Submission (non-confidential)

Exposure Draft

Tax Laws Amendment (2012 Measures No. 2) Bill 2012, Schedule 1: consolidation amendments

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1 General comments

1.1 Retrospectivity

As foreshadowed in the media release of 25 November 2011 and now reflected in the Exposure Draft (**ED**) material, a number of critically important aspects in the proposed changes will have retrospective application. In many circumstances these retrospective changes override and are totally contrary to quite specific and intended outcomes contained in the consolidation legislative package enacted in June 2010 (including being contrary to quite specific examples contained in the Explanatory Memorandum to that legislation).

To introduce retrospective changes of this nature is not only extremely inequitable, but undermines the confidence of the corporate community in the tax system.

While this submission focuses primarily on technical issues and ambiguities raised by the ED, we recommend that the Government reconsider aspects associated with a number of the retrospective amendments, and we would be happy to provide further input in this regard.

1.2 Extremely limited period for submissions

While the media release foreshadowing these changes was issued on 25 November 2011, it has taken almost five months for this ED material to be released, and then only two weeks has been allowed for public submissions. This is extremely disappointing, particularly as the then Assistant Treasurer in his media release stated that the drafting of legislation would be undertaken as a matter of priority.

Given it has taken the Treasury five months to draft the provisions, it is unsatisfactory to only provide taxpayers two weeks to review them. The review process is made even more difficult by the very peculiar way in which the ED has been drafted, as noted at 1.6 below.

As such, the points contained in our submission are preliminary only, as we have not had the opportunity to either consider a number of these issues in more depth, or to canvass our clients for comments (and this is particularly relevant in relation to specific practical issues that may emerge).

1.3 Introduction of these measures into Parliament – timing

Even in the very limited time that has been provided for reviewing and consultation on the ED, we have identified a number of important issues which are likely to take some time and attention to correctly address.

Given the long history of a number of the issues addressed in the ED (many of which go back to a Government press release in December 2005), it would be extremely disappointing and also damage the credibility of Treasury and the Government if these measures were introduced and passed by the Parliament without due consideration of submission points contained in this and other submissions.

Therefore, we strongly recommend that the introduction into Parliament of these measures be deferred to allow for the issuing of a second ED, so that to the extent possible all issues are considered and addressed. [If the full public release of a second ED is not possible, then we submit that consideration should be given to its release on a limited basis to those parties who have lodged submissions.]

1.4 Inconsistencies with the 25 November 2011 media release

In some important aspects, as outlined in this submission at 2.1. 4.5 and 5.3, the outcomes under the ED provisions differ significantly from those stated in the Assistant Treasurer's detailed media release of 25 November 2011.

It is assumed that these discrepancies are unintended and will be corrected.

1.5 Proposed business acquisition approach

The most significant long-term implication of these measures is the introduction (for the prospective period) of a 'business acquisition approach' in the context of the application of the residual tax cost setting provisions of section 701-55(6). This is dealt with in the ED material only by the insertion of some brief sections in proposed section 701-56, and there is no substantive discussion of issues and implications in the draft Explanatory Memorandum (**EM**).

As illustrated in some of the basic examples contained in 4.1 of this submission, it is evident that considerably more detailed consideration is required as to the method of implementing the proposed asset acquisition approach, including interactions with other components of the consolidation provisions.

It is critical that, to the maximum extent possible, all issues and ambiguities be clarified by the provisions that are ultimately enacted, to avoid creating further confusion and ambiguity.

1.6 Drafting approach

The practice that has been adopted of inserting provisions in relation to the Pre-rules and then repealing them and substituting other sections with the same number in the Interim Rules (and then in some cases repealing them again in the Prospective Rules) causes considerable confusion. Not only does this cause a problem in reviewing the draft Bill, but we envisage that it will also create considerable ongoing difficulties when enacted, given the way it will no doubt have to be dealt with by publishers of the legislation.

We query whether thought has been given to inserting in the Act the Prospective Rules and dealing with other amendments by way of the *Income Tax (Transitional Provisions) Act 1997*.

