6 March 2006

The Manager
Taxation of Financial Arrangements Unit
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

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Dear Sir/Madam

The Taxation of Financial Arrangements - Proposed Division 230

The Property Council of Australia welcomes the opportunity to review the Exposure Draft Legislation and Explanatory Memorandum (TOFA proposals) released by the Assistant Treasurer Mr Mal Brough on 16 December, 2005.

The Property Council is the peak body representing the interests of investors in Australia's $320billion commercial property investment industry. As such, our members will be significantly affected by the TOFA proposals.

The TOFA proposals are aimed at providing greater coherency and effectiveness to the tax system, lower compliance costs and greater clarity and certainty however, from our consultation with members and other industry bodies, it is clear that the proposed Division 230 still needs considerable refinement.

The Property Council's key concern with the TOFA proposals is the breadth and scope of the definition of "Financial Arrangements". The definition is too broad and encompasses arrangements that are not ordinarily considered financial arrangements. This will place a huge burden on the property industry whose transactions are not substantively financial arrangements but are forced to comply with legislation that is not specifically designed for the industry. In any event, if the provisions apply, the concept of assessing the "reasonable likelihood" of an actual gain or loss will be largely unworkable in the property industry due to the uncertainty it poses for the industry and the sharp escalation in compliance costs for assessment each year.

Due to the current breadth of the TOFA proposals, their inappropriateness for this industry and the additional costs of compliance which will result, the Property Council cannot support the TOFA proposals in their current form.

If the above key concerns can be managed, and there is more focus on alignment of financial accounting and tax outcomes with a lower cost of compliance, then the Property Council is positive that the other issues raised in our submission can be managed.

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In a meeting with us earlier this week, the Assistant Treasurer commented that further consultation with industry is required and a sensible outcome for all parties can be achieved. We are comforted that there will be further industry consultation and urge Treasury to engage with the Property Council throughout the process to resolve the substantial issues we raise below.

In drafting our submission we have had the opportunity to review the submission proposed by the Australian Banking Association (ABA). Our own submission deals with the TOFA legislation from the Property Industry perspective however, we support the broad thrust of the ABA submission and in particular the alignment of accounting and taxation rules.

The attached submission outlines our recommendations and we look forward to close ongoing consultation with you to solve these challenges and create a practical, workable proposal.

Yours sincerely,

Peter Verwer
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Property Council of Australia
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Property Council of Australia

Submission on the Exposure Draft Legislation

Taxation of Financial Arrangements

(TOFA 3&4)

(Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006)

(Released 16 December 2005)

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Taxation of Financial Arrangements (TOFA) Submission

1. Summary of the Property Council Recommendations

This submission contains a number of recommendations made by the Property Council of Australia in relation to the TOFA proposals. The recommendations are not listed in priority order; however the critical recommendations from the Property Council's perspective are the ones addressing the following issues:

- That the definition of "financial arrangement" make it clear that it is intended to apply only to the "financing" element of contracts, not the profit or loss from those contracts themselves.
- That the TOFA proposals seek to use the accounting rules as an elective "fall-back" position to minimise compliance costs.
- That the interaction of the TOFA proposals with other provisions in the tax law, in particular the trading stock and capital gains tax provisions, be carefully considered, with particular reference to property transactions and property trusts.
- That there be further consultation with the Property Council in relation to the development of the TOFA proposals.

The recommendations are summarised below. Commentary on the reason for each recommendation is detailed in later sections, where applicable.

General
Recommendation 1 That the objective of reducing compliance costs is formally recognised in the Objects clause of the TOFA proposals.

Application of the proposed Division 230
Recommendation 2 That the Objects clause also formally recognise that the objective of TOFA, for entities which are not financial institutions, is to bring to account under the TOFA rules, only the "financing" element of any transaction, and not the profits or losses from the transaction itself.

Scope of Financial Arrangement relevant to the Property Industry

Recommendation 3 That the definition of "financial arrangement" be replaced by the definition and scope of "financial instrument" in accounting standards.

Recommendation 4 That (if Recommendation 3 is not adopted) the definition of "financial arrangement" in the TOFA proposals be replaced by a narrower definition based on debt and derivatives.

Recommendation 5 That (if neither of Recommendations 3 and 4 are adopted) further carve-outs to the existing definition of "financial arrangement" in the TOFA proposals be made to deal with the nature of contracts in the property sector.

