THE TAX INSTITUTE

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25 May 2015

Mr Tony Regan
Corporate Tax Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: taxlawdesign@treasury.gov.au

Dear Mr Regan,

Restoring integrity to the consolidation regime

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the *Tax and Superannuation Laws Amendment (2015 Measures No. 4) Bill 2015: Consolidations* exposure draft legislation (**Exposure Draft**). Our comments focus specifically on Part 1 of the Exposure Draft which relates to acquired liabilities.

Acquired liabilities measure

Start date

The acquired liabilities measure should be applied prospectively. The proposed start date of 14 May 2013 is the date of the 2013-14 Budget announcement. The content of the measure proposed could not be gauged from that announcement and there are certain features of the Exposure Draft which could not have been factored into the pricing of business transactions occurring between the time of the announcement and this release. The Board of Taxation report recommended a prospective application:

> "**Application date of changes**
> 2.79 The Board considers that, if the alternative approach is implemented, the changes should apply prospectively. In this regard, as details of the changes will need to be further developed during their implementation, consideration should be given to applying the changes to joining events under transactions that commence after the date amending legislation is introduced (rather than the date of announcement)"[1]

[1] The Board of Taxation *Post implementation review of certain aspects of the consolidation tax cost setting process* April 2013

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Exclusion for exit of joining liability in joining year

The exclusion in section 716-435 refers to an exit of an entity with the liability "in the income year" in which an entity joined with the liability. This may result in arbitrary results where the joining time and exit occur within a short period of time but straddles two income years. For example, if the entity joins with the liability on 30 June and an entity exits with the liability on 1 July. Accordingly, we suggest that the section apply to joining and exit within a 12 month period rather than within a specific income year.

Owned part of a deductible liability

The shortcut method proposed in section 716-425 for determining the owned component of a deductible liability in progressive acquisitions should be treated as a "safe harbour". Entities that are able to trace the acquired component of deductible liabilities should be allowed to do so as there may be instances where the compliance costs associated with the tracing exercise are offset by a lower reduction in the Step 2 amount of owned deductible liabilities (while still achieving the desired policy outcome).

The reference to 'members of the consolidated group' in the formula for the shortcut method in section 716-425 should also be clarified. It is unclear how this formula operates where the joining entity was not previously held by the joined group, but was legally held by other entities (including while being part of a separate consolidated group) that become members of the joined group.

Inappropriate outcomes are likely to arise under the currently proposed formula in the following circumstances:

1. Where companies are established within 4 years of a joining time
2. Where a CGT rollover has applied to a joining transaction resulting in a step 1 ACA amount which is inherited or based on historic asset cost bases (including scrip-for-scrip rollover with "restructure" or "common/significant stakeholder" limitations; restructure to interpose a new parent company in circumstances where there is no continuation of an existing consolidated group; and demerger transactions)
3. On formation of a new tax consolidated group immediately following an exit from a tax consolidated group as a result of a share issue (eg for an IPO or to establish a joint venture with an external party). In these circumstances, the step 1 ACA amount to allocate across the assets of subsidiary entities is based on the preceding Division 711 exit cost base calculation.

There is no policy rationale for the differing treatment that arises for particular consolidated groups, MEC groups and standalone entities under this measure.

Section 716-420 should only apply where "revenue assets" are stepped-up

The deductible liabilities measure also results in a significant disincentive for businesses to acquire the shares of a company rather than its assets, particularly where the company holds intangible assets. The measure acts as an impediment to joining the company to the consolidated group, as it converts into assessable income amounts which may only be realisable as capital losses or reduction of capital gain at some distant point in time, if at all (e.g. goodwill on the sale of the business). This could be solved by limiting the assessable income amount to the amount of ACA allocated to the revenue assets of the joining entity, rather than calculating it as a percentage of the liability.

Deferred tax liabilities

It is recommended that measures to remove deferred tax liabilities from entry and exit calculations be included in the Bill when introduced into Parliament, with prospective effect, as recommended by the Board of Taxation.

The Government accepted the Board of Taxation’s recommendation to remove deferred tax liabilities on this basis (Media release No 068 of 14 May 2013).

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If you would like to discuss any of the above, please contact either me or Tax Counsel, Thilini Wickramasuriya, on 02 8223 0044.

Yours faithfully,

Stephen Healey
President