Senate Economics Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Additional Estimates 14 – 15 February 2007

Question: **aet102**

Topic: **Entity Structures**

Hansard Page: **E59**

Senator JOYCE asked:
I understand the interposed entity situation. Will the closing-off of the interposed entity section mean there will be a substantiation of the costings? Will that mitigate in some way the obvious loss of income that we are going to get from the purchase and sale of Qantas? It is going to be purchased and sold. If there is a $2 billion profit, there is $600 million in income just in that transaction alone that will be compromised.

Mr Callaghan—This is foreigners selling it between themselves?

Senator JOYCE—Yes.

Mr Callaghan—What I was saying previously is that, if they had a company structure and they were selling the company that held the assets here, we would not get the money now. A fact of life is that this was happening quite a bit in terms of the way people could get around the CGT liability.

Senator JOYCE—Couldn't we have changed the interposed entity structure without having to give an exemption to foreigners?

Mr Callaghan—As this was debated, we moved ourselves into line with the OECD model. We moved ourselves into line, which was the outcome of many of our treaty negotiations in terms of the rationale— improving the attractiveness of Australia as an investment location—and we tightened up on the interposed entity on the land-rich aspect.

Senator JOYCE—The OECD: England is one that is called to mind. Does America have a similar arrangement?

Mr Callaghan—I would have to check.

Senator JOYCE—Do you know of any country apart from England that has it?

Mr Callaghan—I think the US has it. The majority of OECD countries have it. I do not have a list of those who do or do not. I would have to take that on notice.

Answer:

The international norm, as reflected in the OECD Model Tax Convention, is for the taxing right over capital gains that arise on the disposal of an asset by a foreigner to rest with the country in which the foreigner is resident, unless the asset concerned is land. There are a handful of OECD countries that seek to apply wider CGT rights for

foreign investors. France, Germany and Japan seek to impose CGT more broadly on the disposal by a foreigner of shares in limited circumstances.
The land rich provisions covering domestic and foreign land rich entities are an integral part of protecting Australia's foreign resident CGT tax base. In the absence of provisions covering foreign residents holding Australian real property through Australian and foreign entities, it would be relatively easy for foreign residents to avoid Australian CGT by selling those entities, instead of the Australian real property. The avoidance of Australian CGT by using such structures would have been legitimised.

It is standard practice internationally for domestic land rich entities to be taxed in the country of source. This recognises the practical difficulties in enforcing taxing rights beyond a country's borders, except in the case of land which has a physical connection to a country.

It is also recognised internationally that source countries may enforce land rich provisions for real property held indirectly by foreign residents through a foreign entity. Canada has enforced taxing rights over foreign land rich entities since the introduction of the Canadian capital gains tax regime in 1972. Australia implemented land rich provisions, effective from 12 December 2006. Although few other OECD countries have indirect land rich measures, the Government considered this a necessary feature to maintain the integrity of Australia's foreign resident CGT regime.