In particular, the concept underlying the proposed exception contained in s.230-25(2), for financial arrangements consisting of a right to take delivery of, or an obligation to deliver, a commodity, share or other thing, should be extended to completely exclude from the TOFA proposals:

- all arrangements involving the "delivery" of real property (eg sale, acquisition or use by way of lease or license of real property);
- all arrangements which are incidental to, or necessary to facilitate the, delivery of real property (eg lease incentives); and
- other arrangements which relate, in any way, to real property (eg long term construction contracts and management agreements)

Unless the primary purpose of the arrangement is the financing of the relevant dealing.

Reasonably Likely Test

Recommendation 6 That the "reasonably likely" test be modified to create greater certainty and be undertaken only at commencement of the relevant financial arrangement and not on an annual basis, on the grounds of certainty and compliance costs.

Elections

Recommendation 7 Subject to the above exceptions, to the extent that a property financing arrangement falls within the TOFA proposals, the relevant entity should have an election to adopt a tax treatment which aligns with the AIFRS treatment.

Recommendation 8 That the elections are available to all entities, regardless of whether the entities are required to be audited, or prepare financial accounts.

Recommendation 9 That the head company of a tax consolidated group can make the election in respect of the whole group, or individual entities within a tax consolidation group may make different elections as appropriate for their business or can be excluded from the Head Company election.

Recommendation 10 That the elections can be made separately by each trust in a group of trusts.

Exclusions

Recommendation 11 It should be made clear that the exclusion for units in a trust contained in proposed s.230-135(2) is applicable even if the units are treated as debt for accounting purposes as a result of the application of the AIFRS rules.

Recommendation 12 That notwithstanding an arrangement may exceed the 12 month period, the contract is excluded from proposed Division 230 where periodic payments are made under the contract.

Hedging Election

Recommendation 13 That the hedging rules provide for elective alignment of the tax treatment of a hedge with the applicable financial accounting treatment.

Recommendation 14 That the disregarding of gains and losses extend to hedging transactions referable to the derivation of exempt or non-assessable non-exempt income.

Recommendation 15 That in addition to the proposed tax-timing hedging rules, character matching/hedging rules be implemented.

Other Issues

Recommendation 16 That the Commissioner's discretion to apply the regime on an arm's length basis be clarified or reduced.

Recommendation 17 That the interaction of the new regime with other provisions in the tax law be the subject to further and extensive consultation. In particular in relation to the trading stock and capital gains tax provisions. Eg in relation to deliverable instruments such as options & futures.

Recommendation 18 That the commencement date for the new regime aligns with the beginning of a taxpayer's year of income and that adequate time is allowed after Royal

Assent for taxpayers to assess the impact of the rules on their compliance systems and make necessary changes.

2. General

Recommendation 1 *That the objective of reducing compliance costs be formally recognised in the Objects clause of the TOFA proposals.*

Although the draft *Explanatory Memorandum* to the TOFA proposals, refers to reducing taxpayer uncertainty and compliance costs at Para 2.15, the objective should form part of the legislation itself.

The current draft of the TOFA proposals will have a significant impact on Property Council members if it is introduced in its current form because it will give rise to a significant increase in compliance costs. However, it is clear that the TOFA proposals are only the initial stage of the proposed legislative reform as they do not contain details about the commencement date and transitional provisions, and interactions with the remaining areas of the income tax laws (particularly the trading stock and CGT provisions).

The primary reason for the increased compliance burden arises due to the breadth and scope of proposed Division 230. It was not the original intention of the recommendations in *A Tax System Redesigned* that the TOFA proposals would have the breadth and scope which appears in the Exposure Draft legislation.

The Property Council considers that it is essential that further consultation occurs in relation to the TOFA proposals as subsequent legislation is released. In particular, the Property Council wishes to make further submissions in relation to the TOFA proposals in the future.

3 Scope of Financial Arrangement relevant to the Property Sector

The overriding principle which is of concern to the Property Sector is the breadth and scope of proposed Division 230, to transactions which are not, by their nature, financial arrangements. Therefore, clarity is required that the profit or loss from these arrangements is not brought within the scope of the proposed Division 230.

Recommendation 2 *That the Objects clause also formally recognise that the objective of TOFA, for entities which are not financial institutions, is to bring to account under the TOFA rules, only the "financing" element of any transaction, and not the profits or losses from the transaction itself.*

There are several different alternative methods of clarifying the financial arrangements, or components thereof, to which proposed Division 230 should be applicable.

