



## Australian Government

### The Board of Taxation

6 April 2011

## BOARD OF TAXATION REVIEW OF RIGHTS TO FUTURE INCOME AND RESIDUAL TAX COST SETTING RULES

### ADDITIONAL GUIDANCE MATERIAL FOR STAKEHOLDERS

On 30 March 2011, the Assistant Treasurer and Minister for Financial Services and Superannuation released an announcement requesting that the Board of Taxation undertake a review of the consolidation rights to future income and residual tax cost setting rules. The Board was asked to report back to the Government by 31 May 2011.

On the same day, the Board announced that it was inviting submissions from the public for the purposes of this review. Submissions are to be made to the Board by 20 April 2011.

The Board also foreshadowed that it would consider whether it was necessary to provide additional guidance material to clarify the issues stakeholders should address in their submissions. This document provides that additional guidance material.

Stakeholders making submissions should note that Board members and members of the Board's Working Group will have full access to all submissions to this review. All information (including name and contact details) contained in submissions may be made available to the public on the Board of Taxation website unless it is indicated that all or part of the submission is to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like all or part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request for a submission to be made available under the *Freedom of Information Act 1982* (Commonwealth) that is marked 'confidential' will be determined in accordance with that Act.

The Board's Working Group is also available to meet with stakeholders, either individually or collectively, where circumstances warrant. Please contact Sean Lee (02 6263 3246) or Simone Abbot (02 6263 3816) at the Board of Taxation Secretariat to check the Working Group's availability.

### Background

The tax consolidation regime was introduced with effect from 1 July 2002. Under the regime, wholly-owned Australian groups are treated as a single entity for income tax purposes.

During the initial years of operation of the regime, uncertainty arose as to the treatment of particular types of assets held by an entity joining a tax consolidated group. Three particular asset types were problematic: (1) rights to future income assets (including work-in-progress assets); (2) consumables; and (3) revenue assets.

On 1 December 2005 the then Assistant Treasurer announced that amendments would be made to the tax consolidation rules to clarify the tax cost setting rules, including the treatment of rights to future income, with effect from 1 July 2002<sup>1</sup>. The relevant extract from the announcement follows:

"... a modification will be made to ensure that the tax cost of a joining entity's assets determined under the tax cost setting rules is used by the head company of a consolidated group or MEC group for the purpose of applying all other provisions in the income tax law. In addition, the head company will be taken to have incurred expenditure to acquire a joining entity's assets equal to their tax cost setting amount at the joining time.

Finally, rights to future income (such as work-in-progress amounts and unbilled revenue) held by a joining entity will be treated as retained cost base assets provided that those rights accrued to the head company. The tax cost setting amount will be equal to the terminating value of those rights. In addition, the head company will be taken to have incurred expenditure to acquire the rights at the joining time."

Following extensive consultation with stakeholders, the rights to future income and residual tax cost setting rules were enacted on 3 June 2010 in the *Tax Laws Amendment (2010 Measures No. 1) Act 2010*. As a consequence of the consultation process, the scope of the rules was expanded beyond the tax treatment of consumables, revenue assets and the types of right to future income assets originally envisaged.

The rights to future income rules provide a statutory deduction for contractual rights to receive an amount for the performance of work or services or the provision of goods. The deduction is spread over the life of the contract, capped at 10 years. The Supplementary Explanatory Memorandum to the *Tax Laws Amendment (2010 Measures No. 1) Act 2010* includes examples which illustrate that the rights to future income rules apply to:

- Rights to future income under a long-term construction contract;
- Rights to receive trailing commissions;
- Rights to future income under a land development agreement; and
- Rights to unbilled income for the supply of gas.

Examples in the Explanatory Memorandum to the *Tax Laws Amendment (2010 Measures No. 1) Act 2010* illustrate that the amended residual tax cost setting rules apply to:

- Consumable stores;
- Assets held on revenue account;
- Traditional securities; and
- Trade receivables.

(The eight examples listed are referred to below as the Explanatory Memorandum examples.)

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<sup>1</sup> The then Assistant Treasurer's announcement can be viewed at the following link:

<http://assistant.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=pressreleases/2005/098.htm&min=mtb>

## Scope of Board's Review

The scope of the Board's review is established by the Terms of Reference provided by the Government<sup>2</sup>. Under the Terms of Reference the Board has been asked to:

- Examine the operation of the rights to future income and residual tax cost setting rules (the rules) with a view to clarifying their scope; and
- Propose changes to limit the scope of the rules, if necessary, and advise on the date of effect of those proposed changes (including whether they should apply retrospectively).

In undertaking the review, the Board is to consider:

- The taxation outcomes that arise when assets of the type that are covered by the rules are acquired directly by a company as part of a business acquisition outside of the consolidation regime;
- Whether there are any circumstances in which these tax outcomes should be different if these assets are held by a company that joins a consolidated group;
- If a difference in tax outcomes is warranted, the appropriate basis for recognising the tax costs of any assets that should be treated differently on entry into a consolidated group; and
- The revenue impact of any changes to the rules it proposes.

The rules being examined are set out in the *Income Tax Assessment Act 1997*: for the rights to future income rules, sections 701-55(5C), 701-90, 716-405 and 716-410; for the residual tax cost setting rules, sections 701-55(6) and 701-56.

## Additional Guidance for Stakeholders' Submissions

The Board has set out below matters which stakeholders may wish to address in their submissions.

