A Model Idea: Is the ICAA proposal for a tax transparent company the ideal model for Australia?

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This is a short extract from an upcoming article by the author in the Australian Tax Review.

Abstract

Currently one of the potential reforms being considered by the Henry Review is a proposal by the Institute of Chartered Accountants Australia and Deloitte for the introduction of a tax transparent company (the ICAA proposal). The ICAA proposal argues that tax transparency applying to closely held corporations and unit trusts would provide an enhanced tax system for micro-enterprises in Australia.

While there are arguments that tax transparency does provide for an enhance method for taxing business forms and their members, there are various concerns about the consequences of following this economic ideal. This article will evaluate the model outlined in the ICAA proposal, and raise concerns about what will be achieved if a transparent company was introduced in Australia.
1.1. Introduction

Recently the Australian government announced that the proposal for a tax transparent company by the Institute of Chartered Accountants in Australia and Deloitte (the ICAA proposal) would be considered in a Tax Review to be chaired by Ken Henry (the Henry Review). The ICAA proposal is based on the attractive proposition that a tax transparent company will provide an improved tax regime for closely held businesses, in particular alleviating them from such provisions as Division 7A. Within this article, it will be considered whether Australia should strive for the economic ideal of a tax transparent company. In doing this, the historical relationship between transparent companies and closely held businesses will be critiqued.

It will be argued that Australia may have little to gain from introducing such a tax transparent company. However, due to both domestic and international factors the government may find itself being subject to increasing pressure to broaden its recognition of transparent forms.

The next section of this article will outline the definition of tax transparent companies and how they may be classified. Then the model of transparency advocated within the ICAA proposal will be outlined. The article will then consider the association between closely held businesses and transparent companies. The final section of the article will outline the conclusions as to whether a tax transparent company is a model idea for Australia.

1.2. What is a tax transparent company?

The taxation of business forms can be conceptualised in terms of a continuum, from an ‘entity approach’ to an ‘aggregate approach’, with an ‘integrated approach’ lying between

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these two points. While an entity approach can be conceived in relatively simplistic terms, economists have advocated that an aggregate (tax transparent) approach is preferable with income and/or losses directly allocated to members. Such a tax transparent approach is stated to improve tax neutrality, and thus reduce the tax system’s potential to distort investment decisions. Also it has been argued that, in addition to their economic benefits, tax transparent companies are advantageous for closely held businesses.


In relation to the continuum conceptualised in Figure 1 pertaining to the taxing of business forms, a fully transparent company represents the aggregate approach. However, the fully transparent company, unlike a general partnership, also provides for limited liability and is a separate legal entity from its constituent members. It is these three core characteristics, separate legal entity status and limited liability with flow-through taxation, that define the nature of a tax transparent company (or transparent company). The extent of limited liability protection does vary amongst transparent companies. Of course, it is quite possible to have corporate characteristics without limited liability, as in the case of unlimited companies and to have separate legal personality without the other characteristics of a company, as in the case of Scottish and of United States general partnerships. Or legal personality. Tax transparent treatment is argued to be an attribute of general partnerships, particularly in the Australian context. Utilising these attributes, a ‘fully transparent company’ allows for all income and losses of the transparent company to flow-through directly to its members. In other words, all of the transparent company’s income (whether distributed to members or retained) is allocated and assessed for tax purposes to members. Referred to as aggregate approach, transparency or flow-through taxation The transparent company’s losses, when deductions exceed assessable income, are similarly directly allocated to members. Normally, in this respect, a conduit principle applies to these allocations, so that receipts and expenditure items of the business form retain their identity for members. Note even though transparency applies, at times there can be recognition of the business form for tax purposes (referred to as entity acknowledgement), such as the lodgement of information returns by the business form. Important terms associated with tax transparency are ‘allocations’ and ‘distributions’. ‘Allocations’ refer to the allocating of income or losses for tax purposes directly to members even though, legally, the income and/or loss may have been earned or been incurred by the business form. ‘Distributions’ refers to the payment or the transfer of assets (including money) to members of the transparent company.
Consideration of transparent companies is not new, and reference to them can be found internationally\textsuperscript{13} and in Australia.\textsuperscript{14} Historically, however, it has been argued the

\textsuperscript{11} Figure modified from Cnossen S, “Alternative Forms of Corporation Tax” (1984) 1\textit{ Australian Tax Forum} 253 at 255.