1.7 EM background comments

Correction is needed to the description in paragraph 1.30 of the draft EM. In particular, the statement that the '2010 amendments have had a broader impact than expected and unintentionally gave consolidated groups an advantage over other taxpayers' is inconsistent with the fact that a number of these outcomes were specifically stated in examples contained in the EM to the 2010 amendments. In addition, the TOFA amendments are not related to the 2010 amendments. Similarly, the reference in paragraph 1.30 to 'windfall' gains is inappropriate.

These same comments apply in relation to paragraph 1.27.

In contrast, paragraphs 8 to 14 of the 25 November 2011 media release provide a more accurate description of the background to these changes, as does the wording in paragraphs 1.7 to 1.12 of the draft EM.

1.8 General comments regarding Schedule 2 (TOFA amendments)

Greenwoods & Freehills' detailed comments in relation to Schedule 2 of the ED dealing with TOFA/consolidation interactions are contained in a separate submission lodged with Treasury.

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2 Pre-rules

2.1 Clause 2: section 701-55(5C) WIP deductions

(a) In respect of the Pre-rules, section 701-63 operates to preclude a deduction being claimed for a 'non-deductible right to future income' which, broadly, is a valuable right (including a contingent right) to receive an amount for the performance of work, or services or the provision of goods. However, there is a specific section 701-55(5C) inclusion for WIP amounts to be deductible relating only to 'work', dovetailing back into section 25-95.

This approach is far more restrictive than detailed in the 25 November 2011 media release. In particular, paragraph 19 of the media release specifically confirmed that Category 1 rights to future income would be deductible, and paragraph 20 indicated that residual cost setting rules in respect of this period would not apply to 'rights to future income, **other than Category 1 rights to future income**'. This was further clarified in paragraph 24.

Importantly, Category 1 also included amounts in respect of 'services' or 'goods' provided before the joining time where a recoverable debt had not arisen, with Category 1 rights also being defined in paragraph 16.

In contrast, the ED section 701-63(5) 'WIP amount asset" definition is far narrower, in that it only applies to 'work' and hence may exclude services and goods.

(b) The definition of a "WIP amount asset" in subsection 701-63(5) would not include work, goods or services that have been completed but, as a result of other contractual terms, have not given rise to a recoverable debt. Such amounts are clearly intended to be covered by this rule and the definition should be expanded accordingly (refer paragraph 24 of the 25 November 2011 media release).

This aspect is more than apparent in situations such as the critically relevant AGL Case, where the task had been completed (e.g. the supply of gas) but a recoverable debt had not arisen because the relevant meters had not been read. A similar situation arises in relation to a number of service arrangements where the service provider secures a customer for a client and is remunerated by the client under a trailing commission arrangement, based on the period that the client retains the customer. That is, the service has been provided to the client 'up front', but the relevant fee becomes a recoverable debt over time.

Amendments should ensure that these 'classic' WIP situations are not excluded from the 'WIP amount asset' definition.

In addition, in relation to both the section 701-63(4) definition of 'right to future income' and the associated section 25-95(3) definition of 'work in progress amount', they respectively make reference to 'a valuable right ... to receive <u>an amount</u>' and 'an entity agrees to pay <u>the amount</u> to another entity'. To avoid any ambiguity in this regard, we recommend that the provisions and/or EM reference confirm that the references to 'an amount' will encompass an amount which will ultimately be determined by reference to the existing agreement/contract, but may not actually be quantifiable at the joining time, as will be the position both in an AGL Case situation and in a trailing commission situation.

(c) The 2010 RTFI provisions can operate to spread deductions over a period of up to ten years. Given that section 25-95 operates to provide a maximum write-off period of two years, it is obviously contemplated and acknowledged by Government that in some circumstances these provisions will have the effect of accelerating deductions. [This same outcome can also occur for WIP amounts under the Prospective Rules.]

2.2 Clause 7: section 701-63 RTFI/goodwill treatment

(a) The proposed section 701-63(1)(a) deemed treatment of all goodwill of an entity as a single asset is unduly restrictive and contrary to the legal concepts of goodwill. As such, it would significantly complicate future tax outcomes.

