MINERALS COUNCIL OF AUSTRALIA

CONSOLIDATION - RESPONSE TO EXPOSURE DRAFT LEGISLATION RELEASED ON 28 APRIL 2009

1 JUNE 2009

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1. INTRODUCTION AND KEY POINTS

The MCA has consistently supported the tax consolidation regime because it enhances the efficiency of corporate taxation in Australia. Therefore, since the introduction of the regime in 2002 the MCA has committed significant resources to working with Government via submissions and consultation to continue to improve the operation of the regime by addressing technical anomalies and policy distortions that have emerged.

The MCA generally supports the measures detailed in the Exposure Draft legislation and accompanying Explanatory Memorandum released on 28 April 2009, however we believe that important refinements should be made to these measures as detailed in this submission and our associated earlier submission of 12 December 2007 (attached at Appendix 1). In addition, the delay in the initial announcement of a number of these measures and then further significant delay in the drafting and introduction of these measures now means that it is essential that aspects of retrospectivity and the ability to re-exercise prior statutory choices be addressed.

Therefore, in respect of the Exposure Draft, the MCA has concerns in a number of key areas, and a number of revisions are clearly necessary. These specific concerns relate in the main to:

- the detrimental retrospective nature of some of the proposed amendments (13 proposed amendments have 1 July 2002 effective dates);
- the necessity that taxpayers be given time to 're-exercise' consolidation choices as a result of the broad impact of the proposed amendments;
- the lack of clarity in relation to the operation of some of the measures; and
- inconsistencies as to the policy rationale of some of those measures.

Having now lodged 2 detailed submissions on this package of consolidation amendments, the MCA would like the opportunity to meet with Government and Treasury officials in the near future to agree how these aspects can be most appropriately and efficiently addressed.

2. SUMMARY OF SPECIFIC RECOMMENDATIONS

2.1 Aspects raised by the Exposure Draft provisions

- Recommendation 1 – Retrospectivity
  Amendments made retrospectively from 1 July 2002, that are generally detrimental to taxpayers should <u>not</u> apply 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.
- Recommendation 2 - Entry ACA liability amendments

  A legislative amendment is not now required in relation to the issue decided in *Envestra*. However, if legislative amendment was still thought necessary, the proposed amendments need to drafted in a way that will not lead to unintended outcomes.
- Recommendation 3 - Treatment of deferred tax liabilities

  Pending a more comprehensive review of the tax consolidation treatment of deferred tax liabilities (and deferred tax assets) the current law should remain unchanged. Hence, the proposed amendment should not proceed in its current form. In addition, the amendment should not have application prior to the date of release of the Exposure Draft.
- Recommendation 4 - Choices should be re-exercisable

  In the light of this package of amendments, it is imperative that taxpayers should now be given an opportunity to re-exercise both:
  - stick/spread allocable cost amount (ACA) choices; and
  - loss/value donation loss choices.
- Recommendation 5 - FX trade receivables

  The proposed amendments regarding how to determine the extent to which an amount is 'attributable to' currency exchange rate fluctuations needs to respect the methods previously employed by taxpayers in seeking to comply with TD 2004/D80, provided those methods are reasonable. This should be made clear in the legislation and/or the explanatory memorandum.
- Recommendation 6 - Consumables: "purpose"

  The proposed amendment concerning the application of the entry history rule should not proceed.

  In determining the head company's entitlement to a deduction in respect of the tax cost setting amount of a consumable it should be clarified that the head company's purpose is the relevant purpose and that a deduction will be available in respect of the tax cost of the consumable provided the head company conducts an income producing business.(Note, similar clarification is required even if, contrary to our recommendation, the proposed amendment regarding the application of the entry history rule does proceed). .
- Recommendation 7 - Consumables: "timing"

  The proposed amendments concerning the application of the entry history rule should not proceed.

