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The International Taxation Project
Board of Taxation Secretariat
C/- The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

REVIEW OF INTERNATIONAL TAX ARRANGEMENTS

Representing Clough I recently attended a session with Ernst & Young to give input to them in preparing a unified response to your Consultative Paper. In order to ensure that you are aware of Clough's strong feelings on this subject I will summarise below our position so that you can take it directly into account. Our position can be put into three separate categories. Specific matters relating to the current Australian tax laws relating to foreign activities; general matters relating to taxing for foreign activities of Australian companies; and finally some general comments about Australian Foreign Taxation Policy (but also applicable to Domestic Taxation Policy).

1. Summary of some specific recommendations of taxing foreign activities that should be changed immediately:

1.1 Transfer of losses between countries outside of Australia

Clough sells Australian based construction services overseas. In the construction industry we bid a number of jobs and only ever win a percentage of them. Which ones we win are very difficult to control. In order to compete effectively we need to be specialised and when overseas we need to be even more specialised. This means we have relatively few opportunities to bid and cannot afford to only target specific countries. Further our industry is very competitive worldwide and we have to bid at fine margins and rely upon our contracting skills as projects progress to try and make additional profits. However, working in many environments means we often lose money on specific projects and in specific countries. When we lose money in a country that loss is quarantined under the present system. Whether it is exempt income or not. The net effect of this is that we generally pay higher rates of tax on our overseas activities then those in Australia. To overcome this we must either increase our margins to cover those potential losses or increase our margin to pay for the overall higher tax rate (net profits are our target not pre-tax profits). If it is not considered possible to allow offsets of both exempt

countries and non-exempt countries at least non-exempt income from all sources should be able to be grouped.

1.2 Deductibility of tender costs

All tender costs by the group should be allowed as deductions in Australia. Clearly unsuccessful bids anywhere are undertaken for the benefit of the group and therefore should be allowed as a deduction.

2. General matters relating to taxation of foreign activities. Matters include:

2.1 Lack of imputation credits for foreign jurisdiction tax paid or a direct credit for foreign jurisdiction tax paid against Australian tax payable

This proposal would cost the Australian Treasury funds. It would be an indirect form of foreign aid. We would understand that as an indirect form of aid it may be appropriate to have this process only for designated countries (i.e. developing countries) that Australia wishes to assist. If tax paid in such countries is a credit in Australia not only will it benefit us but it will benefit the developing countries in which we operate. This process would allow us to bid much more competitively because we would know that in the final instance taxes paid in those countries together with relevant tax payable on those contracts in Australia would always equal out to the same level as Australian Tax rates (this proposal is a restricted form of how the USA system works - for Clough if Australia adopted the USA system we would also be happy).

2.2 Tax Treaties

When speaking to Foreign Jurisdictions they all imply Australia is the one delaying the finalisation of a Tax Treaty with their country. This is almost certainly a two-way issue. Getting a simple treaty covering some (mutually agreeable) aspects would help us. A comprehensive treaty is often not necessary. Just getting withholding tax reductions or other simple matters would help. Once a treaty is in place expanding its scope will be easier. This should be a priority of the Australian Government.

2.3 Transfer pricing compliance costs are a concern to us

The way the transfer pricing legislation is being interpreted the compliance costs are a heavy burden. Such proposals as 2.1 would help, as more activities would be included inside the Consolidation Tax Return; alternatively some simpler rules need to apply.

3. Some more matters apply to both Foreign and Domestic Tax. Major matters include:

3.1 Reduced tax to compensate for higher cost of capital

The cost of raising equity capital, in our industry, is about double the world market. This is both for raising cash for capital and working capital as well as for guarantees of performance, which is a high ratio in our business. In many foreign environments the level of giving guarantees is generally 15% to 30% of the construction contract value (i.e. generally twice the levels required in Australia). Australia's construction market in most of the sectors in which we operate is both open to foreign competition as well as dominated by foreign owned companies. Their reduced (50%) cost of capital means their costs of

supplying required guarantees (their cost is 50% of ours) clearly gives them a competitive edge when bidding against us. When we operate outside of Australia we almost exclusively compete against non-Australians and are therefore always cost disadvantaged by our Cost of Capital and Guarantees. The argument that compensating this cost disadvantage through the tax system is not allowed by the World Trade Organisation is clearly not applied by the Chinese and Koreans governments who support their contractors directly (rather than through the tax system).

3.2 Uncertainty and compliance costs

The complexity of the tax laws is now so bad that we not only aren't certain how to self-assess but we can't be certain that we know everything that we should do to comply. Audits come later and apply new standards that we could never have expected when we self-assessed. The only solution if self-assessment is to continue is to have a very strict time bar between lodging returns and audits. The audits should be finalised within 12 months of lodgement of the returns. Industry will then only have one year of uncertainty rather than the 6 to 10 years we currently have. If there is a problem doing something innocently wrong for one year it is never as expensive as doing it innocently wrong for 10 years. The alternate is to abolish self-assessment and go back to the old system of the ATO finding the problems.

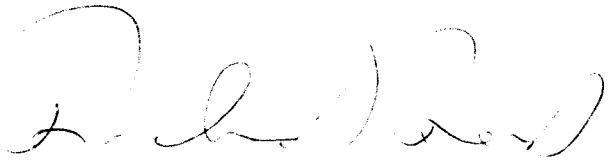
3.3 Australian managed companies

In order to encourage companies and groups to be based in Australia (with all the attendant economic and social advantages) consideration should be given to introducing an overall tax rebate to be offset against the tax payable on foreign net income generated by those groups. This is the complete reverse of the thrust of the Controlled Foreign Corporations (CFC) Tax Legislation. The idea would be to encourage exporters and operators that control overseas operations from Australia. A calculation could be made of all tax payable on those foreign or export operations and rebate 30% (say) of that tax. This could be a tax driven incentive scheme for encouraging both exporters of services as well as Australian Managers of overseas operations. Currently filmmakers and R&D are encouraged. This is at least an equally worthy cause.

The above is only a general submission. Both time constraints and lack of knowledge of all the details do not make a more detailed proposal useful. If some of the concepts highlighted above are not properly explained we can soon rectify that with responses to questions or discussions as you see appropriate. The main consideration is that revision of the current system is required but please make it better not worse.

We have not tried to be comprehensive in our arguments but rather given the main thrusts.

Yours faithfully,
CLOUGH LIMITED



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