

17 October 2008

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir or Madam,

Enclosed, please find British American Tobacco Australia's submission in response to the Commonwealth Government Inquiry into "Architecture of Australia's tax and transfer system".

We would be happy to submit further detail throughout the course of the Inquiry.

We look forward to assisting the Inquiry as a decision is reached as to which specific areas of reform will become the focus of this review.

Yours sincerely,



ANDREAS VECCHIET
Director, Corporate and Regulatory Affairs



**BRITISH AMERICAN
TOBACCO**
AUSTRALIA

**A Submission prepared by
British American Tobacco Australia Limited
in response to the
Commonwealth Government Inquiry
into “Australia’s Future Tax System” 2008**

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1. Executive Summary

This submission outlines British American Tobacco Australia's (BATA's) general response to the review of Australia's tax and transfer system titled "Architecture of Australia's tax and transfer system" ("the Henry report").

BATA is a large taxpayer contributing around 1% of total government tax collections, with over 75% of our external net turnover being paid to the Federal and State governments. For example, in the year ended 31 December 2007, BATA paid:¹

- \$2.7 billion in tobacco excise;
- \$350 million in goods and services tax;
- \$125 million in federal income tax; and
- \$50 million in employee income tax , fringe benefit tax and payroll taxes.

It is our view that, an ideal tax system should be one which facilitates and supports economic growth and investment in the country, and does not impede the ability of Australian businesses to compete in a global economy.

We believe that the Australian tax system should demonstrate the following characteristics for corporate taxpayers, being **competitiveness, simplicity, certainty and equity**.

With these characteristics in mind, the following broad summary presents our initial recommendations on the areas of Australia's tax and transfer system that BATA's view should be considered as part of the Review.

Competitiveness

- We support further international tax reforms in order to increase the attractiveness of Australia as a competitive location for international business; and
- We support a reduction in the corporate income tax rate to the extent that such a reduction is not funded in an inequitable manner by way of regressive taxes such as consumption taxes and excise.

Simplicity

- We support the standardisation and reduction of State taxes where possible, to reduce compliance costs and enhance simplicity in the State tax system. In particular, we believe that payroll tax is a disincentive in promoting employment in Australia and we support the removal of payroll tax from the State tax system.

¹ All figures relate to the calendar year 2007

Certainty

- The current anti avoidance provisions in the Income Tax Assessment Act 1997 (Cth) (i.e. Part IVA) do not provide a taxpayer with clarity or certainty in making business decisions because the interpretation of these provisions, in our view, is unclear. We support a more prescriptive approach to the general anti avoidance provisions similar to the one operating in the United States. Alternatively, we support the introduction of legislation which specifies the type of transactions to which Part IVA applies.
- The current self assessment regime does not allow for the certainty demanded by modern businesses. We support any proposal to implement a strict time limit on the conduct of Australian Taxation Office's (ATO's) risk reviews and audits relating to a taxpayer's open years. This would allow taxpayers a level of certainty as well as "capping" the penalties and interest a taxpayer must pay when a dispute arises.
- Delays in the administration of justice by the ATO impose a significant burden on business conduct and transactions. Additionally, taxpayers bear the financial burden of delays in the process through the application of excessive general interest charges ("GIC") and penalties. The ATO dispute resolution processes needs improvement to expedite resolution of disputes.

Equity

- We understand that the Government's intention is to use the tax transfer system as a mechanism to influence society's behaviour. This means that the mix of taxes will change as society and governments seek to achieve policy objectives. We support the overall objective of revenue neutrality for the Australian Government in this Review. However the achievement of revenue neutrality whilst changing the mix of taxes needs to be done in a way that no one sector, group of businesses or individuals are unfairly affected by such changes. The regressive nature of indirect taxes, means any sudden increases impact those in lower socioeconomic groups more, and in the case of tobacco also fuels growth in illicit tobacco consumption.
- Moreover, BATA is of the view that societal change cannot just be effected through tax reform or changes to the tax transfer policy. Reliance on the tax system is a blunt and often ineffectual way of influencing behaviour. Other holistic measures, such as communication, education, legislation and regulation, are equally important in achieving the Government's objectives of societal change.
- The current Tobacco Excise regime has achieved the right balance in terms of meeting Government revenue targets and reducing consumption whilst increasing cigarette prices above inflation and above other comparable excisable products. We are keen to ensure that the Australian Government's strategy continues to support both health and revenue objectives in a balanced and simplified manner, with a particular emphasis on government revenue, the

control of illicit tobacco, and youth smoking prevention.² In this regard we strongly believe that the Henry Review and the Preventative Health Task Force deliberations and recommendations regarding Tobacco should be coordinated and co-dependant so as to preserve the holistic nature of the tobacco strategy in the future.