  The proposed amendment should make clear when the head company can deduct the consumable's tax cost in cases where either the joining entity used the 'incurred' method or the 'usage' method and that the timing of the deduction is based on the head company's method for deducting the cost of consumables. (Note, similar clarification is required even if, contrary to our recommendation, the proposed amendment regarding the application of the entry history rule does proceed).
- Recommendation 8 - Subdivision 165-CD

  The proposed amendments to Subdivision 165-CD should be broadened to allow losses to arise to entities which are the head company of a consolidated group and which are also 100% subsidiaries of foreign listed companies. In cases where the shares in the head company are not 'indirect Australian real property interests' this could be done by amending subsection 165-115(X)(3). In cases where the shares in the head company are 'indirect Australian real property interests' this could be done by allowing the loss to the head company of the consolidated group and making adjustments to the reduced cost bases of shares in entities 'up the chain' to avoid loss duplication.

2.2 Previous announcements not included in the Exposure Draft package

- Recommendation 9 - CGT straddle transactions

  The previously announced CGT straddle amendments should be introduced as soon as possible.

- Recommendation 10 - Depreciating assets

  As detailed in our 12 December 2007 submission the proposed amendment (which is intended to ensure the entry history rule applies to determine the time the head company is taken to acquire a joining entity's depreciating assets) should not proceed as it is inconsistent with the policy intent of consolidation's cost setting rules.

2.3 Other critical tax consolidation issues

- Recommendation 11 - Asset based model: policy objectives

  Treasury should engage in consultation on the broader policy objectives of the consolidations regime, specifically, in relation to the operation of the asset based model with an objective of revisiting the various areas where both the current law and proposed amendments result in anomalies, inconsistencies and departures from the original policy rationale of the consolidations regime and the asset based model.

3. DETRIMENTAL AMENDMENTS SHOULD NOT BE RETROSPECTIVE

For the reasons set out in our previous submission of 12 December 2007 we consider that the proposed amendments that would generally give rise to taxpayer detrimental outcomes should not have retrospective application prior to their date of announcement.

Under general legislative practise, amendments should not apply retrospectively where those amendments are expected to have an adverse impact for taxpayers. However, we recognise that the announcement of some of these proposed amendments relate to areas where the Government now believes that the existing law does not operate appropriately. Therefore we propose a 'balanced' approach be adopted in relation to this retrospectivity issue.

Recommendation 1

Amendments made retrospectively from 1 July 2002, that are detrimental to taxpayers, should not apply 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.

There are 13 proposed amendments which would have a 1 July 2002 effective date. The key proposed retrospective detrimental amendments are as follows :

Description of measure	Effective date	Part in Exposure Draft
Pre joining time rollover	1 July 2002	5
Accounting principles	1 July 2002	8
Leaving time liabilities	1 July 2002	7

We consider the first two of these proposed amendments below. We accept that the third proposed measure dealing with leaving time liabilities provides an outcome consistent with the policy behind tax consolidation. However, given the lack of previous guidance on the issue (save the recent decision in *Handbury Holdings*) the retrospective nature of this amendment is also of concern.

3.1 Pre joining time rollover

There was no indication at 1 July 2002 that the law operated in the way proposed by the amendments. In fact, <u>there was a clear indication that the law did not operate </u>in the way proposed by the amendment.

That is, section 705-93 and the allied provision 705-147 on formation (the subject of the proposed amendment) was very clear about which type of rollover was to be covered (Subdivision 126-B and section 160ZZO) and which entity (foreign resident or head company).

There was no guidance suggesting these provisions were in any way deficient.
Hence, taxpayers who made their consolidation decisions about whether to adopt the ACA or "stick" method and how to calculate the ACA were doing so <u>on the basis of law that was clear</u>.

A retrospective amendment to these provisions has a significant adverse impact for many taxpayers. Moreover, these impacts could not have been foreseen when taxpayers were making their tax consolidation decisions. Hence, it would be grossly inequitable for such amendments to have retrospective application.
Accordingly, we submit that the amendment should not have retrospective application.

3.2 Accounting principles

We consider that there are two elements to the proposed amendment concerning the use of 'accounting principles'.

(a) Legislating the decision in Envestra

The first is intended to, in effect, legislate the decision in *Envestra Ltd v Federal Commissioner of Taxation* [2008] FCA 249.

