PITCHER PARTNERS
ACCOUNTANTS AUDITORS & ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

Tel: 03 8610 5000
Fax: 03 8610 5999
www.pitcher.com.au
partners@pitcher.com.au

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Melbourne | Sydney | Brisbane | Perth | Adelaide

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Ref: I.83356.1

6 March 2007

The Manager
Taxation of Financial Arrangements
The Treasury
Langton Crescent
PARKES ACT 2600
E-mail tofa@treasury.gov.au

Submission in respect of the Exposure Draft to the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2007 ("the 2007 Bill")

We thank you for the opportunity to make a submission in respect of the 2007 Bill, the accompanying Explanatory Material ("EM") and the Interactions and Consequential Amendments Consultation Paper ("the Consultation Paper").

For the purposes of this Submission Pitcher Partners comprises 5 independent firms operating in Melbourne, Adelaide, Sydney, Brisbane and Perth. Collectively we would be regarded as one of the largest accounting associations outside the Big Four. Our specialisation is servicing and advising smaller public companies, large family businesses, small to medium enterprises ("SMEs") and high wealth individuals - which we refer to as "the middle market" or "our target client base" in this submission. Thus our particular focus in reviewing the 2007 Bill is on its implications for the middle market.

Main submission points

The proposed regime is inappropriate and unnecessary for the middle market

In our experience, a complex set of taxation rules to deal with financial arrangements is unnecessary for our target client base. Typically, the middle market only uses 'plain vanilla' loan, option and swap arrangements - all of which are dealt with satisfactorily by the current law.

The proposed regime is also inappropriate for our target client base. Most middle market taxpayers will be forced to use the Accruals/Realisation default methodologies

and will not have the processes/resources to enable them to cope with the determination of a 'sufficiently certain gain', re-assessments, re-estimations, running balance adjustments and the like.

The turnover threshold needs to be increased to at least $100 million

If the Government decides to introduce a new taxation regime for financial arrangements then it is our strongly held opinion that the currently proposed $20 million turnover threshold should be increased to at least $100 million (indexed annually).

We submit that an increase in the threshold to (at least) this amount is necessary to exclude all those enterprises that the ATO regards as SMEs under the market segments in its 2006/7 Compliance Program.

The arm's length test should not apply to interest free 'at call' loans

As recognised in the existing debt/equity rules the use of interest free 'at call' loans is widespread in the middle market [see, for example, the 'carve out' for many such loans in subsection 974-75(6)]. Any application of the arm's length test in the 2007 Bill to impute interest on an interest free loan would thus, have a great impact on our target client base.

In our opinion, the arm's length test in the 2007 Bill should either:

- simply not apply to interest free 'at call' loans (ie, leave them to be dealt with by the existing debt/equity rules); or

- only apply in cases where it can be (objectively) shown that the parties have a tax avoidance purpose.

Debt forgiveness should be left to the existing commercial debt forgiveness rules

It is inappropriate that a taxable gain can arise from a debt forgiveness under the general rules in the 2007 Bill whilst no gain arises from that debt forgiveness under the specific (existing) commercial debt forgiveness rules.

For example, the middle market often forgives loans between solvent entities as a way of 'tidying up' a group structure. In such a case there are no gains under the existing commercial debt forgiveness rules because the market values of the loans are deemed to be received as consideration - thereby reducing the net forgiven amounts to nil.

If no taxable gain arises under the specific rules dealing with a debt forgiveness then a taxable gain should not arise under a more general set of rules such as those in the 2007 Bill.

Proceeds from a sale of shares/units should be excluded

The current exception in the 2007 Bill for proceeds from business sales does not extend to the sale of the shares/units in the company and/or trust conducting that business. We are not aware of any policy reason for limiting the exception in this way and it should apply to any means by which a business is sold.

Further details on the above issues are contained in the attached appendices. Please contact Peter Gillies, Chris Birchall or the writer if you would like additional information/require clarification on any of the matters we have raised.

Yours faithfully

Peter Riley
Partner - Tax Consulting