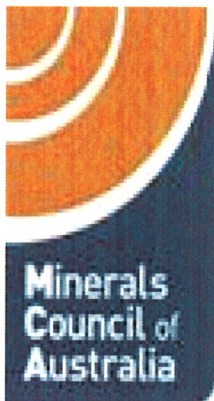




CORPORATE TAX  
ASSOCIATION  
of Australia Incorporated



Submission

12 March 2010

## Board of Taxation's post-implementation consolidation regime review

CTA/MCA comments on the preliminary  
Discussion Paper

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### 1 Introduction and objectives

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#### 1.1 Importance of the review

The Corporate Tax Association (**CTA**) and the Minerals Council of Australia (**MCA**) both recognise the importance of the Consolidation Regime in providing a taxation framework to support corporate growth and operating efficiency. It is for this reason that the bodies fully endorse the Government's decision to request that the Board of Taxation (**BoT**) undertake a detailed post-implementation review (**PIR**) of certain aspects associated with the Consolidation Regime, and why the bodies are fully committed to support this PIR by the preparation of detailed submissions and by meeting with the BoT at any time to discuss issues and developments.

The CTA and the MCA bring to this process the experience and views of the combined membership of over 120 corporate groups that represents a significant proportion of total corporate income tax paid. In addition, the fact that the bodies are working jointly on inputting into the BoT review process evidences that they do not see the future development of the Consolidation Regime as an industry/sectoral-specific issue. Rather, being a broader corporate policy issue, it is essential that modifications to the Consolidation Regime meet the needs of the corporate sector generally, within the context of the Government's tax policy objectives.

#### 1.2 The review process and this submission

As the BoT is already aware, the Consolidation Regime is extremely complex. Therefore, the policy and practical issues that will arise in further enhancing the operation of the Consolidation Regime will not only raise complex issues, but considerable care will have to be taken in formulating recommendations so as to not create additional complexity and/or new problems. The fact that particular care needs to be taken in formulating recommendations is acknowledged, in effect, by the fact that the BoT report to Government is not scheduled to be finalised before the end of 2010.

For these same reasons the CTA/MCA intend to proceed with this consultation/submission process with equal diligence and care, and do not wish to prematurely 'lock into' specific recommendations to the BoT.

That is not to say that a number of CTA/MCA members do not have strong views on certain aspects under review, but consistent with the approach being adopted by the BoT, the CTA/MCA believe that at this early stage in the process it is more productive to identify issues and options. We would hope that these issues and options identified would be further considered by the BoT (including direct discussions with the CTA, MCA, and others) before the BoT formulates its subsequent position paper scheduled to be released in the second quarter of 2010. In the expectation that this subsequent position paper will outline and discuss the range of issues 'in play', this should provide a more appropriate platform for the CTA/MCA to consult with their members before formulating more detailed and considered recommendations to then be lodged with the BoT.

As such, the objective of this current submission is to raise issues which we believe the BoT should be considering as part of its PIR (a number of which are already encompassed in the discussion paper released on 9 December 2009 (**Discussion Paper**)), and to discuss possible options for dealing with these issues.

Representatives of the CTA and MCA would be more than happy to meet with the BoT at any time to further discuss these points or to discuss other points/issues that may be identified in the course of the review process during 2010.

### **1.3 Small business issues**

One of the issues that Government has requested the BoT to address as part of this PIR relates to specific Consolidation Regime aspects of relevance to small businesses. Given that small business issues and concerns are outside the scope and experience of the membership of both the CTA and the MCA, we believe it would be inappropriate for our submission to consider these aspects in any detail.

However, the CTA and MCA recognise that small businesses face very different compliance challenges to those faced by larger businesses, and therefore the CTA and MCA would not object to specific 'carve-outs' and/or calculation shortcuts being provided only to small businesses, where for various reasons it may not be considered appropriate for such concessions to be extended to the corporate community more generally.

## 2 Policy framework relevant to specific issues

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### 2.1 General comments

The 9 December 2009 Discussion Paper raises a number of issues and questions, the majority of which can be categorised under the following three headings:

- (a) Operation of the single entity rule (Chapter 3);
- (b) Interaction between the Consolidation Regime and other parts of the income tax law (Chapter 4); and
- (c) Review of the inherited history rules (Chapter 5).

In order to discuss each of these three aspects more specifically, the CTA/MCA believe that it is first necessary to consider the broader policy approaches on which the Consolidation Regime was initially formulated.

Our concern is that it may be counterproductive and create further confusion and complexity to separately address individual issues raised in the chapters noted above. Rather, we would suggest that the BoT first consider whether a renewed review of the appropriateness and application of the more general consolidation principles/policies may ensure that a number of these individual issues are addressed in a more co-ordinated/comprehensive manner.

As such, we would recommend that, to the extent possible, the specific issues noted in Chapters 3 and 4 of the Discussion Paper be considered in the context of the basic policy outcomes that the Consolidation Regime should in the future be seeking to replicate. To this end, outlined below are the two key policy drivers that underpin much of the current regime, being the 'asset-based model' (refer 2.2 below) and the 'inherited history rules' (refer 2.3 below). In relation to each of these current policies, we outline alternative approaches which we believe represent options that should be acknowledged and considered by the BoT, so that in the context of this important review 'all the cards are on the table'.

**The CTA/MCA again stress that they are not, at this stage, endorsing or recommending the rejection of any of these policy approaches; but possibly in tandem with the BoT over the next few weeks, the CTA/MCA would like to further consider and research the relative merits of each of these approaches and to also obtain the views of their broader memberships.**

The table at 2.4 below provides a very high level comparative summary of potential outcomes of these alternative policy approaches.

In relation to each of the specific technical issues raised in Chapters 3 and 4 of the Discussion Paper, as well as providing preliminary comments on these individual issues at 3 and 4 below, outcomes that may flow from these alternative policy approaches are also noted. However, as the review proceeds and the BoT determines which (if any) of these alternative policy approaches it may be interested in further pursuing, the CTA/MCA anticipate providing more specific and detailed input on these individual technical issues.

We believe that consideration of these broader issues is within the terms of reference for the BoT's review, as per the Government's announcement on 3 June 2009. This is due to the fact that these issues involve both the operation of the entry history rule (and alternatives thereto) and interactions between the consolidation provisions and other parts of the income tax law (specifically in the context of how other provisions of the Act should best deal with the consolidation provisions requiring the resetting of the tax value of assets of a joining entity). A number of related issues are already noted in Chapter 5 of the Discussion Paper.

## 2.2 Asset-based model and alternatives

### (a) The current asset-based model (ABM)

As outlined in the Platform for Consultation document that in 1999 initially raised for consideration the concept of consolidation, the Consolidation Regime was established based on the following six 'framework design principles'.<sup>1</sup>

- (1) **Principle 1:** consolidation to be optional, but if a group decides to consolidate, all its wholly-owned Australian resident group entities must consolidate.
- (2) **Principle 2:** consolidated groups to be treated as a single entity.
- (3) **Principle 3:** current grouping provisions to be repealed.
- (4) **Principle 4:** individual entity losses and franking account balances able to be brought into the Consolidation Regime.
- (5) **Principle 5:** carry-forward losses and franking balances to remain with the consolidated group on an entity's exit.
- (6) **Principle 6:** provisions to be established for determining the cost bases on exit.

It was in relation to this last principle (ie 'provisions to be established for determining the cost bases on exit') that the Platform for Consultation document considered two approaches for, in effect, tracking the costs to a consolidated group of acquiring a joining entity through to the time that entity leaves the group, being the ABM and the 'entity-based model'. The ABM was ultimately recommended by the Ralph Review, and this recommendation was accepted by the Government and forms the basis of the entry and exit allocable cost amount (ACA) provisions that are currently in the Act. [As outlined in Attachment 1, the entity-based model was rejected by the Ralph Review for reasons that remain valid, and therefore it is not again raised in this paper as an alternative approach that should be considered by the BoT.]

The ABM was described in the Platform for Consultation document as follows.<sup>2</sup>

27.12 The asset-based model dispenses entirely with tax recognition of group entities in consolidation. Upon the entry of an entity into consolidation, the group's cost base for its equity in the entity is transferred to the assets the entity brings with it, including goodwill on acquisition. The cost base for equity, when transferred to the individual assets, replaces existing asset cost bases. Where a group sells equity, the group's cost base for that equity is reconstructed equal to the sum of the cost bases of the assets that go with it.

27.13 The intuition underlying this approach is that on entry into consolidation the equity cost base is transferred to the assets of the entity as a representation of the actual cost on consolidation of the assets to the overall group. On exit from the group the process is reversed and the cost base of the equity is derived from the assets of the entity at that time, as this is what is actually being taken out of consolidation.

Therefore, it is by way of the ABM that the tax value of assets are reset when an entity joins a tax consolidated group and, conversely, the tax value of equity interests is reset when an entity leaves a tax consolidated group (as well as other tax attributes being taken to have joined the consolidated group).

It is by way of the ABM that the key objectives of preventing the double taxation of gains and the double benefits from economic losses, etc (as stated in section 700-10) are satisfied.

<sup>1</sup> Platform for Consultation, pages 545 to 567.

<sup>2</sup> Platform for Consultation, pages 574 and 575.

(b) **An alternative to the ABM – the ‘asset transaction model’ (ATM)**

In some respects there has been confusion within the corporate tax community as to whether an objective of the ABM has been to replicate asset acquisition outcomes. This confusion has no doubt arisen because of the ABM’s somewhat ambiguous ‘asset-based’ title, and this has been compounded because in relation to many types of assets, outcomes under the ABM do to a large extent already mirror those that would arise under an asset acquisition transaction. However, importantly the outcomes of the interaction between the ABM and the entry history rule can be inconsistent and ad hoc as to whether or not tax outcomes replicate those that would arise under an asset acquisition. This is to be expected, as it is not the stated intent of either the ABM or the entry history rule to achieve outcomes that necessarily equate to an asset acquisition.

Therefore, the CTA/MCA raise for discussion an ATM as a possible alternative to the ABM. The objectives of the ATM would be that in the context of an entity acquisition or disposal to replicate, as closely as possible, the tax outcomes in respect of assets that would have arisen if the transaction had been undertaken as a direct acquisition or disposal of the underlying assets (and liabilities) of the relevant subsidiary.

The conceptual underpinning of an ATM approach would be to reflect the economic substance of a group’s acquisition of 100% of the shares in a joining entity, being that the group is economically acquiring full ownership of the underlying assets of the joining entity, and that this should be recognised for all go-forward income tax purposes in respect of such assets.

Therefore, the ATM is totally consistent with, and in effect further supports, the operation of the single entity rule. However, the ATM would render redundant the entry history rule, because in the context of a direct asset acquisition the past history of the asset in the hands of the vendor is of no relevance to the purchaser.<sup>3</sup>

Being an alternative to the ABM, the adoption of an ATM need not necessarily alter the current tax consolidation treatment of non-asset related corporate tax attributes such as tax losses and franking credits of a joining entity, which currently become available to the joined group (subject to satisfying rigid entry rules in respect of tax losses). However, it is recognised that under an asset acquisition transaction such tax attributes would not transfer to the acquiring entity. Therefore, in further developing the ATM framework consideration would have to be given to the appropriate policy approach to be adopted in relation to such non-asset tax attributes. In this regard, the following points are noted.

(1) **Franking credits and tax losses are a separate consolidation principle**

From the inception of the concept of consolidation, the treatment of franking credits and tax losses are seen as a totally separate issue and impacted by a different principle (refer Principle 4 at 2.2(a)(4) above) to the issues and principles relevant to assets and entity cost bases (refer Principle 6 at 2.2(a)(6) above). Therefore, taking a different approach to asset cost base related issues need not impact on the policy treatment of tax losses and franking credits.

(2) **Potential discrimination against consolidated groups**

If tax losses and franking credits were not able to transfer to the joined group, then this would discriminate against groups that have elected to consolidate and may discourage other groups from similarly electing to consolidate in the future.

<sup>3</sup> There are some very limited exceptions, the two principal ones being where assets are acquired from an associate or related party, and where assets are acquired from a Government agency.

(3) **Franking credits and tax losses are not terminated in an asset acquisition**

In the context of an actual asset acquisition, tax losses and franking credits of the vendor entity are not terminated but remain available to be utilised by the vendor entity (or in the context of franking credits, to be utilised by its shareholders). Hence, causing these tax losses and franking credits to be totally cancelled under an ATM where an entity joins the group may be seen to be inequitable and inappropriate.

