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From: @ato.gov.au>
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Attachments: TIA RTFI session - (2).ppt

This is the paper. But it does not give the references. I will look further.

From:
Sent: Tuesday, 8 March 2011 17:41
To:
Cc:
Subject: TIA RTFI session - (2).ppt [SEC=IN-CONFIDENCE]

<<TIA RTFI session - (2).ppt>>

, we need that other case on services. Citations needed for the extra slides I created.

and : we have to thin these tomorrow. I want more on our rulings process. We haven't mentioned s.40-880. I wonder if we need to mention the CGT ruling on underlying assets, as I am inclined to indicate that myth-making has been occurring here. CGT event H2 must do something! Could digress on Zim Properties.

, and : these won't be finished before tomorrow afternoon, but the info will grow thinner not greater and this should suffice for the AT's office.

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Rights to Future Income

Australian Taxation Office



Rights to future income rules



- In June last year tax Laws Amendment (2010 Measures No.1) Act 2010 (TLAA1) received Royal Assent.
- The amending Act introduced section 716-405 a provision that allows a deduction for a tax cost setting amount allocated to an asset. Only an asset covered by section 716-410 is cost set by 701-55(5C) for section 715-405 purposes.
- 701-90 was introduced by the amending Act to identify in what circumstances a valuable right to future income would be treated as a separate asset under Part 3-90 of the ITAA 1997.

Section 701-90 provides



701-90 Valuable right to future income treated as separate asset

- (1) This subsection covers a valuable right (including a contingent right) to receive an amount for the performance of work or services or the provision of goods (other than *trading stock) if:
 - (a) the valuable right forms part of a contract or agreement; and
 - (b) the *market value of the valuable right (taking into account all the obligations and conditions relating to the right) is greater than nil.
- (2) For the purposes of this Part, treat a valuable right covered by subsection (1) as a separate asset.

(3) For the purposes of this Part, if:

(a) a valuable right is treated as a separate asset under subsection (2); and

(b) the contract or agreement mentioned in paragraph (1)(a) also includes one or more other rights; for the purposes of this Part, treat the contract or agreement (excluding the valuable right) as a separate asset.

- (4) For the purposes of this Part:
- (a) take into account all the obligations and conditions relating to a valuable right treated as a separate asset under subsection (2) in working out the *market value of that separate asset; and
 - (b) if a contract or agreement (excluding the valuable right) is treated as a separate asset under subsection (3)- take into account all the obligations and conditions relating to each right (other than the valuable right) that forms part of the contract or agreement in working out the market value of that separate asset.

The search for purpose



What is the rationale?



Is it to relieve economic double taxation of capital gains on the disposal of membership interests?

(There is no double taxation of persons)

Context



The acquisition rules in Part 3-90 are not symmetrical with the disposal rules, either in Part 3-90 or generally.

A disposal of membership interests is generally treated as a disposal of membership interests; it is generally on capital account.

The effective rate of CGT is significantly less on average than the effective rate of income taxation.

Rationale continued



Is it to achieve neutrality with direct acquisitions of assets?

Context



- Styles case
- John Smith & Son v. Moore
- NZ Forestry case

What is special about RTFI?



- A wasting asset?
- An underlying asset?
- A transitional asset?

Epexegis of subs.701-55(6)?



- RTFI always an asset
- RTFI always revenue
- RTFI always spread

Swings and roundabouts



Whether one is better off in or out of s.701-90 varies according to the facts:

- Revenue anyway?
- Not spread?
- Different valuation?

Enigmatic Extrinsic Material



- No explicit rationale
- Suggestive examples
- But commentary not based on the text of the statute
- Bankstown case versus other more reactionary case

Work, work and more work



No answers today.

We have rulings processes, including consultation

It will take time to work through the issues.

This is not a case where one view is necessarily pro-revenue
and another pro-taxpayer.

Strongly-held, differing views in the community

What are these issues?



This provision raises a sequence of legal issues:



- What is a valuable right?
- What is a contingent right?
- What is covered by the words “performance of work or services”?
- What is covered by the words “provision of goods (other than trading stock)”?
- What is the meaning of contract or agreement?
- What is the market value of the right?
- What obligations and conditions might relate to the right?

The role of the Rights to future income rules



- Subsection 701-55(5C) provides that if section 716-410 covers the asset section 716-405 applies.
- Section 716-410 covers an asset if that asset falls within the terms of section 701-90.
- Section 701-90 defines what is the asset for the purposes of the rules.
- To the extent that subsection 701-90 operates it displaces the ordinary rules regarding identification of assets for the purposes of Part 3-90.
- The rules do more than treat the tax cost setting amounts as notionally paid for assets; they make it deductible over a period of ten years.