- We support an appropriate Emissions Trading Scheme to deal with global warming. However, BATA is of the view that it is not necessary to hypothecate taxes to address the other environmental challenges of the 21st Century such as Extended Producer Responsibility (EPR) levies to pay for litter management. We support a holistic approach to these challenges, which involves the tax and transfer system but also encompasses increased communication between the relevant stakeholders, education, legislation and regulation.

² http://www.redi.gov.au/reading_room/profile/nat_tobacco_strat_04_09.htm

2. Introduction

2.1 Current corporate profile

BATA is Australia's leading tobacco company, accounting for about 45.5³ percent of the tobacco market in Australia.

The company manufactures and distributes cigarettes and roll-your-own tobaccos; it also distributes pipe tobaccos and cigars. Our brands include Winfield, Benson & Hedges, Dunhill, Pall Mall and Holiday.

BATA currently employs over 1,000 people in our corporate and manufacturing functions in Australia.

BATA is a large taxpayer contributing around 1% of total annual government tax collections. Over 75% of our external net turnover is paid to the Federal and State Governments by way of tax.

BATA's contribution to Australia is highlighted in the following table.

BATA TAX CONTRIBUTION YEAR ENDED DEC 2007	A\$	COMMENT
Excise Duty	\$2,655.4 million	BATA contributes about 48% of total tobacco excise
Net GST	\$349.6 million	
Income Tax	\$125.7 million	
Employee Tax	\$50.3 million	Includes \$38.2 million income tax, \$7.6 million payroll tax, and \$4.5million Fringe Benefits Tax.
Other Taxes	\$11.7 million	Includes withholding taxes, insurance taxes, rates, etc
Total Taxes Contributed by BATA	\$3,192.7 million	Around 1% of total government tax collections

³ Exchange of sales data.

BATA is a responsible member of the business community and as such is involved in many initiatives to address community concerns. For example, BATA is an active member of the voluntary National Packaging Covenant, supports Keep Australia Beautiful's *National Litter Index* and *Branded Litter Study*, and has committed \$4.4 million to date to facilitate the development and activities of the Butt Littering Trust⁴. As a business, we maintain significant and complex manufacturing operations in Australia to supply our products to both the domestic market and export markets in Oceania. The taxes imposed at both state and federal level represent a significant cost associated with supporting these operations. Ultimately, there may be a threshold at which a decision to move parts of these operations (such as manufacturing or administration) offshore becomes economically desirable.

Maintenance of a globally competitive environment in Australia is paramount to the retention of these parts of our business operations in Australia. This would underpin employment and tax revenue for Australia. We believe that some of the factors discussed below would assist in reducing the cost of doing business in Australia.

From our analysis, it seems that the Henry report will focus on the following four key themes in respect of Corporate taxpayers:

1. the need to improve the international **competitiveness** of our tax and investment systems;
2. the **complexity** of the current tax system;
3. the use of the tax and transfer system to influence society's behaviour; and;
4. that the Review should result in a tax neutral outcome.

2.2 Features of an ideal tax system

In BATA's opinion, an ideal tax system should be one which facilitates and supports economic growth and investment in the country, and does not impede the ability of Australian businesses to compete in a global economy.

Furthermore, we believe that the Australian tax system should demonstrate the following four characteristics for corporate taxpayers, being:

- **Competitiveness** - Australia's tax system needs to be internationally competitive so as to attract investment whilst retaining businesses currently operating in Australia, and promote efficient resource allocation to enhance productivity;
- **Simplicity** - the taxation legislation should allow for more transparent outcomes and reduced compliance costs. It should also allow for resources, both capital and labour to be directed towards other, more productive, areas. Whilst we appreciate that there will be an inherent complexity in company taxation law due to the variety of transactions it must encompass, in our view many provisions are outdated, unnecessary and ignore the demands of the modern business environment;

⁴ www.buttlitteringtrust.org

- **Certainty** – Australian tax law should allow a corporate taxpayer to have certainty in relation to the positions they adopt in respect of income tax law. For example, a law that carries some degree of uncertainty, in the guise of Part IVA is flawed; and
- **Equity** - our future tax system should be equitable to all resulting in the same tax outcomes regardless of residency and corporate structures. It should not unfairly penalise specific classes of taxpayers. Nor should taxpayers bear the burden resulting from delays in the administration of the system in the form of substantial rates of interest and penalties.