We believe this issue has now been satisfactorily dealt with by the Courts and that as such no specific amendment is now required. However, if it was still thought necessary to provide a legislative amendment we believe that the proposed amendments could achieve this result in a way that would not lead to the unintended outcomes referred to below at 0(b).

Specifically, we submit that, using subsection 705-70(1) as an example, the issue addressed in *Envestra* could be dealt with by amending the subsection to read:

> For the purposes of step 2 in the table in section 705-60, the step 2 amount is worked out by adding up the amounts of each thing (an accounting liability) that, in accordance with *accounting principles, is a liability of the joining entity at the joining time.

The proposed definition of 'accounting principles' could then remain.

This 'minimalist approach' should overcome the unintended consequences of the current proposed amendments referred to below at 0(b). Anything other than a minimalist approach to the amendments to ensure that the 'can or must' issue decided in *Envestra* was legislated would lead to additional complexity in interpreting section 705-70.

Recommendation 2

We submit that no legislative amendment is now required in relation to the issue decided in *Envestra*. However, if legislative amendment was still thought necessary the proposed amendments need to achieve this result in a way that would not lead to unintended outcomes.

(b) Potentially unintended change regarding deferred tax liabilities

The second, and perhaps more important, element is the potential for making an unintended amendment to the current law with respect to deferred tax liabilities as impacted by subsection 705-70(1A). In this regard, we appreciate that the tax consolidation treatment of a joining entity's deferred tax liabilities is somewhat complex and we understand this is an area that is intended to be reviewed.

For example, we are aware that the future treatment of deferred tax liabilities is an issue that was discussed at the 26 February 2009 National Tax Liaison Group Consolidation Subcommittee meeting and was the subject of a draft discussion paper issued by the ATO.

Also, a recent example of the complexity associated with deferred tax liabilities and consolidation in the resources industry is contained in ATO Interpretative Decision ATO ID 2008/164. That ATO ID concerned the treatment of deferred tax liabilities in relation to an exploration permit.

Under the current law it is necessary to consider the deferred tax liability in the joining entity's accounts under step 2 of the ACA. Then, under subsection 705-70(1A), if the amount of an accounting liability of the joining entity would be different when it became an accounting liability of the joined group, the different amount is treated as the amount of the liability.

The proposed amendment would suggest (although not clearly) that it would be necessary to consider the quantum deferred tax liability in the joining entity's accounts post the joining time when applying subsection 705-70(1A) rather than the amount of the this liability as a liability of the joined group.

This is at odds with the purpose of the tax cost setting rules. Section 701-10 provides that the object of the section (and Division 705 which relates to it) is to recognise the <u>cost to the head company</u> of such assets as an amount reflecting the group's cost of acquiring the entity. Hence, it is the deferred tax liability in the joined group's accounts that is relevant to step 2 of the joining entity's ACA. For this reason the proposed amendment should not proceed. Also, as discussed above, there was no indication at 1 July 2002 that the law operated in the way proposed by the amendments.

Recommendation 3

Pending a more comprehensive review of the tax consolidation treatment of deferred tax liabilities (and deferred tax assets) the current law should remain unchanged. Hence, the proposed amendment should not proceed in its current form. In addition, the amendment should not have application prior to the date of release of the Exposure Draft.

4. ADDITIONAL TIME SHOULD BE ALLOWED FOR CONSOLIDATION CHOICES

As mentioned at Error! Reference source not found. above, 13 of the proposed measures have a 1 July 2002 effective date. As also mentioned some of the proposed amendments will have a detrimental impact on taxpayers. Others are generally beneficial to taxpayers. The key proposed amendments which are beneficial to taxpayers are set out in the table below .

Description of measure	Effective date	Part in Exposure Draft
Use of tax cost setting amount	1 July 2002	1
Transitional concessions for SAP's	1 July 2002	17
Inherited deductions	1 July 2002	9
Nil available fractions	1 July 2002	12
Insurance companies	1 July 2002	10
Application of Subdivision 165-CD	1 July 2002	18
Pre-CGT aspects	1 July 2002	3

Given the nature of some of these proposed amendments taxpayers will not have, in many cases, anticipated the proposed amendments. Hence, in many cases, taxpayers would have made tax consolidation choices (eg stick/spread choices with respect to assets and loss and value donation choices with respect to losses) without anticipating these proposed amendments. Since 31 December 2005 it has not been possible for taxpayers to amend or revoke these choices.

