Greenwoods & Freehills

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

26 May 2009

By email

Email: consolidation@treasury.gov.au

Dear Sir/Madam

Income tax consolidation regime exposure draft

In regard to the above Exposure Draft issued on 28 April 2009 we enclose our submission dealing with the important issue of retrospectivity, given that a number of these amendments that will have an adverse impact on taxpayers are stated to apply retrospectively back to 1 July 2002 (and hence before the date that such changes were even foreshadowed by the previous Government).

This submission also notes that in the view of the range of measures dealt with in this Exposure Draft material it is essential that corporate groups now also have the opportunity to re-consider and re-exercise various consolidation legislative choices which otherwise are now irrevocable.

Given the critical importance of these aspects Greenwoods & Freehills would appreciate the opportunity to meet with representatives of the Assistant Treasurer and/or Treasury to further discuss how best these timing issues can be dealt with from a technical and practical perspective.

Yours sincerely

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Copies to:

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Submission

Tax consolidation exposure draft provisions

Dealing with proposed retrospective amendments with adverse impacts for taxpayers

26 May 2009

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Greenwoods & Freehills

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1 Introduction

Greenwoods & Freehills (**G&F**) welcome the opportunity to be able to comment on the very extensive consolidation regime amendments issued in exposure draft (**ED**) form on 24 April 2009.

This submission does not deal with the details of any particular proposal, as G&F has contributed points on these aspects for the submissions being lodged by other groups.[1] Rather, this submission considers the very important broader issue of 'retrospectivity' and how it should best be dealt with, given that a number of these measures are proposed to apply back to 1 July 2002. It is also relevant to note that in relation to a number of the measures, it has now been up to three and a half years since initial announcements were made foreshadowing (in very general terms) the proposed legislative change.

In this context, we note that the Government has also flagged some concerns about retrospectivity, in that paragraph 1.241 of the ED explanatory material states that proposed application dates, etc, are under review.

Given the critical importance of these aspects, G&F would appreciate the opportunity to meet with representatives of the Assistant Treasurer and/or Treasury to further discuss how best these timing issues can be dealt with from a technical and practical perspective.

Please contact Ken Spence (Director) on 03 9288 1451 or by email at ken.spence@gf.com.au regarding this submission.

[1] In relation to specific provisions in the ED package, G&F have contributed a number of specific detailed comments to the joint submission to be lodged by the Taxation Institute of Australia and the Institute of Chartered Accountants in Australia.

2 Summary of key recommendations

2.1 Restricting the retrospectivity of amendments adverse to taxpayers

We recommend that for proposed amendments which are expected to have an adverse impact for taxpayers, those amendments should not be applicable in relation to assessments, private binding ruling requests, objections or appeals which were based on an interpretation of the provisions as currently legislated and which were made or lodged before the date of the relevant announcements.

This will ensure that taxpayers that have already sought to apply the relevant provisions based on the legislation and other extrinsic material available at the time of their assessment or other action will not be retrospectively disadvantaged by these proposed amendments.

However, our proposed approach will also 'protect the revenue' as it will preclude other taxpayers from retrospectively attempting to amend prior assessments to adopt an interpretation that the Government is trying to prevent with the proposed amendments. As such, it is submitted that this approach would strike an appropriate balance between the taxpayer's rights and revenue protection concerns of the Government.

Aspects associated with this recommendation are discussed in more detail at 3 below.

2.2 The necessity of being able to make or revoke various formation choices

Certain choices regarding the income tax consolidation regime had to be made on or before the lodgement of a tax consolidated group's first income tax return or could be made by, or revoked up to, 31 December 2005.

Therefore, to the extent that any amendments to the income tax consolidation provisions with retrospective impact back to 1 July 2002 affect factors relevant to the making of these choices, taxpayers must now be given an opportunity to reconsider these choices.

The critical consolidation choices in this regard are the 'chosen transitional entity' choice[2] (colloquially known as the 'stick/spread' choice) and available fraction (**AF**) choices.[3]

[2] Division 701 of the *Income Tax (Transitional Provisions) Act 1997*.

[3] Division 707 of the *Income Tax (Transitional Provisions) Act 1997*.

3 Restricting the retrospectivity of amendments adverse to taxpayers

3.1 Measures with adverse retrospective impacts

The following table lists those amendments in the ED material that could have adverse implications for taxpayers where the stated date of application is before there was even any announcement made regarding the proposed amendment.

