3 May 2012

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By email: consolidation@treasury.gov.au

Dear Tony

PROPOSED AMENDMENTS TO THE TAX CONSOLIDATION RULES - TAX LAWS AMENDMENT (2012 MEASURES NO. 2) BILL 2012: SCHEDULE 1

The Institute of Chartered Accountants in Australia, The Tax Institute and the Corporate Tax Association (collectively the **Joint Bodies**) welcome the opportunity to comment on the proposed consolidation amendments contained in Schedule 1 of the Exposure Draft (**ED**) legislation above in respect of the rights to future income (**RTFI**) and residual tax cost setting rules (**the proposed amendments**) and the related Exposure Draft Explanatory Material (**EDEM**).

The proposed amendments implement the government's policy decisions outlined in Media Release of 25 November 2011[1] (**the November release**) by the then Assistant Treasurer the Hon Bill Shorten MP.

We thank Treasury and the Australian Taxation Office (**ATO**) for meeting with us on 26 April to discuss the proposed amendments.

Our detailed submission is in tabular form in the Appendix. We highlight some key points:

1. The ED was released by the Government on 18 April 2012, with submissions on the ED due within two weeks. Given the importance of these proposed measures, it is disappointing that more time was not provided to enable a thorough review and greater consideration of these proposed measures.
2. We request an opportunity for a review of the updated draft law (even if by a small group) before a Bill is presented to parliament. This is because the Appendix outlines a significant number of areas where the ED does not properly implement the November release. We also want to ensure that, to the extent possible given the time constraints, the modifications work effectively in real taxpayer circumstances.
3. The rationale for these amendments is a sensitive issue for government, Treasury and all stakeholders. The proposed measures rectify unforeseen issues which arose from the drafting of the 2010 amendments to the consolidation law and also unforeseen costing

[1] Assistant Treasurer's press release no.159 of 2011

issues affecting revenue. However, they also change the policy to reduce tax revenue cost. This is not a mere integrity measure to counter inappropriate behaviour by certain corporates.

Therefore the EDEM comments concerning the rationale for the changes (paragraphs 1.27 and 1.30 referring to companies acting inappropriately to claim inappropriate benefits) should be reworded to align to the November media release at paragraphs 1.7 to 1.12. That formulation was discussed at length with the office of the previous Assistant Treasurer.

4. In the “pre period”, the original formulation of s.701-55(6) is to be reinstated, with clarification only for work in progress and consumables. This will require further clarification by the ATO, as the gaps in s.701-55(6) led to significant controversy involving the ATO and taxpayers: For example, the proposed measures do not deal clearly with a joining entity having incomplete construction contracts.

5. Treasury and the Office of Parliamentary Counsel should confirm with tax publishers that, after the proposed amendments are made, the Income Tax Assessment Act 1997 will show the fully amended prospective period changes (consolidating the three rounds of amendments set out in the complex proposed Schedule 1). This is important to ensure that the law is clearly presented for taxpayers in the future.

6. The Joint Bodies were involved in the earlier confidential consultation on this package, following the announcement by previous Assistant Treasurer the Hon Bill Shorten MP on 30 March 2011 and (after the review by the Board of Taxation) government policy discussions between 30 June and 24 November 2011. We do not expansively discuss issues raised in that process but restate, for the record, two significant concerns raised by the Joint Bodies:

    a) We are concerned about the retrospective nature of the changes and the limited protection given (particularly in the pre period) to consolidated groups, limited in essence to assessments and private rulings obtained. As explained in the confidential consultations, this has disadvantaged those groups which transparently sought guidance from the ATO in relation to the impact of the law prior to amending or lodging their relevant tax returns and incurred significant expenses in preparing amendments not lodged by the 30 March 2011 announcement. This transitional approach has operated to the benefit of groups which took positions and filed their amended tax returns with, in many cases, no discussion about uncertain tax issues with the ATO. This highlights the difficulties with retrospective laws of this nature.

    b) Additionally, while the objective of these rules is “making the tax outcomes for consolidated groups more consistent with the tax outcomes that arise when assets are acquired by entities outside the consolidation regime”[2] the proposed measures will result in some adverse taxation outcomes compared with asset acquisitions outside consolidation. In particular, acquired rights to future income which have a commercial value will, outside consolidation, be recognised at their purchase price

[2] Refer paragraph 1.63 of the Explanatory Memorandum to the ED

for income tax and capital gains tax purposes: in consolidation those assets will be retained cost base assets with, in many cases, no tax value. In our view this outcome is inappropriate and places taxpayers at a disadvantage as compared to the outcome that would have arisen had those assets been acquired outside consolidation.

