou
President