Part	Aspect	Effective date	Initial announcement
4	No double counting – ACA	1 July 2002	8 May 2007
5	Pre-joining roll-overs	1 July 2002	1 December 2005
7	Leaving time liabilities	1 July 2002	8 May 2007
8	Accounting principles – ACA	1 July 2002	8 May 2007
9	Inherited deductions – ACA [Amendment to ss.711-35(1)]	1 July 2002	Not previously announced
	Leaving entity: intra-group assets [Not part of ED package as 'still under review']	1 July 2002	8 May 2007

3.2 Parliamentary policy

We understand that it is parliamentary policy that, amongst other requirements, no legislation is passed that 'trespasses unduly on personal rights and liberties'.[4] To ensure this policy is adhered to, the Senate Standing Committee for the Scrutiny of Bills reports to the Senate on all Bills presented to Parliament.[5] As part of this process, the committee:

> … draws attention to any bill that seeks to have retrospective impact and will comment adversely where such a bill has detrimental effect on people.

This policy is clearly adhered to, although we note that there are some situations where different approaches maybe appropriate. Each of the different situations are considered below.

3.3 No adverse impacts – retrospective amendments

There are numerous examples of legislative amendments that are made retrospective as they contain no adverse impacts for taxpayers.

A good example of this is in the context of the tax consolidation regime in the initial implementation phase. The nature of the implementation of the tax consolidation regime meant that significant amounts of legislation have been retrospective. This is because the

[4] Senate Standing Committee for the Scrutiny of Bills, Terms of Reference, Standing Order 24.

[5] Legislation Handbook, Department of the Prime Minister and Cabinet, Canberra, paragraphs 14.53 – 14.55.

relevant legislation was introduced progressively after the commencement of the regime on 1 July 2002. The first key tranches of legislation were enacted in four separate Acts in 2002 and 2003.[6] The first contained the basic rules, and the others added to and built upon those basic rules. This also catered for industry consultation.

Retrospectivity for these types of amendments was clearly appropriate, as taxpayers needed the rules to be in place in order to apply the regime appropriately. These circumstances are not applicable to the proposed amendments considered in this submission.

3.4 Adverse impacts - prospective amendments

As a general proposition, proposed amendments that have an adverse impact are not made retrospectively. There are numerous examples of legislative amendments that are not made retrospectively on the grounds that they would adversely impact taxpayers. These amendments are made prospectively.

For example, in the context of superannuation, consider the *Superannuation Legislation Amendment 2004 (Measures No. 1) Act 2004*.[7] This Act amended the superannuation provisions to prevent 'double dipping' of co-contributions. The second reading speech to the Bill clearly outlined that the amendments would apply from the 2004/05 year 'to avoid retrospective effect'.

Also consider amendments made to the taxation of life insurance businesses in 2004. *Tax Laws Amendment (2004 Measures No 2) Act 2004* made various amendments to Division 302 of the ITAA 1997.[8] Most of the amendments applied retrospectively from 1 July 2000 as this was the commencement date of Division 302, and the amendments had generally been sought by industry representatives to clarify the anomalies in the law. However, the explanatory memorandum to the Act clearly outlined that certain other related amendments were to be applied prospectively (that is, from the date of Royal Assent) as 'they potentially have an adverse impact on life insurance companies'.

3.5 Amendments retrospective back to date of announcement or publication of ruling or guideline

In some other circumstances it may be appropriate to amend the law retrospectively. The principal example in this regard is a legislative amendment which has retrospective impact back to the date the measure was initially announced by Government. Other examples include retrospectivity back to the date of publication of a ruling or other guideline that indicates the view that is subsequently adopted in the proposed amendment or where that view represents general administrative practise that has been accepted by industry.

For example, consider retrospective changes made to the taxation of general insurance businesses in 2002. The *Tax Laws Amendment Act (No 3) 2002* inserted Division 321 into Schedule 2J of the ITAA 1936.[9] This Act contained amendments regarding the basic principles of taxation of general insurance businesses and applied from the 1991/92 income year.[10] This was the date of effect of Income *Tax Ruling* IT 2663, which provided a 'long-standing view' of the law and which had been agreed by the general insurance

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[6] Act No 68 of 2002; Act No 90 of 2002; Act No 117 of 2002; and Act No 16 of 2003.

[7] Act No 92 of 2004, assented 29 June 2004.

[8] Act No 83 of 2004, assented 25 June 2004.

[9] Act No 97 of 2002, assented 24 October 2002.