For example, one consolidated group could conduct a number of totally separate and distinct business operations, each of which would have very separate and distinct goodwill. To operate to deem all these separate components to be a single combined asset would be unduly confusing and could distort tax outcomes.

(b) The reference to an 'entity' in section 701-63(1)(a) is ambiguous. It should be clarified that this is referring to the joining entity rather than the joined group.

(c) In addition, this deemed single goodwill asset treatment will create ambiguity where, for example, an entity joins a group with the 'offending' intangible assets and then shortly thereafter leaves the group while still retaining those intangible assets. Clearly these intangible assets have left the group, and hence the related tax cost setting amount should be used in exit calculations – but this outcome is far from clear in the context of the current drafting of the provisions.

(d) Proposed section 701-63(1) indicates that this deemed goodwill/single asset treatment is only to be mandated 'for the purposes of this part' – ie only for the purposes of the consolidation provisions of Part 3-90.

Neither the fact that this treatment only applies for Part 3-90 purposes nor the implications of this limited application are acknowledged or discussed in the EM. Is it proposed that this deemed treatment of goodwill primarily only applies for asset cost base setting purposes, but not for the ongoing normal application of the CGT provisions in relation to subsequent dealings with such assets? Or is it contemplated that for the 'purposes of this part' it is intended to apply to all subsequent dealings in assets of the subsidiary (but not a head company), given that the single entity rule will be relevant in such cases?

In short ,it appears that technical complications could well arise where this deemed goodwill/single asset treatment is assumed to apply for some purposes of the Act but not others, particularly where the demarcation is not clear.

(e) In some circumstances the scope of the concept of 'accounting intangibles' will extend to mining information to which section 40-80 applies via section 701-55(2) (refer 4.5 below). 'Deemed goodwill treatment' for such an asset is clearly inappropriate from a policy perspective, and hence this potential outcome should be corrected.

More broadly, other anomalous outcomes of this nature could be addressed if the section 701-63 deemed goodwill treatment (applying both in respect of the Pre-rules and the Interim Rules) only applied to assets for which outcomes were impacted by section 701-55(6). This would avoid unintended consequences in respect of assets that for Division 40 purposes are deemed to be capital allowance assets and subject to section 701-55(2).

(f) The scope of the definition of a 'right to future income' in section 701-63(4) is wide enough to include trade debts that have already been included in the joining entity's assessable income. Applying deemed goodwill treatment to such amounts is clearly inappropriate.

Similar issues arise in the context of proposed section 705-25(5)(d), and in this regard would be most relevant where a foreign currency trade receivable is involved.

(g) The use of the term 'Division 230 financial arrangement' in section 701-63(4)(c) is ambiguous, given that Division 230 will generally only apply to a taxpayer from 1 July 2010. This is however subject to a taxpayer making an un-

grandfathering election for TOFA purposes. The effect of making an un-grandfathering election is to (i) apply the TOFA provisions to financial arrangements that a taxpayer held on entry into TOFA and (ii) effectively recognise gains/losses from the financial arrangement under the TOFA provisions for the period that the taxpayer held the financial arrangement prior to 1 July 2010 (by virtue of the transitional balancing adjustment provisions). As such, a taxpayer that makes an un-grandfathering election will in effect apply the TOFA provisions to financial arrangements on a historic basis.

We therefore submit that, not only to address ambiguities but also to avoid unintended anomalies, it should be clarified that if, because of an un-grandfathering election, Division 230 subsequently applies to an asset of a joining entity that joined a consolidated group at an earlier point of time (i.e. prior to TOFA starting to apply to the taxpayer – generally, 1 July 2010), then in respect of that earlier period (i.e. at the joining time) the asset should be regarded for section 701-63(4)(c) purposes as a Division 230 financial arrangement.

Although we assume that this is the intent of the provisions, this should be clarified within the explanatory memorandum.

(h) The scope of the definition of a 'right to future income' in section 701-63(4) is wide enough to include passive income such as lease income under a leasing contract. Applying deemed goodwill treatment to such amounts is clearly inappropriate.