\textsuperscript{12} Such an entity approach was described in the early 1970s as the ‘classical system’ by Van den Tempel: Van den Tempel, AJ. (1970).\textit{ Corporation Tax and Individual Income Tax in the European Communities}, EEC Brussels, at p 7. It should be noted, however, that, contrary to what the terminology suggests, the imputation system is of older date in Europe.


\textsuperscript{14} Australia, “Taxation Review Committee Full Report”, (Asprey, KW Chairman) (1975), 31 January, Canberra: AGPS at [16.79 to 16.96]. The Asprey Committee did not regard the scheme as being primarily directed to assisting small companies (paragraph 16.85) or available to the subsidiaries of large or foreign companies (paragraph 16.89). Australia, “Committee of Inquiry into the Australian Financial System — Final Report”, (Campbell, J.K. Chairman), (1981) Canberra: AGPS at 223. The Campbell Inquiry recommended full integration in the interests of
The implementation of such an economic ideal is problematic for business forms with limited liability and separate legal entity status. The asserted difficulties relate to the potential of risk to revenue, allocation and administrative issues, complexity and the pressure to distribute money. A consequence of this has been that jurisdictions provide for either an entity approach or a form of integration, rather than full transparency to such business forms.

Nevertheless, there are several examples of foreign jurisdictions embracing a fully tax transparent approach for business forms with separate legal status and liability protection for members. Examples of these tax transparent companies include the United States’ S Corporations and limited liability companies (LLCs), the United

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Kingdom's limited liability partnerships (LLPs) and New Zealand's Loss Attribution Qualifying Companies (LAQCs) and its new limited partnership regime.  

While the S Corporation and LLC, as well as the United Kingdom's LLP, are fully tax transparent companies, the LAQC is not a fully transparent company, but instead is a 'partial loss transparent company', with only the losses are automatically allocated to members, with income initially taxed to the business form.

It is possible that the tax transparent companies studied can be classified into two distinct paradigms. The first classification pertains to whether the tax transparent company was produced by introducing a special set of tax rules to an existing business form, the corporation, referred to as 'special tax rule company'. The second classification specifically relates to when the transparent company represents the creation of an entirely new business form that is subjected to existing tax rules, referred to as a 'new form transparent company'. To enhance understanding of these paradigmatic classifications, Table 1 details the categorisation of the transparent companies studied, and how they relate to the transparent companies referred to.

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18 Other tax transparent companies introduced around the world include Singapore's LLP [Introduced in April 2005 by the Limited Liability Partnership Act (Chapter 163A)], Northern Ireland's LLP [which took effect from 13 September 2004] and Japan's LLP [Known as Godo Kaisha 'GK' commencing 1 May 2006. Note it is not clear whether such an entity for Japanese tax purposes has been granted tax transparent treatment] and LLC. Other jurisdictions have introduced entities with some of these attributes, but these entities currently lack the separate legal entity status. For example: (a) Germany the GmbH&Co.KG which uses a corporation (known as a GmbH) as the general member of a limited partnership (known as a KG); and (b) France the SAS.


20 Similar to the fully transparent company, the partial loss transparent company also provides for limited liability and the notion of a separate legal entity.

21 The S Corporation and the LAQC fall within the ‘special tax rule companies' classification, since both of these entities are essentially corporations for which the respective governments have introduced a special tax transparent regime for particular closely held corporations. In contrast, LLCs and LLPs are categorised within the second classification, ‘new form transparent companies', since both of these entities required the introduction of new legislation for their formation and governance, with transparency provided by the application of existing general partnership tax rules.
Table 1: Classifications of tax transparent companies

<table>
<thead>
<tr>
<th>Classification</th>
<th>Description</th>
<th>Example</th>
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<tbody>
<tr>
<td>Special tax rule companies</td>
<td>The transparent company was introduced by providing a special set of tax transparency rules to corporations.</td>
<td>S Corporation LAQC</td>
</tr>
<tr>
<td>New form transparent companies</td>
<td>The creation of an entirely new business form that is subject to existing tax transparent rules for general partnerships.</td>
<td>LLC LLP</td>
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Until this point in time Australia has given only restricted recognition to tax transparent companies, with the implementation of venture capital incorporated limited partnerships (venture capital ILPs)\(^\text{22}\) and amendments to controlled foreign hybrid companies (CFC hybrids).\(^\text{23}\) However, there have been calls for the broader availability of a transparent company in Australia, most recently being the ICAA proposal.\(^\text{24}\)