[10] The change to the law was made to protect the revenue because the concepts in IT 2663 were challenged in *Mercantile Mutual Insurance (Workers Compensation) Ltd & Anor* 99 ATC 4404.

industry. This retrospective change to the law was therefore considered by the Government to be both appropriate and justified.[11]

3.6 Retrospective amendments with limited application

In some circumstances, amendments that have adverse impacts for taxpayers have been made retrospective however, to protect the interests of taxpayers, the amendments have had no application where the taxpayer has acted upon the law as it was written prior the proposed amendment.

For example, consider the enactment of subsection 51(3) of the ITAA 1936 in 1978. This approach was also adopted in a Victorian stamp duty context when section 20A of the *Limitations of Actions Act 1958* was enacted. These are just some examples of the proposed approach, which are outlined in more detail below.

(a) Subsection 51(3) of the ITAA 1936

Subsection 51(3) of the ITAA 1936 was inserted by *Income Tax Assessment Amendment Act (No 3) 1978*.[12] This subsection prevented taxpayers from deducting leave accrued to employees until the leave was paid to the employees. This subsection was inserted following the Victorian Supreme Court Decision in *Nilsen Development Laboratories Pty Ltd v FCT* in 1978.[13]

Subsection 51(3) applied to assessments for years commencing on 1 July 1977, and subsequent years, unless an assessment had been made before 28 September 1978. The amending Act outlined that:

> The amendment made by sub-section (1) is enacted for the avoidance of doubt and, in particular, shall not be taken as implying that a deduction is or was allowable under section 51 of the *Income Tax Assessment Act 1936* in an assessment in respect of income of a year of income preceding the year of income that commenced on 1 July 1977 or in an assessment made before 28 September 1977.

The explanatory memorandum to the amendment also specified that:

> If the decision is upheld by the final appellate court, the amendment made by the Bill will not prevent 1977-78 assessments made before 28 September 1978 or any prior year assessment from being amended as a consequence where the rights of the taxpayer concerned are protected by an objection, a request for reference to a Board of Review or an appeal to a Court at the time when the appellate Court gives its decision.

(b) Section 20A of the Limitation of Actions Act 1958

A similar approach was adopted in the context of Victorian stamp duty when section 20A was amended by the *Limitation of Actions Act 1958* by the *Limitation of Actions (Amendment) Act 1993* (**the Amendment Act**).[14]

Section 20A related to proceedings for the recovery of money paid by way of tax. Section 6 of the Amendment Act provided that the amendments to section 20A:

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[11] The bill also contained amendments relating to:

- reinsurance activities applicable from the 1995/96 income year, the date of effect of *Taxation Ruling* TR 95/5;
- apportionment of premium income applicable from the 1999/2000 income year, the date of effect of changes to the general taxation prepayment rules in Subdivision 3H of Part III of the ITAA 1936; and
- self insurance rules applicable from the 1997/98 income year, the date of effect of *Taxation Determination* TD 97/14.

[12] Act No 171 of 1978, assented on 28 November 1978.

[13] 8 ATR 760.

[14] No 102 of 1993.

> … appl[y] to payments made before , on or after the commencement of this section, other than payments in respect of which proceedings have been brought before that commencement.

This approach protects taxpayers from the change in the law where they had already taken action under that law, based on the law at the time they commenced their action.

3.7 Suggested approach for proposed amendments with adverse impacts

Whilst we consider that proposed legislative amendments should not be made retrospective where they adversely impact taxpayers, we recognise that the announcement of some of these proposed amendments could be construed as effectively publicising areas where the Government now does not believe that the existing law operates appropriately and may unduly advantage taxpayers. In this case, if the proposed amendments were simply made prospective from the date of the relevant announcement, some taxpayers who had not previously considered these issues could seek to amend prior assessments to now take advantage of possible 'pre-announcement' legislative interpretations.

Therefore, at a minimum, we submit that the proposed amendments are generally made retrospectively from 1 July 2002, **but that they do not apply to the disadvantage of a taxpayer in relation to assessments, private binding ruling requests, objections or appeals which have been based on an interpretation of the provisions as currently legislated, and which have been made or lodged before the date of the relevant announcement**.

This will ensure that taxpayers that have already sought to apply the relevant provisions based on the legislation and other extrinsic material at the time of their assessment or other action will not be now unfairly disadvantaged by the proposed amendments. To change the law retrospectively where taxpayers have, for example, already lodged an objection in relation to a matter clearly 'trespasses unduly on personal rights and liberties' of the taxpayer.[15]

This approach will also protect the revenue, as it will preclude other taxpayers from retrospectively attempting to amend prior assessments to adopt the kind of interpretation that the Government is trying to prevent with the proposed amendment.

