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Submission – Exposure Draft Tax Laws Amendment (2009 Measures No.4) Bill 2009: Consolidation

The Corporate Tax Association (CTA) welcomes this opportunity to provide comments on the Consolidation Exposure Draft (ED) legislation and accompanying Explanatory Memorandum (EM).

We note that the ED addresses 19 of the 25 outstanding announcements as outlined by the Treasurer and Assistant Treasurer in a Joint Press Release dated 13 May 2008. In regards to the six outstanding measures, we make the following comments:

- Although we appreciate the difficulties Treasury has encountered in addressing these issues, seven years into the consolidation regime corporates should be able to proceed without the significant uncertainty and compliance costs associated with these outstanding matters. Given the extensive delay in finalising the other 19 consolidation amendments and the importance of a number of the outstanding issues, we urge the government to address the remaining six measures as a matter of priority.

- In relation to the measure dealing with CGT straddle contracts, we note Treasury's concerns around comments made in a joint TIA/ICAA submission as to the impact of the proposed changes on the timing of CGT events for consolidated groups. Discussions around these comments at a recent meeting between Treasury officials and externals in Melbourne on 8 May indicated that those comments were preliminary in nature and were not intended to derail the process of finalising the government's position on the measure. Discussions with corporates and professional associations since that meeting indicate that the government's proposed treatment of straddle contracts is workable, subject to a few minor technical adjustments which are covered in detail in a separate joint TIA/ICAA submission on the measure. Given this, we encourage and support the inclusion of amendments to the relevant provisions dealing with CGT straddle contracts in the current package of amendments.

Measures addressed in Exposure Draft Tax Laws Amendment (2009 Measures No.4) Bill 2009

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We understand a number of industry and professional bodies will be making detailed submissions on the proposed amendments to the consolidation regime as outlined in the ED. Given these submissions will more than adequately cover the technical aspects of the proposed amendments, we will be limiting our comments to some broader aspects of the ED, along with some specific observations where we consider there is an urgent need for attention.

Effective dates for consolidation measures

Discussions with Treasury officials on this issue have indicated the following:

- The proposed effective dates for the measures detailed in the ED reflect the dates originally proposed for those measures in the relevant Press Releases.

- The government is still considering the appropriateness of effective dates for all measures contained in the ED and all previous submissions on the matter will be taken into account in determining the outcome.

Without going into too much detail about our views on the appropriate effective dates for unlegislated consolidation announcements[1], as a matter of good design policy where a government announcement is aimed at rectifying a known error identified by business, the measure should be, at the election of the taxpayer, retrospective to 1 July 2002. All other measures should be effective on a prospective basis.

Not allowing optional retrospectivity in these circumstances would not only unfairly punish those taxpayers who have had to comply with defective legislation (often at significant cost) but may also see taxpayers being forced to reopen prior years by the Tax Office.

Appropriate effective dates should also be considered in the context of unintended consequences arising from the proposed amendments. An example of this is the proposed amendment of subsec 711-45(8). The amendments to this provision are intended to reduce compliance costs by limiting the circumstances in which it applies. Although this objective (along with the repeal of CGT event L7) is supported, the amendments will have unintended consequences for taxpayers who have accounted for Deferred Tax Liabilities (DTL) on entry which now fall outside the scope of 711-45(8). Having a prospective start date for this change would effectively address this issue.

Re-opening irrevocable elections

In the context of considering the appropriate effective dates for the consolidation measures we urge the government to give serious consideration to allowing taxpayers to

[1] A detailed joint CTA/EY submission dated 16 May 2007 was provided to Treasury on this issue. Based on comments from Treasury officials we assume the comments in that submission will be taken into account, along with the comments in this submission, in determining the appropriate way forward on effective dates.

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re-exercise otherwise irrevocable elections. A number of the proposed amendments will adversely impact the efficacy of previous choices made by consolidated groups. An example is the proposed amendment of sec 705-93 which effectively extends its scope to pre-joining time asset roll-overs from 'stick' entities'. The inclusion of prior roll-overs from such entities could in some cases have very significant and adverse ACA implications. Allowing such impacted entities to re-exercise its stick or spread choice in the context of the amended sec 705-93 is in our view appropriate and, in the interests of fairness, required.