Recommendation 3 *That the definition of "financial arrangement" be replaced by the definition and scope of "financial instrument" in accounting standards.*

The current definition of "financial arrangement" is so broad that it will generally apply to every contractual arrangement which an entity enters into. The consequence is that an entity will need to review each and every single financial arrangement or contract to determine whether or not it is required to utilise a compounding accruals approach to determine the tax outcomes of the arrangement.

The *Explanatory Memorandum* to the TOFA proposals attempts to justify the notion of the broad application of proposed Division 230 (para 4.3) to all contractual arrangements, on the basis that general principles of tax law inadequately apply in the general sense. The EM attempts to justify this notion on the basis that the inclusion of assessable income only where there is a receipt or allowing a deduction only when there is a payment, do not produce appropriate results.

In the main, it is considered that very few property transactions arise, which, under general principles of well established tax law (*see Gasparin v FCT* (1994) 28 ATR 130, Divisions 40, 43 & CGT), do not give rise to the correct reflex of income or deductibility. Property transactions generally are characterised by well developed conveyancing laws and forms well outside the scope of the intended operation of proposed Division 230.

It is not appropriate to impose significant additional compliance burdens on the property sector, under the proposed framework of proposed Division 230, when property transactions are already governed adequately by the general body of tax legislation and case law.

Accordingly, the Property Council recommends that the concept of "financial arrangement" should be generally confined to the definition of "financial instruments" covered in Accounting Standard AASB 132 *Financial Instruments: Disclosure and Presentation,* and AASB 139 *Financial Instruments: Recognition and Measurement.*

Recommendation 4 *That (if Recommendation 3 is not adopted) the definition of "financial arrangement" in the TOFA proposals be replaced by a narrower definition based on debt, derivatives and other synthetic arrangements.*

Under this approach, there would be a stand alone tax definition of "financial arrangement" with no linkage to financial accounting definitions.

For example, the definition of financial arrangement could be based on existing tax law definitions of financing arrangement/debt/security/derivative as found in Div.16E of the Act and the debt/equity rules, with modifications as appropriate, e.g. removal of the 12 month requirement for a qualifying security in Div.16E.

Recommendation 5

That (if neither of Recommendations 3 and 4 are adopted) further carve-outs to the existing definition of "financial arrangement" in the TOFA proposals be made to deal with the nature of contracts in the property sector.

In particular, the concept underlying the proposed exception contained in s.230-25(2), for financial arrangements consisting of a right to take delivery of, or an obligation to deliver, a commodity, share or other thing, should be extended to completely exclude from the TOFA proposals:

- *all arrangements involving the "delivery" of real property (eg sale, acquisition or use by way of lease or license of real property);*
- *all arrangements which are incidental to, or necessary to facilitate the, delivery of real property (eg lease incentives); and*
- *other arrangements which relate, in any way, to real property (eg long term construction contracts and management agreements)*

unless the primary purpose of the arrangement is the financing of the relevant dealing.

Proposed Section 230-25(2) provides an exception for a financial arrangement for the delivery of a commodity, share or other thing (other than money or a *money equivalent). The exception applies provided a fair value election does not apply to the financial arrangement, and provides that Item 4 of the Table does not apply to the arrangement.

It seems relatively clear that there is no intention to exclude such financial arrangements from Item 2 (compounding accruals) provisions of the Table.

We understand that the intention is that the exemption contemplates property as a valid delivery obligation but that the exemption only applies at the time there is disposal and realized gain/loss (as whole or part of the arrangement) under Item 4 of the table in 230-25.

If there is a property transaction that falls within the rules and has an unrealized gain/loss within any year the arrangement is held – (Items 1 to 3) – the exemption cannot apply. The rationale appears to be that the unrealized gains are akin to accrued interest on a loan which would be taxed which is simply not an appropriate analogy for many property transactions which extend beyond a 12 month period.

In addition, there are a number of significant deficiencies with the compounding accruals approach for the property sector.

- The compounding accruals approach does not align with the treatment of property transactions for accounting purposes.
- The compounding accruals approach does not represent a proper reflex of the derivation of income from property transactions.
- The compounding accruals approach does not take into account (for property developers and land traders) that land is trading stock, and therefore it is already covered by the existing trading stock provisions, and does not therefore need to be considered under the proposed Division 230.

- That normal service arrangements should also not need to be considered under the proposed Division 230.

To impose Division 230 on these common property transactions represents a significant and unnecessary increase in the cost of compliance. Therefore, it is submitted that for the property sector a complete exclusion from the TOFA proposals should be provided for the transactions noted above.