The Government could approach the proposed amendments that have adverse impacts for taxpayers broadly in a similar manner to the amendment made for subsection 51(3) in 1978.[16] Although we note that the wording of the application of these proposed consolidation amendments would need to address any action by taxpayers under the private binding rulings system, which was not in existence in 1978 when the subsection 51(3) amendment was made.

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[15] As outlined at 0 above, the Senate Standing Committee for the Scrutiny of Bills operates to ensure that, amongst other things, no legislation is passed that 'trespasses unduly on personal rights and liberties'.

[16] Refer to 3.6 above.

4 The necessity of being able to make or revoke various formation choices

4.1 Relevant formation choices

For groups that initially elected to consolidate during the transitional period (generally from 1 July 2002 to 30 June 2004), two categories of transitional choices were available which were provided to streamline the transition of entities and their tax attributes into the tax consolidation environment.

First, on an entity-by-entity basis a choice could be made to retain the existing tax value of assets of an entity (a 'chosen transitional entity') rather than the tax value of the assets of the entity being reset by way of the allocable cost amount (**ACA**) mechanism. This choice mechanism is colloquially known as a 'stick or spread' choice. The tax impacts of these choices were commonly very significant.

Given that the majority of the ED proposals alter the ACA calculation on the formation of a group (either beneficially or adversely), this can materially impact on the appropriateness of stick/spread choices previously made.

Second, a range of AF choices were available to transitional groups that allowed them to notionally transfer/donate losses and 'value' for the purposes of determining the AF that would then be applicable to losses of the group from the date of its formation. These AF amounts were then utilised to determine the post-consolidation rate of utilisation of these pre-consolidation losses.

Determining the appropriate formation AF choices was highly dependent on the nature, quantum and timing of losses of each individual entity in the group, as well as projections as to post-consolidation taxable income (and capital gains/losses) to be generated by the group. Therefore, given that a number of the consolidation proposals could either alter the quantum of pre-consolidation losses or alter post-consolidation taxable income (including capital gains/losses), it is essential that groups are given the opportunity to now re-exercise these formation AF choices.

4.2 Example

The fact that it would be extremely inequitable if taxpayers could not now re-exercise these critical consolidation choices can be evidenced by a simple example involving the proposed amendments to Subdivision 165-CD, which should have effect back to 1 July 2002.

By way of these Subdivision 165-CD amendments (which are long overdue and beneficial to taxpayers) it is more than likely that a number of consolidated groups will recognise additional capital losses arising in respect of the divestment of particular subsidiaries since 1 July 2002, whereas otherwise the existing legislative provisions could have negated these losses. Therefore, for a group that elected to form a tax consolidated group after 1 July 2002, it is possible that these additional losses that retrospectively arise due to the amendments to Subdivision 165-CD could have the following impacts:

- first, the existence of these losses could dramatically impact on stick/spread formation choices because the existence of these losses will reduce the relevant joining entity's ACA via entry ACA step 6 or 7; and
- second, AF formation choices obviously would have been made without any knowledge of these additional tax losses, and therefore are likely to be totally inadequate, such that these additional losses may never be able to be utilised and/or other AF choices will be sub-optimal.

4.3 Suggested approach regarding formation choices

At a minimum, it is submitted that it is essential that a corporate group be given a minimum of, say, 6 months from the date of enactment of these ED provisions to reassess and, if thought appropriate, re-make stick/spread and AF choices applicable back to the date the group initially elected to consolidate.

In this context we strongly support similar points raised in the earlier joint submission by the Taxation Institute of Australia and the Institute of Chartered Accountants in Australia dated 13 December 2007 and a detailed submission on AF choices dated 17 April 2008 lodged jointly by the Taxation Institute of Australia, the Institute of Chartered Accountants in Australia, CPA Australia and the Corporate Tax Association.

We understand that the Treasury is concerned that allowing choices to now be made or allowing previously made choices to be revoked could cause a significant compliance burden for taxpayers. It is correct that taxpayers may need to recalculate amounts to determine the appropriate decisions in light of the amendments, and this will involve compliance costs. However, it is not difficult to ascertain whether a proposed amendment could have a potentially significant impact for a particular taxpayer. Only significantly impacted taxpayers will need to recalculate amounts and analyse the factors relevant to the making of their decisions. Therefore, it is only these significantly impacted taxpayers that will have a compliance burden, and these taxpayers will not be unduly concerned with the compliance burden if it enables them to correct an inappropriate outcome that has arisen as a result of retrospective changes to the law.

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