2.3 Clauses 53(5) and (6): RTFI/goodwill – assessments issued before 12 May 2010

(a) The 25 November 2011 media release indicated that in respect of assessments issued prior to 12 May 2010 the amendments only operate to disallow deductions that have been claimed under section 701-55(6) in respect of customer relationships assets, know-how and other accounting intangibles, but other Pre-rule restrictions disallowing deductions in relation to non-WIP RTFI will not apply (refer item 2 of Table 2).

However, the way in which this aspect is dealt with in clauses 53(5) and (6) means that if a taxpayer were now to seek an amendment to an original assessment that had issued before 12 May 2010 to claim deductions for WIP amounts under section 701-55(5C) and/or consumable stores under proposed section 701-55(5D), then it would appear that this could be an amendment that 'relates to the application of subsection 701-55(6) of the original 2002 rules' such that the 'protection' otherwise available under clause 53(5) in relation to any previous claims in respect of RTFIs would be lost. Similarly, if a taxpayer makes a 'voluntary disclosure' request for an amended assessment to disallow deductions previously claimed for section 701-63(2)(b) customer relationship etc assets, then this would appear to erode the protection otherwise available under clause 53(5) in respect of previous claims relating to RTFIs.

For the avoidance of doubt, we request that these clauses be modified to ensure that this outcome does not arise.

(b) Paragraph 1.78 of the draft EM states that:

> If an arrangement or transaction is covered by a notice of assessment which was served on the head company by the Commissioner before 12 May 2010, **the original 2002 rules will apply to the arrangement or transaction** unless:
>
> - the head company requests an amendment or the amendment relates to the application of section 701-55(6) of the original 2002 rules in respect of the joining entity; or
> - the amendment of the assessment relates to an asset that is customer relationship, know-how or another accounting intangible asset and is

inconsistent with the treatment of those assets under the pre-rules. [**Emphasis** added.]

This statement suggests that unless an amended assessment is requested or customer relationship/know-how/accounting intangible assets are involved, then the original 2002 rules will continue to apply to the arrangement or transaction and hence the Pre-rules, Interim Rules and Prospective Rules will have no application.

However, it is somewhat ambiguous from the draft provisions themselves as to whether this outcome is achieved. In particular, it would appear that, notwithstanding that a notice of assessment may have been served in relation to the arrangement before 12 May 2010, if deductions under the original 2002 rules are ordinarily deductible over a period that extends past 10 May 2010 then in respect of those later periods it is unclear whether the Pre-rules or the Interim Rules could also apply.

The intention of this rule needs to be clarified by Treasury and the provisions need to be revised to ensure the intention is achieved.

2.4 Clause 53: two or three sets of rules applying over time to the same RTFI

It is unclear whether subsection 53(1) provides that different provisions (as provided in subsections (2),(3),(4) or (5)) could apply to the same RTFI assets in different years of income.

Although the words are also unclear, the 25 November 2011 announcement (in paragraph 30) did indicate that application of the changes to the pre-12 May 2010 period would depend on the time of the relevant assessment or amended assessment.

In addition, the possibility of multiple rules applying to one RTFI asset is not mentioned in the EM.

Again, Treasury needs to clarify its intention in respect of this 'tail' issue, amend the provisions to clearly reflect the position and clearly document the position and its consequences in the EM.

If it is the intention that an RTFI asset could be subject to multiple sets of rules, then it is far from clear what the tax outcomes will be for an RTFI arrangement that is subject to two sets of rules (and it is likely to even lead to more uncertainty and complexity if three sets of rules apply to the arrangement). This is best illustrated by way of an example.

Background	
Joining time:	1 March 2010
RTFI amount:	$1,000
Service period:	Four years
First assessment issued:	1 December 2010

Deduction outcome under ...	2009/10	2010/11	2011/12	2012/13	Total deductions
2010 provisions (ie without ED impact)	$250	$250	$250	$250	$1,000
ED provisions	$250 (no change)	$400 (application of s.25-95(2)[1])	-	-	$650

[1] This would occur, for example, if at the 2009/10 year, the taxpayer expected a recoverable debt of $600 to arise within 12 months of the joining time (accordingly, the balance of $400 would be deductible in the 2010/11 year).

