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Principal Adviser
Business Tax Division
The Treasury
Langton Crescent
PARKES, ACT 2600

By email: consolidation@treasury.gov.au

Dear Sir/Madam

Subject: Submission on the Exposure Draft Legislation – Consolidation Amendment in Schedule 1

CPA Australia represents the diverse interests of more than 139,000 members in 114 countries throughout the world. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we provide the following submission in response to the release of Exposure Draft legislation (ED) and accompanying explanatory materials (EM) issued on 18 April 2012. Our submission specifically addresses the proposed consolidation amendments contained in Schedule 1 of the ED that looks to modify the residual tax cost setting and rights to future income (RTFI) rules so that the outcomes for consolidated groups are more consistent with the tax outcomes that arise when assets are acquired outside the consolidation regime.

General comments

As we have set out in previous submissions, CPA Australia strongly believes that retrospective tax policy and law changes that are detrimental to taxpayers should only be legislated in the most exceptional of circumstances. We are particularly concerned that retrospective legislation is becoming the 'norm' rather than the 'exception' given the proposed retrospective application dates that will apply to the consolidation amendments, the proposed reforms to the transfer pricing rules and the proposed changes to the anti-avoidance provisions contained in Part IVA.

While we understand the proposed retrospective amendments to the 2010 consolidation amendments are necessary to protect a significant amount of revenue at risk as a result of tax deductions being claimed in an unanticipated way, we consider the way the proposed timing rules will apply will give rise to inequitable outcomes for a number of taxpayers who have sought to rely upon the 2010 consolidation amendments.

Specific comments

Protection against retrospective application of the changes

We note that protection from any retrospective application of the proposed changes is limited to taxpayers who:

- **Received** a private binding ruling or written advice under an Advance Compliance Agreement issued before 31 March 2011

- Were **issued** with a notice of assessment or amended assessment between 12 May 2010 and 30 March 2011.

A taxpayer may have lodged a ruling, return or amendment request prior to 31 March 2011 but may not have received the private binding ruling by 31 March 2011 or may not have been issued with a notice of assessment or amended assessment by 30 March 2011. In these circumstances, the 'Pre-rule' period rules will apply rather than the 'Interim' period rules with the result that these taxpayers are disadvantaged when compared to those who have either received a ruling or been issued with an assessment or amended assessment.

It is inequitable that a taxpayer who has lodged a ruling or amendment request prior to 31 March 2011 receives a different treatment simply because it was not actioned by the relevant cut-off time, which at the time of lodgement was not a factor. Taxpayers should not receive differing treatment in circumstances where they have no control over the outcome.

We consider that where a taxpayer has lodged a ruling request by the 31 March 2011 or has lodged an assessment or amended assessment between 12 May 2010 and 30 March 2011, it should be considered under the 'Interim rules' and not the 'Pre rules'. In this way, it is consistent with the treatment of those taxpayers who have received a ruling, assessment or amended assessment during this period.

Accordingly, we recommend that the exposure draft be amended so that the limited protection is afforded to taxpayers who either:

- **Lodged** a request for a private binding ruling or written advice under an Advance Compliance Agreement before 31 March 2011; or

- **Lodged** a return or an objection or request for an amended assessment between 12 May 2010 and 30 March 2011.

By focusing on the date of lodgement of a ruling request, assessment, objection or amended assessment rather than the actual date of receipt or issue, it would at least ensure that taxpayers are not adversely impacted by the proposed changes solely due to factors that are beyond their control.

Treatment of loss companies

Some taxpayers may have been in an overall loss position for a particular income year and as such there was no immediate urgency to claim an amount. In any event, no amendment could be made as there was no tax liability to adjust. Clarification is required as to how the appropriate timing rules will apply to 'loss companies' and the treatment of any 'tail claims'.