Therefore unless taxpayers are given the opportunity to re-exercise both their stick/spread asset choices and their loss/value donation loss choices <u>the intended beneficial impact of the proposed amendments may not be accessible which would be inequitable</u>.

For example, an entity may have previously not claimed a loss due to its application of Subdivision 165-CD (say, on disposal of the shares in a subsidiary on 28 November 2002). The proposed amendments could mean that the loss existed on formation of the consolidated group (say, on 1 July 2003). Hence, the loss could need to be taken into account in the joining entity's ACA and also in the making of loss and value donation choices. Without the ability to re-exercise these choices, inappropriate outcomes may occur. This is because the existence of the loss may mean the head company would apply the stick (transitional) asset method rather than the ACA method. Additionally, loss and value donation choices may have been made with the effect that the loss now available to the joining entity does not receive an available fraction.

Due to the number of proposed amendments and their complexity and the way they potentially interact with each other, it is <u>critically important</u> that the head company be able to re-exercise both stick/spread and loss/value donation loss choices.

As set out in our previous submission (at section 5.1) certain choices regarding the income tax consolidation regime had to be made by lodgement of a group's income tax return or could be revoked (and remade) up to 31

December 2005.[1] To the extent that any amendments to the income tax consolidation provisions affect factors relevant to the making of their decisions, taxpayers should be given an opportunity to now make those choices (if choices available were not made) or revoke previously made choices.

As also set out in the previous submission, Treasury may be concerned that allowing choices to now be made or allowing previously made choices to be revoked could involve compliance costs for taxpayers. However, it is expected that only significantly impacted taxpayers will consider re-exercising these choices, 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. In this regard taxpayers would decide whether to incur these compliance costs or not so the ability to re-exercise choices should not be seen as a compliance cost.

Recommendation 4

It is imperative that the taxpayers be given an opportunity to re-exercise both:

- stick/spread ACA choices; and
- loss/value donation loss choices.

[1] Pursuant to section 705-30 of the *Income Tax Assessment Act 1997*, after 30 June 2002 taxpayers could choose to form a consolidated group on or before the lodgement of their income tax return. This choice was irrevocable. Also, pursuant to section 701-30 of the *Income Tax (Transitional Provisions) Act 1997*, transitional groups could choose not to reset the tax cost of assets held by a transitional entity. This choice could be made or revoked up to 31 December 2005. Thereafter, it was irrevocable.

5. USING THE TAX COST SETTING AMOUNT

5.1 Foreign currency trade receivables

We refer to our previous submission dated 12 December 2007. In that submission we made 10 recommendations related to foreign currency trade receivables. We reiterate the need for these previous recommendations to be actioned.

(a) Definitional aspects

Recommendations 1- 5 related to our recommendation to define what constitutes a 'foreign currency trade receivable' (or, using the language of proposed item 3 of Part 1, a 'trade receivable that is denominated in foreign currency'). Our recommendation remains such that a definition is required to avoid uncertainty as to whether an asset is eligible to use the transitional treatment or not. In this regard, we reiterate our previous submission points that the definition should extend to:

- receivables arising from the provision of services (including accrued interest);
- debts owed to group companies which reflect goods/services provided by other group companies;
- loans made by "finance companies"; and
- foreign currency related to trade receivables.

(b) Guidance on acceptable methods

This is a particularly important practical issue for MCA members.
Recommendation 7 of our previous submission pointed out that legislative guidance is necessary regarding how one determines the extent to which a resulting adjusted capital gain or loss is attributable to currency exchange rate fluctuations.[2]

Most MCA members would have made genuine reasonable attempts to apply the now withdrawn TD 2004/D80. However different taxpayers have, in attempting to comply with TD 2004/D80 taken different approaches. As set out in our previous submission these different approaches are reasonable and stem from the uncertainty in seeking to comply with TD 2004/D80.