4 Reasonably Likely Test

Recommendation 6 *That the "reasonably likely" test be modified to create greater certainty and be undertaken only at commencement of the relevant financial arrangement and not on an annual basis, on the grounds of certainty and compliance costs.*

There are a number of concerns with the reasonably likely test that is currently proposed. Although borrowed from the current Division 16E, the current drafting requires that, for a year of income, it is "reasonably likely" that the taxpayer will make an actual net gain or actual net loss from the arrangement. The test creates a deal of uncertainty - not dissimilar to contemporary issues with Division 16E.

The Property Council recommends that::

- The methodology should follow that applicable for accounting purposes, and certainly not require a taxpayer to prepare separate internal rate of return calculations for tax purposes.
- The entity should specifically be able to quantify or ascertain the amount of the net gain or loss expected to be made under the arrangement i.e. the gain or loss must be capable of quantification.
- The test should be "more likely than not", i.e. a higher than 50% per cent probability.
- For certainty and to minimise compliance costs, it should be necessary that the calculation is undertaken only at the outset, and not on an annual basis.

5 Elections

Recommendation 7 *Subject to the above exceptions, to the extent that a property financing arrangement falls within the TOFA proposals, the relevant entity should have an election to adopt a tax treatment which aligns with the AIFRS treatment.*

In summary, the Property Council believes that alignment between the implementation of the remaining stages of TOFA and AASB 139, would deliver the following benefits:

- leveraging off an already well-thought out and relevant set of principles and rules;
- substantially reduced compliance costs for business, through a major reduction in the potential duplication of lengthy and complex rules in each of tax law and financial accounting standards;
- substantially "self-enforcing" due to the system applying to taxpayers otherwise required to maintain audited financial accounts, e.g. for statutory (non-tax) purposes; and
- the regime will have in-built flexibility to deal with developments in financial transactions and related accounting rules.

Recommendation 8 *That the elections be available to all entities, regardless of whether the entities are required to be audited, or prepare financial accounts.*

Under the TOFA proposals, it is a requirement that, in order to make the elections, an entity must have financial accounts, and those financial accounts must be audited.

Many entities within audited accounting consolidated groups are not required to prepare financial accounts, due to an ASIC Class Order. In a sub group of trusts, where there is a Head Trust, or Stapled Trust as the Head Trust, it may not be a requirement that the accounts of each Trust be audited. There is also the possibility that other types of entities eg standalone partnerships and incorporated joint venture vehicles, may have no requirement to be audited, but may prepare financial accounts.

The elections should therefore be available to all entities, regardless of whether the entity is required to be audited or prepare financial accounts.

Recommendation 9 *That the head company of a tax consolidation group can make the election in respect of the whole group, or individual entities within a tax consolidation group may make different elections, as appropriate for their business, or can be excluded from the Head Company elections.*

It is usual that only a few entities in a corporate group, particularly a Tax Consolidated group, are designated as group borrowing entities i.e. all external finance documents would be entered into by the group's designated borrowing entity. It would therefore ease the compliance burden if the Head Entity of the Tax Consolidated group, were able to make relevant elections for either all group entities or selected group entities.

Recommendation 10 *That the elections can be made separately by each trust in a group of trusts.*

Investment trusts in the property sector may have significant numbers of sub-trusts under the existing listed or stapled Head Trust. To avoid inappropriate outcomes (eg mismatches between trusts within a trust group) and additional compliance costs, it is important that within the property trust sector, entity by entity elections are able to be made under proposed Division 230, even though the turnover of an individual trust may fall below the de minimus thresholds in proposed subsection 230-130.

6 Exclusions

Recommendation 11: *It should be made clear that the exclusion for units in a trust contained in proposed s.230-135(2) is applicable even if the units are treated as debt for accounting purposes as a result of the application of the AIFRS rules.*

Interests in trusts should receive the same exception as equity interests. Some interests in trusts are now reclassified as "debt" for accounting purposes. However, notwithstanding that classification for accounting purposes, interests in those trusts which are "equity like" should be entitled to the same exception as "equity". The current exception in s.230-135(3) may not be broad enough to provide certain investment trusts with the necessary exception. For example, this may particularly be an issue for "closed end" investment trusts.