(4) **A 'benefits and burdens' perspective**

Under an ATM it is not proposed that tax liabilities and exposures of the joining entity are terminated, but rather they remain liabilities of the joining entity notwithstanding it becomes a wholly-owned subsidiary of the joined group. Under a direct asset acquisition, the asset purchaser would have no direct or indirect exposure to past tax liabilities of the vendor. Therefore, given that under an entity acquisition the joined group can become exposed to prior tax liabilities of the acquired entity, it is not inconsistent that it should similarly be able to access prior non-asset related tax attributes of the joining entity (ie a 'benefits and burdens' type approach).

No doubt a range of other issues would arise for discussion if further consideration was given to the possibility of adopting an ATM as a substitute for the current ABM.

## 2.3 Inherited history rules and alternatives

(a) **The current inherited history rules (IHRs)**

While the ABM requires that the tax value of assets of the joining entity be reset when the entity joins a consolidated group, the IHRs (being the entry history rule (**Entry HR**) and the exit history rule (**Exit HR**)) are then relevant in determining the history relating to such assets to which the consolidated group is to have regard in determining the tax status of subsequent transactions. The objectives of the IHRs were outlined in the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, at paragraph 2.30:

2.30 ... Rules are provided to identify the history that an entity takes with it into a consolidated group or takes with it when it leaves a group. This history can affect the future tax liabilities of the group that it joins. The inherited history can also affect future tax liabilities of a subsidiary member after it leaves a group. The inherited history rules reduce the compliance costs that would result if the previous history had been ignored and a 'clean slate' approach (reflected in the February 2002 Exposure Draft) adopted.

The initial consolidation Exposure Draft provisions that were released on 7 February 2002<sup>4</sup> did not utilise the IHRs but rather proposed the alternative mechanism of a 'clean slate rule' (**CSR**). However, following the release of that Exposure Draft there was considerable concern that the application of the CSR on the initial formation of consolidated groups would further complicate an already enormously difficult process. The principal concern in this regard was the potentially dramatic implications of adopting a system which would immediately disregard the history relating to every asset owned by major corporate groups in Australia in determining subsequent tax outcomes.

These concerns were compounded by the fact that many groups intended to utilise the transitional option whereby the pre-existing tax basis of assets of nominated subsidiaries could be retained. As such, retaining the tax value of assets while eliminating the prior tax history in respect of such assets created

<sup>4</sup> New Business Tax System (Consolidation) Bill 2002 – Exposure Draft.



obvious risks that such an inconsistency would create uncertainty and/or complexity.

These factors are understood to be the major reason why ultimately a decision was made to utilise IHRs rather than the CSR in that the IHRs enabled regard to be had to pre-formation/pre-joining time asset related history in determining post-formation/joining time tax outcomes.

However, in many respects, both legislatively and administratively, the policy underlying the IHRs has been compromised and less than clear, as illustrated in the following table in relation to the tax treatment of depreciating assets held by a joining entity.

Nature of depreciating asset of joining entity	Treatment accords with the entry history rule	Treatment does not seem to accord with the entry history rule
1 Effective life rates (s.701-55)		
1.1 Prime cost method		
– no step-up	Use existing effective life	
– step-up		Use new effective life
1.2 Diminishing value method	Use existing effective life	
2 Accelerated rates (s.701-80)		
– no step-up	Accelerated rates continue to apply	
– step-up		Accelerated rates cease to apply
3 New application of 200% diminishing value rate		
Final decision of Government outstanding		
4 Privatised assets (s.705-47)		
– if joining entity has been part of a consolidated group for at least 24 months		Depreciable value limitations cease to apply <sup>5</sup>
– in other cases	Depreciable value limitations continue to apply	
5 Pre-1 July 2001 mining rights (s.702-1 IT(TP)A)		
Remain non-depreciable		

As an aside, it is important to note that the fact that on an entity acquisition pre-1 July 2001 mining rights retain a 'non-depreciable' tax status has been seen for some time as anomalous and can distort commercial decision-making. This is because by way of an asset acquisition the acquiring entity is able to

<sup>5</sup> However, the application of this exemption is itself anomalous and unduly restrictive as evidenced in ATO ID 2007/74 in the context of the creeping acquisition of a consolidated group holding privatised assets – correcting legislative amendments required.

commence to claim tax depreciation deductions in respect of the mining rights acquired, irrespective of their prior pre-1 July 2001 status. Previous submissions to Government lodged by the MCA have raised these points.

While specifically addressing this issue may be yet another departure from the application of the entry history rule, as was the case in relation to the treatment of privatised assets, not to do so would be to further perpetuate the resulting anomalous outcomes and distortions.

(b) **An alternative to the IHRs – the CSR**

While the IHRs are an important conceptual element of the current Consolidation Regime, the fact that they are not a fundamental foundation element of the Regime is evidenced by the following:

- (1) the IHRs were not discussed and were not part of the key recommendations of the Ralph Review in relation to the Consolidation Regime; and
- (2) as noted above, the Exposure Draft provisions released on 7 February 2002 in relation to the Consolidation Regime<sup>6</sup> did not utilise IHRs, but rather proposed the alternative mechanism of a CSR.

Chapter 5 of the Discussion Paper also recognises that the IHRs are important but not a fundamental consolidation principle, and therefore the BoT indicates that it is open to the possibility of considering substantial modifications to the IHRs, and alternative approaches such as a CSR.

While the detail of a CSR approach need not necessarily be identical in all respects to that raised in the 2002 Exposure Draft material, the general approach as outlined at that time, as per the statements below, are a reasonable starting point for considering and evaluating issues and impacts.

2.35 ... subsidiary members lose their individual income tax identity on consolidation. Also, the head company is taken to have acquired the assets and businesses of the subsidiary members, when they join a consolidated group. A corollary of these rules is that subsidiary members' individual income tax histories are not taken into account for the purposes of working out the income tax liability or losses:

- of the group, for any income year during which the subsidiary is a member; or
- of the entity, for any income year after it leaves the group.

2.36 The clean slate rules apply for the core purposes only, and do not, for example, affect an entity's responsibility for taxation liabilities relating to pre-consolidation periods.

*Entry clean slate rule*

2.37 Subject to certain exceptions (discussed in paragraphs 2.42 and 2.43), an entity does not bring its income tax history into a group for the purposes of calculating the income tax liability or losses of the head company. The cost setting rules treat the acquisition of an entity by a consolidated group as the acquisition of the business of that entity. The entry clean slate rule will make it clear that amounts are not included in the assessable income nor deductions allowed to the head company for events that relate purely to the subsidiary before it joined the group.

...

*Exit clean slate rule*

2.40 It is also necessary, for example, that deductions are not allowed to a leaving entity on the basis of things that happened to it (or any other entity) before it joined the group or while it was a member of the group. The assets and liabilities of an entity that leaves a consolidated group can be very different from its assets and liabilities when it entered the group or when it was created by the group. For this reason, a leaving entity is treated as a completely new entity for income tax purposes. The exit clean slate rule ensures that nothing that happened to an exited entity before it joined or while it was a member of a consolidated group can be taken into account in working out the entity's

<sup>6</sup> New Business Tax System (Consolidation) Bill 2002 – Exposure Draft.

post-consolidation income tax liability or losses for an income year after the entity ceased to be a subsidiary member. There will also be consequences concerning the character of transactions involving certain revenue assets and transactions occurring after the leaving time similar to the examples in paragraph 2.39.

In determining the relative merits of such a CSR approach, the following points are also noted.

(1) **Providing a clearer conceptual approach for considering other issues**

As noted above, whether an IHR or CSR methodology is applied can directly and indirectly impact on the approach to be adopted in relation to a number of the other issues raised in the Discussion Paper, as briefly summarised in the following table.

No.	Question	Outline of relevance	Further discussed in this submission
3.2	Interpretation of the single entity rule	The CSR approach could require associated modifications to the single entity rule.	3.2
3.3/3.4	Acquisitions and disposals of intra-group assets	The CSR approach could be particularly relevant in the context of intra-group assets of an acquired entity.	3.3
4.1	Trust income in a joining period	The CSR approach would have some relevance to the treatment of pre-joining time trust income.	4.2
4.7	Interactions with CGT event J1	The CSR approach would be inconsistent with an ongoing application of CGT event J1.	4.7
4.8	Interactions with the FX provisions and TOFA provisions	The CSR approach would be directly relevant.	4.8

(2) **More closely aligning asset-related tax outcomes to an asset acquisition**

While under the ABM there would remain fundamental differences between the commercial and economic (and hence tax) outcomes associated with an entity acquisition as compared to an asset acquisition, the CSR approach would assist in reducing these disparities (being an aspect that was noted in the 2002 Exposure Draft material which initially proposed the CSR – paragraphs 2.37 to 2.39).

(3) **Addressing other technical problems**

Taxpayers, the ATO, and Treasury, in some cases still have to grapple with difficult issues as to the implications of resetting the tax values of some assets when an entity joins a consolidated group. The most common example in this regard is subsection 701-55(6) (both as initially enacted in 2002 and as to be amended by Tax Laws Amendment (2010 Measures No.1) Bill 2010) in that no contextual setting is provided as to the deemed incurrence of the tax cost setting amount in respect of the relevant asset. The introduction of a CSR would not, in itself, address this issue (and potentially could exacerbate the problem by not allowing regard to be had to prior occurrences in relation to the relevant asset). Therefore, this issue would have to be addressed in the context of the provisions introducing a CSR to, presumably, deem the tax cost setting amount to be the incurrence of an outgoing or expenditure in association with the assumed acquisition of the relevant asset.

## 2.4 Alternative models – outline of possible outcomes

The alternative policy approaches raised above for consideration and discussion would obviously result in different tax outcomes as compared to outcomes under the current Consolidation Regime. The table below contains a very high level outline of how tax outcomes under the current ABM/entry history rule position could vary under alternative models of either an ABM/CSR approach or an ATM approach. Some suggested outcomes noted in this table could be contentious, and as such, if the BoT were to further consider these alternative approaches then more detailed consideration should be given to a number of these potential outcomes.

	Asset based model (ABM)	Asset transaction model (ATM)
<b>1 POLICY OBJECTIVES</b>	<p>Primarily intended as a method of warehousing equity cost base amounts, ie transfers the group's cost base for equity in the joining entity to its underlying assets, and reverses this process when an entity leaves the group.</p> <p><b>Entry history rule – present regime</b> Preserves prior history in determining future tax outcomes in respect of assets and liabilities of the joining entity.</p>	<p>Would be intended to equate asset-related outcomes to those that would have arisen under a direct asset acquisition transaction or disposal and to similarly disregard prior history for all purposes.</p>
<b>2 AN ENTITY JOINING THE GROUP</b>		
<b>2.1 Calculation of ACA</b>	<p>Reduced for:</p> <ul style="list-style-type: none"> <li>• tax losses;</li> <li>• non-asset tax deductions (eg undeducted s.40-880 amounts).</li> </ul>	<p>Reduced for tax losses.</p> <p>Reduced for tax losses (subject to points at 2.3 below).</p>

	Asset based model (ABM)		Asset transaction model (ATM)
	Entry history rule – present regime	Clean slate rule – based on 2002 proposal	
2.2 Franking credits	Available.	Available.	Potentially available (but would be dependent on the precise formulation of the policy framework).
2.3 Tax losses	Available.	Available (as per the 2002 ED.)	Potentially available (but would be dependent on the precise formulation of the policy framework).
2.4 Other non-asset tax attributes (eg undeducted s.40-880 amounts).	Available.	Not available. <sup>7</sup>	Not available.
2.5 Intra-group assets	Absorb ACA but are then disregarded.	Absorb ACA but are then disregarded.	Tax outcomes determined as if the ACA allocated to the intra-group assets was a payment to terminate these assets.
<b>3 OPERATING AS A GROUP</b>			
3.1 Asset-based deductions (eg capital allowances, repairs, and pre- 1 July 2001 mining rights)	Based on an inconsistent blend of history (eg mining rights and depreciation methods) and 'acquisition' outcomes (eg depreciation rates and privatised assets).	In principle, should be based on 'asset acquisition' outcomes (but 2002 proposal somewhat inconsistent in regard to accelerated depreciation, etc).	Based on deemed 'asset acquisition' outcomes.
3.2 Pre-joining trade debt written off as bad	Deductible based on 'assessable' history.	Not deductible for non-money lenders.	Not deductible for non-money lenders.
3.3 Capital/revenue status of assets and also subsequent transactions	Based on history (but Whitford Beach principle can alter status).	History irrelevant (but no 'deemed acquisition' status in 2002 proposal).	History irrelevant as specific deemed acquisition status.
3.4 Status of prior tax rulings of the joining entity	Generally continue to apply.	To the extent they relate to assets (and liabilities), they would cease to apply.	To the extent they relate to assets (and liabilities), they would cease to apply.
<b>4 AN ENTITY LEAVES THE GROUP</b>			
4.1 Quantification of exit ACA	Tax values of leaving assets plus non-asset deductions (undeducted s.40-880 amounts).	Tax values of leaving assets.	Tax values of leaving assets.