We will be writing to the Assistant Treasurer separately to restate our concerns with the broad impact of these proposed amendments.

To discuss any of these items, please contact at first instance Susan Cantamessa on 02 9290 5625 or Peter Murray on 03 9288 6677.

Yours Sincerely

Yasser El-Ansary
General Manager – Leadership & Quality
The Institute of Chartered Accountants in Australia

Ken Schurgott
President
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Frank Drenth
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cc: The Hon David Bradbury MP, Assistant Treasurer and Minister Assisting for Deregulation

APPENDIX

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
1.	-,-,4	170	• The extended amendment period is inconsistent with Attachment A. • Paragraphs 31 to 33 of Attachment A specified that the normal (generally four year) amendment period would continue to apply in relation to “ATO activated amendments” but the additional two year amendment period would apply to specific taxpayer that activated amendments under the pre rules.	• Consistent with Attachment A, the proposed extended period of amendment should only be available to taxpayers that are under the pre rules and that choose to amend.
PRE RULES				
2.	S1, P1, 2	701-55(5C)	• The provision only applies to WIP amounts assets that are in relation to “work but not goods”. This is inconsistent with paragraph 24 of Attachment A.	• Treasury should amend the definition of a WIP amount asset in section 701-63(5) to include goods or services.
3.	S1, P1, 2	701-55(5C)	• The provision is more restrictive than Attachment A. For example, work for a particular stage of a contact could be complete but a recoverable debt may not have arisen as a result of the terms of the contact rather than simply as a result of the work being incomplete.	• Treasury should amend the definition of a WIP amount asset in section 701-63(5) to also include completed work, goods and services where a recoverable debt has not arisen. • Treasury and ATO should develop an example for the EM of a joining entity engaged in a part-complete construction contract, to ensure clarity for this conventional and very common scenario affecting various sectors. Draft TD 2004/D85 (withdrawn in contemplation of the 2010 amendments) illustrates the issues involved.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
4.	S1, P1, 2	701-55(5C)	• Section 25-95 provides for a deduction over 2 years (at worst). Therefore, the provision may bring forward the deductions as compared to the "original 2010 rules".	• We assume that the impact of bringing forward deductions for WIP amount assets has been taken into consideration.
5.	S1, P1, 3	701-55(6)	• Section 701-55(3) was amended specifically to allow section 701-55(6) the ability to deal with Subdivision 70-E items (i.e. Land carrying trees and rights to fell trees). • However, section 70-120(2) requires one to "have paid to acquire land carrying trees" for the provision to operate.	• A specific provision is required to ensure that section 70-120 operates appropriately with section 701-55.
6.	S1, P1, 7	701-63(1)	• The treatment of goodwill as a single asset will be problematic in practice where the joining entity carries on multiple businesses with multiple goodwill assets.	• An adjustment to the single goodwill rule is required.
7.	S1, P1, 7	701-63(1)	• The provision is framed as an "avoidance of doubt" provision. However, it includes items that are clearly not goodwill under (1)(b) – i.e. RTFI assets.	• The provision is a deeming provision and therefore should not be labelled as an avoidance of doubt provision.
8.	S1, P1, 7	701-63(1)	• The provision refers to an "entity", rather than the joining entity.	• Treasury should amend paragraph 701-63(1) to clarify that it refers to the joining entity.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
9.	S1, P1, 7	701-63(1)	• The provision states it only applies for the purposes of Part 3-90. It is understood that this is intended to ensure that a subsequent disposal of the asset will still be treated as a separate asset for tax purposes, however without an ACA amount.	• Treasury should clarify (in the EM) the reason for the use of the words "for the purposes of this Part" and the consequences thereon. • Further, if the consequences are that a subsequent disposal of the asset will not have any cost base, the inappropriateness of this outcome should be considered further (given that outside of consolidation the cost of the asset would be reflected on disposal of the asset).
10.	S1, P1, 7	701-63(2)	• The provision is inconsistent with Attachment A as it does not exclude mine site improvements.	• For completeness, Treasury should mention (in the EM) the current status of the mine site improvements issue.
11.	S1, P1, 7	701-63(2)(b)	• The current definition of accounting intangibles would include mining information. • Mining information in respect of exploration activities is specifically dealt with under subsection 701-55(2) and is deductible under section 40-80. To also include the value of this intangible asset in goodwill is clearly an unintended outcome.	• Treasury should modify para (b) to exclude mining information. This amendment should carry through all relevant periods.
12.	S1, P1, 7	701-63(2)(b)	• The current definition of accounting intangibles may include deferred tax assets. Whilst the outcome is inconsequential for non-excluded assets, this will result in excluded assets being allocated ACA. This is clearly inappropriate.	• Treasury should modify para (b) to also exclude deferred tax assets.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
13.	S1, P1, 7	701-63(2)(b)	• Clarity is required that the deemed definition of goodwill would not include assets such as copyright.	• Treasury should clarify (in the EM) that an intangible that constitutes a CGT asset, a Division 40 asset, or an asset otherwise recognised for tax purposes will not fall within the deemed goodwill definition. • This would also eliminate the need to separately mention mine site improvements and mining information which are otherwise dealt with under subsection 701-55(2) and Division 40.
14.	S1, P1, 7	701-63(2)(b)	• Clarity is required regarding the terms "customer relationship asset" and "know how asset".	• Treasury should clarify (in the EM) that these terms are based on their accounting meaning. A summary of their accounting meanings may also be useful.