3. Key recommendations

In our view, the following measures should be implemented to enhance Australia's tax system.

3.1 Competitiveness

3.1.1 Domestic taxation

We support a reduction in the corporate income tax rate, given, as discussed in the Henry report, Australia has a significantly high corporate tax rate when compared to other OECD countries. However in order to fund such a reduction we do not support a consequent increase in consumption taxes or excise as this will have a negative impact on the lower socio economic demographic of the Australian population.

3.1.2 International taxation

We support further tax reform in order to increase the attractiveness of Australia as a competitive location for international business. We acknowledge that there has been reform but believe that there is room for more as outlined below.

3.1.2.1 Foreign Income Tax Offset

Under the new foreign income tax offset regime, where a company pays underlying tax on income in a foreign jurisdiction, and subsequently pays withholding tax upon repatriation of profit, no foreign tax credit is available. This in effect supports the double taxation of profits generated offshore with no relief available from the underlying tax suffered.

3.1.2.2 Thin capitalisation

We believe that the thin capitalisation rules, with respect to the Arms Length Debt test, should allow multinational businesses with operations based in Australia to leverage off the balance sheet of their international overseas controlled entities so that the economic reality of the Australian business as part of a multi-national group is reflected to a certain extent in determining the amount of debt and therefore debt deductions they are able to claim. For example, United Kingdom legislation allows for

consideration of related party guarantees in calculating its permissible arms length debt limits.

3.1.2.3 Withholding tax

Recently renegotiated Double Tax Agreements (“DTA’s”) between the United States and the United Kingdom have initiated a trend towards reductions in withholding tax rates in order to facilitate investment and trade between these jurisdictions.

We support the policy of renegotiation of Australia’s DTA’s and consider the DTA’s entered into with the United States and the United Kingdom as representing “world’s best practice”.

We are supportive of similar DTA renegotiation with our major trading partners as this will enhance our ability to conduct business with entities located in foreign jurisdictions, reduce leakage of funds, and ensure profits can be repatriated effectively. A reduction in withholding tax rates is also conducive to encouraging foreign direct investment into Australia.

3.1.2.4 CFC’s/FIF

We consider that the current Controlled Foreign Company and Foreign Investment Fund rules are overly complex and too broad in their application. These regimes need to be simplified and be precise in their application. As such, we support the current review being undertaken by the Board of Taxation.

3.2 Simplicity

3.2.1 State and Territory Taxes (“State taxes”)

In a PricewaterhouseCoopers 2008 report, “Total Tax Contribution”, which surveyed 63 Australian corporates, it was reported that only 9.2% of total taxes borne by the participants (both entities Federal and State) were collected from 34 different State taxes. This illustrates the level of complexity of the tax system between both Federal and State and then each of the states. Each tax is administered differently in each State with different thresholds and amounts payable resulting in a significant compliance burden on businesses. Accordingly, we support the standardisation and/or reduction of State taxes where possible, to reduce compliance costs and enhance simplicity in the State tax system.

With regard to Payroll Tax, we view a tax on employment as a disincentive in promoting employment in Australia and contrary to the Australian Government’s intent to maintain Australia as a desirable location for international business. As such, we support the removal of Payroll Tax from the State tax system.

3.3 Certainty

3.3.1 Anti Avoidance Provisions

The current anti avoidance provisions do not provide clarity, certainty or consistency for taxpayers thereby inhibiting taxpayers from making business decisions.

On the basis of statements made in the Explanatory Memorandum to the *Tax Laws Amendment Act (No. 2) 1981* (which introduced Part IVA), it was initially considered that Part IVA would only apply to arrangements which were generally of a “*blatant, artificial or contrived kind*”. However, such a limitation on the scope of the provision is not necessarily accepted by the Commissioner of Taxation. In our view, Part IVA was never intended to apply to everyday, common, business transactions. It was always the intention that taxpayers be allowed to structure their affairs in a tax effective manner. It was only those transactions that were “*blatant, artificial or contrived*” which were meant to fall within the parameters of Part IVA.