<sup>7</sup> 2002 Exposure Draft explanatory material, paragraph 238.

	Asset based model (ABM)	Asset transaction model (ATM)	
	Entry history rule – present regime	Clean slate rule – based on 2002 proposal	
4.2 Nature of gain	Based on revenue/capital status of shares of the leaving entity (normally capital status).	Based on revenue/capital status of shares of the leaving entity (normally capital status).	The tax status of shares will require further policy consideration. If some revenue/capital status split method was to apply based on the status of underlying assets, then this would raise a number of policy and compliance issues. <sup>8</sup>
4.3 Other non-asset tax attributes relating to activities of the leaving entity (eg undeducted s.40-880 amounts)	Transfer to the leaving entity.	Retained by group, ie ongoing deductions to the group.	Retained by group, ie ongoing deductions to the group.
5 TRANSITIONAL ASPECTS			
5.1 Transitioning from the current Consolidation Regime to a modified or new regime	As the current Consolidation Regime would continue, there would be no transitional issues other than in dealing with issues associated with intra-group assets, etc.	The new regime could only apply prospectively to entities joining or leaving a consolidated group after a specific date. Therefore, the current entry history rule would continue to apply to assets acquired by way of previous acquisitions. It is not anticipated that this grandfather operation of the entry history rule would create significant issues, but this would require further consideration.	

<sup>8</sup> These policy and compliance issues would include:

- to the extent a material portion of the gain on the sale of shares in the leaving entity was then regarded as having a revenue status, this could raise equity issues regarding the reduced utilisation of prior capital losses arising from prior disposals of subsidiaries;
- from a compliance perspective, it would be inappropriate to base this split on the relative cost bases of underlying revenue and capital assets, as cost is an inappropriate proxy for unrealised gains (eg trading stock acquired may proportionately have a high cost but a low unrealised gain as compared to, say, goodwill);
- undertaking this split based on unrealised gains in underlying assets would raise significant compliance issues.

## 3 The single entity rule – Chapter 3 of the Discussion Paper

### 3.1 General comments – an initial limited response by the CTA/MCA

Chapter 3 of the Discussion Paper raises five sets of questions regarding the operation of the single entity rule (**SER**) and associated issues and problems that have emerged.

As explained at 2.1 above, this initial response by the CTA/MCA does not seek to address these BoT questions individually or in detail, but rather to comment more broadly on these issues in the context of the alternative policy approaches raised for discussion in 2 above. In particular, to the extent that alternative policy approaches would alter the scope and operation of the SER, then it would be unnecessary to consider possible solutions to problems under the current ABM/entry history rule policy framework if a particular alternative policy framework were to be adopted.

Therefore, the comments below discuss in a policy framework context each of the three main SER problem areas identified in the Discussion Paper. The CTA/MCA would be able to respond to any additional points that may be raised by the BoT, either in direct discussions with the BoT or by way of a subsequent submission.

### 3.2 SER – general operation

The paper prepared and presented by Mr Des Maloney and Mr Peter Walmsley of the ATO to the TIA and CTA's 4th National Consolidation Symposium in April/May 2009 (being a conference paper referred to in the Discussion Paper) evidences some of the difficulties that the ATO and taxpayers are experiencing in determining the precise implications of the SER.

A particularly difficult issue in this context is to what extent the fact that subsidiary members of the group are taken to be 'parts' of the head company is relevant, with pages 11 and 12 of the Maloney/Walmsley paper highlighting this point as follows:

The alternative, and favoured, approach is that the SER does not actually say 'pretend the subsidiary does not exist' – it certainly does not say, 'disregard intra-group transactions and freely reconstruct when necessary or convenient'. What it says is that subsidiaries are taken to be part of the head company and not separate entities. That is not 'part of' but 'parts of'. This perspective could be described as the personality that exists as part of a single entity, viz, 'hypostasis'. Put another way, the SER is not meant to ignore the existence of legal reality.

Under this line of argument the subsidiary member still exists, but as 'a part' of the head company. The head company, although a single taxpayer, consists of distinct parts. These parts are capable in law of transacting with others that are not part of the single taxpayer as well as with each other ...

In other words, the subsidiary members of a consolidated group, under the SER, are part of a single entity that still undertakes legally identifiable transactions between themselves and entities outside the consolidated group as does the head company ...

The ongoing separate relevance of subsidiary members of a consolidated group under the SER is further complicated by the entry history rule. For example, the pre-joining time transactions of members (including pre-joining time transactions between one member and other members of the group) continue to have ongoing relevance even though the nature of these transactions and their objectives may have been somewhat different to those of other members of the group.

This issue touches on a related (and emerging) further ambiguity as to the operation of the SER – being its relevance in relation to pre-joining transactions and its ongoing impact on post-leaving transactions. For example, to the extent that tax outcomes that arise while an entity is a member of a group can be impacted by transactions that occurred between the two companies prior to them both being members of the same group, should the SER in effect have retrospective application to those pre-joining time transactions? At the other end of the spectrum, when an entity has left the group, in

applying the exit history rule in determining the tax status of subsequent transactions, can regard be had to prior intra-group transactions? That is, does the SER continue to apply in respect of these earlier transactions once an entity has left the group?

From an alternative policy framework perspective, prima facie the ATM approach (and possibly also the ABM/CSR approach) should address much of the confusion noted above because of the flow-through implications of a direct deemed acquisition by the head company of the assets and liabilities of the joining entity (or the deemed disposal of the assets and liabilities of a leaving entity). Therefore, for no ongoing purpose would it be necessary for the group to have any regard to subsidiary members of the group, as for all relevant purposes subsidiary members would cease to have any relevance and hence all future transactions could be regarded as transactions directly involving the head company of the group.

However, it is recognised that transitional issues would arise in that the entry history rule etc would no doubt have to continue to apply in respect of entities that had joined the consolidated group prior to the commencement of an ATM or CSR approach.

### 3.3 SER – intra-group assets

Currently, as highlighted in the Discussion Paper, difficulties arise when an entity joins a consolidated group with an asset that is an agreement or contract with another member of the joined group, eg where the joining entity is the lessor of a property and the joined group is the lessee of that property. In such circumstances, the ACA attributable to that intra-group asset is effectively totally disregarded (section 701-58) and that ACA is not re-allocated to other assets. This can be a significant problem (particularly in relation to valuable leases and management rights), and the CTA/MCA concur that it is important that the BoT recommendations address this anomaly.

Prima facie, the ATM would directly deal with this issue by regarding the ACA allocated to an intra-group asset as being a payment made by the joined group to terminate the intra-group asset. Other provisions of the Act would then operate as normal to determine the tax status of a termination payment of this nature. Such an approach would reflect the economic reality that from the group's perspective the acquisition of the joining entity has had the result of negating the commercial and legal obligations associated with the intra-group asset owned by the joining entity.

A similar outcome could no doubt be achieved under the current ABM (particularly if the CSR were to apply rather than the entry history rule), but this would require some legislative amendments.

There are a number of other intra-group asset permutations that were identified as issues in the Discussion Paper and, similarly, the general policy approaches that are taken in relation to the ABM, ATM and SER could themselves alter associated tax outcomes, possibly without the need for specific legislative amendment. However, what is clear is that the Consolidation Regime will continue to result in anomalous and inequitable outcomes until such time as these intra-group asset issues are addressed.

### 3.4 SER – interactions with third parties

Unlike the discussion above, the issues associated with the SER and third parties that deal with a consolidated group are not impacted by policy frameworks such as the ABM or alternative approaches. Rather, they involve determining how broadly the Consolidation Regime (and more particularly the SER) should operate in effecting tax outcomes for parties outside the consolidated group.

It is the view of both the CTA and the MCA that the scope of the SER should **not** be generally expanded to impact on tax outcomes associated with third parties, but rather that on a very limited and targeted basis, third parties could have regard to the SER.

This view is based on the following points.



- (a) To extend the application of the SER to third parties generally would require consolidated groups to provide additional information to third parties (and possibly to the public more generally). While some listed entities will already have had to disclose their tax consolidation status in their statutory accounts, this may not necessarily be the case for a number of foreign-owned groups and/or other unlisted entities.
- (b) This additional disclosure requirement could also become particularly onerous in that, potentially, public disclosure would have to be made immediately following even an individual entity joining a consolidated group or an entity leaving a consolidated group.
- (c) In some circumstances there can be disputes with the ATO as to whether a consolidated group was validly formed and/or whether particular entities are members of that consolidated group. Therefore, tax uncertainties associated with these issues and related disputes could have far wider application. In addition, potentially a consolidated group could be sued by a third party if it was ultimately determined that information on its consolidation status that had been provided to the third party was incorrect.
- (d) Extending the application of the SER to third parties could also then place an obligation on groups to consider the implications on third parties of electing to consolidate. This would further complicate this decision process and could potentially expose the group to damages claims if the group's decision to form a consolidated group had adverse implications for third parties.

However, there will be certain circumstances where the problems and risks noted above will be of limited concern such that the benefits of the extension of the SER will outweigh the potential detriments. This is likely to be the situation where the extension of the SER can only have beneficial impact on third parties and where the consolidated group is closely held – which, for example, would be the case in relation to the proposed application of CGT event K6 and the application of the CGT discount rules.<sup>9</sup>

No doubt there will be other specific circumstances where the extension of the SER would be justified based on the above criteria.

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<sup>9</sup> The Discussion Paper in this context also refers to the application of the grouping rules in the commercial debt forgiveness provisions. However, on 5 November 2009, the Assistant Treasurer announced a package of legislative changes to 'streamline the tax system'. Included in this package were measures to move the commercial debt forgiveness provisions from the 1936 Act into the 1997 Act and to make certain changes to the commercial debt forgiveness provisions. In the current context it is noted that the so called grouping provisions are proposed to be omitted from the re-written law. Paragraph 3.7 of the Explanatory Memorandum to the Exposure Draft notes the following as the basis for this change:

The main exception is that Subdivision G is not rewritten. Subdivision G provides special rules for forgiveness of a debt between companies in the same group. As a consequence of enacting provisions for consolidated groups in 2002 (see Part 3-90 of the ITAA 1997), Subdivision G was no longer necessary and has been omitted from the rewrite.

Therefore, by default, these SER/commercial debt forgiveness provision problems referred to in the Discussion Paper may be automatically addressed in the enactment of the proposed legislation.

## 4 Interactions between the Consolidation Regime and other parts of the income tax law

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### 4.1 General comments

As noted at 1 above, the focus of this initial submission is to raise for consideration some of the broader framework issues of relevance to the Consolidation Regime. The position taken in relation to such issues can significantly alter approaches that may be necessary in regard to a number of more specific and practical issues of current concern. Therefore, while the CTA/MCA provide below some comments in relation to particular issues identified in Chapter 4 of the Discussion Paper, these comments should be seen as preliminary in nature and the bodies anticipate providing more detailed input on these and other issues in the next few months, particularly in the context of any discussions with the BoT regarding more general framework aspects.

### 4.2 Question 4.1: joining entities that are trusts – net income of the trust for the non-membership period

(a) **How should the net income for a trust's non-membership period be assessed to beneficiaries and trustees?**

The CTA/MCA note that the allocation of net income between beneficiaries is an issue which is not contained to the tax consolidation provisions. It is a longstanding and ongoing issue which arises where interests in trusts are sold part way through a year.