15.	S1, P1, 7	701-63(4)	• The term "right to future income" is defined without including a limitation for rights that constitute recoverable debts. • This drafting would inadvertently include trade and service receivables that have already been assessed to the joining entity.	• Treasury should amend the definition of a right to future income to exclude rights that constitute a recoverable debt.
16.	S1, P1, 7	701-63(4)(c)	• The use of the term "Division 230 financial arrangement" can create some ambiguity given that Division 230 could generally only apply from 1 July 2010 however, as a result of the proposed TOFA interaction provisions, in undertaking a number of associated TOFA calculations, Division 230 would be deemed to apply back to an earlier joining time.	• Treasury should clarify these ambiguities by confirming that if, because of an ungrandfathering election, Division 230 subsequently applies to an asset of the joining entity that joined the consolidated group or multiple entry consolidated group at an earlier time then, in respect of that earlier joining time, the asset should be regarded under para (4)(c) as a Division 230 financial arrangement.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
17.	S1, P1, 7	701-63(5)	• The definition of WIP does not include a separate asset type rule, similar to section 701-90. • Arguably, an asset that includes a component of WIP could be treated as a WIP asset in totality (or alternatively may not be considered a WIP asset).	• Treasury should consider whether a WIP asset is treated as a separate asset (from the contract) for Part 3-90 purposes. • Consideration of this issue should also involve consideration of valuation issues. • This issue is similar for all periods, where WIP is defined as the asset, but is not separated from the contract.
18.	S1, P1, 7	701-63(5)	• As outlined earlier, the definition of a WIP amount asset is inconsistent with the definition contained in para 24 of Attachment A. The attachment extended to goods or services.	• Treasury should amend the definition of WIP amount asset in section 701-63(5) to include goods or services.
INTERIM RULES				
19.	S1, P2, 23	701-63(3)(b)	• The EM examples 1.1 – 1.5 use terminology which is inconsistent with the provisions. Given the potential breadth of its application, the provision needs to be given useful examples in the EM based upon the Press Release and Draft Legislation. In particular example 1.3 in the EM suggests that a contract which can be unilaterally cancelled by the payment of a compensation amount will be a non-deductible RTFI yet it is not within the terms of the provision as proposed.	• Treasury to amend the examples contained in the EM to achieve the recommended consistency and usefulness.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
20.	S1, P2, 23	701-63(3)	• Under subsection 701-63(3) a non-deductible RTFI is one to the extent that the value of the right is contingent on contract renewal, a renewal contingency. Subsection 701-63(3)(a) specifically includes a contingent right to an amount. The EM in various places suggests that the only deductible RTFI is to the extent the future income is 'guaranteed'. Example 1.3 is not supported in the legislation. • In addition, the "to the extent rule" raises a concern where fixed term contracts are cancellable, compensation may be paid, but the compensation does not reflect the cancelled remainder of the contract. The question is whether it is appropriate to treat these types of fixed term contracts as goodwill.	• Contingent, non-guaranteed RTFI under existing contracts should be eligible for deductibility. This should be specifically acknowledged and confirmed in the EM. Paragraph 1.53 in particular should be amended to reflect this. It is not correct that the joining entity's RTFI is uncertain if the other party is able to unilaterally cancel the contract without compensation. There are numerous examples of consumer contracts (eg. funds management and telecommunications) where fees are charged according to the level of services provided, rather than being a guaranteed amount, which, nonetheless, should be RTFI. • Guidance in the EM on how taxpayers are expected to value that part of the contract that may be cancelled without compensation would be useful.
21.	S1, P2, 23	701-63(3)(a) and (b)	• Whether the expression "to the extent" will operate as intended, which is to apportion the value of the right as between the non-contingent and the contingent (paragraph (a)) and to characterise the right as a non-deductible RTFI, as between unilateral cancellation without compensation and with compensation.	• Treasury should confirm with the drafter that this is effective and that the expression "to the extent" in paragraph (a) in particular does not operate to make the whole of the right a non-deductible RTFI merely because to some extent there is a renewal contingency. Simple clear examples in the EM illustrating that "to the extent "is not to be interpreted as "ïf" or some similar expression.
22.	S1,P2, 23 (and 7 in Pre-rules)	701-63	• See comments in respect of item 7 and section 701-63 for the pre-rules comments in respect of the goodwill asset. These apply equally here.	• Treasury to reconsider approach to the deemed goodwill asset to ensure that the problems identified are resolved.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
23.	S1,P2, 23 (and 7 in Pre-rules)	701-63	• An issue arises in relation to the treatment of RTFIs which relate to passive income, e.g. income under a lease contract. The RTFI definition in the pre rules is per the 2010 amendments. The EM commented that leasing contracts did not fit within the RTFI definition.	• Treasury should ensure that the treatment of potentially passive income generating assets is clarified.
24.	S1,P2, 23 (and 7 in Pre-rules)	701-63	• Double counting of accrued income that is assessable and amount treated as goodwill is inappropriate	• Accrued income should be treated as a retained cost base asset instead.
25.	S1, P2, 26	701-90	• The removal of subsection 701-90(1) in this period may cause unnecessary enquiries being made to publishers as to what happened to it.	• Appropriate acknowledgement in the text to minimise concerns or possible renumbering.
26.	S1, P2, 28	705-56A(2)	• It would appear that this provision goes further than is intended. • The implication of paragraph (1)(b) is that the encumbrance is one created by the "contract" that includes the right to future income. • However, the reference to encumbrance in subsection (2) is not limited. Therefore, an encumbrance not created under the contract could inappropriately reduce the value of the RTFI asset.	• Subsection (2) should be amended to ensure that an encumbrance is in relation to the contract giving rise to the right covered by paragraph (1)(b)