Pre-rules – WIP definition

Under subsection 701-63(2)(c), a non-deductible right to future income is to be treated as an asset forming part of goodwill. Subsection 701-63(3) defines a non-deductible right to future income as a right to future income that is not a WIP amount asset. A WIP amount asset is then defined under subsection 701-63(5) as an asset that is in respect of work (but not goods) that has been partially performed by a recipient mentioned in paragraph 25-95(3)(b) for a third entity but not yet completed to the stage where a recoverable debt has arisen in respect of the completion or partial completion of the work. Subsection 701-55(5C) effectively provides that where the asset's tax cost is set and the asset is a WIP amount asset, the tax cost setting amount for the asset is deductible to the head company under section 25-95.

The definition of a 'WIP amount asset' is limited to 'work performed' and does not appear to include a right to future income that is a valuable right (including a contingent right) to receive an amount for the performance of work or services or the provision of goods.

This approach is much more restrictive than that detailed in the Assistant Treasurer's media release of 25 November 2011. Paragraph 19 of the media release stated that the reset tax costs for assets that are Category 1 rights to future income would be deductible in the Pre-12 May (pre-rule) period. A Category 1 right to future income asset was defined in paragraph 16 of the media release to be 'a right to receive income where the work has been done, or the goods or services have been provided, by the joining entity before the joining time'.
Paragraph 20 of the media release then referred to certain assets being excluded from the scope of the residual tax cost setting rule and being treated as goodwill. These excluded assets included rights to future income, **other than Category 1 rights to future income.**

We consider that the definition of 'WIP amount asset' for the Pre-rule period should be amended to reflect the original announcement. That is, the definition of a WIP amount asset should not be confined to work performed but should be expanded to include the provision of services and goods (but not trading stock).

If this recommendation is not adopted, we would recommend that the definition of work within the definition of a 'WIP amount asset' be defined to include the provision of services as the 'provision of services' connotes the doing of something, and would typically be interpreted as doing some form of ‘work’. The meaning of ‘work’ as defined in section 25-95 would also need to be clarified.

By not expanding the meaning of work to include the provision of services or not clarifying the meaning or definition of work would of itself create even more uncertainty given the announcement of 25 November 2011 clearly meant for deductions to be available for the provision of services. Given the unprecedented approach to legislate retrospective changes to retrospective amendments, and the potential impact of these changes back to 1 July 2002, urgent clarification on this point is required.

Pre-rules – Treating non-deductible rights to future income as goodwill assets

A trade receivable may constitute a RTFI under subsection 701-63(4) as it would be a valuable right under a contract or agreement to receive an amount (greater than Nil) for the performance of work or services or the provision of goods. On the basis that the settlement terms of the trade receivable are less than 12 months and therefore not falling within the definition of a Division 230 financial arrangement, it would be a RTFI asset. However, given the trade receivable represents a recoverable debt, it would not appear to constitute a WIP asset as defined under subsection 701-63(5) of the ED. The consequence is that the trade receivable would be a non-deductible RTFI asset that forms part of the goodwill, with the result that trade receivables would be on capital account.

This is in contrast to the current treatment of trade receivables (denominated in Australian currency) where they are generally treated in a consolidation context upon joining as a retained cost base asset where the tax cost setting amount would generally be equal to their face value at the joining time. For the majority of taxpayers, no gain or loss would arise on realisation of the receivable. It is noted that a gain or loss arising from foreign exchange movements in trade receivables that are denominated in a foreign currency would be on revenue account under Division 775.

Given the current treatment of trade receivables in a consolidation context is to treat trade receivables denominated in Australian currency as retained cost base assets, we recommend that the definition of non-deductible RTFI should be amended to exclude trade receivables as this was clearly not the intent of the provision.

Pre-rules and Interim-rules - Application of rights to future income rules to “tails”

We recommend that, for the avoidance of doubt, the law or the EM include an explicit statement on the application of the rules to the ‘tails’ of claims for deductions in respect of the tax cost setting amount of RTFI assets. In particular we recommend that it be made clear that if the taxpayer, through the relevant notice of assessment and joining time, has identified a particular period as applying to the initial claim for a deduction for the tax cost of its RTFI asset, all claims for all subsequent income years should apply the rules applying for that period.