Furthermore, there is currently no certainty for corporate taxpayers in the application of Part IVA. There appears to be inconsistencies in the judicial interpretation of Part IVA, with numerous decisions of the lower courts on the application of Part IVA overturned and a number of split decisions in the higher courts. Accordingly, we support a more prescriptive approach to the general anti avoidance provisions.

That is, a prescriptive regime similar to the one that operates in the United States should be adopted, or legislation should be introduced which specifies the specific transactions to which Part IVA applies.

3.3.2 Tax Administration

3.3.2.1 Assessment Regime

Currently, the Australian taxation system operates as a self assessment regime. This system does not provide the certainty demanded by the modern corporate world. We support any proposal to implement a time limitation on the conduct of ATO's risk reviews and audits in relation to a taxpayer's open years. This allows a taxpayer a level of certainty as well as “capping” any penalties and interest a taxpayer has to pay should a dispute arise.

3.3.2.2 Dispute resolution

A good tax system needs to have an effective dispute resolution system in order to quickly and efficiently resolve disputes with minimal cost to both taxpayers and tax authorities.

We submit that The Henry Inquiry should consider the manner in which taxation disputes are resolved.

Delays in determination of matters by the ATO still impose a significant burden on business conduct and transactions. Additionally, taxpayers bear the financial burden of delays in the process through the subsequent application of excessive GIC and

penalties. This is particularly relevant where a taxpayer believes they have adopted a “reasonably arguable position”. Further to this point, we believe GIC should be based on a commercial rate of interest, rather than the currently imposed commercial rate of interest.

Further, the ATO dispute resolution processes needs to be expedited. Major decisions can take years to reach a resolution. For example, the factual scenario in *FCT v Hart* took place in 1996, whilst the decision of the High Court was handed down eight years later in 2004.

3.4 Equity

3.4.1 Tax Transfer Policy

The Government has stated its intention to use various tax measures as a mechanism to influence society’s behaviour. This will inherently mean that the mix of taxes will need to change to affect societal behaviour, whilst endeavouring to ensure no one sector, group of business or individuals are unfairly affected by such changes. BATA is of the view that societal change cannot simply be effected through tax reform or changes to the tax transfer policy. Our experience tells us that other holistic measures such as communication, education, legislation and regulation are just as important in achieving societal change.

In this respect we see two key areas where any potential tax transfer policy changes need to be carefully managed.

3.4.1.1 Tobacco excise tax

BATA estimates the Australian government will collect around \$5.9bn in tobacco excise in 2007-08 financial year. BATA will pay more than \$2.7bn of that number which is inclusive of both local and imported excise payments.

BATA supports the current holistic National Tobacco Strategy. We share many of the central objectives of government with respect to tobacco regulation. In particular, BATA supports education about the risks associated with smoking, regulation to reduce underage smoking, and policies to reduce the flourishing black market tobacco trade.

The results of the current tobacco strategy are set out below.

Since December 1999 the holistic tobacco strategy has delivered a 30% increase in tobacco excise rates which has led to an 18% reduction in cigarette sales.⁵

The 30% tobacco excise growth reflects six monthly CPI increases which, when coupled with higher cost recovery from manufacturers and increased GST, has caused cigarette prices to increase by about 68% since 1999. By comparison, alcohol prices increased by about 37% over the same period. The incidence of taxation on tobacco products in Australia is already one of the highest in the world – currently, tobacco

⁵ ABS data, Customs tariffs, Industry Exchange of Sales

excise/taxes represents approximately 70% of the price of a pack of cigarettes on average (including GST). The practice of the six monthly CPI excise increases is optimal as it minimises the impact on the overall inflation rate, especially on lower socio economic groups, whilst balancing an increase in government excise revenue with a fall in consumption (around 2% per annum)⁶

Unfortunately one of the adverse impacts of the high levels of excise is illicit tobacco and it is shown that when cigarette prices rise in the legal market, sales fall partly because smokers substitute legal cigarettes for smuggled tobacco products. It is estimated that the illicit tobacco market was around 1.8bn cigarettes in 2007, which equates to about A\$450million in lost excise revenue.⁷ Moreover the regressive nature of indirect taxes, means any sudden increases impact those in lower socioeconomic groups, more, which in the case of tobacco only further fuels the growth in illicit tobacco consumption.