\(^{22}\) ITAA 1997 (Cth), Sub–Div 118–F. The new venture capital regime was introduced on 1 July 2002 by two pieces of legislation, being: Venture Capital Act 2002 (Cth) and Taxation Laws Amendment (Venture Capital) Act 2002 (Cth). Australia has two other venture capital programs being (a) PDF program introduced in 1992; and (b) the Foreign Superannuation Fund program introduced in 1999.

\(^{23}\) ITAA 1997 (Cth), Div 830. Commencing 1 July 2003, the CFC hybrid amendments were introduced to address the asymmetrical tax treatment applying to Australian residents investing in certain foreign transparent companies.

1.3. **ICAA proposal**

The ICAA proposal advocates for the introduction of tax transparent company, particularly for micro enterprises.\(^{25}\) The proposal, if implemented, would see transparency through application of the general partnership tax provisions to corporations and unit trust that elect to be part of the regime.\(^{26}\) As currently drafted the ICAA proposal is for a fully tax transparent company (as defined), and would be best classified as a ‘special tax rule company’.\(^{27}\)

A reason underlying the ICAA proposal is that the application of tax transparency could remove the need for the application of complex tax integrity measures imposed to address the disguised distribution of profits from private corporations, and thereby reduce compliance costs. The ICAA proposal argues that Division 7A would not need to apply nor fringe benefits tax for benefits to employee-members.\(^{28}\) Other complex provision that need not necessarily apply to a transparent company could include share value shifting,\(^{29}\) tracing capital gain discounts,\(^{30}\) and tracing rules for capital assets acquired prior to 20 September 1985.\(^{31}\) Furthermore, a tax transparent company could provide an alternative form of tax consolidations that can be problematic for small businesses.\(^{32}\)

However, is the model of transparency advocated within the ICAA proposal the preferable way for a transparent company to be implemented in Australia. Indeed is tax

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\(^{25}\) Institute of Chartered Accountants in Australia and Deloitte, *Entity flow-through (EFT) submission* (Institute of Chartered Accountants, 2008) at [3.7.10].

\(^{26}\) The ICAA proposal applies to unit trusts as well as corporations. Institute of Chartered Accountants in Australia and Deloitte, *Entity flow-through (EFT) submission* (Institute of Chartered Accountants, 2008) p 6. With a membership restriction of five.

\(^{27}\) Although this is classification is not precise, as the ICAA proposal envisages that the existing Australian general partnership tax rules would apply to the transparent company rather than introducing a special set of transparent tax rules.

\(^{28}\) Institute of Chartered Accountants in Australia and Deloitte, *Entity flow-through (EFT) submission* (Institute of Chartered Accountants, 2008) p 9 and 12.

\(^{29}\) ITAA 1997 (Cth), Div 723 to 727.

\(^{30}\) ITAA 1997 (Cth), s 115-40.

\(^{31}\) ITAA 1997 (Cth), CGT event K6.

transparency necessary at all? It is advocated that these are important considerations given the importance of closely held businesses, because, if it is accepted that most small and medium enterprises are closely held,\textsuperscript{33} then when aggregated they can account for a large percentage of a country's economic activity. For example, it was estimated that in Australia there were 1,233,200 private sector small businesses\textsuperscript{34} during 2000–2001, representing 97 per cent of all private sector businesses and employing almost 3.6 million people (49 per cent of all private sector employment).\textsuperscript{35} Small businesses account for around 30 per cent of Australia's gross domestic product.\textsuperscript{36} For this reason, this sector has been described as 'the engine room of the Australian economy'.\textsuperscript{37}

Apart from their contribution to a country's current GDP, small closely held businesses are seen as important for future economic performance, being described as the 'seed bed for a country's future economic growth'.\textsuperscript{38} For example in the United States, small