Accordingly, we submit that a legislative safeguard is necessary to respect the methods previously used by taxpayers in seeking to apply their understanding of the proposed legislation where those methods are reasonable.

Hence, in the interest of simplicity, the draft legislation could simply specify that there is no specific method to be used to determine the extent to which a gain or loss is attributable to currency exchange rate fluctuations but that whatever method employed must be "reasonable".[2]

At a minimum, comments should be made in the Explanatory Memorandum that the Commissioner should respect a taxpayer's previous attempts to comply with (now withdrawn) TD 2004/D80.

Given that the proposed transitional measures relating to foreign currency trade receivables end on 22 August 2006, taking a simple 'reasonable' approach referred to above would also not create any go-forward issues. The approach would adequately resolve the past issues and mean past treatments adopted would, in many cases, not need to be revisited; hence reducing compliance costs.

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[2] The EM provides some guidance on this aspect (by way of example 1.11 of the Explanatory Memorandum). However, that example is too simplistic in that it assumes the exchange rate applicable at the time the receivable is collected is the same exchange rate as that prevailing at the time the receivable was initially acquired. Hence, the issues previously pointed out at section 1.2 of our previous submission concerning how to determine the 'extent to which' an amount is attributable to currency exchange rate fluctuations still apply (particularly where three exchange rates apply. That is, one rate in acquiring the receivable, another in setting the tax cost of the asset and a third in collecting the receivable). We previously proposed two methods to provide additional clarity on this aspect (please refer to section 1.2.3 of the earlier 12 December 2007 submission). In the interests of simplicity it may be preferable not to specify a method in the legislation. However, the methods set out in our submission could be included in the Explanatory Memorandum as examples of what is reasonable.

Recommendation 5

The proposed amendments regarding the extent to which an amount is 'attributable to' currency exchange rate fluctuations need to respect the methods previously employed by taxpayers in seeking to comply with TD 2004/D80 provided those methods are reasonable. This should be made clear in the legislation and/or the explanatory memorandum.

5.2 Consumables

Given that the treatment of a tax cost setting amount allocated to a consumable was initially the principal reason for the proposed amendment we believe it is important that the amendment remove all uncertainty regarding whether and when the tax cost setting amount of a consumable can be deducted.

We support the proposition that the head company of a tax consolidated group is able to deduct the tax cost setting amount allocated to a joining entity's consumables.

However, on two important points of detail we consider that the proposed amendments would benefit from additional clarity to make absolutely certain that the head company can deduct the cost of the consumable of a joining entity.

(a) Factual matrix and head company purpose

The first point of detail concerns the fact that the note to the proposed amendment to section 701-55(6) states that the entry history rule is relevant to 'other purposes'. Consistent with recommendation 21 of our previous submission which recommended a return to the asset based model (refer also 0 below) we consider that the entry history rule should not apply for these 'other purposes'. Instead, consistent with the objects of consolidation (at section 700-10) we believe that the relevant purpose should be the head company's purpose.

Accordingly, we do not support the application of the entry history rule to determine these 'other purposes'.

As set out at section 2.1 of our previous submission the proposed amendments also stop short of providing the additional factual background necessary to ensure a deduction to the head company results in respect of the tax cost setting amount of the asset (consumables in particular).

The proposed amendment should make clear, either by way of further provisions or note, that in determining the head company's entitlement to a deduction in respect of the tax cost setting amount of the consumables, the head company's purpose in holding the consumable is the relevant purpose and that provided the head company conducts an income producing business that purpose will be a purpose that enables a deduction to the head company.

Without these, we feel that there is at least a technical risk that a deduction may not be available such that the proposed amendments would not have their intended effect.

Recommendation 6

The proposed amendment that the 'entry history rule' applies to determine 'other purposes' should not proceed.

The proposed amendment should make clear that in determining the head company's entitlement to a deduction in respect of the tax cost setting amount of a consumable, the head company's purpose for holding the consumable is the relevant purpose and that a deduction in respect of the tax cost of the consumable will be available provided the head company conducts an income producing business.