Indeed this issue is one which we understand is the subject of current consideration by the BoT as part of the Managed Investment Trust as announced by the then Assistant Treasurer on 22 February 2008.

The most simple example of this issue in a non-consolidated environment arises from holding units in a listed property trust. If the trust makes distributions throughout the year it is generally accepted by taxpayers and the ATO (albeit with some difficulty from a legislative perspective) that the unitholders who receive the distributions are subject to tax on those distributions, notwithstanding net income is determined on an annual basis.

The CTA/MCA consider that a similar approach should be adopted where a beneficiary joins or exits a tax consolidated group or indeed a trust joins or exits a tax consolidated group. That is, taxation of net income should be determined by reference to either distributions received or entitled to be received during and at the end of the income year. Any distributions paid during the year to beneficiaries not holding interests in the trust at the end of the year should proportionately reduce the net income to which beneficiaries at the end of the year are entitled.

The existing rules in relation to deemed income years when entities join and exit a tax consolidated group would be consistent with this approach.

(b) **Do the current rules need to be amended to achieve an appropriate outcome?**

Not if the above changes are made. Division 6 should be the primary basis for allocating net income tax to beneficiaries.

(c) **Should a single set of rules apply to assess all beneficiaries on a share of the trust's net income for a non-membership period?**

Yes, see 4.2(a) above.

- (d) **Are there any other issues which are not identified in this Chapter that arise when a trust joins or leaves a consolidated group part way through an income year?**

None to note at this stage.

#### 4.3 Question 4.2: specific entry and exit ACA issues for trusts

- (a) **When working out the allocable cost amount for a trust, should the head company recognise its liability for income tax payable on its share of the net income of the trust as a cost of acquiring the joining entity? If yes, do the current cost setting rules need to be amended to achieve this outcome? If so, how?**

This will depend on how the rules for allocating net income between beneficiaries are amended. Where the head company will be taxed on income which has been derived prior to acquisition (and on which it would not have been taxed but for its acquisition of trust interests during the income year), then the tax cost setting process should be amended to increase the step 2 amount by an amount equal to the corporate tax rate multiplied by the proportion of the net income at that time. This would be an 'acquired' tax liability approach not dissimilar to the concept of 'acquired losses' in ACA step 6; see section 705-110. This will recognise that the head company is subjecting itself to a liability upon acquisition and hence this is effectively a 'cost' of acquisition (which is not recognised in the step 1 amount).

- (b) **Are there any other issues which are not identified in this Chapter that arise with the way the cost setting rules apply to trusts when they join or leave a consolidated group?**

Not at this stage.

#### 4.4 Question 4.3: specific membership issues for trusts and trustees

- (a) **Does a trustee need to be a member of the same consolidated group as the trust?**

No – from a general policy perspective, the trustee should not need to be a member of the same tax consolidated group of the trust. Membership of a tax consolidated group is based on ownership of the relevant membership interests. A requirement that a trustee also be a member of the same tax consolidated group would be inconsistent with this premise.

It is also noted that many trusts employ external trustees and many trustees act as trustees for more than one trust and as such it would not be possible for many trusts to form part of a tax consolidated group. Further, individuals can be trustees of trusts and as such any such trusts would not be eligible to be part of a tax consolidated group.

The ease of changing trustees would also likely lead to significant integrity risk as trusts could be taken in an out of tax consolidated groups with no economic change of ownership.

Therefore, given this general policy perspective, it would be inappropriate to require the trustee to be a member of the same tax consolidated group as the trust. However, as noted at (b) below, some legislative refinements/clarifications would be warranted due to possible arguments as to the application and operation of the SER in this context.

- (b) **If a trustee is not a member of the same consolidated group as the trust, do the core rules and other tax rules operate appropriately to deem the income and expenditure of the trust to be that of the head company?**

The areas of the Act which refer to holder and owner should and are generally interpreted as a reference to that entity in their capacity as trustee of a trust that is the relevant trust. However, it is recognised that where the trustee is not a member of the consolidated group, technical issues can arise as to how various provisions in Division 6 of the Act operate if the trustee is not taken as being also subject to the SER. Therefore, if clarity is required, where a reference in the Act is to a holder or owner, it could be made clear that the actions/ownership/status of a trustee in their capacity as a trustee are imputed to the trust as an entity.

- (c) **Should a trust be a member of a consolidated group if it has beneficiaries that are not members of the group? If yes, what other issues need to be resolved? If not, why not?**

No, as noted in 4.4(a), membership of a tax consolidated group is based on membership interests and those membership interests being wholly owned by other group members. Trusts should not be subject to differing treatment as again this leads to integrity risks.

- (d) **How can the current provisions be altered so they are workable and provide certainty?**

Other than as noted in 4.4(b) no changes are required.

#### 4.5 **Question 4.4: consolidation status of foreign hybrid entities**

Given that for other purposes a Division 830 foreign hybrid entity is taken to be a partnership, the CTA/MCA believe that it would be inconsistent to not similarly regard such an entity as a partnership for tax consolidation purposes and hence eligible to be a member of a consolidated group if all the partnership interests are held by members of the group.

To preclude this outcome, without similarly precluding other partnerships that could be regarded as 'non-residents' from joining a group, would be inequitable and no doubt create a number of inconsistent tax outcomes. As such, the CTA/MCA, from both a policy and technical perspective, concur with the approach adopted by the ATO as illustrated in ATO ID 2009/149.

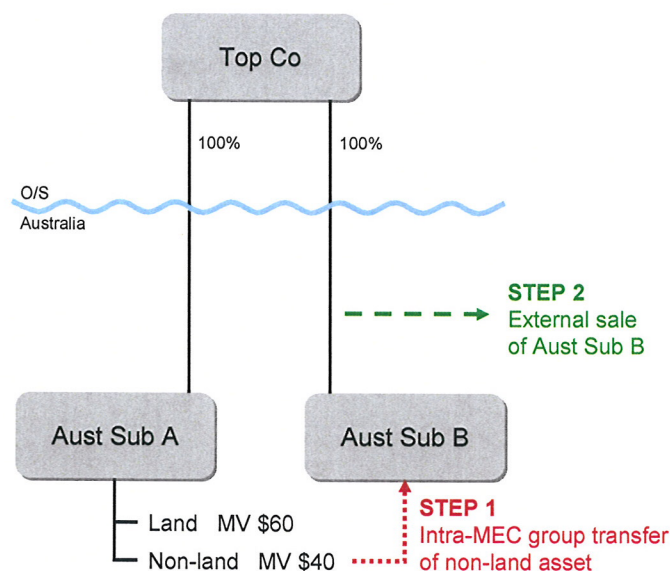
#### 4.6 **Question 4.5: interactions with the non-resident CGT rules – group restructures; Question 4.6: specific group restructuring aspects**

Questions 4.5 and 4.6 of the Discussion Paper relate to particular issues associated with the interaction of the non-resident CGT provisions of Division 855 and the Consolidation Regime.

On the face of it, the targeted 'tax benefit' of tax-driven restructures of the nature outlined in the Discussion Paper should be sought to be negated. However, the real issue is whether this task can be adequately addressed by the existing general anti-avoidance provisions of Part IVA or whether specific adjustment or anti-avoidance provisions are required.

From a general policy perspective, the CTA/MCA believe that the general anti-avoidance provisions of Part IVA should be applied to deal with transactions of this nature where the dominant purpose for the restructure was to achieve these beneficial tax outcomes. In addition, for the reasons discussed below in the context of each of these individual situations, where a restructure of this nature is not tax-driven, the CTA/MCA believe it could be counterproductive to introduce specific adjustment and/or anti-avoidance provisions.

## BoT Question 4.5 transaction

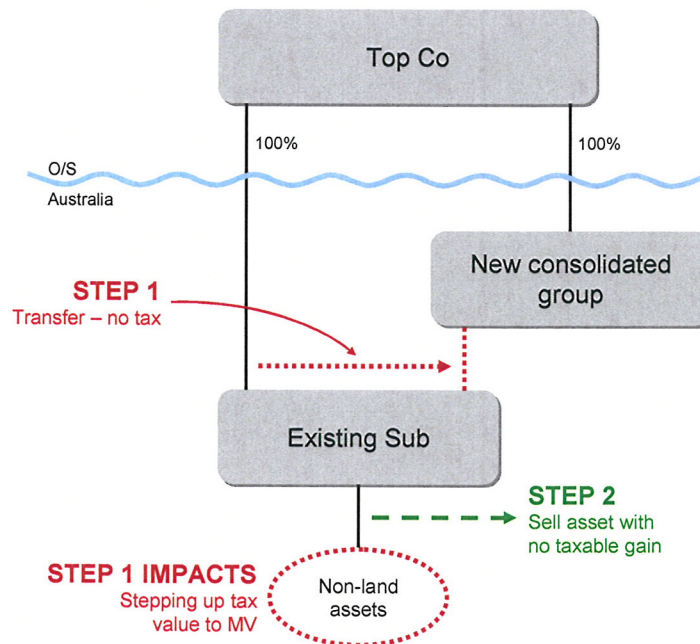


Current outcome	
<p>No Australian tax exposure on the subsequent sale of Aust Sub B, provided:</p> <ul style="list-style-type: none"> <li>more than 50% of the market value of its gross underlying assets at that time do not represent Australian real property (ie land, etc); and</li> <li>the profit on the disposal of the shares in Aust Sub B is of a capital nature (rather than being of a revenue nature).</li> </ul>	
Possible adjustment mechanisms	
Method	Comments
Application of Part IVA	<ul style="list-style-type: none"> <li>No legislative amendments or complexity involved.</li> <li>Targets only arrangements where the dominant purpose is obtaining this tax advantage.</li> <li>Would not impact or complicate commercially driven (ie non-tax driven) restructures.</li> </ul>
Application of a CGT event J1 principle to deem a taxable disposal of the non-land asset to Aust Sub B when it ceases to be wholly-owned by Top Co	<ul style="list-style-type: none"> <li>Ongoing complexity and compliance issues, as there would be a need to continue to track this special tax status of the non-land asset.</li> <li>As this mechanism would no doubt only apply if Top Co's shares in Aust Sub A were Division 855 taxable Australian property at the time the non-land asset was initially transferred to Aust Sub B, this would add considerable complexity and compliance costs as transfers of assets between MEC group members of this nature can in some cases be part of the normal operations of a group.</li> <li>This restructure may have been totally commercially based and, notwithstanding that it may be many years before Aust Sub B may happen to leave the group, this additional tax impost would then be contrary to the policy underlying Division 855.</li> </ul>



	<ul style="list-style-type: none"> <li>Complex issues would arise if the non-land asset was modified or enhanced after it had been acquired by Aust Sub B – eg at the time of transfer the non-land asset may be a start-up enterprise with negligible goodwill, but at the time Aust Sub B leaves the group the business may have been substantially developed and have a significant market value. Tax imposts in this situation would be totally inappropriate.</li> <li>As noted at 4.7 below, there are currently a number of anomalies in the way that CGT event J1 operates, and it would therefore, unless these deficiencies are addressed, be extremely inequitable if the scope of this provision was further expanded.</li> </ul>
Taxing Aust Sub A on the transfer of the non-land asset to Aust Sub B	<ul style="list-style-type: none"> <li>This would significantly erode the objectives of the Consolidation Regime, in that it would substantially restrict the transfers of assets within a MEC group.</li> </ul>

### BoT Question 4.6 transaction



Current outcome	
The tax value of the underlying non-land assets could be stepped up to approximately their market value, so that the tax liability on the subsequent direct sale of these assets would be substantially reduced (as recognised in the Discussion Paper).	
Possible adjustment mechanisms	
Method	Comments
Application of Part IVA	<ul style="list-style-type: none"> <li>No legislative amendments or complexity involved.</li> <li>Targets only arrangements where the dominant purpose is obtaining this tax advantage.</li> <li>Would not impact or complicate commercially driven (ie non-</li> </ul>

<p>Deem the transfer of Existing Sub to New consolidated group to be a roll-over such that the ACA limitation provisions of section 705-93 apply.</p>	<p>tax driven) restructures.</p> <ul style="list-style-type: none"> <li>• This would require Top Co to obtain and retain cost base information in relation to its shares in Existing Sub when for all other reasons this information would not be required.</li> <li>• If Existing Sub was sold to an unrelated Australian tax consolidated group then no tax would be paid on the transfer, but similarly the tax value of underlying assets would be stepped up to market value. Given that such an outcome is consistent with policy objectives more generally, the question would arise as to why different tax outcomes should result in relation to related party transactions that are not tax driven (for tax-driven transactions, Part IVA would otherwise apply).</li> </ul>
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The CTA/MCA would be pleased to consider and discuss in more detail with the BoT these Division 855/Consolidation Regime interaction issues, and any other alternative mechanisms that deal with these issues. However, for the reasons discussed above, at this stage the CTA/MCA believe that reliance on Part IVA to deal with tax-driven restructures of this nature is the most appropriate way of dealing with these issues.