Recommendation 12: *That notwithstanding an arrangement may exceed the 12 month period, the contract is excluded from proposed Division 230 where periodic payments are made under the contract.*

We understand that the 12 month exclusion is intended to also exclude longer term contracts which involve regular annual payments commensurate to benefits received under the contract (eg lease agreements, land development contracts, building & construction contracts, joint venture agreements for land developments). As currently drafted, s.230-125 is unclear regarding the treatment of these types of contracts and clarity is required that profits and losses under such contracts are outside the scope of proposed Division 230.

7 Hedging

Recommendation 13 *That the hedging rules provide for elective alignment of the tax treatment of a hedge with the applicable financial accounting treatment.*

There are a number of issues with the TOFA proposals which appear to result in misalignment of the tax outcome with the AIFRS treatment. Property Council would appreciate the opportunity to further discuss with Treasury, the accounting treatment of hedges under AIFRS in the property sector, to avoid unintended outcomes in the operation of these rules.

A very significant issue arises for property trusts in relation to the proposed Division 230 tax treatment of hedges. Some property trusts do not make accounting distributions of unrealised movement on hedges. Therefore, for property trusts, there must be the flexibility to elect whether to make the hedging election on a hedge by hedge basis, and/or for a group of hedges within a recognised class. Otherwise, the potential issue arises that these property trusts may not in fact be distributing taxable income applicable to those unrealised gains.

The matters of concern or matters which require further clarification may be summarised as follows:

- It is unclear that the proposed tax treatment will align the tax treatment with the accounting treatment of a hedge in all situations eg what treatment applies if the mark to market on the hedge is treated as a balance sheet item and recognition is deferred for accounting purposes until an event occurs to the underlying asset?
- For the election to be available on a hedge by hedge basis, and/or for a group of hedges within a recognised class.
- That there is suitable time to make such an election, eg the time when a tax return is filed in respect of the year of income when the hedge is entered into.
- Proposed section 230-110 is not clear on the tax treatment for that part of a hedge which is "ineffective" and there is a gain or loss for accounting purposes.
- It is considered that the 5 and 20 year time limits will create distortions between financial accounting and tax outcomes due to the incidence of long dated instruments.

Recommendation 14 *That the disregarding of gains and losses extend to hedging transactions referable to the derivation of exempt or non assessable non-exempt income.*

The Property Council is concerned that the proposals provide complete symmetry of treatment between hedges and the tax treatment of underlying transactions when combined and interacted with other provisions of the tax law.

An exemption is currently provided at s.230-20 for gains and losses from financial arrangements realised to the extent that they are made in gaining or producing exempt or non-assessable non-exempt income. An example of this would be gains and losses from financial arrangements associated with derivation of dividends that are non-assessable non-exempt income under s.23AJ.

It is not clear from the current drafting whether this exemption extends to cover gains and losses realised on hedging financial arrangements covered by Subdivision 230-D and referable to the derivation of exempt or non-assessable non-exempt income. For example, it is not clear on the current drafting that a gain or loss on a forward contract (determined under Subdivision 230-D) hedging the value of dividends to be received that are non-assessable non-exempt income under s.23AJ would be disregarded.

There is obviously a potential for significant mismatches if such gains and losses are not disregarded.

Accordingly, Treasury is requested to clarify the operation of these provisions will provide symmetry of treatment for hedging transactions referable to foreign transactions.

Recommendation 15 *That in addition to the proposed tax-timing hedging rules, character matching/hedging rules be implemented.*

Australian listed property trusts ("LPT's") are now significant investors in offshore property funds, particularly in the USA and Europe. It is common for the foreign exchange risks on these (FX-denominated) equity investments to be hedged via entry into cross currency swaps (equity hedge) and forward exchange contracts (income hedge).

While Division 230 covers the **timing** basis on which gains / losses on the hedge are recognised, it does not deal with potential mismatches between the **character** (revenue / capital) of: (a) the gain / loss on the hedge and (b) the corresponding loss / gain on the underlying investment.

Example:

- Australian LPT invests (on capital account) in a US Real Estate Investment Trust ("REIT") via USD denominated equity.
- LPT hedges its USD exposure via entry into a cross currency swap (lend AUD / borrow USD).
- FX gain / loss on USD equity is on capital account (ie wrapped up into overall CGT result on disposal) but corresponding FX loss / gain on currency swap is on revenue account – hence the mismatch.
- Mismatch is particularly acute where there is a capital loss but a revenue gain.

Similar issues arise in connection with the hedging of proceeds from the disposal of foreign denominated investments prior to repatriation and the hedging of foreign denominated profit distributions.

