25 May 2009

The Manager
Company Tax Unit
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Madam/Sir

**Draft Taxation Laws Amendment (2009 Measures No 4) Bill 2009 – Start Date for Group Conversions Involving MEC Groups**

I refer to the exposure draft legislation (ED), released by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP on 28 April 2009, to implement tax consolidation amendments.

The Australian financial services industry is very open by international standards and many foreign owned providers offer diversity, competition, innovation and enhanced access to international capital markets. The Australian Financial Markets Association (AFMA) represents the interests of participants in Australia's wholesale banking and financial markets, where the level of integration with overseas markets is greatest. Our members include Australian and foreign banks, securities companies, traders across a wide range of markets and industry service providers, most of whom operate through consolidated or MEC groups.

AFMA welcomes the confirmation of these long awaited announcements. We particularly welcome the decision that most of the measures are to apply from the date of commencement of the consolidation rules. However, we wish to draw your attention to subdivision 719-BA regarding group conversions involving multiple entry consolidated (MEC) groups. Paragraph 13 "Application" provides:

> "*The amendments made by this Part apply in relation to the creation of a MEC group from a consolidated group, or a consolidated group from a MEC group, on or after 27 October 2006*."

It is acknowledged in paragraph 1.32 of the draft explanatory memorandum (EM) that significant tax consequences "inappropriately" arise for members of the old group that become members of the new group. In that context, we are concerned the 27 October 2006 commencement date will result in arbitrary outcomes for MEC groups that

**Australian Financial Markets Association**
ABN 69 793 968 987
Level 3, Plaza Building, 95 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7955 Fax: +61 2 9776 4488
Email: info@afma.com.au Web: www.afma.com.au

converted prior to 27 October 2006. We therefore encourage you to ensure the ED gives proper effect to this by including an election to apply the proposed amendment retrospectively from 1 July 2002. We note that paragraph 1.241 of the draft EM states that the commencement date of this measure "will be reviewed" in light of submissions received.

Please find below a more detailed explanation of the issues and our recommendations.

## 1. Current Operation of Conversion Rules

Paragraph 1.32 of the draft EM summarises the existing law as follows:

> Currently, when a group conversion occurs, the old group ceases to exist and a new group comes into existence. As a result, significant tax consequences inappropriately arise for members of the old group that become members of the new group — that is, for entities that are ongoing members of the group. For example:
>
> - the tax cost setting rules that apply when an entity ceases to be a member of (or leaves) a consolidated group or MEC group operate to set the tax costs of the membership interests in each subsidiary member that leaves the old group, potentially causing a capital gain to arise because, for example, CGT event L5 happens; and
> - the tax cost setting rules that apply when an entity becomes a member of (or joins) a consolidated group or MEC group operate to reset the tax costs of the assets of each subsidiary member that joins the new group.

These inappropriate tax consequences result in a significant compliance burden, including practical problems such as:

- The need to prepare special purpose financial statements in accordance with accounting standards as at the time the transaction took effect (which often is not the date when such financial statements would normally be prepared).
- The need to obtain market valuations of a large number of assets and entities.
- Having to engage tax advisory services.
- Other associated administrative services.

The provisions in the ED provide a solution to these inappropriate tax consequences and the resulting compliance burden, but only from the time which the amendments apply, which as the ED stands is 27 October 2006.

## 2. Proposed Amendments in the ED

The ED legislation dates back to 27 October 2006 when the then Minister for Revenue and Assistant Treasurer announced a "change to the consolidation regime allowing ongoing consolidated groups and multiple entry consolidated groups (MEC groups) to restructure with minimal tax consequences".

The media release included the statement: "The new rule will apply to conversions that occur on or after today" (27 October 2006). This start date is reflected in subdivision 719-BA at paragraph 13 on application which states:

"*The amendments made by this Part apply in relation to the creation of a MEC group from a consolidated group, or a consolidated group from a MEC group, on or after 27 October 2006*."

For the reasons given below, we consider this to be arbitrary and potentially unfair to some taxpayers.

## 3. Problems with a 27 October 2006 Commencement Date

### *3.1 Uncertainty*

The proposed amendments aim to reduce uncertainty in the existing special conversion event rules. We applaud the objective of removing uncertainty, however we submit that not having the proposed amendments apply retrospectively will actually increase uncertainty for some taxpayers. This is because prior to the proposed amendments being announced, professional tax advisers and taxpayers have taken a practical interpretation of section 703-55, looking to the policy intent behind the section. Such an interpretation meant taxpayers could rely on section 703-55 to allow a seamless transition from a MEC group to a consolidated group.

Legislating the ED in its current form would make it harder to take this practical interpretation of section 703-55, as the amendments imply there is indeed a problem with the existing legislation. The proposed amendment will put this practical interpretation in doubt and force taxpayers to review their decisions.

For groups that converted prior to 27 October 2006, there will remain uncertainty as to whether the issues listed above did or did not require resolution.

### *3.2 Inconsistency of Start Dates*

We note that of the 18 consolidation issues being amended in the ED, 15 have a start date of 1 July 2002. There is no compelling reason for the MEC group restructure issue not to also have a start date of 1 July 2002.

All other amendments in the ED which fix technical problems with the consolidation regime have start dates of 1 July 2002, and so should the MEC group restructure amendments.

We note that, prior to 27 October 2006, most previous amendments to the tax consolidation provisions (contained in 17 separate Acts to date) have applied retrospectively from the commencement of the consolidation regime on 1 July 2002.

There have also been numerous instances where the Government introduced retrospective income tax related amendments many years after the introduction of the original provisions (for example Tax Laws Amendment (2006 Measures No. 3) Bill 2006 concerning share capital tainting rules applied from as early as 1 July 1998).

## 4. Recommendation: Elective Start Date of 1 July 2002

In our view, there could be inappropriate results if groups do not have the option to apply the amendments retrospectively from 1 July 2002. An application date of 27 October 2006 appears to be an oversight or a matter that the Government would want to reconsider from a policy perspective in light of additional information provided.

We submit that just as there are good reasons for the amendments to occur, there are equally good reasons for these amendments to apply from 1 July 2002. Denying consolidated groups that have undertaken conversion events before 27 October 2006 the benefits of the proposed amendments will not reflect the stated policy intention for these measures, which is to "significantly reduce compliance costs for businesses that restructure".

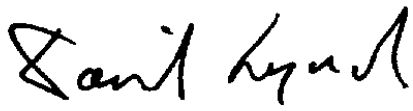
We respectfully submit that while the proposed amendments should apply from 27 October 2006, there should be an election for groups to choose to apply the proposed amendments retrospectively from 1 July 2002.

We would emphasise the importance of the retrospective application of the new rules on an elective basis. This is because, for some groups, a compulsory retrospective application may be equally as detrimental. There may be some consolidated groups that have experienced conversion events before 27 October 2006 where the application of the existing law may have produced acceptable or manageable outcomes. Such groups may be unwilling to now be forced to reconsider their positions given the high compliance costs involved.

* * * * * *

Please feel free to contact me on (02) 9776 7991 if you wish to discuss the issue and I can make the necessary arrangements with relevant members.

Yours sincerely



**David Lynch**
**Head of Policy & Markets**