(b) Note, if contrary to our recommendation, the proposed amendment regarding the application of the entry history rule does proceed then we consider that elaborating comments are still required regarding purpose. In that case the comments should make clear that it is the joining entity's purpose (in initially acquiring the consumable) that is the relevant purpose in determining whether the head company is entitled to a deduction. Relevance to consumables deducted on 'incurred' and 'usage' basis

The second point of detail concerns a request for elaborating comments in the Explanatory Memorandum as to when the head company can deduct the consumable's tax cost where the joining entity has used either the 'incurred' method or the 'usage' method of deducting the cost of consumables. (The current example 1.2 does not deal with this issue).

The explanatory memorandum should make clear that it is the method used by the head company that will determine the time at which the tax cost of the consumable is deductible. So, for example, in cases where the head company applies the usage method the head company should be entitled to deduct the tax cost of the consumable when it uses the consumable. In cases where the head company applies the incurred method then the head company should be entitled to deduct the tax cost setting amount of the consumable at (just after) the joining time.

Recommendation 7

The proposed amendment should make clear when the head company can deduct the consumable's tax cost in cases where either the joining entity used the 'incurred' method or the 'usage' method. The explanatory memorandum should make clear that it is the method used by the head company that will determine the time at which the tax cost of the consumable is deductible

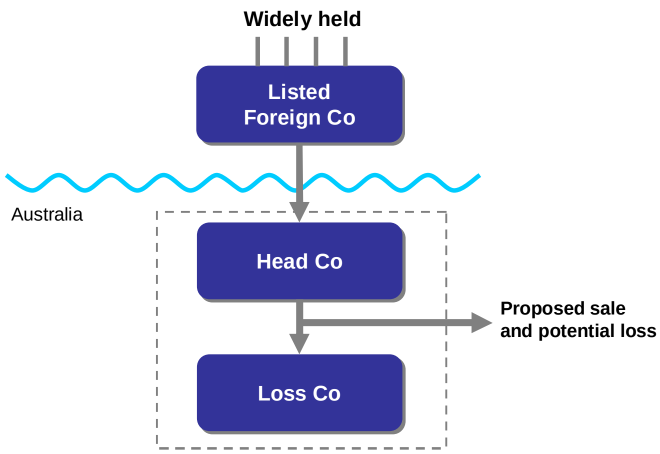
Note, if contrary to our recommendation, the proposed amendment regarding the application of the entry history rule does proceed then we consider that elaborating comments are still required regarding the time at which a deduction is available in respect of the tax cost of a consumable. In that case the comments should make clear that if the joining entity applied the usage method then the head company can deduct the tax cost of the consumable when the head company uses the consumable (and if the joining entity applied the incurred method then the head company can deduct the tax cost of the consumable at (just after) the joining time).

6. SUBDIVISION 165-CD

We welcome the proposed amendments to Subdivision 165-CD. We suspect that the proposed amendments will help clarify that many listed public company groups can dispose of shareholdings in subsidiary members without having to consider the technical provisions of Subdivision 165-CD (to some extent the proposed amendments legislate the outcomes in Private Rulings 72715 and 71337).

However, we reiterate our previous recommendation 13 that the proposed amendments to Subdivision 165-CD should be broadened to cover 100% subsidiaries of widely held companies.

Consider the diagram below (the same structure that was included in our previous submission).



Head Co is the head company of a tax consolidated group. Head Co is 100% owned by a non-resident company, Listed Foreign Co, whose shares are listed on an approved stock exchange. Head Co proposes to sell Loss Co and, subject to Subdivision 165-CD, would crystallise a capital loss on that disposal.

Head Co will not come within the scope of the proposed amendments to Subdivision 165-CD in respect of the sale of its shares in Loss Co (ie Head Co would still have a relevant equity interest in Loss Co). This is because Head Co itself is not a widely held company.

