

# Tax insight



## Significant financial services tax reform in 2009

### At a glance

- ▶ Capital treatment election for MITs
- ▶ Off-market share buybacks changes
- ▶ Financial services tax policies and reforms under consideration
- ▶ TOFA issues

### How will the forthcoming tax reform changes impact you?

Over the next few months debate will intensify around numerous tax reform proposals affecting financial services businesses. These proposals may significantly impact financial product and market opportunities.

Funds managers, banks and other financial services providers, including custodians, must consider the impact of these proposed changes as some measures will apply to the 2009 income year while others may require action early in the 2010 income year.

We highlight these emerging tax policy issues to help you anticipate what the changes mean to your business and, importantly, how you can take active steps to influence the debate.

### Capital treatment election for managed investment trusts may affect 2009 distributions

As part of the Federal Government's 2009-10 Budget commitment to promote Australia as a financial services hub and to improve the competitiveness of the Australian managed funds industry, certain managed investment trusts (MITs) will be able to choose the capital gains tax (CGT) regime as the primary code for taxing gains and losses on the disposal of eligible assets.

Managed funds need to determine if proposed changes will apply for their 30 June 2009 distributions and factor this into processes for distribution statements.

Under the proposals, a formal election ('the capital election') can be made to apply capital gains treatment to disposals of certain investments by managed investment trusts. Consultation on implementation of the proposal has commenced, with a Treasury discussion paper released. Comments are due by 10 July 2009.

### **Who is affected?**

The proposals set out in the Treasury discussion paper will apply narrowly in respect of eligible Australian MITs, in line with the government's Budget announcement. This requires, broadly, that:

- ▶ The MIT must be a trust which is an Australian resident
- ▶ It must be regulated by the Corporations Act 2001
- ▶ It must be listed or widely held

The proposed measure does not currently apply to listed investment companies, public trading trusts, public unit trusts, private equity funds and other widely held market participants such as funds owned by life insurance companies that are not MITs. In our view this classification is too narrow.

### **What assets will be affected?**

- ▶ The gains and losses must arise on disposal of eligible assets (broadly, real property, shares and units)
- ▶ The disposal must be an eligible disposal subject to the CGT rules

Issues to be resolved with Treasury include what assets are eligible for the election and how rules to exclude certain assets, for example financial arrangements under the new tax rules for taxation of financial arrangements (TOFA), will apply.

### **How does it apply?**

The trustee of the MIT must make an irrevocable election to apply the CGT regime to all eligible disposals.

Once implemented, the capital election is to apply to the MIT for the year ending 30 June 2009. It will also apply to 31 December 2008 early balancing funds.

Funds will soon be calculating and advising unitholders of distribution amounts and components for the year ending 30 June 2009. The capital election and its effects on investment disposals (and associated loss utilisation and gain discounting) will be important in this process. Fund managers should consider the implications before distribution advices are issued.

Funds managers need to understand the limitations of the rules and consider making submissions or providing input to the Ernst & Young submission.

### **Off-market share buybacks may become less appealing**

Fund managers and other investors should assess the impact of the 2009 Budget announcement on changes to the tax treatment of off-market share buybacks conducted by listed companies as, from the date of Royal Assent of the amending legislation, the outcomes for participants in future buybacks may alter.

Broadly, these proposals intend to legislate many of the current administrative practices of the Australian Taxation Office. However, some policy changes are also on the table. The new measures remove the current cap on the allowable discount to market price which can be tendered by participating investors. This potentially means that non-taxable shareholders will have a more competitive tax position in such tenders than superannuation funds and other taxable investors. Importantly for non-corporate investors, the proposed new rules will deny shareholders in listed companies any notional capital loss as a result of off-market share buybacks.

Treasury has released their discussion paper on these measures for consultation, with invitation to comment by 10 July 2009. If you wish to provide input to our submission, please contact your Ernst & Young advisor.

## Further financial services tax policies may affect funding and marketing strategies

The government continues to look for ways to improve our tax laws to promote Australia as a financial services hub, including consideration of proposals put forward by the Australian Financial Centre Forum (AFCF)<sup>1</sup> and other market participants. These proposals include:

- ▶ Removing interest withholding tax on interest paid on borrowings by Australian branches and subsidiaries of foreign financial institutions to their parent companies; and on interest paid by Australian banks in respect of foreign sourced deposits.
- ▶ Removing the London Inter-bank Offer Rate (LIBOR) cap on deductibility of interest paid to foreign bank branch parents.
- ▶ Introducing an investment manager exemption for foreign funds. This would provide foreign funds with a tax exemption for non-Australian sourced income whether the investment is managed by an Australian fund manager or the investment is made through an Australian investment vehicle. Similar exemptions are offered by other major financial services hubs such as the USA, UK, Singapore, Hong Kong and Japan.

