

Business Tax Working Group Secretariat
The Treasury
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By email: BTWG@treasury.gov.au

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Dear Sir/Madam

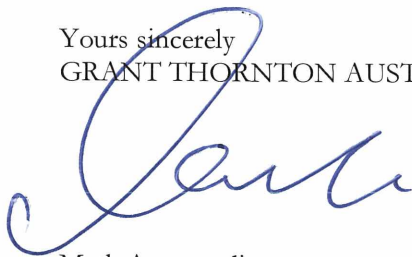
Grant Thornton Australia Limited (Grant Thornton Australia) appreciates the opportunity to provide comments to Treasury on the Business Tax Working Group's 'Interim report on the tax treatment of losses' dated 21 November 2011.

Grant Thornton's response reflects our position as auditors and business advisers both to listed companies and privately held companies and businesses.

Our comments in the form of responses to the questions posed in the Consultation Guide are attached to this letter.

Should you have any queries in relation to these matters please contact me on 03 8663 6200.

Yours sincerely
GRANT THORNTON AUSTRALIA LIMITED



Mark Azzopardi
National Head of Tax

Responses to Questions

1.1 How does the current tax treatment of losses affect decisions about your business or businesses that you are familiar with, in particular; decisions about:

- a Undertaking new investment;*
- b Raising equity and debt; and*
- c Undertaking research and development and introducing innovations?*

Present tax treatment of losses affects business decisions in a number of ways. New investment decisions are assessed on the basis that the benefits from any losses incurred cannot be realised when they are incurred and may never be available for utilisation, given the constraints of the continuity of ownership (COT) and same business (SBT) tests. This may cause businesses to refrain from engaging in risky investments where the return of the investment is less certain.

Similar concerns arise in respect of the raising of equity or debt and research and development activities, which also may cause issues in respect of a business' ability to satisfy the loss recoupment tests.

Consequently, some sub-optimal decisions may be made in these areas to take into account the risk of losses being unavailable for recoupment in the future.

2.1 How do the current integrity provisions (COT and SBT) affect decisions about your business or businesses you are familiar with?

In certain situations a business may refrain from raising equity due to the limits imposed by both the COT and SBT tests and the administration costs involved. For example an entity with carry forward losses may seek to change the nature of its business and raise equity to fund its new direction in order to become more profitable. In this case it may be difficult for the entity to satisfy the COT and SBT tests due to the change in both the ownership and direction of the business. A company in a loss position may need to seek substantial change to derive profit, however the COT and SBT tests limit the ability of businesses to change without the potential cancellation of their losses.

Even if the COT/SBT is satisfied, the ability to utilise carried forward losses in a tax consolidated environment may be substantially diminished due to the impact the equity raising will have on the Available Fraction.

In applying the COT and SBT tests, companies (especially SMEs) may need to seek professional advice due to the complexity of these tests. When a company has losses they are or have been unprofitable at some stage and therefore often require change in order to become more profitable. The COT and SBT tests may discourage companies from attempting to restructure out of a loss situation.

2.3 What costs are incurred in meeting the COT and SBT?

In meeting the COT and SBT tests, businesses either utilise internal resources or seek external professional advice to maintain compliance with COT and SBT. Due to the complexity of the tests and the continuous monitoring required in certain cases, substantial compliance costs can arise.

2.4 What would be the impact on your business decision making of introducing:

a an available fraction test; and

b a purpose test?

Introducing an available fraction test similar to the test used for consolidated groups will still place an administrative burden on relevant entities. Although SMEs may have less complicated affairs resulting in a potentially simpler calculation, companies may still require professional advice on how to apply the test, potentially every year if they have substantial losses to utilise. In addition, companies may require expensive external market valuations to be performed to incorporate in the available fraction calculation. A simpler test for SMEs which does not require professional support could be of benefit.

Introducing a purpose test may have a negative impact on decision making due to the potential uncertainty about the test and how it applies. Similarly to the Part IVA purpose test, uncertainty about the meaning and interpretation of purpose in this area may lead to expensive litigation or professional advice.

Many SMEs may not consider this test practical due to these risks, and may therefore be prevented from recouping losses under such a test.