\textsuperscript{33} For the purposes of this article, the qualitative characteristics inherent for a 'closely held business' is that membership interest is not widely dispersed, and that it is not publicly traded: Holmes S and Gibson B, \textit{Definition of Small Business} (The University of Newcastle, 2001) p 8; Coleman C and Evans C, “Tax Compliance Issues for Small Business in Australia” in \textit{Taxing Small Business: Developing Good Tax Policies} (Australian Tax Research Foundation, 2003) (Conference Series 23):147 at 149; Small Business Deregulation Task Force, \textit{Time for Business}, (AGPS, 1996) p 13. Normally, a closely held business is one that is independently owned and operated, with most, if not all, capital contributed by members and managers. Furthermore, members are likely to participate in the management of the business (member-management). Due to these characteristics it has been stated that 'it is difficult to view closely held' businesses regardless of the structure used as 'economic entities independent of their owners': Harris PA, \textit{Corporate/Shareholder Income Taxation and Allocating Taxing Rights Between Countries: A Comparison of Imputation Systems}. Amsterdam (IBFD Publications BV 1996) p 47. While it is acknowledged that 'closely held' and 'small business' are not \textit{per se} interchangeable, the vast majority of closely held businesses will nonetheless be small to medium enterprises. However, there can be a number of closely held businesses that are large. Freedman J and Ward J, "Taxation of Small and Medium–Sized Enterprises“ (2000) \textit{European Taxation} May:158 at 159.

\textsuperscript{34} Defined to be businesses that employ less than 20 people.


\textsuperscript{37} Howard, J (Prime Minister), \textit{More Time for Business}, 24 March 1997, (AGPS).

businesses have 13 times more patents per employee than large corporations, and employ 39 per cent of the high tech workforce.  

Closely held businesses can have a range of advantages for the economy, as they can be flexible, perform important sub-contractor functions and be a source of new ideas and innovation. It is argued, that due to their current and future influence on a country’s economy, it is important to consider the issues confronting this sector. Accordingly, the argument that a tax transparent company may be a better way to tax closely held businesses deserves careful analysis.

1.4. A model idea?

For the Australian government regulatory burden, in terms of both governance and tax rules, is a major concern with small businesses that generally are closely held. For the Australian government to adopt a tax transparent company it would need to be satisfied that transparency does reduce the regulatory burden for small businesses. However, it is argued that this is not necessarily the case.

It is not certain whether there would be any substantial benefits for closely held businesses if Australia strived for the economic ideal of a tax transparent company, particularly if tax transparency was introduced as an ‘alternative’ way of taxing business forms in addition to the established methods in Australia. If it were not part of an overall

43 For example, the full imputation system applying to corporations and limited partnerships, partial income transparency applying to discretionary and unit trusts, and full aggregation for general partnership, venture capital ILPs, CFC hybrids and sole traders.
comprehensive reform package, such an additional alternative would merely add to an already complex system. This is reinforced by the acknowledgement that complexity can also be influenced by the frequency of changes made to tax laws.\(^{44}\) Indeed, such an optional additional approach may encourage taxpayers to choose a business form due to tax arbitrages.\(^{45}\)

Unfortunately, it is such an ‘additional’ methodology advocated in the ICAA proposal, although the ICAA proposal does provide for a conversion mechanism for established businesses to move into the transparent regime.\(^{46}\) Furthermore, the demand or desire for such transparency may be insufficient to see it adopted by a large number of taxpayers. This is due, in part, to the fact that the breaches of tax neutrality in Australia may not be as significant as in other jurisdictions because of the full imputation system for corporations and the use of discretionary trusts for businesses.\(^{47}\) To explain more fully, in Australia there is not the ‘catalyst for change’ for wide scale adoption of tax transparent companies. While the United Kingdom and New Zealand both introduced transparent companies when they had an integrated tax system applying to corporations and their members, there are characteristics unique to those jurisdictions that largely are not replicable in Australia.

It is argued that a peculiarity in the United Kingdom is the application of the National Insurance Contribution (NIC) scheme and the instrumental role that professional firms

\(^{44}\) Australian Chamber of Commerce and Industry, “Business Tax Reform: A Process that is Never Complete” in ACCI Review No 102. (Barton, 2003) p 2: “Small, medium and large sized businesses all found that the complexity of the tax system and the frequency of changes made was the greatest problem facing their businesses while the level of taxation came a close second”.