In regards to the issue of revenue cost, we don't consider that this or the proposal to allow optional retrospectivity should be considered as having an additional revenue cost beyond that which has already been budgeted. In undertaking costing estimates, it would have been anticipated that taxpayers would, in the context of a complete and workable set of rules, make the choices that were most advantageous to them.[2]

Any concerns regarding the compliance cost of such measures are in our view unwarranted as taxpayers will be able to choose whether to reopen prior years or change previous elections.

Treatment of DTLs generally

We note that a number of the proposed amendments impact the treatment of DTLs, most notably the proposed amendments to subsection 705-70(1A) (see further below) and 711-45(8)) (see above and further below). As Treasury is aware the Tax Office has released a discussion paper looking at how DTAs and DTLs impact on the ACA and tax cost setting processes. One of the proposals put forward in the paper is to amend the consolidation legislation to remove the impacts of DTAs and DTLs from the ACA and cost setting process completely.

Understanding that this proposal does not necessarily represent the Tax Office's view, it is fair to say that the treatment of DTAs and DTLs in the context of consolidation generally is under review. Given this, we have concerns about any measures which impact on the treatment of DTAs or DTLs, particularly where those impacts may be detrimental to taxpayers. Without wanting to unravel any of the positives associated with the proposed amendments, we believe the appropriate approach to those which impact on the treatment of DTAs and DTLs should be to give them a prospective effective date and to consider their impact in the context of the current climate surrounding DTAs and DTLs generally.

Modifications to the tax cost setting rules of a joining entity

Use of the tax cost setting amount – sub-section 701-55(6)

[2] Further details on the CTA's position on allowing groups further time to exercise previous choices (in the context of retrospective amendments and other circumstances) can be found in our joint submission dated 1 May 2008 entitled 'Exercising transitional tax consolidation loss choices'.

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Much of the early consultation around the ED has been on the effectiveness of the proposed amendments to subsec 701-55(6). We also note that a working group of Treasury officials, tax officers and members of the NTLG consolidation sub-committee has been proposed to sort out some of the more critical interpretational issues surrounding this provision. Given the level of feedback Treasury is likely to receive on this issue both via the submission process and afterwards, we will limit are comments to the following:

- Although there are a number of perceived problems with the operation of the proposed amendments (including the possible need for specific deduction provisions where tensions between the need to override and maintain the entry history rule cannot be overcome) most of concern with the proposed subsec 701-55(6) is around the Tax Office's approach to its interpretation. It is understood that there is still disagreement within the Tax Office as to the intended scope of the provision. Given the inherent complexities associated with its interpretation, there are concerns about inconsistent and in some cases unfair outcomes for taxpayers who are forced to rely on Tax Office interpretations where the operation of the provision is unclear. The outcomes of the proposed working group will be critical in addressing this concern and to finding a way through those issues that are not identified and resolved during this consultation process.

- Paragraph 1.15 of the EM provides a relatively clear explanation of the policy intention behind subsec 701-55(6), in particular the relevance of an asset's history both pre and post acquisition. As this is the issue that is at the heart of most of the problems associated with subsec 701-55(6), we suggest the paragraph be given more emphasis in the EM and consideration be given to enshrining some of its words in the provision itself.

Foreign currency trade receivables

The transitional modifications aimed at 'legislating' Draft Taxation Determination TD 2004/D80 do not extend to any gain or loss attributable to currency exchange rate fluctuations which will then be subject to Div 775. Although there is an example in the EM outlining the proposed method for determining the amount of the ultimate gain that falls into this category, there is no acknowledgement of the alternative calculation methods some large corporates may have applied in seeking to comply with draft TD 2008/D80. To ensure the position of those that have relied on the draft TD is preserved, the EM should acknowledge that any reasonable method of calculation used in complying with draft TD 2004/D80 is acceptable.