As illustrated in the above example, if it is intended that the Interim Rules will apply (and continue to apply) in relation to the 2009/10 assessment but that the Pre-rules will apply in respect of the 2010/11 and later year assessments (albeit without amending the earlier 2009/10 assessment), the taxpayer in this circumstance appears to be substantially worse off by the loss of deductions of $350, even though the RTFI is a 'WIP amount' and hence intended to get full deductible status.

This issue was also raised in the 25 November 2011 announcement (also paragraph 30) in the context of losses. For example, where a deduction claimed in an earlier year (say, under the Pre-rules) results in a tax loss that is carried forward and sought to be claimed in an assessment issued after 30 March 2011.

Using the above example, if, say, in the 2009/10 notice of assessment the taxpayer could only utilise $200 of the RTFI deduction with resulting carry-forward losses of $50, it is unclear as to what the intended impact is on the notice of assessment for the 2010/11 year when that earlier loss is recouped. For example, are the 2009/10 carry-forward losses recalculated by applying section 25-95(1), hence resulting in a deemed retrospective deduction back in the 2009/10 year of $600 such that the adjusted carry-forward loss is $400 (rather than the original $50)? A further $400 deduction would then appear to be available separately in respect of the 2010/11 income year.

These examples illustrate that if it is intended that RTFI arrangements will straddle more than one RTFI deduction regime, it is critical that the potential outcomes are correctly dealt with in the legislative provisions to ensure there is not a loss or duplication of deductions. It is also very important that the EM provides taxpayers with guidance as to how to apply these provisions in common scenarios.

3 Interim Rules

3.1 Deemed goodwill

The comments regarding goodwill and assets forming part of goodwill, as noted in regard to the Pre-rules at 2.2 above, similarly apply in relation to the Interim Rules.

3.2 Clause 23: section 701-63(3)(b) definition of 'non-deductible rights to future income'

The clause 23, section 701-63(3)(b) definition of 'non-deductible rights to future income' raises specific issues.

Under the definition provided, a contract that can only be unilaterally cancelled by the payment of a compensation amount or penalty will fall outside the definition, but Example 1.3 in the EM suggests that such a contract will in fact be regarded as a non-deductible right to future income.

The EM examples are particularly unhelpful.

3.3 Interaction of Clauses 7 and 23: sections 701-63(3) and (4) definition of 'non-deductible rights to future income' and 'right to future income'

Various statements in the EM seem to suggest that deductible rights to future income status will only apply where the future income is effectively 'guaranteed'. This is evident from the wording of a number of the specific examples. However, the relevant definition of 'a right to future income' in section 701-63(4) quite specifically includes 'a contingent

right', with the clause 23, section 701-63(3) exclusion of 'non-deductible rights to future income' only applying where such rights are subject to **contingency of renewal or unilateral cancellation.**

Therefore, contingent (and hence not 'guaranteed') rights to future income that exist under an existing contract that is not unilaterally cancellable should be eligible for deductions, and this should be specifically acknowledged and confirmed in the EM. Possibly this could be done by amending the first sentence in paragraph 1.53, given that this sentence only refers to circumstances where the party to the contract has an 'actual obligation to pay an amount' to the joining entity. EM examples should also be broadened accordingly.

Relevant in this context, in practical terms, are numerous types of fixed term non-cancellable service contracts where future income under the contract is contingent upon the use the customer makes of the relevant service/good. In this regard it is extremely common for the funds management and telecommunication agreements (to which Examples 1.2 and 1.4, respectively, apply) to be circumstances where the fees chargeable depend on the level of usage of the service by the customer.

3.4 Mine site improvements

In relation to the Interim Rules, paragraph 46 of the 25 November 2011 media release indicated that the cost setting rules would be amended to clarify that the residual tax cost setting rule would not apply to mine site improvements. A footnote then stated that the ATO was currently considering whether certain mine improvements are depreciating assets and therefore come within the scope of section 701-55(2) rather than under section 701-55(6).