#### 4.7 Question 4.7: interactions with CGT event J1

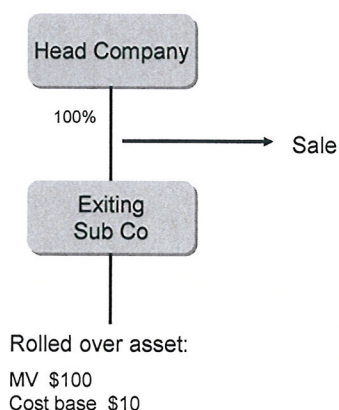
The Discussion Paper outlines a number of long-standing issues associated with the interaction of the Consolidation Regime and CGT event J1. The CTA/MCA agree that these particular interaction issues need to be considered and addressed. This will no doubt involve clarifying that CGT event J1 should apply in some additional circumstances, with an associated increase in its scope as discussed in the context of various scenarios below.

However, over a number of years the CTA, MCA, and other bodies have been raising with Treasury significant technical, equitable, and compliance problems inherent in CGT event J1. Therefore, the CTA/MCA do not believe that the scope of CGT event J1 should be further extended as part of this review without at the same time addressing the existing problems with the provision – as to do so would be to further compound the impact of these technical, equitable, and compliance problems.

The CTA/MCA believe it would be relatively straightforward to address these existing problems associated with CGT event J1, and in that regard reference is made to the points noted in a 13 July 2006 submission to the Minister for Revenue and the Assistant Treasurer lodged jointly by the CTA, MCA, and the Australian Petroleum Production and Exploration Association, at pages 9 and 10 (Attachment 2).

The various consolidation/CGT event J1 interaction issues raised in the Discussion Paper and associated preliminary comments of the CTA/MCA are outlined below. The CTA/MCA would be able to discuss these issues in more detail with the BoT in seeking to determine the most appropriate way of addressing these issues.

**1 Subsidiary of a consolidated group holds the rolled over assets – the subsidiary leaves the wholly-owned group**



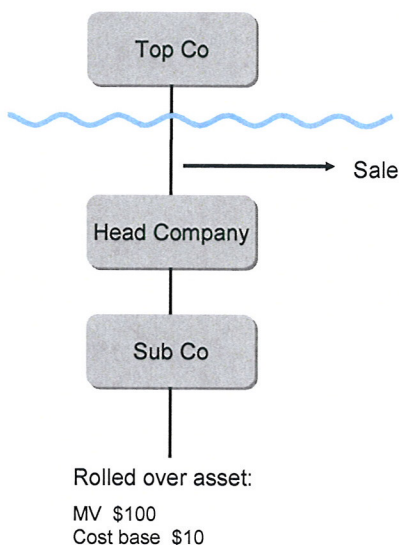
**Current tax treatment**

By way of section 104-182 there is a specific exemption from the application of CGT event J1 in such circumstances.

**Comment**

As recognised in the Discussion Paper, this exemption is appropriate as the lower cost base of the underlying rolled over asset will, via Division 711, be reflected in a corresponding lower cost base of Head Company's shares in Exiting Sub Co, ie no change required.

**2 Subsidiary of a consolidated group holds the rolled over asset – and the head company leaves the wholly-owned group**



**Current tax treatment**

CGT event J1 would apply to trigger to the Head Company a gain of \$90.

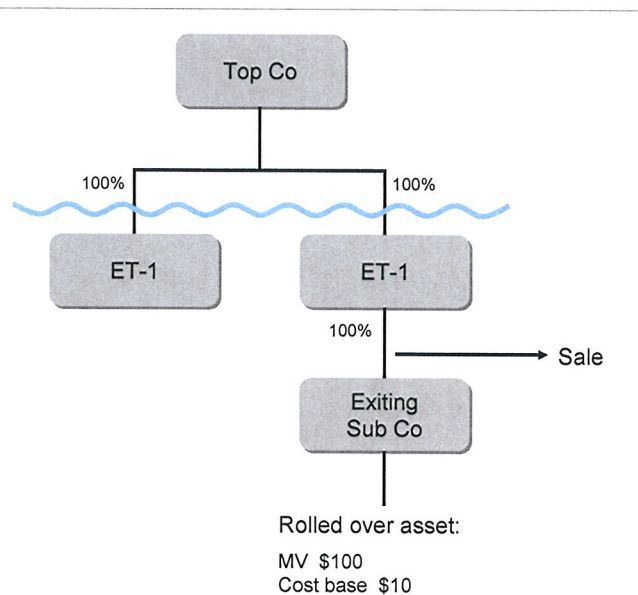
**Comment**

While in broad terms this tax treatment is appropriate, as per the points made in Attachment 2 (pages 9 and 10) the following deficiencies with CGT event J1 should be addressed:

- there should be introduction of a time limitation such that it only applies, for example, on a three year 'look back' basis;
- there should be an exemption for minority interest divestments of, for example, 10% or less; and
- a number of sub-group exemption anomalies need to be addressed.



3 Subsidiary of a MEC group holds the rolled over asset – the subsidiary leaves the wholly-owned group



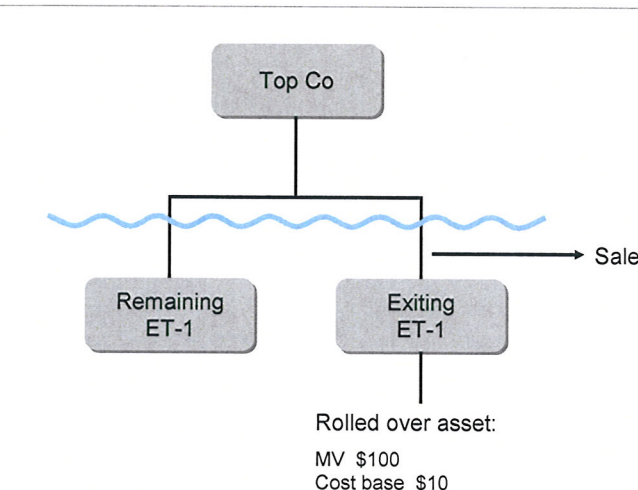
**Current tax treatment**

CGT event J1 will trigger a \$90 gain to Exiting Sub Co, and there will be a further replication of all or part of this taxable gain to ET-1 in respect of the disposal of its shares on Exiting Sub Co via the operation of Division 711.

**Comment**

It has been long accepted that this is an inappropriate and inequitable 'double tax' outcome. Therefore, the section 104-182 CGT event J1 exemption should be extended to apply in such circumstances.

4 An ET-1 of a MEC group holds the rolled over asset – the ET-1 leaves the wholly-owned group



**Current tax treatment**

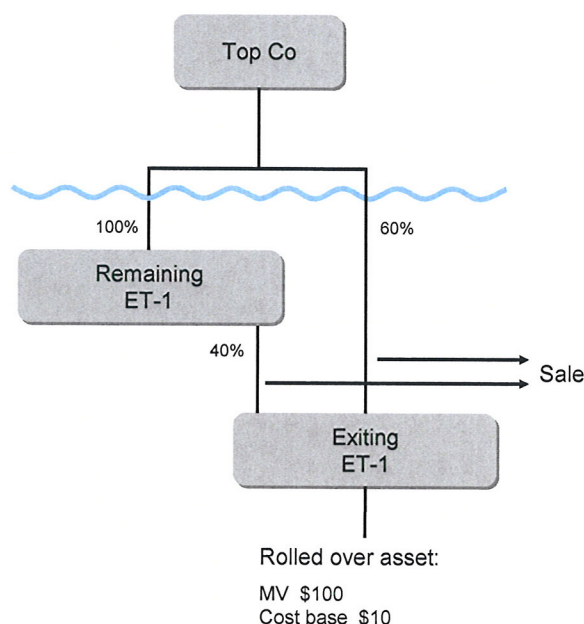
CGT event J1 would be triggered such that a \$90 CGT gain arises in Exiting ET-1.

**Comment**

It is recognised that, in broad terms, CGT event J1 should continue to have some application in these circumstances. However, the following points are noted.

- Taxable gains can, to some extent, still be duplicated because the MEC cost base pooling rules may have transferred cost base from shares in the Exiting ET-1 to the shares in Remaining ET-1. Therefore, there would need to be some modification to these pooling rules to modify their application to avoid such double tax imposts.
- The CGT event J1 anomalies noted in Attachment 2 should also be addressed.

5 A partial onshore ET-1 of a MEC groups holds the rolled over asset – the partial onshore ET-1 leaves the wholly-owned group



**Current tax treatment**

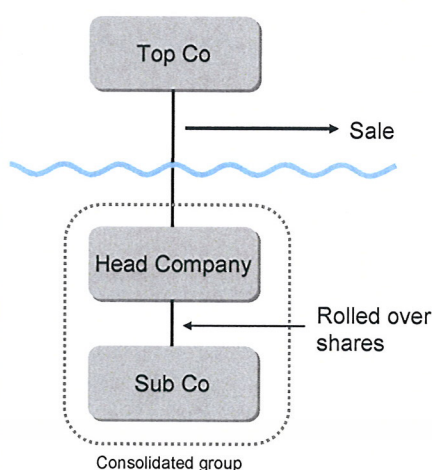
CGT event J1 would apply to trigger a gain to Exiting ET-1.

**Comment**

Understandably, the aspects arising under this scenario are more complex in that they simultaneously involve issues arising in both examples 3 and 4 above. As such, at least from a conceptual perspective, 40% of the CGT event J1 gain should be negated (as per example 3 above in relation to the intra-group 40% shareholding) and MEC cost base pooling adjustments made in respect of 60% of the CGT gain (as per example 4 above regarding Top Co's 60% shareholding). Obviously this could raise complexity/practicality issues that would have to be further considered.

However, at a minimum, the approaches proposed in the situations in example 3 or 4 above should be allowed to apply if, by disregarding a minority shareholding, this would otherwise be the case. For example, if Remaining ET-1 had a greater than 90% shareholding in Exiting ET-1 (with Top Co having a less than 10% interest in Exiting ET-1), then pragmatically the example 3 full CGT event J1 exemption approach should be permitted to apply.

6 The head company of a consolidated group holds shares in the subsidiary member which are the rolled over asset – the head company leaves the wholly-owned group



**Current tax treatment**

As outlined in the Discussion Paper, this situation is not currently directly addressed in relevant legislative provisions. For the reasons noted, it is generally regarded as more likely that CGT event J1 would not arise, if for no other reason that the relevant shares are in effect disregarded under the SER and there is no mechanism for determining their cost base at the relevant time.

**Comment**

The CTA/MCA are further considering the policy and compliance issues that this scenario raises, and therefore are not currently in a position to comment further at this time.

The comments above do not consider how outcomes may alter under an alternative ABM/CSR model or an alternative ATM model (as discussed at 2 above). However, it is anticipated that these alternative models would not significantly impact on CGT event J1 issues under consideration, where the relevant underlying asset had been rolled over to the consolidated group itself. However, if the relevant asset had been rolled over to an

entity prior to it joining the consolidated group (potentially only of relevance to a foreign wholly-owned consolidated group or MEC group), then it would appear appropriate that CGT event J1 had no ongoing application in relation to the asset via an ABM/CSR model or an ATM model (other than possibly for a rolled over asset held by an ET-1 entity).

#### 4.8 Question 4.8: interactions with the FX provisions and the TOFA provisions

##### (a) Foreign currency gains and losses

The Discussion Paper (at paragraphs 4.71 to 4.76) implicitly proceeds on the basis that 'gains and losses arising from foreign currency exchange rate fluctuations' are only the concern of Division 775. However, this is not the case for two main reasons.

