Greenwoods & Freehills

1 June 2009
Matter 80359
By email

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

By email: consolidation@treasury.gov.au

Dear Manager

Proposed Group Restructure Measures
Exposure draft legislation and explanatory material

Greenwoods & Freehills is pleased to provide the attached additional submission points in response to Treasury's release of the Exposure Draft of the *Tax Laws Amendment (2009 Measures No.4) Bill 2009* (**the ED**) and associated explanatory material (**the EM**).

These submission points focus on the proposed group restructure measures and are in addition to the earlier Greenwoods & Freehills submission in relation to the broader issues of retrospectivity, etc, lodged on 26 May 2009.

We strongly support the Government's initiative in providing a mechanism to allow consolidated groups to convert to multiple entry consolidated (**MEC**) groups, with minimal income tax consequences (ie the proposed Group Restructure Measures). Some of our clients have however expressed their concerns that the current provisions operate in anomalous and inequitable manner and as such could restrict the Australian development and growth of foreign owned groups.

Greenwoods & Freehills believe that there are opportunities for this initiative to be improved in order to ensure that new unintended tax outcomes do not arise. In this respect, we submit that the proposed Subdivision 719-BA of the *Income Tax Assessment Act 1997* can be improved with the following technical amendments:

1 Putting beyond any doubt that Subdivision 707-A of the *Income Tax Assessment Act 1997* does not apply at the conversion time;

2 Not inappropriately eroding the status of prior group losses in 'transfer-up formation' cases;

3 Addressing transition issues relating to tax sharing agreements; and

4 Not disturbing the current tax treatment in relation to the expansion of an existing MEC group.

Details in relation to these technical issues and associated recommendations are contained in the attached Appendix.

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In relation to a broader policy issue, we believe that these measures should not just commence to apply for restructures from 27 October 2006, but rather should also apply back to 1 July 2002. Given that it has been accepted that the existing provisions operate inequitably in triggering adverse 'exit' and 're-entry' consolidation implications for no conceivable policy reason, then it is only appropriate that this position be corrected back to the commencement of the consolidation regime.

If you have any question regarding the matters raised in the submission, please do not hesitate to contact myself.

Yours sincerely

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Greenwoods & Freehills

Appendix

Submitted to the Treasury

Key Submissions Group Restructures – Technical Issues

1 June 2009

Greenwoods & Freehills
101 Collins Street, Melbourne Vic 3000

Submission Appendix

1 Putting beyond any doubt that Subdivision 707-A of the *Income Tax Assessment Act 1997* does not apply at the conversion time

The ED provides that the consolidation provisions in Part 3-90 of the *Income Tax Assessment Act 1997* (other than the single entity rule and Subdivision 719-BA) that ordinarily apply when an entity joins a consolidated group or a MEC group do not apply to an ongoing member that joins the group because of a group conversion.

The wording of the ED in its current form is however open to an interpretation that only those consolidation provisions that 'apply to an entity' will be 'switched off' at the joining time. Therefore, if a consolidation provision does not directly 'apply to an entity', arguably it could still apply at the conversion time even though its application is triggered by the conversion event. Subdivision 707-A is such a provision because technically it applies to a loss and does not directly apply to an entity.

If Subdivision 707-A applies at a conversion time, the old group's losses would be deemed to be transferred to the head company of the new group (subject to certain tests and cancellation elections). This would have significant adverse tax consequences for the new group including, but certainly not limited to, that:

- the prior group losses of the old group would become transferred losses of the new group and therefore the future utilisation of these losses by the new group would become subject to available fraction limitations and ongoing capital injection tests; and
- the initial available fraction of these losses could in some cases be set at significantly less than one.

Recommendation 1:

Given the stated policy intent is to minimise conversion related tax consequences, it is submitted that the legislation should be amended to specifically confirm that Subdivision 707-A does not apply at the conversion time.

2 Not inappropriately eroding the status of prior group losses in 'transfer-up formation' cases

Section 719-300 of the *Income Tax Assessment Act 1997* applies when a new MEC group is created from a consolidated group and in certain circumstances can have the effect of deeming prior group losses to be transferred losses of the new group. Paragraph 1.45 of the EM states that the proposed Subdivision 719-BA does not affect the operation of section 719-300.

We are concerned that this statement regarding section 719-300 is overly broad. Currently subsection 719-300(4) contains an important statutory exception that if a MEC group is created from a consolidated group because a subsidiary member of the consolidated group becomes an eligible tier-1 company of the MEC group (known as a

transfer-up formation), then section 719-300 will have no effect. We submit that the existing statutory exception should be respected.

Recommendation 2:

Given the policy intent is to minimise conversion related tax consequences, it is submitted that the legislation (or possibly the associated explanatory memorandum) should be amended to confirm any exceptions contained in section 719-300 including subsection 719-300(4) can continue to apply. This will ensure, among other things, that in a transfer-up formation case section 719-300 will appropriately continue not to deem prior group losses to be transferred losses.

3 Addressing transition issues relating to tax sharing agreements

For the purposes of Division 721 of the *Income Tax Assessment Act 1997*, it is not entirely clear whether the group tax liability of the new group can continue to be covered by the tax sharing agreement of the old group after the conversion time. This is because the proposed group conversion provisions are still predicated on the basis that at the conversion time the old group ceases to exist and a new group is formed.

Recommendation 3:

It is submitted that the legislation should confirm that 'old' tax sharing agreements continue to comply with Division 721 after the conversion time ie the conversion event should not of itself preclude the old tax sharing agreement from ongoing application.

Even if an old tax sharing agreement still complies with Division 721 after the conversion time, the actual wording of the agreement may not permit its continued application. This is because the proposed Subdivision 719-BA operates on the basis that the old group still ceases to exist at the conversion time, and as a result the relevant contributing entities may also cease to be legally bound by the agreement at the conversion time. It is therefore quite possible in practice that the new group will need to amend the old group's tax sharing agreement to ensure its continued application as a matter of contract law. However, unless these amendments are effected at the conversion time, there will possibly be a gap period in which the new group is not covered by a valid tax sharing agreement.

Recommendation 4:

It is submitted that the legislation should allow the new group to elect to have any necessary related amendments to the old tax sharing agreement to apply retrospectively from the conversion time up to 27 October 2006 (when the proposed group conversion amendment was announced).

4 Not disturbing the current tax treatment in relation to the expansion of an existing MEC group

Para 1.43 of the EM states that Division 711 of the *Income Tax Assessment Act 1997* will apply where an on-going member becomes an eligible tier-1 company in respect of a new group.

Prima facie this could be seen as inconsistent with the views expressed in a discussion paper the Australian Taxation Office issued in November 2006. In that discussion paper it was stated that in the case of expansion of an existing MEC group by way of transferring up an existing subsidiary member to be an eligible tier-1 company, the transferred-up company does not leave the group and hence Division 711 does not apply.

The EM could reconcile the two propositions by limiting the application of Division 711 only to conversion cases. This is because in a conversion scenario an old group will be taken to have ceased and a new group will taken to be formed.

It has already been acknowledged by Treasury, the Australian Taxation Office and industry groups that the MEC provisions need to be reassessed as to whether they deal appropriately with restructures involving an existing MEC group.

Therefore, prior to this review being undertaken and policy change announced we believe it would further add to confusion and uncertainty if these MEC 'conversion' related amendments inadvertently altered tax outcomes in respect of further MEC group transactions.

Recommendation 5:

It is submitted that clarification should be made that the above comments in the EM is only relevant in a group conversion context and does not affect the existing law concerning transfer-up transactions of existing MEC groups.

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