The AFCF is due to provide government with a policy blueprint for promoting Australia as a leading financial services centre later this year. Any eventual reforms could affect funding and marketing strategies, therefore we urge financial services entities to monitor the potential benefits and issues that emerge and engage in any consultation.

## Fine tuning of new tax rules for financial arrangements may influence your implementation

Companies are either planning for or starting to implement the new tax rules for financial arrangements. While the law now applies for transactions and financial assets and liabilities acquired from 1 July 2010 (for June-balancing eligible taxpayers) with an option for taxpayers to enter the system from 1 July 2009, consultation continues on some aspects of the rules. We are participating in the government's TOFA working group, established to review and resolve a long list of issues raised by the business community and, in particular, financial services organisations. If you would like to know more about these outstanding issues and how they may impact TOFA planning and timing, please contact your Ernst & Young advisor.

## Prepare for tax reform measures still to come

Consultation is started or yet to commence on many other announced changes to tax law that may impact the financial services industry including:

- ▶ Proposed changes to the Australian anti-tax deferral regimes (likely to apply from 2010-11)
- ▶ Improvements to the thin capitalisation rules for authorised deposit-taking institutions (from 1 January 2009)
- ▶ Capital gains tax rollover relief for fixed trusts with the same beneficiaries, which will be important for the managed funds sector when undertaking re-organisations (from 1 November 2008)
- ▶ Superannuation fund rollovers for mergers of complying superannuation funds (from 24 December 2008 to 30 June 2011).

Additionally, the Board of Taxation's final report on their review of the taxation of MITs is due to be presented to the government around the end of June. After the government considers the report, announcements may occur later this year.

You should determine the priority of each of the above items in anticipation of the release of further details, as the timeframe to understand the consequences to your business and to provide input to government may be limited.

<sup>1</sup> Ministerial Statement by the former Assistant Treasurer Chris Bowen "Promoting Australia as a Financial Services Hub - Progress of the Australian Financial Centre Forum", House of Representatives Hansard, 27 May 2009, page 58

## How can we help?

Ernst & Young has a long-standing commitment to improving the competitiveness of our tax system for Australian businesses and we actively participate alongside business leaders, industry networks and professional bodies to explore the issues and influence policy outcomes.

Ernst & Young's financial services tax advisors, supported by our Tax Policy team, can help you understand what these proposed changes mean for your business and help you prepare a submission directly to government or incorporate your views into Ernst & Young's submissions.

For more information about these developments or to help shape the reform debate, please contact your Ernst & Young advisor or one of the advisors below.

### Adelaide

Sean van der Linden  
[sean.van.der.linden@au.ey.com](mailto:sean.van.der.linden@au.ey.com)  
+61 8 8417 1688

### Brisbane

Paul Laxon  
[paul.laxon@au.ey.com](mailto:paul.laxon@au.ey.com)  
+61 7 3243 3735

### Canberra

David Manton  
[david.manton@au.ey.com](mailto:david.manton@au.ey.com)  
+61 2 6267 3930

### Melbourne

Dale Judd  
[dale.judd@au.ey.com](mailto:dale.judd@au.ey.com)  
+61 3 9655 2769

### Perth

Matthew Davidson  
[matthew.davidson@au.ey.com](mailto:matthew.davidson@au.ey.com)  
+61 8 9429 2343

### Sydney

Greg Pratt  
[greg.pratt@au.ey.com](mailto:greg.pratt@au.ey.com)  
+61 2 8295 6095

**Adelaide**

Ernst & Young Building  
121 King William Street  
Adelaide SA 5000  
Tel: +61 8 8417 1600  
Fax: +61 8 8417 1775

**Brisbane**

1 Eagle Street  
Brisbane QLD 4000  
Tel: +61 7 3011 3333  
Fax: +61 7 3011 3100

**Canberra**

Ernst & Young House  
51 Allara Street  
Canberra ACT 2600  
Tel: +61 2 6267 3888  
Fax: +61 2 6246 1500

**Gold Coast**

12-14 Marine Parade  
Southport QLD 4215  
Tel: +61 7 5571 3000  
Fax: +61 7 5571 3033

**Melbourne**

Ernst & Young Building  
8 Exhibition Street  
Melbourne VIC 3000  
Tel: +61 3 9288 8000  
Fax: +61 3 8650 7777

**Perth**

Ernst & Young Building  
11 Mounts Bay Road  
Perth WA 6000  
Tel: +61 8 9429 2222  
Fax: +61 8 9429 2436

**Sydney**

Ernst & Young Centre  
680 George Street  
Sydney NSW 2000  
Tel: +61 2 9248 5555  
Fax: +61 2 9248 5959

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