Currently there is the potential for uncertainty as to which rules may apply to the ‘tail’ of a claim as compared with the initial claim. For example pursuant to item 53(2) of the main application rules, the “pre rules” should apply if the joining time is before 12 May 2010 (or the arrangement giving rise to the joining time was entered into before 10 February 2010). An exception to this is if item 53(3) applies. Item 53(3) applies if, amongst other circumstances, the joining time is before 12 May 2010 and the latest notice of assessment <u>for the income year</u> was served between 12 May 2010 and 30 March 2011. Consequently, if a taxpayer has a joining time before 12 May 2010 with a notice of assessment arising in the interim period, the ‘interim rules’ should apply.

The language of item 53(3), however, appears to restrict the exception to the claim relating to the notice of assessment ‘for the income year’. In relation to subsequent years there would be no corresponding assessment ‘for the income year’ falling in the interim period. At face value, therefore, there would appear to be a potential interpretation of the main application rules that would cause the subsequent claims to fall under the operation of the ‘pre rules’.

We understand that Treasury’s intention was not to apply separate rules to an initial claim and subsequent claims. Given this understanding and the example above, we recommend that additional clarity be made in the final legislation to remove any uncertainty on this point. In particular we ask that either the legislation or EM state that, in respect of deductions relating to assets that are RTFI, the relevant notice of assessment for identifying the applicable period’s rules is the assessment relating to the initial claim. Once the applicable period’s rules has been identified, the availability of all subsequent claims is determined in accordance with the rules for that same period, irrespective of the date on which the notice of assessment may be or may have been served for those later years.

Prospective rules – business acquisition approach to the residual tax cost setting rule

Subsection 701-56(2) of the ED treats the head company as having acquired each of the relevant assets of the joining entity at the joining time as part of acquiring the business of the joining entity as a going concern.

Paragraph 1.63 of the EM suggests that by applying a business acquisition approach to the residual tax cost setting rule, assets acquired by a consolidated group as a result of acquiring an entity as a going concern will generally be taken to be on capital account and this will ensure that the tax costs allocated to assets will be recognised only when a CGT event happens to the asset rather than giving rise to immediate revenue deductions. It is further stated in the EM that the consolidation tax cost setting rules will only apply to things that are CGT assets but will include assets that are not taxed under the CGT provisions, such as revenue assets.

The concern is that where an asset is acquired as part of a business acquisition and it is a revenue asset that is not trading stock, notwithstanding that the head company is treated as acquiring a going concern business which may ordinarily be treated on capital account, this should not preclude the head company from being able to allocate under subsection 701-55(6) a cost or outgoing equal to the tax cost setting amount to the revenue asset. This way, if the revenue asset is ultimately disposed of, the net profit assessable as ordinary income would take into account the tax cost amount allocated to that asset pursuant to subsection 701-55(6). If this were not the case, the gross proceeds upon disposal of the revenue asset would be taxable.

We recommend that the legislation clearly recognise that where an asset of a joining entity is a revenue asset and remains a revenue asset of the head company after the joining time, then a tax cost setting amount is to be allocated to the revenue asset under the residual tax cost setting rule.

An example of how the business acquisition approach to the residual tax cost setting rule for revenue assets acquired by a consolidated group as a result of acquiring an entity would be of great assistance in understanding the interaction between subsection 701-56(2) and subsection 701-55(6).

Treatment of interest and penalties

Paragraph 1.89 of the ED indicates that no interest or penalties will be payable where additional tax becomes payable because the Commissioner amends an assessment that issued before 31 March 2011, or further amends an amended assessment that issued before that date, to disallow a deduction for a claim under the pre-rules or interim rules. This would indicate that interest or penalties could be imposed for adjustments relating to assessments or amended assessments to give effect to the new changes issued after 30 March 2011 and which relate to the prospective period.

While the ATO has indicated it will not look to impose penalties and interest for adjustments resulting from the revised law and which relate to the prospective period, this is provided the taxpayer makes the necessary amendments within a reasonable period. Some reference to this administrative practice should be added to the EM to avoid any possible later confusion.

If you have any questions regarding the above, please contact Mark Morris, Senior Tax Counsel, on (03) 9606 9860 or via email at mark.morris@cpaaustralia.com.au.

Yours faithfully

Paul Drum

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