Treasury is requested to consider a more equitable approach to the characterisation of gains and losses to ensure that either:

- There is an appropriate hedge matching regime (i.e. character of hedge gain / loss matched to character of underlying transaction loss / gain); or
- A hedge integration regime applies (as for example in the USA) whereby in the above example the hedge and the underlying transaction are treated as the one (AUD denominated) transaction - with the result that FX gains / losses never arise in the first place.

Whether a "two transactions" or "one transaction" approach is taken, there would need to be appropriate designation, effectiveness, and etc requirements to address integrity concerns.

Significantly, we note that Division 775 already authorises a similar result via the short-term FX gain / loss rules in Sections 775-70 and 775-75. These rules cover the situation where for example a taxpayer acquires an (FX-denominated) CGT asset or depreciating asset and pays / settles the purchase price within 12 months. The rules prima facie **require** the taxpayer to integrate any FX gain / loss arising between contract date and settlement into the cost base of the asset itself (unless the taxpayer elects to separately recognise the FX gain / loss). Presumably these rules were included in recognition that from a theoretical perspective the FX gain / loss here is really part of the cost of the underlying asset.

Similarly, on sale of say an (FX-denominated) CGT asset, the retranslation rules in Subdivision 960-C effectively integrate the FX gain / loss arising between acquisition date and disposal date into the (AUD-denominated) calculation of the CGT capital gain / loss.

We submit that the position is theoretically no different where there is a separate FX instrument hedging the underlying equity investment. The loss / gain on the hedge is economically part of the overall gain / loss on the investment, and should be characterised accordingly. (As noted above, US tax rules already permit this result.)

We anticipate such alignment would be revenue-neutral on an overall basis. Where for example the underlying equity investment is held by a unit trust, a capital gain on sale of the investment may be distributed to individual or superannuation fund investors entitled to the CGT discounting concession (i.e. 50% or 1/3 reduction), whereas the offsetting FX loss on the hedge is on revenue account – effectively creating a net tax deduction to the investor that does not correspond to any economic loss. Under the Property Council proposal the tax result would be aligned with the economic position.

8 Other Issues

Recommendation 16 *That the Commissioner's discretion to apply the regime on an arm's length basis be clarified or reduced.*

The Property Council considers that each of the Commissioner's discretions should be augmented by further detail, outlining how the discretions will be exercised. Specifically, adopting objective standards regarding their exercise will avoid the possibility of uneven exercise of powers and perceived uncertainty in the market. We comment specifically however, in relation to proposed section 230-120.

Section 230-120 gives the Commissioner discretion to substitute an arm's length result, where of the opinion having regard to any connection between the parties that the parties were not dealing at arm's length in relation to a financial arrangement.

Section 230-120 appears to open the door to the Commissioner resetting interest rates on loans between related parties. For example, where an LPT borrows from the wholesale market and then on-lends interest free to lower tier sub-trusts (relying on the principle in *Total Holdings* case), an interest charge could be deemed between the LPT and the sub-trust. This may have flow-on interest deductibility implications for the sub-trust, for example under the thin capitalisation rules if it has offshore equity investments (eg in US / European REITs).

In addition, given the wide meaning given to financial arrangements, it arguably represents a de-facto domestic transfer pricing regime which having regard to the existing provisions dealing with value shifting which are themselves backstopped by Part IVA, is simply not justified.

Recommendation 17: *That the interaction of the new regime with other provisions in the tax law be the subject to further and extensive consultation. In particular in relation to the trading stock and capital gains tax provisions. Eg in relation to deliverable instruments such as options & futures.*

The general approach should be that the new TOFA regime would take precedence over other provisions in tax law only in relation to dealing with the financing component of contractual arrangements and should not result in new, more complicated and costly to manage, treatments for issues which are well settled. Careful consideration of the interaction between the TOFA regime and the rest of the existing tax law will be required, regardless of which model is adopted in relation to TOFA. This is particularly the case for the property sector, in relation to the Trading Stock and Capital Gains Tax provisions. In particular, care is required that in relation to deliverable instruments, such as options and futures, that unintended outcomes in the property sector do not arise.

Recommendation 18: *That the commencement date for the new regime align with the beginning of a taxpayer's year of income and that adequate time be allowed after Royal Assent for taxpayers to assess the impact of the rules on their compliance systems and make necessary changes.*

Any new system will take time to implement and accordingly, there must be a reasonable time between legislation being passed and the commencement date. Eg: for entities that are not financial institutions, a 12 to 24 month transition period is appropriate.