1 November 2000

Assistant Commissioner
Law Design Development (Entities)
P O Box 900
Civic Square
CANBERRA, ACT 2608

Dear Assistant Commissioner

New Business Tax System (Entity Taxation) Bill 2000

This letter is a response to the invitation to comment on the exposure draft of the proposed legislation dealing with restructure relief and other matters concerning entity taxation.

Australian Foundation Investment Company Limited (AFIC) is a closed-end listed investment company. AFIC has 61,000 shareholders and 2,800 holders of convertible notes. It was established in 1928. It has the primary purpose of providing its shareholders, predominantly Australian retirees and others who wish to receive income from self-funded sources, with a smoothly growing stream of income using equity investments to provide protection from the effects of inflation. Total assets at 30 June 2000 were $2.3 billion and were comprised mainly of investments in Australian companies. A copy of AFIC's annual report for the year to 30 June 2000 is enclosed.

AFIC has a general concern with the entity taxation proposals, which the draft legislation is designed to implement. By retaining its present legal form as a company AFIC would be put at a significant disadvantage compared with fixed trusts that retain or obtain full flow-through status. The effect would be that AFIC's shareholders would not benefit from the concessional taxation treatment of capital gains. To obtain this concessional treatment individual shareholders (or their superannuation funds) would need to invest directly in the entities in which AFIC invests for them, thereby involving themselves in the selection and administration of their investments. To avoid the expense and complexities involved in self managed investment they could, alternatively, put their investment funds in the hands of trusts and fund managers and thereby incur much greater costs and fees than the 0.11% of average investments that it costs to administer AFIC.

In short, AFIC is an efficient and economic investment vehicle for many Australians. It is unfair to impose significant taxation penalties on them. The proposals would put AFIC at a significant competitive disadvantage relative to other investment intermediaries. Moreover, by depriving independent retirees of an efficient mode of investment the proposal is at variance with the Government's policy of encouraging provision for self-funded retirement income.

It would be open to AFIC to adopt the fixed trust structure envisaged in the draft legislation. While the transition arrangements proposed in the draft legislation would provide relief from capital gains tax consequences, they would not relieve AFIC of stamp duties, legal costs and other significant costs involved in the radical changes required. Moreover, a fixed trust structure and the associated management investments regime, would involve significant additional ongoing administrative costs.

Ways of removing these difficulties while achieving the Government's goals, as recommended by the Ralph Committee, have already been suggested by the Australian Investment Companies Association. They include a simple concept of a "Capital Profits Account" similar to the existing "Foreign Dividend Account" in which taxed realised capital gains would be held, and which when distributed would be taxed in the hands of recipients as capital gains but would carry full franking for the tax paid at company level.

Another suggestion was to give investment companies the flow-through treatment that would be available to fixed trusts under the draft proposed legislation. It would be relatively simple to define such companies and, if it is desired to restrict extension of the concession, it could be limited to investment companies meeting the definition at the date of last year's media announcement by the Treasurer (11 November 1999).

A more specific point of concern to us is the requirement in the draft legislation for a company that transfers its assets to a trust to cease to exist within six months if it wishes to obtain the relief offered by the transition provisions. It is not clear why this stipulation is made and it would involve additional expense, make the transition process more complex and deprive the entity of the significant value of a name built up over a long period.

Yours sincerely

Bruce B Teele
Chairman