\(^{45}\) It is for a similar reason that a United States’ style of Check-the-Box, allowing businesses to choose which tax methodology will apply to them is not advocated. A similar conclusion has recently been articulated in the United Kingdom. Crawford, C, and Freedman, J. (2008). Small Business Taxation. In Prepared for the Report of a Commission on Reforming the Tax System for the 21st Century, Chaired by Sir James Mirrless: The Institute of Fiscal Studies.

\(^{46}\) Institute of Chartered Accountants in Australia and Deloitte, Entity flow-through (EFT) submission (Institute of Chartered Accountants, 2008), at paragraph 4.3. Of course, such conversions may have adverse stamp duty consequences.

\(^{47}\) Freudenberg B, “Are transparent companies the way of the future for Australia?” (2006) 35(3) AT Rev 200, 219-220. However, it could be argued that the use of discretionary trusts for tax planning strategies actually breaches tax neutrality. Of course, the imputation system for corporations or the partial transparency applying to trust does not achieve total tax neutrality – for example losses remain trapped within these business forms.
played in lobbying for the introduction of LLPs.\textsuperscript{48} In the United Kingdom, tax transparency for LLPs has meant that a more favourable rate of NIC is applied to professionals as self-employed persons, compared to corporations and their employee-members.\textsuperscript{49} The application of the NIC could be significant, given that members of a professional firm are likely to be active in their business. This discrete tax saving for professionals encouraged them to lobby for the LLP to have transparent treatment.\textsuperscript{50} In Australia there is also differing tax treatment applying to self-employed persons compared to employee-members. Generally, the status of being an employee for an active member can be beneficial as it may increase access to concessional taxed fringe benefits and preferable superannuation treatment.\textsuperscript{51} However, wages\textsuperscript{52} paid to an active member could be subject to payroll taxes levied by the various Australian states and territories, whereas the allocation of profits would not be.\textsuperscript{53} Overall, then, the status as an ‘employee’ for active members can be beneficial and the Australian government considers some practices to achieve this status as abusive.\textsuperscript{54} Currently, it is not possible for a sole proprietor or a member of a general or limited partnership to obtain employee

\begin{footnotesize}
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\item The NIC is a hypothecated tax to pay most of the cost of retirement pensions, unemployment benefits and sickness benefits. The different application of NIC between the two entities results from NIC rates depending upon whether an employment or self-employment relationship exists. See: Kay JA and King MA, \textit{The British Tax System}. 5 ed. (Oxford University Press, 1990) p 22-23. For a detailed discussion about the reasons behind the introduction of the LLP see: Freudenberg B, “Are transparent companies the way of the future for Australia?” (2006) 35(3) \textit{AT Rev} 200, 210-213.
\end{list}
\begin{list}{\textsuperscript{49}}{\usecounter{footnote}}
\item The overall rates of NIC that are applicable to a corporation are greater than those applicable to an LLP self-employed situation. In terms of a corporation which employs its members, an overall NIC rate of up to 23.8 per cent could indeed be payable, with some by the corporation as employer, and the remainder then being paid by the employee-member. In contrast, when the LLP form is utilised, an LLP member would be regarded as self-employed rather than as an employee, and thus subject to a lower NIC rate. The maximum NIC rate applicable to those who are self-employed is approximately nine per cent.
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\begin{list}{\textsuperscript{50}}{\usecounter{footnote}}
\item Also the conversion for established professional firms from general partnerships to corporations could be costly due to the application of capital gains tax (CGT), which does not occur with conversions to an LLP.
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\begin{list}{\textsuperscript{51}}{\usecounter{footnote}}
\item However, this is subject to many qualifications and legislative changes. For example commencing 1 July 2007, a self-employed person can now claim a 100 per cent deduction on contributions made to a qualifying superannuation fund. \textit{ITAA 1997} (Cth), s 290-170.
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\begin{list}{\textsuperscript{52}}{\usecounter{footnote}}
\item Including fringe benefits and superannuation.
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\begin{list}{\textsuperscript{53}}{\usecounter{footnote}}
\item However, this payroll tax can be mitigated through the manipulation of the wage level paid to active members.
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\begin{list}{\textsuperscript{54}}{\usecounter{footnote}}
\item For example, the Australian government introduced Personal Services Business provisions, which restrict the extent that the benefits can be obtained: \textit{ITAA 1997} (Cth), Div 84 to 87. Also there have been introduced caps on the extent of salary packaging allowed for employees of tax-exempt employers.
\end{list}
\end{footnotesize}
status,\textsuperscript{55} while it is possible for an active member of a corporation or a beneficiary of trust to do so. The ICAA proposal argues that the introduction of a transparent company could have the effect of reducing the additional compliance cost due to the non-application of FBT to benefits provided to employee-members, as they should not be regarded as an ‘employee’.\textsuperscript{56}