As a result, Head Co would need to apply Subdivision 165-CD on its terms, regardless of whether or not Listed Foreign Co could make a loss on the Head Co shares that reflected the overall loss in Loss Co. Arguably, the mere existence of a single Australian corporate shareholder in Listed Foreign Co would preclude a loss to Head Co. This is inappropriate and could produce a result inconsistent with that where Listed Foreign Co was an Australian listed head company.

(a) Where shares in Head Co not indirect Australian real property interests

The proposed amendments should make it clear that in cases where Listed Foreign Co's shares in Head Co (or interposed entity if there was an interposed entity between Listed Foreign Co and Head Co) do not constitute Division 855 indirect Australian real property interests, Head Co would not have a relevant equity interest in Loss Co. This would recognise the fact that the loss Head Co would make on the disposal of Loss Co could not be 'duplicated' in the Listed Foreign Co group. This could be achieved by amending subsection 165-115(X)(3) with the effect that an entity (first entity) will not have a relevant equity interest in another entity where the shares in the first entity are held by a foreign resident and are not indirect Australian real property interests.

(b) Where shares in Head Co were indirect Australian real property interests

If the shares in Head Co were Division 855 indirect Australian real property interests, the proposed amendments should allow a loss to arise to Head Co (provided Head Co is the head company of a consolidated or MEC group). However, in allowing that loss any 'revenue risk' could be addressed by ensuring that an amount equal to the loss claimed by HeadCo reduces the reduced cost base of shares that Listed Foreign Co (and interposed entities if relevant) holds in Head Co. In effect this proposal would employ a 'Subdivision 165-CD' type of adjustment but that adjustment would apply to entities 'up in the chain' to the entity which would be allowed the loss (rather than entities 'below in the chain' under the current position). Under this approach loss duplication would also not occur.

We believe such a change is necessary in the interest of providing a broadly equivalent outcome for consolidated groups where the head company is a 100% subsidiary of a foreign listed entity as compared to Australian listed consolidated groups. A loss would be allowed to the head company of the Australian listed group and should be allowed to the head company of the foreign listed group.

Subsequently allowing a loss to a non-resident entity above the Australian head company of the foreign listed group would not provide the same economic result as the loss would, in many cases, be wasted (as the non-resident entity may not have an other Australian asset/operation and there is no tax loss grouping available). The loss should be allowed to the Australian head company where it is able to be utilised by the consolidated group more appropriately. We note this would not be an issue if the other legislative amendments were made to allow a loss made by the foreign resident to be 'grouped'.

Recommendation 8

The proposed amendments to Subdivision 165-CD should be broadened to allow losses to arise to entities which are the head company of a consolidated group and which are also 100% subsidiaries of foreign listed companies.

In cases where the shares in the head company are not 'indirect Australian real property interests' this could be done by amending subsection 165-115(X)(3).

In cases where the shares in the head company are 'indirect Australian real property interests' this could be equitably achieved by allowing the loss to the head company of the consolidated group and making adjustments to the reduced cost bases of shares in entities 'up the chain' to avoid loss duplication.

7. CGT STRADDLES

On 8 May 2007 the previous Government announced that provisions would be introduced, operative from that day, to alter the timing of capital gains tax (CGT) events where a relevant contract straddles the time at which the contracting entity joins or leaves a consolidated group (CGT straddle transactions). This measure and its operative date were endorsed by the current Government on 13 May 2008. However, we note that these important amendments are not included in the Exposure Draft material, and paragraph 1.6 of the draft Explanatory Memorandum somewhat ambiguously states that this is one of the issues 'currently under review'.

The MCA strongly believes that this measure should be drafted and legislated as previously announced as soon as possible. It is only through the introduction of these previously announced provisions that a range of significant anomalies and inequities that arise under the existing law can be appropriately addressed, including:

- the inability of an entity subject to tax on a straddle CGT gain to determine the quantification and timing of that gain;
- the entity subject to tax on the CGT gain may not be the entity that receives the proceeds in respect of that sale;
- in exit-sell scenarios the vendor consolidated group can otherwise be taxed twice in respect of the same CGT gain;
- it is possible for 2 taxpayers to be assessed in respect of the same capital gain.