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
PROSPECTIVE RULES				
27.	S1, P3, 36	701-56	• It is unclear as to what the proposed words "business of the joining entity as a going concern" achieve. • The words are not consistent with the approach recommended by the Board of Taxation, as contained in para 59 of Attachment A. • For example, if a target entity was a passive investment company with a single asset, the proposed provision may deem an outcome which is inconsistent with the actual factual situation. • As well, the phrase 'going concern' invites comparison with the GST rules which may add uncertainty.	• Proposed section 701-56 be modified so that it is more consistent with the proposal made by the Board of Taxation and cited at para 59 of Attachment A. For example, reference could be made to the head company acquiring all of the assets of the joining entity as part of a business acquisition. • To assist in taxpayer and judicial consideration of this provision, the section or EM might note the assumed underlying policy of aligning the tax consequences to the treatment of a business acquisition outside tax consolidation. For example paras 61 and 62 of Attachment A and para 6.14 of the Board of Taxation's report state that the "modifications (are) to ensure that the outcomes under the rule are closer to those that arise outside consolidation under a business acquisition approach. (62) Under a business acquisition approach, the head company will be treated as having acquired the assets of the joining entity as if they were acquired directly, as part of a business acquisition. The revenue or capital character of the assets will then be determined based on the character of the asset in the hands of the head company, rather than the joining entity."