In relation to the Pre-rules for post-31 March 2011 assessments, an equivalent statement was contained in paragraph 20 of the media release.

However, the ED provisions and the associated EM make no reference to mine site improvements. It is understood that this is due to the fact that the ATO are forming the view that such mine site improvements will be separate depreciating assets to which section 701-55(2) will apply and hence they are automatically excluded from the application of section 701-55(6).

It would be beneficial if this could be clarified/confirmed in the EM.

4 Prospective Rules

4.1 Clause 36: section 701-56 business acquisition approach

(a) The approach adopted in relation to the application of the business acquisition approach has been to simply add section 701-56(2) without otherwise amending section 701-55(6) (other than to delete Note 1).

In the limited time available we have not had the opportunity to fully consider all the related implications, but we are concerned that the approach adopted will further confuse the operation of these provisions, particularly in the context of the application of the entry history rule. In this regard, by virtue of section 701-56(1B) the asset acquisition approach in section 701-55(6)(2) applies 'despite the entry history rule', but otherwise the entry history rule will continue to apply notwithstanding the deemed acquisition of the relevant asset.

Paragraph 1.70 of the EM does not further discuss these aspects.

Therefore, the provisions appear to operate for section 701-55(6) purposes only to deem the head company as acquiring the assets of the joining entity by way of a business acquisition, but in other contexts other factors relevant to determining tax outcomes are to be determined by reference to the entry history rule.

Just one extremely common example of ambiguities that will arise in this regard relates to the treatment of trade debts of the joining entity that subsequently are written off as bad.

When the Board of Taxation discussed the business acquisition approach in its October 2010 Position Paper (at paragraph 2.56), it observed that the acquiring group will only be able to 'deduct trade debts held by a joining entity that are written off as bad only if the group is a money lender'. The Board recognised that this could create anomalies, given that trade debts are commonly regarded as retained cost base assets, and then suggested that an appropriate measure to rectify this outcome could be to treat trade debts as being reset cost base assets (footnote 22).

However, the approach adopted in the ED is not to totally negate the entry history rule in this context, but rather to modify its application. Further, in the context of bad debts the fact that Note 2 to section 701-55(6) cross-references to Subdivision 716-S, that deals with COT/SBT aspects, indicates that it is anticipated that bad debt deductions will be available under the amended provisions.

A range of other important issues will arise in relation to the interaction of the entry history rule, because the direction in this regard that was provided by the June 2010 version of section 701-56(1) will no longer apply, given the repeal of this provision. For example, it is unclear as to whether, in determining tax outcomes in respect of such assets held at the joining time, regard is to be had to whether deductions have been claimed prior to the joining time by the joining entity in respect of such assets.

Further, in determining CGT outcomes in respect of an asset, the deemed acquisition under the business acquisition approach will not apply, but for other purposes it will apply. Therefore, careful consideration will be required to determine whether unintended consequences will arise when the entry history rule is disregarded for some purposes but not others in respect of an asset (including its pre-CGT status).

In short, the adoption of a business acquisition approach in this context is a very important development that is intended to have significant implications. In the very limited time that we have had to review the ED, it is far from clear that the full implications of the proposed method of adopting the business acquisition approach have been fully considered. If they have, they have certainly not been explained in the accompanying EM.

As well as addressing the points noted above, it would also be extremely beneficial if material that may have been prepared by Treasury or the ATO considering issues associated with the application of the business acquisition approach was made available, to assist in facilitating a more meaningful discussion of these issues in the limited time available.

(b) We also question the use of the term 'as a going concern'. It appears unnecessary and will create unnecessary confusion.

4.2 Clauses 7 and 40: section 701-63(4) RTFI definition

We are unclear as to the proposed application of section 701-63(4) in the context of these Prospective Rules.

4.3 Clause 41: section 701-63(5) WIP

The treatment of WIP is confusing.

For example, section 701-55(5C) operates to apply the tax cost setting amount into the application of section 25-95, but in so doing only operates in respect of an asset which is

a 'WIP amount asset'. A WIP amount asset is then defined in section 701-63(5) using terms equivalent to those contained in section 25-95(3). While this definition appears to replicate much of section 25-95(3), in the application of section 701-55(5C), section 25-95(3) itself applies.