Australia's experience with an *ad hoc* excise increase for pre-mixed drinks holds lessons for government considering similar excise changes for tobacco or other excisable products.

We believe that it is important that the co-dependency between government, health and revenue objectives remains intact going forward. In this regard we strongly believe that the Henry Review and the Preventative Health Task Force deliberations and recommendations regarding tobacco should be coordinated and co-dependant so as to preserve the holistic nature of the tobacco strategy in the future.

The current excise regime has achieved the right balance in terms of meeting Government revenue targets whilst increasing cigarette prices above inflation and other comparable excisable products. In the future BATA is keen to ensure the tobacco strategy continues to support both health and revenue objectives in a balanced and simplified manner, with a particular emphasis on, youth smoking prevention, government revenue and the control of illicit tobacco.

3.4.1.2 *Hypothecated taxation*

BATA does not support "hypothecated taxation". Earmarked taxation to engineer social change, for example, in respect of environmental issues, limits the ability of Government to make decisions about revenue allocation, produces 'lumpy' budgetary flows, is complex, and can be seen as 'old school' Labor social engineering. Further, according to recent community attitude polling⁸ regulation of this sort is seen by the public as a "quick fix" rather than addressing the real issues.

BATA is committed to addressing environmental issues and believes much can be achieved in improving environmental outcomes without the use of the Australian tax system as a means of effecting change. The next section explores the downsides to a suggested Extended Producer Responsibility Levy enforced through the tax system, and suggests alternative measures that the government should encourage all tobacco

⁶ ABS data, Customs tariffs, Industry Exchange of Sales, Retail Tobacconist

⁷ PricewaterhouseCoopers report 2007, Illegal tobacco trade: costing Australia millions

⁸ Conducted by Auspoll in 2008

companies to adopt to address environmental concerns, including our support for an appropriate Emissions Trading Scheme.

3.4.1.3 Extended Producer Responsibility enforced through the tax system

For BATA, our continued multi-million dollar investment in the Butt Littering Trust constitutes a large part of our voluntary Extended Producer Responsibility (EPR) activities. It is believed that, through education, fines and infrastructure, the issue of cigarette butt litter can be effectively minimised.

In previous years, it has been proposed that a levy be placed on certain products (such as plastic bags) to assist in minimising the impact on the environment. This discussion has also extended to FMCG products, whereby a levy would be built into the price of the product and passed onto the consumer. It would be expected that the money generated from such a levy would go towards street cleaning.

BATA does not believe that a litter levy on tobacco products is an appropriate measure to address cigarette butt litter. Any EPR levy would be passed on to the consumer, penalizing responsible Australians and litterers alike. A focus on enforcing existing littering fines (and more education) is a more appropriate policy. By addressing littering behaviour, we believe that a real impact can be achieved.

3.4.1.4 Other non-tax initiatives

As a signatory to the National Packaging Covenant (NPC) BATA has taken significant steps in its supply chain to reduce the amount of packaging produced and to increase the percentage of recycled materials it uses. It has also made substantial investment in butt littering reduction initiatives to meet NPC targets.

BATA has for several years contributed towards the conservation of native biodiversity in Australia through a long term partnership with Conservation Volunteers Australia providing funding that facilitates an average of 300 volunteer days a year, resulting in cleanups, tree planting and the repair of fences and walking tracks in national parks. Globally, BAT Plc established the British American Tobacco Biodiversity Partnership in 2000 – working with three conservation NGOs, Earthwatch, Flora & Fauna and the Tropical Biology Association to better understand the environmental impacts of BAT operations, and to support external conservation projects through the partner NGOs.

3.4.1.5 Emissions Trading Scheme

BATA fully supports the introduction of a carbon cost through an Emissions Trading Scheme. Whilst BATA is not required to participate in the proposed Carbon Pollution Reduction Scheme, the introduced carbon cost will impact on the Company through an increase in energy and fuel costs as well as a general increase in the cost of goods and services. BATA will continue to focus on reducing energy consumption and emissions. The Company continues to publicly report its energy consumption and emissions, based on the Global Reporting Initiative Framework through our publicly available Social Reports.

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