- First, ADIs, non-ADI financial institutions, and securitisation vehicles have not been subject to Division 775 since its introduction and will not become subject to the Division until Division 230 starts to apply to them.
- Second, many taxpayers of a type other than those immediately above did not elect to apply Division 775 to all of their foreign currency rights and obligations. In other words, a number of their foreign currency rights and obligations remain subject to sections 6-5 and 8-1, Division 3B and Part 3-1 in respect of gains and losses attributable to currency movements. (And, of course, this is the case for all such rights and obligations of ADIs and the like.)

Also, the Discussion Paper makes no mention of the translation rules of Subdivisions 960-C and 960-D (the functional currency rules). We would consider that sections 6-5 and 8-1, Division 3B, and Subdivisions 960-C and 960-D should all be the subject of consideration.

##### (1) Characterisation

Unlike Division 775, it is necessary to characterise gains and losses as being on either (effectively) revenue or capital account. The process by which a consolidated group ought to go about such characterisation is made problematic by the intersection of the SER and entry history rules.

It would seem appropriate to characterise such resulting gains and losses when they are derived and incurred, respectively. Accordingly, they ought to be characterised in light of the business (or businesses) of the head company of a consolidated group as determined having regard to the SER. Of course, pre-consolidation happenings may be made relevant to the overall situation by the entry history rule, and thus have an additional bearing on characterisation. However, it most certainly should not be the case that future characterisation to the group is entirely determined by reference to the pre-consolidation activity of a particular subsidiary member. To do so would fatally nobble the operation of the SER. Nevertheless, we understand that the ATO has internally taken the contrary position. Elevating the entry history rule in this way at the expense of the SER should be reviewed if the position is considered to be technically correct. [As discussed at 3.1 above, these single entity related type issues would be substantially altered/addressed if an alternative general consolidation framework was to apply, eg the ATM or a CSR.]

(2) **Foreign exchange component of a gain or loss**

The recent consolidation Bill<sup>10</sup> proposes an amendment that would make it clear how the foreign exchange component of a gain or loss on an asset (that has obtained a tax cost setting amount) is to be calculated. Such prescription is not only warranted in the case of Division 775. Certainly, Division 3B would benefit. Furthermore, it is considered that sections 6-5 and 8-1 would also benefit, as it should not be assumed that those sections would automatically apply to the entire difference between the amount received on discharge and an asset's tax cost setting amount.

(3) **Functional currency**

The ATO has only tangentially considered the application of the functional currency rules in the context of consolidation. The ATO has expressed the view that a head company of a consolidated group that has an 'applicable functional currency' under Subdivision 960-D would nevertheless treat receivables of a joining entity denominated in that same currency as foreign currency for consolidation purposes and therefore as a reset cost base asset. This would tend to strongly suggest that such a head company should also conduct the entire tax cost setting process in Australian dollars and presumably translate the results. Such a view seems strongly at odds with the design and intent of Subdivision 960-D. This view would be expected to have an impact on compliance approaches adopted by taxpayers as well as resulting tax outcomes.

This issue is significant when one has regard that entities in the energy and resources segment would generally be regarded as having the most use for Subdivision 960-D, and that segment may continue to experience significant levels of M&A activity.

(b) **Taxation of financial arrangements**

The tax cost setting process of consolidation has a general asymmetry regarding the treatment of assets and liabilities.

In truth, this asymmetry stands apart from Division 230; for example, while assets that are capable of giving rise to assessable or deductible foreign exchange gains or losses, respectively, under sections 6-5 and 8-1, Division 3B or Division 775 can have their tax basis reset under the tax cost setting rules, the tax bases of corresponding liabilities are not. Accordingly, unrealised foreign exchange gains and losses on assets can be eliminated. However, on acquisition, such gains and losses on liabilities must be inherited.

But Division 230 takes this asymmetry to another level. This is because it makes possible the tax recognition of gains and losses on liabilities other than just those of a foreign exchange nature. Even then, sections dealing with the interaction between the tax cost setting rules and Division 230 (introduced when Division 230 was introduced) have closed this gap in one instance: if the head company of a consolidated group uses an accounting elective method by which the fair value of liabilities is made relevant to Division 230, then the tax basis of those liabilities (in the case of a joining entity) is essentially reset from their historical cost to their fair value for Division 230 purposes. Thus, the amount that enters step 2 of the joining entity's entry ACA (to begin with) would generally correspond with the starting tax basis of the liability for Division 230.

In a way, Division 230 has both expanded and contained the problem of asymmetry. First, it has broadened the category of liabilities that can now take

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<sup>10</sup> Tax Laws Amendment (2010 Measures No. 1) Bill 2010.



an implicit tax basis. Second, it has permitted in one instance one such liability to be reset. Perhaps a principled decision ought to be taken regarding whether any liability should continue to receive an inherited history treatment.

The points raised above deal with the broad interaction of Division 230 and the Consolidation Regime. However, there are a number of examples of specific technical interaction issues which the CTA/MCA are further considering. In addition, the bodies are also canvassing members for other associated issues for the purposes of then raising these with the BoT.

## 4.9 Question 4.9: other interaction issues

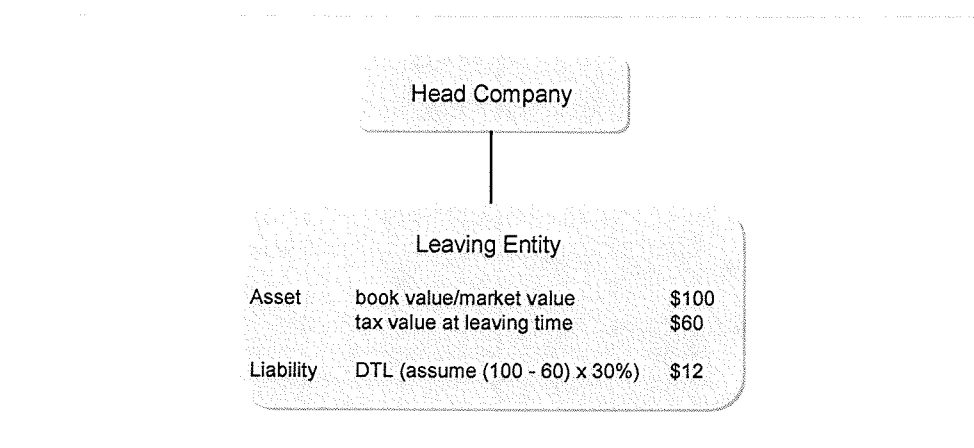
The CTA/MCA recommend that the BoT's review also encompass two areas where there is broad acceptance that the existing provisions do not always operate in a manner consistent with policy objectives. However, the fact that the Government has not yet sought to address these problem areas reflects the fact that they involve very complex issues and to date Government (and the corporate tax community) have not committed the time and resources necessary to consider and resolve them. Therefore, it is hoped that via this BoT review some real 'traction' can be given to once and for all dealing with these issues.

### (a) Deferred tax assets and liabilities – entry ACA and exit ACA implications

There has been discussion and debate for some time as to the conceptual merit in the consolidation entry ACA and exit ACA calculations of the inclusion and quantification of certain financial accounting assets and liabilities associated with the tax timing differences, being deferred tax assets (DTAs) and deferred tax liabilities (DTLs).

The Discussion Paper issued by the ATO at the National Tax Liaison Group Consolidation Subcommittee meeting of 26 February 2009 considers some aspects associated with the ACA implications of DTAs and DTLs. Although the CTA/MCA do not agree with a number of comments made in that Discussion Paper (including a number of the examples utilised), it was seen as a very worthwhile initiative to engender consideration and discussion of these difficult issues. However, disappointingly, the ATO subsequently determined that it was inappropriate for them to seek to facilitate discussion on a tax policy issue of this nature, and therefore they terminated the consultation process in relation to these policy issues.

While the issues associated with DTLs in the entry ACA context are more difficult and contentious, the inequities and anomalies associated with the treatment of DTLs in exit ACA calculations are well-known and generally accepted. These inappropriate outcomes associated with DTLs being included in the exit ACA step 4 liability amount are illustrated in the following example.



If, in this example the underlying asset was directly disposed of, the group would be exposed to tax on the difference between the \$60 tax value of the asset and its market value of \$100, being a taxable gain of \$40. However, if the disposal is undertaken by way of a sale of shares in the Leaving Entity then the exit ACA will be \$48 (step 1 \$60 less step 4 \$12) such that the taxable gain is inappropriately increased to \$52.

This additional taxable gain of \$12 does not in any sense reflect an unrealised gain in respect of the underlying asset or a gain to the group on the disposal of the Leaving Entity.

This exit ACA anomaly related to DTLs is known to have distorted commercial decision-making in a number of major divestments (and in some cases has caused divestments to be cancelled).

While the above comments focus on issues associated with DTLs, equally important issues arise in the context of the consolidation treatment of DTAs. Where ACA is allocated to DTAs, it is far from clear what the consequences of such an allocation are, and it is generally assumed that this ACA will have no ongoing tax relevance (ie it is in effect 'wasted'). Therefore, it is necessary that issues associated with DTAs are not overlooked.

The CTA/MCA believe that it would be extremely worthwhile if the BoT could reignite the discussion and review of these consolidation DTA/DTL interaction issues, with input from Treasury, the ATO, and the taxpaying community.<sup>11</sup>

(b) **MEC group issues**

The technical problems associated with MEC groups have not, until recently, received the legislative attention that they deserve. However, longstanding problems associated with 'special conversion events' have now been addressed in Tax Laws Amendment (2010 Measures No.1) Bill 2010, and a number of issues associated with MEC groups and CGT event J1 are acknowledged by the BoT in Question 4.7 of the Discussion Paper.

Importantly, there are a number of other specific MEC issues that have been discussed over many years by the National Tax Liaison Group Consolidation Subcommittee, and it has generally been acknowledged that these issues cannot be addressed by ATO administrative practice, but rather requires legislative attention. These issues are briefly noted below, and aspects associated with each of them will be well known to Treasury and ATO specialists assisting the BoT in its review.

(1) Restructures: 'transfer-up'

A 'transfer-up' transaction involves a lower level member of a MEC group being transferred to become an eligible tier-1 (**ET-1**) member of the group. What is far from clear in this context is how the taxable gain/loss to the MEC group in respect of the transfer of these shares should be quantified, given that the transferred entity at all times remains a member of the MEC group.

(2) Restructures – 'transfer-down'

In 'transfer-down' transactions, an ET-1 entity is transferred to become an underlying subsidiary member of the group. Given that the entity (and its assets) at all times remains part of the MEC group, it appears that the cost to the MEC group of acquiring the shares in the transferred entity is not in any way reflected in resetting the tax value of underlying assets.

<sup>11</sup> The CTA/MCA are also aware that a submission in relation to these DTL issues was prepared and lodged with Treasury by Shaddick & Spence in February 2008.

(3) MEC pooling rules – functional currency

It is unclear as to how the Subdivision 719-K MEC group cost base pooling rules operate in the context of section 960-61 where, mandatorily, the cost base of non-resident holders of membership interests in the MEC group is calculated by reference to the functional currency of the non-resident. This raises particularly difficult issues where not all holders of membership interests in ET-1 entities have the same functional currency.

(4) Losses – more restrictive COT rules

Section 719-20 applies far more restrictive continuity of ownership test (**COT**) rules to MEC groups, which as pointed out in previous NTLG submissions, can prove to be unduly burdensome and inequitable.

(5) Losses – available fraction aspects

Where a new ET-1 joins a MEC group, under Subdivision 719-F (sections 719-300 to 719-325), prior 'group losses' become subject to available fraction utilisation limitations, and then that available fraction can be subject to subsequent adjustments for, among other things, capital injections or future acquisitions of a joining entity with losses. This outcome is regarded as inconsistent and inequitable on the basis that when an ordinary consolidated groups expands by acquiring another consolidated group or subsidiary with losses, the joined group's losses incurred post-formation do not lose their status as group losses, and do not become deemed transferred losses subject to available fraction utilisation limitations.

The CTA/MCA recommend that the BoT consider and seek to address these MEC issues in the context of its review.