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
28.	S1, P3, 42	701-67	• Part 3-90 will be limited to CGT assets. • This is inconsistent with the comment in para 55 of Attachment A, which refers to assets that are recognised for taxation purposes. In fact, para 56 specifically notes that assets that are recognised for taxation purposes are "primarily" CGT assets, which envisages that CGT assets are not the only kinds of assets that can be included. • This is also inconsistent with TR 2004/13, "Income tax: the meaning of an asset for the purposes of Part 3-90 ..." of which para 11 states that "Assets recognised under the [ITAA 1936 and 1997] would come within the ordinary commercial or business meaning of an asset for Part 3-90 ... Assets within these categories would include items of trading stock, revenue assets, traditional and qualifying securities, depreciating assets and CGT assets." They would include assets held by the taxpayer under arrangements that are not their CGT assets (e.g. trading stock under a consignment agreement). • Mining information may be inappropriately excluded as a reset cost base asset under the proposed approach (as it may not be a CGT asset)	• Treasury should consider changing the words used to be consistent with para 11 of TR 2004/13. The section should also contain a note listing the various specific tax-recognised assets. • RTFI and WIP amount assets should also be expressly referred to in s.701-67 to remove potential uncertainty raised in next submission point. • It is highlighted that the risk of anticipated revenue implications is managed by the Item 37 amendment to 701-56(3)(d) that would ensure that blackhole assets are excluded from Part 3-90. • Mining information should be specifically included as an asset for the purposes of Part 3-90.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
29.	S1, P3, 44	705-25(5)(d)	• The definition of “RTFI assets” includes any right to income, even if the income has been assessed. Accordingly, a foreign currency trade receivable would be treated as a retained cost base asset under the proposed rule if the asset were a majority owned asset. • The recognition of RTFI needs to interact precisely with proposed s.701-67 - RTFI might be incapable of recognition by current drafting of s.701-67. Amendment of s.701-67 as above will reduce this risk,	• In line with our recommendation made on S1, P1, Item 7, the definition of RTFI should not include income amounts that already constitute recoverable debts. • As noted, s.701-67 and this item should ensure that a RTFI asset can be recognised as a separate asset for the purpose of Part 3-90.
30.	S1,P3,51	701-63(5)	• Same issue as for RTFI assets given current drafting of s.701-67. “WIP amount asset” will be defined in s.701-63(5). However, with the proposed repeal of s.701-90, it is unclear whether WIP amount asset can be recognised as a separate asset in view of s.701-67.	• As noted, s.701-67 and this item should ensure that a WIP amount asset can be recognised as a separate asset for the purpose of Part 3-90.
TRANSITIONAL RULES				
31.	S1, P4, 52		• The cumulative mechanics of Part 4 do not seem to achieve the required outcomes	• Treasury to reconsider. For example, the definition of prospective rules should be “... means Part 3-90 of the Income Tax Assessment Act 1997 as amended by Parts 1 of this Schedule and then by Part 2 of this Schedule and then by Part 3 of this Schedule”.

#	ED ref (schedule, part, item)	Section	Comment	Recommendation
32.	S1, P4, 53	(1)	• The EM does not provide guidance on how the provisions would operate where there is a tail. The current wording of the provisions would seem to provide protection for tail deductions.	• Treasury should consider providing an example in the EM that outlines how the application rules operate to a pre-12 May 2010 joining time, where a deduction spans the original 2002 rules, the interim rules, and has a remaining undeducted amount post 30 March 2011.
33.	S1, P4, 53	(3)	• The protection of assessments issued between 12 May 2010 and 30 March 2011 may not operate as intended. Refer to attached examples 1, 2, 3 attached to this submission.	• Treasury is asked to reconsider the wording of this protection provision or to provide clear guidance on what is meant by "assessment ... that relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules".
34.	S1, P4, 53	(5)	• The protection of assessments issued pre 12 May 2010 may not operate as intended. Refer to attached example 4 attached to this submission.	• Treasury is asked to reconsider the wording of this protection provision or to provide clear guidance on what is meant by "assessment ... that relates to the application of subsection 701-55(6) of the original 2002 rules".
35.	S1, P4, 53	(6)	• Attachment A allowed an amendment to be made if a taxpayer were to seek a deduction for WIP or consumables (para 33). This is not currently reflected in Item 53(6).	• Item 53(6) should be updated to ensure that a taxpayer can make an amendment for WIP and consumables in line with para 33 of Attachment A. [WSP comment – I think this provision does work to allow a deduction for WIP and consumables as those deductions would not be sought through the application of s701-55(6) of the original rules, but through new subsections (5C) and (5D).]
36.	S1, P4, 54	(3)	• The current drafting of the provision does not allow a taxpayer to amend their return to be consistent with the ruling.	• Item 54(3) should be removed.