Peculiarities of the New Zealand tax model relate to the access to tax losses and tax preferences. It has been observed that New Zealand does not have any substantive loss restriction rules based on members’ contributed equity to the LAQC.\textsuperscript{57} This means that tax transparency in New Zealand can provide, to an extent, the unfettered access to losses for LAQC members.\textsuperscript{58} The other peculiarity in New Zealand is its large tax preference of the non-taxation of capital gains,\textsuperscript{59} with LAQC members being able to access this tax preference.\textsuperscript{60} For tax transparency to broadly apply in Australia it has been argued that the Australian government would require the application of a loss restriction rule to a transparent company.\textsuperscript{61} Furthermore, since 1985 Australia has included most capital gains in taxpayers’ assessable income, thereby having the effect of reducing the extent of this tax preference. Due to the combination of these factors, the

\textsuperscript{55} However, it appears that it is possible for ‘salaried partners’ who are not equity members of a general partnership to obtain ‘employee’ status.

\textsuperscript{56} Institute of Chartered Accountants in Australia and Deloitte, \textit{Entity flow-through (EFT) submission} (Institute of Chartered Accountants, 2008) p 12.


\textsuperscript{59} While New Zealand does not have a comprehensive capital gains tax it does have s DB 26 \textit{ITA 2007 (NZ)}, which assesses amounts from profit-making undertakings. For a discussion about some of the tax preferences available in Australia see: Freudenberg B and McDermott, “The Forgotten CGT events: Are asset revaluations reserve distributions by trustees of discretionary trusts capital gains?” (2005) 34(2) \textit{AT Rev} 67 at 67.


\textsuperscript{61} This is reflected with the introduction of venture capital ILPs and the CFC hybrid amendments. See: Freudenberg B, “Are transparent companies the way of the future for Australia?” (2006) 35(3) \textit{AT Rev} 200 at 216. Freudenberg B, “Losing My Losses: Are the Loss Restriction Rules Applying to Australia’s Tax Transparent Companies Adequate?” (2008) 23(2) \textit{Australian Tax Forum} 125.
peculiarities in the New Zealand model are generally not replicable in Australia, although there is some concessional treatment of capital gains.  

The reduced benefit of a tax transparent company in Australia may be aggravated if there is a relationship between the extent of breaches of tax neutrality and the extent of utilisation of transparent company forms, especially in the early years when uncertainty costs concerning them could be the greatest. For example, Bankman has argued that transparent companies do have attendant uncertainty costs, particularly when they are introduced, and even more so if they are ‘new form’ transparent companies. This uncertainty can relate to various issues: the recognition of their limited liability; an unfamiliar governance regime; and the ‘blending’ of general partnership and corporations law. There can also be conversion expenses for established businesses into the new form. These costs may be aggravated by increased tax compliance costs that may result with tax transparency applying to a business form with limited liability and separate legal entity status. To be successfully introduced into a jurisdiction, a transparent company needs to provide its members with benefits that outweigh these potential costs.

One such benefit could be an improved governance regime provided by the transparent company form, particularly ‘new form transparent companies’. However, governance benefits may of course be difficult to quantify precisely. For example, they could be accumulative or, alternatively, they may never need to be utilised. It is argued, then, that

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62 For example the 50 per cent discount provided to capital gains for CGT assets held greater than 12 months: ITAA 1997 (Cth), Div 115.
64 While historically there was some relationship between corporations and partnership law, over the years the rules governing both forms have diverged.
potential tax savings make a more immediate, tangible and discernible benefit. For example, the access to losses through a transparent company could offset a member’s overall tax liability. Such discrete savings could encourage the utilisation of a transparent company form. Furthermore, transparency in some circumstances decrease the overall tax burden for the business and its members, compared to the treatment of corporations.

It is argued that tax savings may play an important part in the willingness of businesses to adopt a transparent company form, as an offset to any perceived costs (including uncertainty and tax compliance costs). Of course such an acknowledgement is at odds with the idea that tax transparency enhances tax neutrality.