## Attachment 1

**Entity-based model rejected by the Ralph Review and not again raised for discussion by the CTA/MCA**

In the context of consolidation Principle 5 noted above (ie 'provisions to be established for determining the cost bases on exit'), the Platform for Consultation document raised for discussion not only the ABM, but also the entity-based model which it outlined as follows.<sup>12</sup>

27.7 The entity-based model reconstructs an equity cost base by adding to an entity's equity cost base on entry into consolidation any net increase in the aggregate cost base of the assets of the entity during consolidation. If the aggregate cost base of the assets of the entity declines during consolidation, the reconstructed cost base for equity on exit will be correspondingly smaller than the cost base for the entity when it was brought into consolidation.

27.8 The basic intuition underlying the model is to continue to use the existing cost bases of assets and equity on entry into consolidation, and to use changes in the entity's asset cost bases to make adjustments to the cost base of equity on exit. During consolidation it is possible for there to be some duplication of pre-consolidation gains and losses (when assets held by the acquired entity on entry, with their original cost bases, are realised outside the consolidated group). However, the options discussed in Chapter 28 would limit the duplication of pre-consolidation losses and any remaining double counting is reversed by the cost base adjustment to equity on exit.

Ultimately, the Ralph Review recommended against the adoption of the entity-based model 'because it would require special rules to deal with intra-group transfers of assets that an entity has on entry into a consolidated group. These rules would add to the complexity of the law and to compliance and administrative costs'.<sup>13</sup>

For similar reasons to those outlined above, the CTA/MCA are not even raising for consideration an entity-based model, in that they agree that it would be conceptually, technically, and administratively complex and a retrograde step as it would require ongoing recognition and tracking of intra-group transactions and would substantially erode the achievements of the Consolidation Regime.

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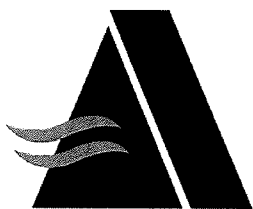
<sup>12</sup> Platform for Consultation, pages 572 and 573.

<sup>13</sup> A Tax System Redesigned, page 527.



## Attachment 2

[See next page]



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13 July 2006

The Honourable Peter Dutton MP  
Minister for Revenue and Assistant Treasurer  
Parliament House  
CANBERRA ACT 2600

Dear Minister

**Proposed Division 855: Joint submission by the Minerals Council of Australia, Australian Petroleum Production and Exploration Association Ltd and the Corporate Tax Association**

On 22 June 2006, Division 855 of *Tax Laws Amendment (2006 Measures No. 4) Bill 2006* ("Measures No. 4 Bill 2006") was introduced into Parliament. This legislation will substantially alter the capital gains tax treatment of non-residents.

The Minerals Council of Australia (MCA), the Australian Petroleum Production and Exploration Association Ltd (APPEA), and the Corporate Tax Association (CTA) (the "Joint Submission Parties") acknowledge and accept the broad policy objectives underlying proposed Division 855. That is, to tax non-residents on capital gains that relate to underlying Australian real property, including mining and petroleum rights. However, the Joint Submission Parties have significant concerns regarding some specific compliance, transitional and equity aspects of these proposed measures and we collectively seek a number of amendments.

The attached submission outlines these concerns, as well as proposing some relatively simple amendments.

In particular, and as outlined in the attached material, these amendments by the Joint Submission Parties would:

- (a) Remain consistent with the policy objectives underlying proposed Division 855 (that is, and in the context of non-residents, Australia's capital gains tax regime should focus more specifically on Australian real property assets - including Australian minerals and petroleum interests);
- (b) Substantially reduce compliance costs, which otherwise would be a significant impost on foreign owned groups;
- (c) Introduce transitional measures that would be consistent with standard legislative practice when the capital gains tax regime has previously been broadened to apply to new categories of taxpayers or assets (these proposed transitional arrangements would also address what could otherwise be substantial transitional compliance difficulties);
- (d) Adopt a more equitable treatment, by consistently focusing the thrust of these new measures on Australian real property assets rather than also encompassing other assets (including foreign assets); and

- (e) Ensuring that these measures do not unnecessarily impede upstream reorganisations of foreign wholly-owned corporate groups.

The Joint Submission Parties would appreciate the opportunity to meet with you to discuss these concerns and our proposed amendments. As such, discussions with your Office in confirming a date, time and location have already commenced. We appreciate the efforts of your Office in this regard.

As you may be aware, a number of parties, notably the MCA and APPEA, were not invited to be a part of the CGT for non-residents consultation process - despite the principal objective of this legislation being to firmly secure mining and petroleum interests within the Australian capital gains tax net. As such, we are also eager to discuss with you how this situation can be avoided in the future.

If you have any queries in relation to this issue please do not hesitate to contact us. Mr David Rynne, Assistant Director Economics Policy, MCA, (02) 6233 0649 ([david.rynne@minerals.org.au](mailto:david.rynne@minerals.org.au)) should be your contact in the first instance.

Yours sincerely



**BELINDA ROBINSON**  
Chief Executive

Australian Petroleum Production  
& Exploration Production



**FRANK DRENTH**  
Executive Director

Corporate Tax Association

Quotefix " and a  
1/4" (uncompressed) decompressor  
are needed to see this picture

**MITCHELL H. HOOKE**  
Chief Executive

Minerals Council of Australia

**Proposed Division 855 – Joint Submission**  
**(The Minerals Council of Australia, the Australian Petroleum  
Production and Exploration Association Ltd, and the Corporate  
Tax Association)**

**13 July 2006**

**Summary of submission points**

<b>Issue</b>	<b>Proposal</b>	<b>Key outcomes</b>	<b>Page</b>
<b>1</b> A transitional mechanism is required for pre-commencement unrealised gains/losses (only applicable to shareholdings in non-resident entities).	Exclude unrealised gains/losses as at 1 July 2006 in respect of interests in non-resident entities; ie interests in non-resident entities should obtain a 1 July 2006 market value cost base.	<ul style="list-style-type: none"> <li>• Equitable treatment consistent with the transition of other assets/taxpayers into CGT.</li> <li>• Avoids substantial (and in some cases insurmountable) compliance difficulties regarding prior cost base calculations.</li> </ul>	2
<b>2</b> More precisely focusing the taxable CGT gain/loss on underlying Australian real property.	Only a proportion of the gain on the sale of interests in a resident or non-resident entity that is "land-rich" should be subject to CGT, equal to the Australian land-rich proportion.	<ul style="list-style-type: none"> <li>• Assists in addressing significant industry concerns that gains in respect of underlying non-Australian assets will inequitably also be taxed in Australia.</li> </ul>	4
<b>3</b> Addressing impediments to upstream corporate restructures.	<b>3.1 Dealing with CGT event J1 anomalies</b>  Necessary amendments should be made to CGT event J1 such that it: <ul style="list-style-type: none"> <li>(i) is subject to a 3 year post-roll-over limit;</li> <li>(ii) exempts minority interest divestments; and</li> <li>(iii) addresses sub-group exemption anomalies that currently require a 100% disposal of a higher level entity.</li> </ul>	<ul style="list-style-type: none"> <li>• Addresses clearly anomalous tax exposures.</li> <li>• Reduces ongoing compliance costs.</li> </ul>	6
	<b>3.2 Dealing with other CGT restructuring impediments</b>  Introduce measures to address CGT gains that could otherwise arise in an off-shore restructure of a wholly-owned group that cannot be protected by roll-overs.	<ul style="list-style-type: none"> <li>• Addresses anomalous tax exposures.</li> <li>• Will eliminate Australian tax impediments to streamlining foreign structures of wholly-owned groups.</li> </ul>	8
<b>4</b> Market valuation requirements regarding all underlying assets in many cases will introduce significant ongoing complexity and substantially add to ongoing compliance costs.	Taxpayers should be able to choose to utilise book values (as per recognised accounting standards) in all "indirect Australian real property interest" calculations, rather than being required to undertake market valuations of underlying assets.	<ul style="list-style-type: none"> <li>• Substantially streamlines calculations and would reduce compliance costs.</li> <li>• Consistent with other equivalent tax provisions.</li> </ul>	10
<b>5</b> Avoiding the imposition of double taxation.	A credit mechanism should be introduced to avoid potential double taxation exposures where an Australian	<ul style="list-style-type: none"> <li>• Addresses anomalous potential double tax exposures.</li> <li>• Provides immediate certainty while</li> </ul>	12

Issue	Proposal	Key outcomes	Page
	tax impost resulting from proposed Division 855 is not creditable against the equivalent gain taxed in a foreign jurisdiction.	the position of each of Australia's tax treaty partners is confirmed.	
<b>6 Providing grouping relief for losses.</b>	Allowing grouping access to CGT losses and tax losses of wholly-owned companies.	<ul style="list-style-type: none"> <li>Equitably allows taxation of only <b>net</b> CGT gains (not gross CGT gains).</li> </ul>	14

## Issue 1

<b>Issue:</b>	<b>Transitional mechanism for pre-commencement unrealised gains/losses (only applicable to shareholdings in non-resident entities)</b>
<b>Proposal:</b>	<b>Exclude unrealised gains/losses as at 1 July 2006 in respect of interests in non-resident entities, ie interests in non-resident entities would obtain a 1 July 2006 market value cost base</b>
<b>Background</b>	
<p>Proposed Division 855 does not currently contain a transitional exemption in respect of unrealised gains or losses as at the date of commencement. For example, if a non-resident was to dispose of shares in a non-resident entity the day before the enactment of the provisions the gain would not be taxable in Australia. However, if this transaction was to occur immediately following the enactment of these provisions potentially 100% of the gain could be subject to Australian tax.</p> <p>In addition, taxing pre-commencement CGT gains dramatically increases transitional compliance costs as it requires non-resident taxpayers to now attempt to retrospectively recalculate the CGT cost base of shareholdings in non-resident companies, where this information would previously have been totally irrelevant from an Australian tax perspective.</p>	
<b>Submission points</b>	
<p><b>1. Consistent policy treatment</b></p> <p>It has been standard Australian tax policy practice that when the CGT regime first commences to apply to a category of taxpayers or to a category of assets, the then unrealised gains in respect of relevant assets held at that transition date will remain free of tax when ultimately disposed of. Similarly, unrealised losses in respect of relevant assets held at a transition date cannot subsequently be claimed as a CGT loss on ultimate realisation.</p> <p>For example, when a foreign company first becomes an Australian controlled foreign company ("CFC"), in subsequently determining the attributable income in respect of that CFC the CGT cost base of an asset held by the CFC at the transition date is taken to be the greater of the asset's market value at that date or its cost base (sections 411 and 412). Similarly, when a non-resident company, trust or individual becomes an Australian resident, the assets that they own at that time that are not already in the Australian CGT tax net obtain a market value cost base (Subdivision 136-B).</p> <p>Similar transitional arrangements have applied on the introduction of new legislative provisions. For example, when superannuation funds first became taxable on 30 June 1988 a deemed CGT cost base acquisition mechanism applied for assets held by superannuation funds at that date (section 308). Equivalent provisions also applied when gold mining activities ceased to be tax exempt on 1 January 1991 (sections 159GZZZBC and 159GZZZBD), to in effect continue to exempt from tax unrealised gains and losses up to the date such activities first became taxable.</p>	
<p><b>2. Transitional mechanism proposed</b></p> <p>Using the approach adopted for CGT purposes in other areas (refer 1. above), the CGT cost base of shares in a non-resident entity that is "land-rich" could be taken to be the greater of the market value or cost base of the shares at 1 July 2006. Similarly, the reduced cost base at 1 July 2006 of such shares could be taken to be the lesser of their market value or cost base at that date. As such, the cost base or reduced cost base of each such share held at 1 July 2006 would be whichever of the cost base or market value at 1 July 2006 yielded the lower gain or loss on the ultimate disposal of the share.</p> <p>The following additional points are also noted in relation to this proposal.</p> <ul style="list-style-type: none"> <li>(i) For compliance reasons it is proposed that 1 July 2006, rather than the actual date that Division 855 commences to apply, should be the date in respect of which transitional unrealised gains and losses are to be determined.</li> <li>(ii) It is accepted that this exemption mechanism in respect of 1 July 2006 unrealised gains and losses should not also apply to shareholdings and trust interests held by a non-resident that would have been subject to Australian CGT prior to the enactment of Division 855. This would include any interests held in: a non-listed Australian company; non-portfolio interests in an Australian listed company/trust; and shares in a non-resident company that were issued in consideration for certain prior CGT roll-over transitions.</li> </ul>	

**Submission points (continued)**

- (iii) Conceptually, it would be more appropriate for interests in a non-resident entity to obtain a market value cost base only when the non-resident entity first becomes land-rich at or after the date Division 855 is enacted. However, this is not proposed because it is recognised that it would be impractical to require non-residents to perpetually monitor the Australian land-rich status of non-resident entities in which they hold interests.