2.5 What compliance costs would be incurred in meeting the above tests?

As discussed above there may be substantial compliance costs in meeting both of the above tests. Entities seeking to benefit from the available fraction test will require professional advice and potentially ongoing reviews of their financials each period to determine the amount of losses available to offset. Similarly, a purpose type test will also involve substantial administrative costs, especially from a professional/legal perspective as outlined above.

3.1 What would be the impact of a one-year carry back on your business (including impacts on decision making and cash flow)?

Allowing businesses to carry back losses for a year may improve their cash flow as refunds are available when losses are incurred (where companies had tax payable in the previous year). Consequently businesses may adjust their risk profiles and accept additional risk in implementing projects as a result of their ability to offset losses when incurred.

3.2 What would be the impacts of a three year carry back compared to the one year carry back?

Businesses operating in certain industries with cyclical or fluctuating profits may not benefit in full from a one year carry back where losses are incurred over a number of years. Where this is the case, businesses may only assess the value of losses in regard to the previous year's profit to determine if a project is feasible. In situations where a company's profitability decreases over time or where it makes a substantial loss in one year, the ability to carry back losses for up to three periods will provide greater opportunity to realise the full benefit of loss carry back.

3.3 What do you think of a loss carry back restricted by time? Should the carry back be restricted in terms of the amount of loss carry back instead of, or in addition to, the time restriction?

Loss carry back restricted by time is most appropriate for SMEs. Many SMEs will struggle to survive over multiple loss periods as their cash flow rapidly depletes. Therefore a loss carry back unrestricted by time is likely to be of little use many SMEs.

However, one possible option would be to allow a proportion of losses to be carried back for a set time period beyond the proposed year. For example, losses could be carried back under the 1 year proposed option, however after that one year (assuming there are still excess losses to utilise) a proportion of those losses may be available to offset against an additional 2 years of profits. This would grant extended relief and support for companies (especially SMEs) undertaking new investment or in times of economic uncertainty.

3.4 What would be the impact on your business of limiting the loss carry back to the franking credit account balance?

Limiting loss carry back to the franking account balance is appropriate, given that the franking account balance represents the value of tax paid by the company that has not been passed onto the shareholder already. To offer the ability to carry back losses in excess of this balance would result in a double benefit as both the shareholder and the company would have received an economic benefit in respect of their amount.

However, one repercussion of this approach may be that the entity, in hope of utilising losses, reduces the overall shareholder benefit through applicable distributions.

3.5 Should loss carry back be limited to the franking account balance or the increase in the balance over the allowable period?

We believe the loss carry back provision should be limited to the franking account balance. Limiting losses to the increase in the balance over the allowable period may involve complex processes and result in substantial administrative costs.

3.6 Should the amendment periods applying to companies accessing loss carry back be increased?

Yes, if the loss carry back provisions are implemented, the amendment periods should be extended for by the implemented carry back time period. If an entity's assessment is amended to incorporate the offsetting of losses, it is reasonable that the adjustment period should be increased to allow an appropriate time period for subsequent amendment.

3.7 What is the appropriate uplift rate to be applied to losses carried forward?

We agree the Government 10 year bond rate is an appropriate uplift rate as it represents a return based on a minimal risk investment. This rate of return would be a good representation of the return likely to be earned on the funds related to the losses had they been immediately refunded.

3.8 Of the possible reform outlined in the interim report, which element or combination of elements would be most valuable from the perspective of your business or businesses you are familiar with? How would they be of benefit?

We believe a one year loss carry back provision would be the most valuable from the perspective of SMEs. As discussed previously we believe limiting the utilisation of losses to the franking account balance is the appropriate option. However, removal of the COT and SBT tests may be appropriate if an alternative integrity test is introduced, such as the available fraction test or similar.

Another option is to extend the loss carry back provisions for businesses of a certain size ie SMEs. We believe SMEs who predominately deal in one type of good or service are disadvantaged compared to larger companies who have more diversified product lines or services. These larger entities have a greater ability to absorb losses through profitable channels, as opposed to SMEs. Therefore SMEs may substantially benefit from the ability to carry back losses for an extended period of time (i.e. 3 years).

4.1 How would you rank reforms to the tax treatment of losses against other changes to the business tax system?

In times of economic uncertainty, we believe reform to the tax treatment of losses ranks ahead of many other business tax changes as it is a targeted measure which will provide assistance to businesses which require it the most.