What is a valuable right?



- Should the words valuable right be understood as referable to “rights” in a technical and legal sense?
- Rights were given a technical meaning in the context of the capital gains tax provisions in the ITAA 1936 (*Hepples v FC of T* (1990) 22 FCR 1; (1990) 94 ALR 81 per Gummow J)
- The valuable right must form part of a contract or agreement.
- Note use of word “contract or agreement” might be taken to suggest that right is used in a wider, non-technical sense.
- However what is added by the use of the term “agreement”?

What is a contingent right?



- The extent of the contingencies comprehended by the word “contingent” depends on its legislative context. The courts have told us that it is impossible to formulate a universally applicable definition of contingent (*Fisher v Madden* [2002] NSWCA 28; *FC of T v Gosstray* [1986] VR 876).
- The Supplementary Explanatory Memorandum provides little guidance.
- If “contingent” covers the contingency of cancellation or the contingency of renewal then value attributable to the expectancy or propensity of customers to stay where they are (value that is part of goodwill) is attributed to the right.
- Should value be attributed to contingencies if that value is part of the value of goodwill?

Performance of work or services



- The words “performance of work or services” could be construed broadly or narrowly. However, the question is: what is the meaning of the words in an income tax context.
- The leading authority on the meaning of service is *Employers’ Mutual Indemnity Association Ltd v FC of T* [1943] HCA 36; (1936) 68 CLR 165.
- In *Employers’ Mutual* the majority held that the issuing of insurance contracts was not the rendering of services. The majority were of the view that the expression was used in the technical sense, the making of a contract of itself does not amount to a service and that it essentially meant doing work of some kind.
- *Employers’ Mutual* has been followed on a number of occasions in a taxation or corporations law context.
- The lending of money is not the rendering of services (*Social Credit Savings and Loans Society Ltd v FC of T* (1971) 125 CLR 560; *RE Ansett (No 1)* (2002) 115 FCR 376).
- The performance of franchising obligations is not the provision of services (*Gloria Jeans Coffees International v Chief Commr of State Revenue (NSW)* [2008] NSWSC 1327).

Provision of goods (other than trading stock)



- The meaning of the word “goods” depends upon the context in which it is found (*The Noordham (No. 2)* [1920] AC 904).
- At common law “goods” comprehends moveable personal property of every kind. The word refers to choses in possession, as distinct from choses in action, and is distinguished from real property (*AGL Victoria Pty Ltd v Lockwood* (2003) 10 VR 596; [2003] VSC 453).
- For the purposes of section 701-90 goods are tangible, personal property capable of physical possession and which are capable of transfer by delivery and are not trading stock.
- Electricity has been held to be a good (*AGL Victoria*).

The meaning of contract or agreement



- Under contract law there is a distinction between a contract, which is a promise that is enforceable at law, and an agreement, which is one of the requirements for a contract to exist.
- An agreement does not necessarily constitute a contract.
- Rights under an agreement that is not a contract may still be legally enforceable, for instance in equity.
- Does section 701-90 only apply to rights under an agreement that are legally enforceable? It does not necessarily follow from the use of the word agreement that non-enforceable rights under agreements fall within its terms.
- If a right is not legally enforceable in some manner, this also raises questions about its value.

What is the market value of the right?



- Subsection 701-90(4) requires that all the obligations and conditions relating to the valuable right treated as a separate asset under subsection 701-90(2) be taken into account in working out the market value of that separate asset.
- The present value of the income stream is not the market value of the right.
- The operation of the phrase "relating to" is determined by the statutory context and purpose (*Butler v Johnson* [1984] FCA 118; (1984) 55 ALR 265 and *Hatfield v Health Insurance Commission* (1987) 77 ALR 103).
- The phrase is used to accommodate a range of factual situations, and commercial and valuation principles may be relevant in determining which obligations relate to the right.

Are rights valued collectively?



The market value of a right is presumptively the amount that right, sold by itself, accompanied by obligations, would bring from a willing but not anxious buyer of that right.

Practical compliance shortcuts for valuing many rights will not justify a greater value derived from selling all RTFI together: no goodwill premium.

Should not include value of goodwill!

Allocating cost amounts



- ACA is allocated proportionately to market values of assets.
- The market values must add up to one: no double counting!
- Tax assets must have ACA allocated.
- Therefore tax asset concepts trump non-tax asset concepts.
- (Non-tax assets may exist in addition to tax assets, but not instead of them.)
- TR whatever on tax assets

Goodwill is a tax asset



And Goodwill as a tax asset is the legal property identified by the High Court in Murry's case. It is not the accounting asset.

Goodwill is not divisible.

How is legal goodwill valued?

Is goodwill value attributable to other assets?