Proposed amendment of subsec 705-70(1A)

Clarification should be provided in the EM, possibly by way of example, as to the intended operation of the proposed amended subsec 705-70(1A), particularly in respect of its application to DTLs.

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There has been considerable debate as to how a DTL should be quantified for inclusion in the ACA calculation under this subsection. With the revised wording, it appears the intention is that the accounting principles of the joining entity are applied to calculate a DTL of the joining entity which would arise to the joined group.

This approach would appear to require comparison between the reset tax values and the reset accounting values of the joining entity which would be included in the accounts of the joined group, but applying the accounting principles of the joining entity to the quantification of those asset and liability values. The difference between these values is then used for the calculation of the DTL, which is performed in accordance with the accounting principles of the joining entity.

Confirmation should be provided that this is the approach intended by the law, if in fact that is so. If another approach is intended, this should be clearly stated, preferably by way of example.

In relation to the proposed amendment we also note the following:

- Preliminary comments from Treasury officials around the proposed amendment of subsec 705-70(1A) seemed to indicate that it was not the intention that the proposed amendment would result in any significant changes to current outcomes.

- Any amendments impacting the treatment of DTLs should be considered in the context of the current review of their treatment and as such should at the very least be prospective (see above).

Modifications to the tax cost setting rules of a leaving entity

Proposed amendment of subs 711-45(8)

The proposed amendment of subsec 711-45(8) is a consequential amendment resulting from the proposal to repeal CGT event L7. Aimed at maintaining its previous role whilst reducing compliance costs, the modifications to subsec 711-45(8) will limit the circumstances (ie: liabilities) to which it applies. The circumstances in which the modified provision will apply are set out at paragraph 1.123 of the EM.

An unintended consequence of these amendments is the removal of its application to DTLs where those DTLs were recognised at step 2 of the joining ACA. This unintended outcome will have significant and adverse ACA implications for those affected.

Given this impact falls outside the clear objectives of amending subsec 711-45(8), the proposed amendments should only apply on a prospective basis.

In relation to DTLs, we note there are significant issues around their treatment on exit generally, particularly in regards to the current operation of subsec 711-45(5). As suggested above, any amendments to the treatment of DTLs or DTAs under the

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consolidation regime should be considered as a package and in the context of the current climate surrounding the treatment of DTLs and DTAs generally.

Group re-structures – special conversion events

The insertion of Subdiv 719-BA is aimed at addressing a number of anomalous outcomes that currently arise under the current special conversion event rules. These issues have been the cause of great concern for those taxpayers in the MEC regime and as such are very welcome. However, there are a few shortcomings that require further attention:

- The amendments implement the announcement by former Assistant Treasurer Peter Dutton on 27 October 2006 in which it was stated that "apart from certain integrity measures, a group conversion will, in essence, be a *seamless transition* for the ongoing [consolidated] group" (Emphasis added). The use of the phrase 'seamless transition' in the context of a conversion from a MEC to a consolidated group and visa versa would appear to be fairly clear. However, the EM states that the intent of the proposed Subdiv 719-BA is to ensure that "minimal tax consequences" will arise on conversion. In our view, the proposed amendments should embody what appears to be the clear intention of government, that groups undertaking conversions should not suffer any tax consequences.

- The effective date for the proposed amendments is the date of the abovementioned announcement (27 October 2006). This means that the amendments will only apply to 'conversion' restructures occurring on or after that date, leaving restructures that occurred before that date exposed. Penalising those taxpayers who have had to endure entry and exit ACA impacts under the current law is unacceptable, both from a position of fairness and good design policy. In our view, such an outcome places these amendments squarely in the 'optional retrospectivity' category.

* * * *

Once again we thank you for the opportunity to contribute to the consultation process on these measures and applaud Treasury for its continued work with the CTA others in addressing and finalising the consolidation measures.

Please feel free to contact me should you wish to discuss any of the matters raised above.

Yours sincerely,

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