1. *The taxation outcomes that arise when assets of the type that are covered by the rules are acquired directly by a company as part of a business acquisition outside of the consolidation regime*

The Board notes that a consideration of the tax outcomes that arise when assets are acquired directly outside of the consolidation regime appears to be broadly consistent with the 'asset acquisition approach' which the Board is considering as part of its Post-Implementation Review into Aspects of the Consolidation Regime. Details on the asset acquisition approach are set out in the Board's position paper to this review<sup>3</sup>.

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<sup>2</sup> The Terms of Reference are detailed in the Assistant Treasurer's Press Release dated 30 March 2011: <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/045.htm&pageID=003&min=brs&Year=&DocType>

<sup>3</sup> Page 15, Board of Taxation Position Paper, Post-Implementation Review into Certain Aspects of the Consolidation Regime (October 2010): [http://www.taxboard.gov.au/content/reviews\\_and\\_consultations/aspects\\_of\\_the\\_consolidation\\_regime/position\\_paper/consolidation\\_regime\\_position\\_paper.pdf](http://www.taxboard.gov.au/content/reviews_and_consultations/aspects_of_the_consolidation_regime/position_paper/consolidation_regime_position_paper.pdf)

Stakeholders may wish to comment on the tax outcomes which arise on acquisition for various types of assets acquired as part of a business acquisition outside of consolidation.

Examples of such asset types include the eight Explanatory Memorandum examples listed above.

Other asset types include:

- Customer contracts;
- Insurance policies;
- Non-contractual customer relationships; and
- Goodwill.

Stakeholders are asked to provide other examples of assets that could be covered by the rules and the applicable tax outcomes where these assets are acquired outside of consolidation. This will ensure that the Board is made aware of the views of stakeholders as to the types of assets whose tax treatments should be retained and the types of assets whose tax treatments should be amended under this review.

2. *Whether there are any circumstances in which these tax outcomes should be different if these assets are held by a company that joins a consolidated group*

Stakeholders may wish to comment on the circumstances where tax outcomes should be different if the same types of assets are held by a company which joins a tax consolidated group (the company could join a consolidated group under the acquisition or the formation case). Reasons should also be given as to why the taxation outcomes should differ.

An example may include the case where an asset is held by an entity joining a consolidated group in the formation case.

Stakeholders should also provide comments and reasons on why the tax outcomes for the Explanatory Memorandum examples should or should not differ depending on whether those assets are acquired outside of consolidation or are held by an entity joining a consolidated group.

3. *If a difference in tax outcomes is warranted, the appropriate basis for recognising the tax costs of any assets that should be treated differently on entry into a consolidated group*

Stakeholders may identify cases where the tax outcomes of assets acquired directly by a company should differ to the tax outcomes for a consolidated group acquiring a joining entity which holds the same assets.

Where such cases are identified, stakeholders should propose an appropriate basis for the recognition / treatment of the tax costs of those assets where they are held by an entity joining a tax consolidated group (under the acquisition or the formation case).

Examples may include:

- Treating an amount as deductible over a period of time;
- Deeming an amount to be acquired by a consolidated group to be on revenue account;

- Deeming an amount to be acquired by a consolidated group to be on capital account; or
- Other (please specify).

Stakeholders are also invited to comment on the most appropriate means for identifying, in the law, those assets where tax outcomes should differ, if the Board were to decide that the scope of the existing rules should be clarified. Examples include:

- Using a principled approach;
- Specifying applicable cases;
- Excluding non-applicable cases;
- A combination of the above approaches; or
- Other (please specify).

Where stakeholders identify that tax outcomes for certain assets held by an entity joining a consolidated group should be the same if those assets are acquired outside of consolidation, stakeholders are invited to comment on the most appropriate means for enabling these asset types to be given a symmetrical tax treatment in the law.

#### *4. The revenue impact of any changes to the rules it proposes*

Under the Terms of Reference provided, the Board is required to consider the revenue impact of any changes it proposes to the rules.

The Board does not expect stakeholders to comment on overall revenue impacts, but invites comments on revenue impacts of specific cases of which they may be aware.

#### *5. Date of effect considerations*

Stakeholders may wish to comment on the appropriate date of effect of any proposed changes, including whether they should apply retrospectively. In particular, the Board invites comments on how any retrospective changes should impact taxpayers who may have already relied on the existing rules in the course of structuring their tax affairs or in the course of conducting their business operations.

Stakeholders may wish to consider the following dates in their submissions and are invited to comment on whether different tax treatments should apply before and after these dates:

- 1 July 2002 (the date of effect of the rules);
- 1 December 2005 (the date of initial announcement of proposed rules);
- 10 February 2010 (the date of introduction into Parliament of the Bill containing the rules);
- 3 June 2010 (the date of royal assent for the amendments introducing the rules);
- 30 March 2011 (the date of the Government's announcement of the Board of Taxation's review of the rules);
- The date of any Government announcement following the Board's review;

- 1 July 2011 (the date of the first financial year following conclusion of the Board's review); and
- Any other dates which stakeholders consider relevant.

Stakeholders may also wish to comment on how any proposed changes will apply from these dates relative to the particular circumstances of taxpayers. For example, proposed changes could apply to:

- Any time an entity joins a consolidated group from a particular date;
- Any amendment requests lodged with the ATO after a particular date; or
- Any private ruling requests lodged or approved by the ATO after a particular date.

*6. Addressing present uncertainty pending finalisation of the Board's review*

Stakeholders are invited to comment on any ways in which the uncertainty which would arise pending any ultimate legislative resolution should be addressed.

*7. Other matters*

Stakeholders are invited to comment on any other matters relating to the operation of the rights to future income and residual tax cost setting rules, including the operation of any other provisions in the tax law associated with the rights to future income or residual tax cost setting rules.