The fact that these problems exist under the existing law is evidenced in *Taxation Determinations* TD 2008/29 to 2008/31, and therefore making minor legislative modifications to support the approach adopted in these tax determinations would certainly not be sufficient.

Therefore, the MCA sees no justification for this previously announced measure not proceeding or its introduction and/or commencement date being deferred.

Recommendation 9

The previously announced CGT straddle amendments should be introduced as soon as possible.

8. DEPRECIATING ASSETS

Paragraph 1.5 of the Explanatory Memorandum accompanying the Exposure Draft legislation also states that aspects associated with 'ensuring that the entry history rule applies to determine the time that depreciating assets of a joining entity are acquired by the head company of a consolidated group' are currently under review.
We reiterate the our previous submission points in this regard. They are:

- We strongly submit that the proposed amendment (which is intended to ensure the entry history rule applies to determine the time the head company is taken to acquire a joining entity's depreciating assets) should not proceed as it is inconsistent with the policy intent of consolidation's cost setting rules.
- If the proposed amendment did proceed:
    - the head company of a consolidated group should have the ability to elect to retain accelerated depreciation in respect of depreciating assets which were subject to accelerated depreciation at the time when they were bought into its group and this ability should continue to apply on subsequent consolidation acquisitions of that entity or other entities which hold the relevant assets;
    - Clarification is required regarding how the head entity is to determine the effective life that applies to the joining entities depreciating assets;
    - Clarification is required to ensure that the head company of a consolidated group should continue to be entitled to deduct the tax cost of a depreciating asset where that asset is first used by the head company after the joining time for exploration or prospecting. The current law is very clear on this point. The explanatory memorandum accompanying Tax Laws Amendment (2004 Measures No. 6) Act 2005 states

      1.52 Section 701-55 applies to set out for the head company a depreciating asset's tax cost, effective life and method for working out its decline in value. If the head company satisfies the criteria in subsection 40-80(1) for such an asset (e.g. the head company's first use of the asset after the joining time is for exploration or prospecting), it will be entitled to a deduction for a decline in value equal to the asset's tax cost.

Recommendation 10

As detailed in our 12 December 2007 submission the proposed amendment (which is intended to ensure the entry history rule applies to determine the time the head company is taken to acquire a joining entity's depreciating assets) should not proceed as it is inconsistent with the policy intent of consolidation's cost setting rules.

9. ASSET BASED MODEL

We reiterate the comments made in our submission of November 2008 in relation to the Henry Tax Review. Section 8.3 of that submission stated:

> The MCA was a strong advocate for the introduction of the Tax Consolidation regime recommended by the Ralph Review, and implemented by the Government with effect from 1 July 2002. The original premise for the tax consolidation regime was to increase efficiency in the tax system by eliminating the tax distortion that arises from having different tax implications for transactions involving the acquisition and sale of companies and businesses. The aim of the tax consolidation rules was to provide the same tax outcomes whether a company or its underlying assets were bought or sold.
>
> Unfortunately, the implementation of the tax consolidation regime was unduly focussed on the transition phase of the new law. Accordingly, many compromises were made which resulted in the 'asset based model' (which was originally proposed) not being appropriately implemented. A consequence of this is that a significant difference in tax outcomes can still exist between the sale/purchase of a company when compared to the sale/purchase of the underlying assets/business of that company. It has also resulted in the tax consolidation legislation becoming unnecessarily complex which materially adds to the compliance costs of undertaking business transactions.
>
> The MCA submits that the tax consolidation rules should be rewritten and simplified on a prospective basis, to give effect to a 'pure' asset based model as originally recommended by the Ralph Review.

We also reiterate recommendation 21 of our 12 December 2007 submission for consolidation to return to the asset based model proposed by the Review of Business Taxation.

Recommendation 11

Treasury should engage in consultation on the broader policy objectives of the consolidations regime, specifically, in relation to the operation of the asset based model with an objective of revisiting the various areas where both the current law and proposed amendments result in anomalies, inconsistencies and departures from the original policy rationale of the consolidations regime and the asset based model.