ATTACHMENT – EXAMPLES PROVIDED

1.0 Application

We make the following comments in relation to Schedule 1 Part 4 of the ED.

1.1 Cumulative "mechanics" of the Application provisions

We note that item 52 defines the pre, interim and prospective rules as follows:

> **interim rules** means Part 3-90 of the Income Tax Assessment Act 1997 7 as amended by Part 2 of this Schedule.
>
> **pre rules** means Part 3-90 of the Income Tax Assessment Act 1997 as amended by Part 1 of this Schedule.
>
> **prospective rules** means Part 3-90 of the Income Tax Assessment Act 1997 as amended by Part 3 of this Schedule.

We note that the appropriate application of the interim rules requires that the ITAA 97 is first amended by Part 1 of Schedule 1 before it is amended by Part 2 of Schedule 1. Similarly, the appropriate application of the prospective rules requires that the ITAA 97 is first amended by Part 1 of Schedule 1 and then by Part 2 of Schedule 1 before it is amended by Part 3 of Schedule 1.

It does not seem clear that the mere sequential placement of Parts 1, 2 and 3 will necessarily achieve the necessary cumulative outcomes required. We would have thought that the relevant definitions should be amended as follows:

> **interim rules** means Part 3-90 of the Income Tax Assessment Act 1997 7 as amended by Part 1 of this Schedule and then by Part 2 of this Schedule.
>
> **pre rules** means Part 3-90 of the Income Tax Assessment Act 1997 as amended by Part 1 of this Schedule.
>
> **prospective rules** means Part 3-90 of the Income Tax Assessment Act 1997 as amended by Part 1 of this Schedule and then by Part 2 of this Schedule and then by Part 3 of this Schedule.

1.2 Assessments subject to the interim rules

An assessment will be subject to the interim rules where:

- Under Item 53(3)(a) – “the joining time is before 12 May 2010” and “the head company’s latest notice of assessment, for the income year, that relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules in respect of the joining entity, was served on the head company by the Commissioner on or after 12 May 2010 and on or before 30 March 2011; or

- Under Item 55(3)(b) – “the joining time is on or after 12 May 2010” and “the arrangement under which the joining entity joined the group commenced (see item 55) on or after 10 February 2010 and on or before 30 March 2011”.

Treasury is asked to provide further guidance or examples on what is meant by “relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules”. We provide the following examples to illustrate some of the potential unintended outcomes:

<u>Example 1</u>

A head company may have lodged, in December 2010, a 2010 income tax return which covered a company joining the group in January 2010. A first year RTFI deduction is claimed in that tax return pursuant to sections 701-55(5C) and 716-405. The same head entity may then have lodged a 2011 income tax return in December 2011 containing the second year deduction for the same RTFI asset that was reflected in the 2010 income tax return. Please confirm that the claiming of a second year RTFI deduction under section 716-405 in the 2011 tax return lodged in December 2011 should not be treated as giving rise to a notice of assessment that “relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules” (and should therefore not operate to remove the application of the interim rules to the 2010 assessment).

<u>Example 2</u>

The same facts as above, except that the head company does not include an RTFI deduction in the relevant 2010 tax return when lodged (in December 2010). But the head company does claim a deduction for the reset tax cost of consumable stores in that tax return – pursuant to the application of section 701-55(6) and section 8-1. The head company subsequently (in February 2011) lodges an application for amendment in respect of the 2010 income tax return to claim the RTFI deductions. It would seem that, if the ATO process this application after 30 March 2011 and issue an amended assessment, the head company would have a notice of assessment that “relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules” issued post 30 March 2011 and the head company would thereby lose the protected application of the interim rules to the original 2010 assessment (and any subsequent assessment).

However, if the head company withdraws the application for amended 2010 assessment before it is processed and makes no subsequent request for 2010 amended assessment, the original 2010 assessment would seem to be covered by the interim rules. Accordingly, the tax cost of the RTFI assets of the joining entity are reset under the interim rules (even if the head company did not make an actual RTFI claim in the 2010 year). And there would then seem to be nothing to preclude that head company from claiming RTFI deductions under s716-405 under the interim rules in subsequent years.

<u>Example 3</u>

Same facts as above, except that an RTFI deduction (but not a deduction for consumable stores) is claimed in the relevant 2010 tax return when lodged by the head company (in December 2010).

