Retirement Village Association

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By email transmission: consolidation@treasury.gov.au

2 May 2012

Dear Sir or Madam,

Exposure draft to Consolidation Amendments

Firstly we would like to thank the Treasury for allowing the Retirement Village Association (RVA) to make a submission in respect of the Exposure Draft to the Consolidation amendments, affecting consolidated groups in respect of the consolidation tax cost setting and the rights to future income (RTFI) rules, as part of its continued commitment to maintaining the integrity, equity and fairness of the Australian taxation system.

The RVA is the peak industry body representing 600 retirement villages which are home for more than 80,000 Australians. Our 790 members are representative of the full spectrum of the industry and include church, charitable and not-for-profit operators, private developers/operators, unlisted public companies and mutuals, and publicly listed companies.

The potential impact of the proposed consolidation amendments to our industry is significant and in particular we are deeply concerned that what was announced on 25 November 2011 has not been fully reflected in the exposure draft in its current form

and we request that the Treasury provides further clarification on some of the application of the RTFI rules to consolidated groups.

Specifically, we have set out below specific aspects of the RTFI rules which we would like the Treasury to address to enable clarification of the intended outcomes and certainty for the industry:

1. Pre Rules – Scope of RTFI

The RTFI deduction provided for in the Exposure Draft ("ED") is significantly narrower than that provided for by the November 2011 government announcement.

In the government press release of 25 November 2011, "*Changes to the income tax law affecting consolidated groups*" ("the press release"), taxpayers were told that the original tax cost setting rules applicable to taxpayers who fall within the "pre-rules" (i.e. acquisitions that took place before 12 May 2010) would be modified to ensure that the reset tax costs for 'acquired' Category 1 rights to future income are deductible (paragraph 24).

A Category 1 right to future income was broadly defined in Table 1 of the press release as *"[R]ights to receive income where the work has been done, or the **goods or services** have been provided, by the joining entity before the joining time*" [emphasis added].

Paragraph 24 further provides that, in order to qualify for a deduction, the "*Category 1 rights to future income must arise under an agreement that was entered into between the joining entity and another entity before the joining time where, under the agreement, the other entity has agreed to pay an amount to the joining entity and*:

- *the amount can be identified as being in respect of **work (but not goods)** that has been performed or partially performed before the joining time by the joining entity for the other entity but has not been completed to the stage*

where, at the joining time, a recoverable debt has arisen in respect of the completion or partial completion of the work; or

- *the amount can be identified as being in respect of* ***goods or services*** *that have been provided before the joining time by the joining entity to the other entity, where a recoverable debt has not yet arisen in respect of the provision of the goods or services*" [emphasis added].

However, the RTFI deduction provided for in the ED is limited to section 25-95 Work In Progress amounts.

Section 25-95 of the ITAA 97 specifies the circumstances in which taxpayers can deduct work in progress ("WIP") amounts. Specifically, the new subsection 701-63(5) defines a WIP amount asset as: "*an asset that is in respect of* ***work (but not goods)*** *that has been partially performed by a recipient mentioned in paragraph 25-95(3)(b) for a third entity but not yet completed to the stage where a recoverable debt has arisen in respect of the completion or partial completion of the work*".

Subsection 25-95(3) defines a Work In Progress amount as *"[A]n amount is a work in progress amount to the extent that:*

a) an entity agrees to pay the amount to another entity (the recipient); and

b) the amount can be identified as being in respect of ***work (but not goods)*** *that has been partially performed by the recipient for a third entity but not yet completed to the stage where a recoverable debt has arisen in respect of the completion or partial completion of the work.*

This definition is consistent with the RTFI scope proposed in the first dot point of paragraph 24 of the press release. The ED does not, however, replicate the scope proposed by the second dot point in paragraph 24 of the press release. That is, it does not extend to an amount "identified as being in respect of **goods or services** that have been provided before the joining time by the joining entity, where a

recoverable debt has not yet arisen in respect of the provision of the goods or services".

The ED should be amended to reflect the government's intention of providing a deduction in respect of **goods or services** provided before the joining time where a recoverable debt has not yet arisen as announced in the press release.

2. Pre Rules – Examples of RTFI

The ED (legislation and Explanatory Memorandum) does not provide any examples of the type of work, goods or services that are expected to be covered by the proposed amendments. Given the history of the proposed amendments, it is considered critical that both taxpayers and the Australian Taxation Office are provided with as much guidance as possible as to Treasury's view of the proposed scope of the amendments by giving examples in the supplementary explanatory memorandum in respect of the proposed amendments.

We would urge Treasury to provide some practical examples that will fall within the proposed amendments.

Specifically, clarification of the services that potentially fall within the amendments are needed to clarify the intended practical operation of the provisions. We note that the initial EM to the 2010 amendments (*Tax Laws Amendment (2010 Measures No. 1) Bill 2010* (Cth)) included an example whereby a Head Company that acquired an operator of a Retirement Village business with a right to Deferred Management Fee ("DMF") was entitled to a deduction for the net allocable cost amount allocated to that DMF on the basis that the DMF was a RTFI asset.

Whilst this example was removed from the final supplementary EM, this was not due to the view that DMF was not eligible for RTFI, as DMF was clearly contemplated by Treasury to fall within the RTFI rules.

The RVA considers that DMF falls within the proposed RTFI as announced by the government in the press release. In particular, for a strata village where the resident owns the freehold to their unit, the DMF can only be for services provided by the village operator. In a leasehold village where accommodation is also provided, at least a portion of the DMF accrued at the joining time would represent a fee for services provided by the operator.

3. Pre Rules – Composite Assets

As mentioned at 2 above, there will be instances where a contract is in respect of services provided by the joining entity prior to the joining time as well as other supplies (for example, the provision of accommodation). The ED should ensure that where such an asset exists, an ability to separate the components of the asset is also available to enable the application of the RTFI provisions.

4. Pre Rules – Deemed Goodwill

Proposed section 701-63 treats goodwill as a single asset of the tax consolidated group. Therefore, upon an acquisition of a group with a number of intangibles and non-deductible RTFI contracts, only a single deemed goodwill asset would arise. This may cause complications and/or calculation issues when a contract is disposed of, comes to an end, or a subsidiary containing such a contract is disposed of.

The ED should clarify the ability to utilise or apply the cost base upon disposal. Otherwise, significant Deferred Tax liabilities may arise at the subsidiary level in respect of non-deductible RTFI contracts, whilst a Deferred Tax Asset exists at the head entity level in respect of the goodwill, which may not be able to be recognised.

5. Amendment Period

The November 2011 press release provided that only taxpayers would have a 2 year window post enactment of these measures in which to amend income tax returns notwithstanding they may be outside the 4 year period of assessment. The press release proposed the ability of the ATO to amend prior year assessments was to be limited to the normal periods of amendment.

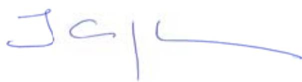
However, the ED provides both the ATO and taxpayers with the ability to amend income tax assessments within 2 years of the enactment of the provisions.

Treasury should align the ED with the government announcement and limit the 2 year window to taxpayers.

In closing, given that we are the peak body representing the retirement village industry, we would be pleased to further consult and discuss this matter with you.

Should you have any questions in relation to any of the above, please do not hesitate to contact Mark Bird who is the chair of our National Tax and Finance Advisory Sub Committee on (03) 8682 6004 or Andrew Hite, Taxation Manager at Lend Lease Primelife on (03) 8699 3494.

Yours sincerely,



Andrew Giles
Chief Executive Officer
RVA