This circularity/repetition is confusing, and we suggest that it be further considered and/or its intended implications explained in the EM. [Note: this issue also applies in relation to the Pre-rules.]

4.4 Section 25-95 WIP scope

Given that section 25-95 is now to have far wider application, we strongly submit that consideration be given to updating it, not only in its application in a non-consolidation environment, but also now in a consolidation environment. Particularly relevant in this regard is its reference only to 'work' rather than clarifying that it also extends to 'services'.

The term 'work' traditionally has a connotation of physical endeavour (ie exertion/labour/toil) which can raise ambiguity and uncertainty in the context of the present digital environment such as in relation to computing and telecommunication activities. Similarly, ambiguities will arise as to whether 'work' encompasses document/warehouse storage and security arrangements etc.

To not provide clear direction in this regard would be extremely inappropriate, particularly given the history of this package of legislation and the fact that it is intended to provide certainty with retrospective application back to 1 July 2002.

4.5 Clause 42: section 701-67 definition of 'asset'

(a) Section 701-67 provides that the reference to 'an asset' in all the consolidation provisions is to be limited to CGT assets.

This is not consistent with paragraph 55 of the 25 November 2011 media release, which quite specifically stated that 'assets held by a joining entity will have their tax costs set only if those assets are **recognised for taxation purposes**'. That paragraph then goes on to specify that 'the tax costs of assets that give rise to deductions for business capital expenditure will not be set'. Paragraphs 56 and 57 indicated that assets that are recognised for taxation purposes are **primarily** CGT assets. However, the ED provisions go further than this and **restrict** the consolidation provisions to CGT assets only.

This restriction would have very significant and potentially unanticipated adverse implications. For example, mining information (that in many cases will not be a CGT asset – TR 98/3) to which section 40-80 applies to date has specifically been intended to have its tax value reset and be subject to section 701-55(2) (refer paragraph 1.50 to 1.56 of the EM to Tax Laws Amendment (2004 Measures No.6) Bill), but now would not receive that treatment, for no apparent policy reason. [In addition, it is noted in this regard that on a direct asset/business acquisition, consideration attributable to mining information can be deductible to the acquirer under section 40-80.]

We therefore strongly submit that section 701-67 be redrafted to more correctly adopt the approach as clearly articulated in paragraph 55 of the media release.

(b) It is submitted that associated amendments will be required to be made to section 703-35(3) which in effect deems an attribute colloquially known as 'synergistic goodwill' to be an asset of the joining entity for ACA allocation purposes. Synergistic goodwill is certainly not otherwise an asset of the joining entity, and is probably not a CGT asset.

In this regard, the following extract from the minutes of the 8 June 2006 NTLG Consolidation Sub-committee is relevant:

A paper was distributed exploring the possible view that synergistic goodwill may not be legal goodwill and therefore not an asset for the purposes of Part 3-90, such view being inconsistent with the view of synergistic goodwill previously expressed in TR 2005/17. This proposed interpretation does not result in the amount of ACA allocated to goodwill changing. Rather, any premium paid for shares in response to perceived synergies would be reflected in the value of the joining entity's goodwill, rather than create a new asset called synergistic goodwill. On this view, subsection 705-35(3) applies only to counter a potential mischief.

5 Other RTFI application aspects (including interest and penalties)

5.1 Clause 54(3): private rulings

This subclause is somewhat ambiguous. It should be confirmed that where a ruling was issued prior to 31 March 2011 the outcomes stated in the ruling should continue to apply even where the head company requests an amendment of an assessment after the issuing of the ruling in order to give effect to the outcomes as confirmed by the ATO in the ruling.

5.2 Clause 54 and its impact on 'tails' of pre-12 May 2010 claims

The original 2010 rules allowed deductions over up to 10 years for the tax cost-setting amount allocated to RTFIs.