In May 2012 (prior to the enactment of the provisions contained in the ED), the head company lodges a request for amendment of the 2010 assessment to claim a deduction for consumable stores. The ATO issue an amended assessment allowing this deduction in June 2012 (also prior to the enactment of the provisions contained in the ED). The issue of this amended assessment would then seem to represent a notice of assessment that “relates to the application of subsection 701-55(5C) or (6) of the original 2010 rules” issued post 30 March 2011 and the head company would thereby lose the protected application of the interim rules to the original 2010 assessment (and any subsequent assessment).

1.3 Protected tail deductions

Treasury is asked to confirm whether RTFI "tail deductions" are intended to be protected if the relevant assessment covering the joining time is subject to the interim rules. As they stand, the provisions in Item 53 seem to protect tail deductions claimed in subsequent years.

Subitem 53(1) provides as follows:

> “The provisions specified in subitem (2), (3), (4) or (5) apply to an assessment of the head company of a consolidated group or MEC group for an income year in respect of an entity (the joining entity) that becomes a member of the group at a time (the joining time).”

It is noted that there is nothing in subitem 53(1) that limits the relevant assessment to be the one for the income year in which the relevant joining time has occurred. On the contrary, the use of the terms “an assessment” in the first line and “a time” in the last line of this provision would suggest such a limitation is not imposed.

1.4 Protected application of the original 2002 rules

Subitems 53(5) and (6) provide protected application of the original 2002 rules in the following circumstances:

> (5) Despite subitems (2), (3) and (4), those provisions are the original 2002 rules if the head company’s latest notice of assessment, for the income year, that relates to the application of subsection 701-55(6) of the original 2002 rules in respect of the joining entity, was served on the head company by the Commissioner before 12 May 2010.
>
> (6) Subitem (5) does not apply if:
>
> (a) the head company of the group requests an amendment of the assessment and the amendment relates to the application of subsection 701-55(6) of the original 2002 rules in respect of the joining entity; or
>
> (b) the amendment of the assessment:
>
> (i) would relate to an asset of a kind mentioned in paragraph 701-63(2)(b) of the pre rules; and
>
> (ii) would not be consistent with the outcome that arises under the pre rules for assets of that kind.

Treasury is asked to provide further guidance or examples on what is meant by “relates to the application of subsection 701-55(6) of the original 2002 rules”. We provide the following examples to illustrate some of the potential unintended outcomes:

<u>Example 4</u>

A head company may have lodged, in December 2008, a 2008 income tax return which covered a company joining the group in January 2008. The joining company has a number of RTFI assets.

Aware of the various Government statements relating to clarification of section 701-55(6), the company decided to not claim any deduction for assets potentially reset under s701-55(6) in the relevant tax return. Neither did it claim a capital loss in that year for the reset CGT cost base of any RTFI contracts that expired in that same year post joining time.

Similarly, in its 2009 tax return, lodged in December 2009, the company claimed no RTFI deduction or capital loss in respect of expired RTFI contracts.

In November 2010 (ie. after the enactment of TLAA (2010 No.1)) the head company lodged an application to amend the 2008 and 2009 tax returns to claim RTFI deductions. These applications have still not been processed by the ATO.

It would seem that, unless the head company had any other asset in respect of which it applied s701-55(6) in the 2008 tax return as lodged, it is not protected by subitem 53(5).

Whereas, if, for example, the head company returned a profit on close out of a hedge contract in its 2008 tax return, the tax cost of which had been reset under s701-55(6), subitem 53(5) would apply. And, it is suggested that the subsequent request for amendment to claim RTFI deductions lodged in November 2010 would not trigger the exclusion in subitem 53(6)(a) because the amendment relates to the application of sections 701-55(5C) and s716-405 (rather than to s701-55(6)). On this basis, the original 2002 rules would apply. The important outcome of the application of these rules is that the RTFI assets would retain a separate CGT cost base (rather than losing that cost base through the application of s701-63).

While this protection mechanism is welcomed, it should not be based on a requirement that the head company actually applied section 701-55(6) in respect of an assessment issued pre 12 May 2010. Given the relevant Government announcements, many companies at that time prudently refrained from applying this provision in the expectation that they would subsequently amend the relevant assessment once the law was clarified.

1.5 Protection for private rulings

It is noted that sub-item (3) of item 54 would render ineffective the protection otherwise provided by a private ruling where, (as would be usual subsequent to the issue of the ruling) a taxpayer lodges a request for amendment to give effect to a positive private ruling. The relevant protection should not be removed in these circumstances.