In terms of closely held businesses benefiting from the introduction of a tax transparent company, there are a number of concerns in the foreign jurisdictions studied. For example, empirical data from overseas suggests that tax transparency can result in greater tax compliance costs compared to transparency applying to businesses without company characteristics and integrated approaches applying to corporations. Reasons for this increased compliance cost may be related to eligibility requirements, the extent of aggregation, loss restrictions and cross-jurisdiction treatment; although, it appears that special tax rule companies may impose less compliance costs than those for new form transparent companies.

Analysis of foreign jurisdictions demonstrates that tax transparent companies will not necessarily assist closely held businesses in addressing their financial challenges. This

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66 The savings that losses present, especially as they could be in early years of operation is that decrease the overall financing cost of the business operations and alleviate pressure on debt funding.
67 For example, consideration of foreign jurisdictions studied demonstrates that the utilisation of transparent companies does not guarantee an overall lower tax liability, because there are inevitably qualifications and exceptions. Indeed, in some circumstances, transparent treatment can increase members’ tax burden. Nevertheless, there is significant potential for tax savings with transparent companies - particularly with access to losses, tax preferences and capital gains.
68 That is, general partnerships and sole proprietors.
70 This potential relationship of complexity and tax transparent companies is the subject of a forthcoming article by the author.
includes concerns about strict eligibility requirements and the adverse effect this may have on raising equity. Also the relationship between corporate, capital and individual tax rates is critical in determining the overall tax benefit. However, tax transparency can be seen to be advantageous in terms of access to tax losses, tax preferences and capital gains.

While, historically, there has been reference to the relationship between tax transparency and closely held businesses, it is argued that tax transparent companies are not necessarily a benefit for closely held businesses. Instead, it can be considered that closely held businesses are beneficial for the implementation of a tax transparent regime. That is, tax transparency is more feasible and operational for governments when membership is closely held. If this is the way the relationship operates, then it brings into question the validity of the notion that tax transparency is a benefit for closely held businesses.

It is due to these reasons that there is serious doubt as to whether the broad introduction of a tax transparent company is a model idea for closely held businesses in Australia. Despite these reservations about what can be achieved by the broad introduction of a transparent company in Australia, if prior conclusions about the persuasiveness of international influences then a transparent company in Australia may be inevitable. This focus is reinforced by the recent ICAA proposal that advocates a transparent company. However, there are a number of alternative models of how this could be achieved; each of which will now be considered.

71 This potential for tax transparent companies to address the financing requirements of closely held businesses is the subject of a forthcoming article by the author.
73 In addition to the potential consequences identified, if a transparent company was to be implemented transitional issues would need to be addresses. For example, whether existing forms could move into the transparent regime. Also issues of goods and services tax and State government treatment would need to be considered.
1.6 Conclusion

Tax transparent companies represent for economists the theoretical model of taxing business forms. However, in striving for this economic ideal to achieve greater tax neutrality, it is important for a jurisdiction to consider the practical applications of such reforms. It needs to be recognised that reform is an ‘intellectual, a legal, and a political one’. For example, lawyers and accountants can identify difficulties in how tax transparent companies can be implemented, although foreign practice indicates that is possible. Given the possible benefits that tax transparent companies may represent, it is important that there is greater economic and legal collaboration, as ‘development of a sound reform strategy requires a merging of these two approaches’.

This article has sought to critique the ICAA proposal as being considered by the Henry Review to ascertain whether it is the ‘ideal model’ to achieve a tax transparent company for Australia. Initially it was questioned whether overall there would be much gained through the introduction of a transparent company given the current structure of the Australian tax system. Also, it was observed that rather than transparency necessarily being a benefit to closely held businesses, that it is in closely held circumstances that the implementation of a transparent regime is more feasible for a jurisdiction.

A concern expressed about some of the foreign transparent companies studied was that their introduction was ‘not particularly well informed’. This article contributes to a greater understanding and appreciation by ‘lifting the veil’ on several aspects. It is with such an informed perspective that the potential consequences of striving for tax neutrality can be understood and this understanding may, in turn, inform improved policy.

development. While it is admirable for a jurisdiction to strive for greater tax neutrality, in striving for a model idea it is critical to look to the future to ascertain exactly what will be achieved.