As outlined at 2.4 above, it is unclear whether the current wording of the ED provides protection for 'tails'. This requires further consideration, given that the 25 November 2011 announcement contemplated that the application of the law would depend on the time of the relevant assessment or amended assessment and in some cases, these times could straddle the three distinct rule periods.

Clause 54 deals with the remainder of RTFI claims that are currently available under the 2010 amendments, but which are yet to be fully realised by the taxpayer due to potential for such claims to stretch over a number of years. Broadly, clause 54 provides protection where the relevant taxpayer has received a private ruling or written advice from the Commissioner under an Annual Compliance Arrangement issued before 30 March 2011.

It is submitted that providing protection for the circumstances outlined in clause 54 only produces iniquitous results. For example, assume a taxpayer that has a RTFI claim for an asset of a subsidiary that joined their consolidated group on, say 1 January 2006 (i.e, after the 1 December 2005 Press Release – thus, the taxpayer may have a reasonable expectation that a tax deduction will be made available for an RTFI asset of that subsidiary). That claim is effectively confirmed by the passing of the original 2010 rules. Further assume that the claim is completely uncontroversial (due to the RFTI being specifically included in the 2010 Explanatory Memorandum examples), such that the taxpayer merely lodges an amendment request and claims 5 years worth of deductions in the period between 12 May 2010 and 30 March 2011, which the ATO agrees is uncontroversial and processes quickly. Such a taxpayer may lose the final 5 years worth of deductions due to the changes proposed within the exposure draft (if the tail is unprotected). By contrast, assume a taxpayer is in the same circumstances but with a more controversial RTFI claim (e.g. one that is not on all-fours with one of the examples in the 2010 Explanatory Memorandum). Due to that taxpayer's claim being controversial, the taxpayer seeks a private ruling. Should that taxpayer obtain a positive private ruling or written advice from the Commissioner, that taxpayer's remaining 5 years of claims would be protected.

Whilst it is acknowledged that the treatment of tails and the protection of taxpayers with private rulings or advance compliance agreements were both contemplated in the 25 November 2011 media release, these concepts have not been the subject of any public consultation.

If the amendments ultimately do not provide protection for tails more generally, an improved transitional rule will be needed for those taxpayers whose RTFI claims were uncontroversial (in light of the examples contained in the 2010 Explanatory Memorandum). This will ensure that taxpayers whose circumstances are such that their RTFI claim did not require a private ruling will not 'lose their tail' while taxpayers whose RTFI claim was more controversial, and thus required a private ruling, can 'keep their tail'.

5.3 Clause 4: four year amendment period

In relation to the Pre-rules, paragraphs 31 to 33 of the 25 November 2011 media release in effect specify that the normal four year amendment period will continue to apply in relation to ATO activated amendments, but that an additional two year amendment period will apply to specific taxpayer activated amendment requests. Similarly, the Assistant Treasurer's media release of 25 November 2011 stated:

> Corporate acquisitions that took place before 12 May 2010 will be affected by the changes subject to the application of normal amendment periods.

It is of concern that clause 4 of the ED provisions and paragraph 1.92 of the draft EM do not reflect this treatment, but rather would allow the ATO to go back more than four years in activating amended assessments to increase tax payable.

5.4 Clause 53(3)(b): main application rule

It is awkward that these provisions activating the Interim Rules in respect of joining times after 12 May 2010, where the arrangement commenced after 10 February 2010, are in fact stated effectively as an exclusion from the clause 53(2) provisions that apply to pre-12 May 2010 joining times or pre-10 February 2010 arrangements.

5.5 Interest and penalties

Paragraph 1.89 of the EM indicates that no interest or penalties will be imposed where additional tax becomes payable where the ATO amended assessment issued before 31 March 2011, to give effect to these new provisions. By omission, this suggests that interest or penalties may be imposed for adjustments relating to assessments issued after 30 March 2011.

Through various statements the ATO have indicated that for original assessment issued prior to the enactment of the revised law they will not seek to impose interest or penalties for adjustments resulting from the revised law, provided taxpayers make the necessary amendments within a reasonable period. It is suggested that some reference to this practice be added in the EM to avoid any confusion in this regard.

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