**3. Substantial reduction in both compliance costs and technical complexity**

Not only should these specific unrealised gains at 1 July 2006 remain exempt from Australian CGT on equity grounds, but importantly this approach would also avoid the substantial (and in some cases insurmountable) practical difficulties of seeking to retrospectively determine the precise Australian CGT cost base of an asset acquired many years ago, at a time when the non-resident had no reason to determine and retain relevant CGT cost base information. For example, this transitional measure would avoid taxpayers, the Australian Taxation Office, and potentially the Government having to specifically deal with the following retrospective cost base determination aspects.

- (i) Under some cost base provisions various calculation choices are available to taxpayers, provided these choices are exercised within specified time frames. The most important example in this regard is Division 149 which can be relevant in determining the CGT cost base of assets acquired by an entity on or before 19 September 1985 (ie "pre-CGT assets").

Without the transitional mechanism proposed, in respect of pre-CGT shareholdings in non-resident companies a taxpayer would: first have to attempt to seek underlying shareholder data as at both 20 September 1985 and 20 January 1997; then request the Commissioner to grant an additional period for making necessary determinations; and finally seek to now ascertain the market value of such shareholdings back at 30 June 1999.

- (ii) Data and retrospective calculations would also be required in respect of prior group loss transfers and transactions that could have involved a "value shift" (including transactions between non-resident entities). Adjustments could also be retrospectively required in relation to the complex inter-entity loss provisions of Subdivision 165-CD.

**Necessary legislative modifications**

The legislative modifications necessary to implement this proposal would not be significant and as a precedence the provisions of sections 411 and 412 or sections 159GZZZBC and 159GZZZBD could be utilised. Conversely, if this proposal is not adopted far more complex transitional measures will inevitably have to be introduced to resolve the issues that would otherwise clearly arise in seeking to retrospectively apply Division 149 and the other cost base adjustment provisions as noted above.

## Issue 2

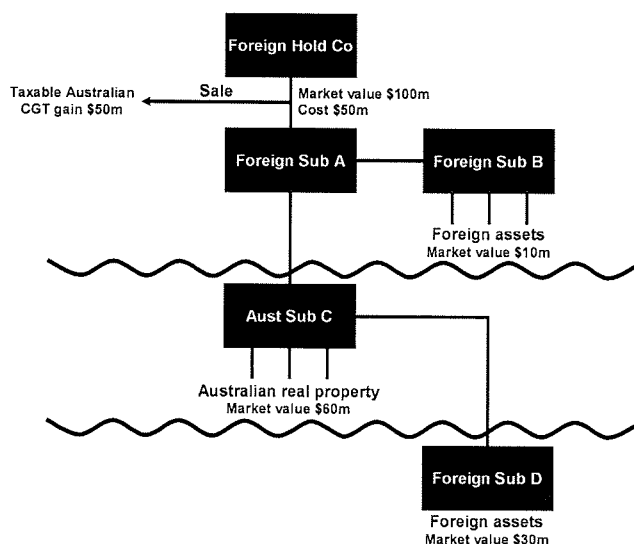
**Issue:** More precisely focusing the taxable CGT gain/loss on Australian real property

**Proposal:** Only a proportion of the gain on the sale of interests in a resident or non-resident entity that is “land-rich” should be subject to CGT, equal to the Australian land-rich proportion

### Background

Under proposed Division 855 as currently drafted, where more than 50% of the market value of the gross assets of an entity (held directly and/or indirectly) is attributable to taxable Australian real property, then on a disposal by a non-resident of interests in that entity 100% of the CGT gain to the non-resident will be taxable in Australia.

This can be the case notwithstanding that a significant portion of the assets of an entity (and potentially a significant portion of the relevant gain) relates to other assets, including foreign assets as illustrated in the following basic example.



This example illustrates the following key points.

- (i) Even though 40% of the market value of Foreign Sub A relates to non-Australian assets, 100% of the gain realised on its sale will be exposed to Australian tax.
- (ii) This outcome discourages the use of Aust Sub C as a regional headquarters company to hold the group's interests in Foreign Sub D. This is due to the fact that Foreign Hold Co will be exposed to Australian tax on the growth in value of Foreign Sub D, which would not have been the case if Foreign Hold Co directly held Foreign Sub D.

### Submission points

#### 1. Inequities will arise without a more focused taxing mechanism

Imposing Australian tax on a non-resident where a significant proportion of the relevant gain relates to underlying foreign assets or non-targeted Australian assets is inequitable and in effect would operate as a penalty on a non-resident owning both Australian real property assets and other assets indirectly by way of the one corporate structure.

#### 2. Treaties do not mandate that the FULL gain must be taxed

Notwithstanding that Australia has the taxing right under treaties to fully assess such a gain to a non-resident, this does not restrict Australia from adopting a more focused and principled approach to determining the percentage of the gain to be taxed in Australia.



### Submission points (continued)

#### 3. *Different policy issues relevant for interests below the 50% threshold*

Just because some non-residents will own interests in entities that have Australian real property assets below this 50% threshold, and as such will not be taxed in Australia, does not mean that it is appropriate or equitable to “over tax” non-residents with interests in entities that exceed this 50% Australian real property asset threshold.

Further, the decision not to impose CGT on a non-resident in respect of interests in entities (including direct interests in Australian resident companies) with less than 50% Australian real property assets no doubt in part reflects the fact that non-real property related assets and businesses are more internationally mobile. Therefore, the Government wishes to provide an internationally attractive and competitive CGT exemption regime in relation to interests in assets and businesses of this nature as a further incentive to non-residents to invest in such undertakings in Australia.

#### 4. *The “focusing” mechanism to be applied*

It is accepted as unrealistic from a technical and practical perspective to seek to attribute and tax the underlying gain on Australian property interests directly to a non-resident on the sale of their shares in an interposed entity. However, only seeking to tax a non-resident by reference to the percentage of gross assets of the interposed entity directly or indirectly attributable to Australian real property as proposed in this submission, does focus the taxed element of the gain on the targeted Australian assets.

#### 5. *Consistency with other similar provisions*

Adopting this proposal would be consistent with the way in which the relatively recently introduced participation exemption (Subdivision 768-G) provisions broadly operate in an international context in determining the portion of the gain realised by an Australian resident company on the sale of shares in a non-resident company that will be taxed in Australia. In particular, the participation exemption provisions only subject the portion of the gain on the sale of shares in a foreign company to Australian tax, equal to the proportion of gross assets of the entity that are not active foreign business assets as compared to the total gross assets of the foreign company.

In the participation exemption context such a methodology was considered appropriate by Government and has been accepted as reasonable by taxpayers. Therefore, it is submitted that this methodology should also be adopted in the context of proposed Division 855.

#### 6. *Corporate restructuring*

Unless this specific issue is addressed, there will be an incentive for non-resident groups to seek to extract interests in non-Australian real property assets from the corporate ownership chains through which they hold Australian subsidiaries that own Australian real property assets. As such, this would partially undermine the Government’s policy objective of promoting Australia as a regional headquarters jurisdiction.

### Necessary legislative modifications

This proposal could be implemented without substantial modifications being required to the existing provisions in proposed Division 855. In particular, proposed section 855-30 already contains a specific mechanism for calculating the percentage of an entity’s direct and indirect assets that are Australian real property. Therefore, all that would be needed would be the introduction of provisions somewhat similar to subsections 768-505(2) and 768-510(4) which similarly prorate a total CGT gain or loss in the context of the participation exemption provisions of Subdivision 768-G (albeit while only applying in the context of the range 50% to 100%).

## Issue 3

<b>Issue:</b>	<b>Addressing impediments to upstream corporate restructures: 3.1 CGT event J1 anomalies</b>
<b>Proposal:</b>	<b>Necessary amendments should be made to CGT event J1 such that it:</b>
	(i) <b>is subject to a 3 year post-roll-over limit;</b>
	(ii) <b>exempts minority interest divestments; and</b>
	(iii) <b>addresses sub-group exemption anomalies that currently require a 100% disposal of a higher level entity.</b>

### Background

In implementing upstream corporate re-organisations, many foreign corporate groups will for the first time have to seek Australian CGT roll-over relief under Subdivision 126-B.

As a result of choosing a roll-over, a CGT gain or loss to the transferee subsidiary could subsequently be triggered under CGT event J1 if at any time while it continues to hold the rolled-over asset it ceases to be a wholly-owned subsidiary of the “ultimate holding company” of the foreign group.

There are a number of significant problems associated with the scope and application of CGT event J1 and these problems will be further amplified as more intra-group transactions will have to be implemented under the protection of a CGT roll-over because of the introduction of Division 855. For example, a full-CGT gain could be triggered, based on the then market value of the rolled-over asset, if subsequently even just one share in the roll-over transferee entity (or any entity interposed between the ultimate holding company and this transferee entity) is acquired by a non-group member. Further, in such circumstances the section 104-180 sub-group break-up exemption will not provide any protection.

### Submission points

#### 1. Introduction of a time limitation

CGT event J1 could be modified to introduce a time limitation to its application, such that it could only apply if the relevant “break-up time” occurred within, say, three years of the relevant roll-over event. An equivalent provision to CGT event J1 in the UK only applies for six years after the relevant event<sup>1</sup>. In the context of stamp duty exemptions for intra-group transactions, claw back provisions only operate for example, for three years in Queensland,<sup>2</sup> three years in Victoria,<sup>3</sup> and five years in Western Australia.<sup>4</sup>

It is submitted that a time limitation of this nature would strike an appropriate balance between the “integrity” concerns of Government and ongoing compliance costs of taxpayers (eg continuing to have to monitor potential share related transactions to ensure that a CGT event J1 exposure is not inadvertently triggered).

Even with a three year limitation being introduced, the following two submission points would also need to be addressed in relation to anomalous outcomes that could otherwise occur within that three year period.

#### 2. Exempt minority interest divestments

As noted above, CGT event J1 can be triggered where only one share in the transferee entity (or an entity interposed between the ultimately holding company and the transferee) is acquired by a non-group entity. At a minimum, as is the case under the relevant stamp duty provisions, a more appropriate minimum threshold would be the acquisition by a non-group entity of at least a 10% interest in a relevant company.

<sup>1</sup> Section 179 *Taxation of Chargeable Gains Act 1992*.

<sup>2</sup> Sections 406 and 412 *Queensland Duties Act 2001*.

<sup>3</sup> Sections 205B and 205D *Victorian Duties Act 2000*.

<sup>4</sup> Sections 75JB and 75JE *Western Australian Stamps Act 1921*.

**Submission points (continued)**

**3. Address sub-group exemption anomalies**

To qualify for the Subdivision 104-180 sub-group break-up exemption from CGT event J1, it is necessary that a **100%** interest in the relevant sub-group is disposed of to a non-group entity. This is anomalous and therefore the sub-group exemption should be amended to also apply where a lesser interest in the sub-group is disposed of to non-group entities.

Until this deficiency is corrected, non-tax motivated legitimate upstream divestments could be adversely impacted and, as such, commercial decisions regarding the divestment of a sub-group could be inappropriately distorted.

**Necessary legislative modifications**

Each of the three submission proposals could be readily implemented with relatively minor legislative amendment as they do not seek to fundamentally change the scope and operation of CGT event J1, but rather would involve the introduction of some specific exemptions.

## Issue 3 (continued)

<p><b>Issue:</b> Addressing impediments to upstream corporate restructures 3.2 Other CGT impediments to upstream corporate restructures</p> <p><b>Proposal:</b> Relief for wholly-owned group restructure related CGT gains that cannot be protected by roll-overs</p>
<p><b>Background</b></p> <p>Foreign owned groups will from time to time need to alter their intra-group ownership structures to satisfy commercial and/or non-Australian tax requirements. Where proposed Division 855 will extend the Australian CGT net to encompass non-resident entities within a wholly-owned ownership chain, in many cases an intra-group restructure of this nature will trigger CGT events for which Subdivision 126-B roll-over cannot be obtained. For example, it would be relatively common for a restructure of a foreign ownership chain to trigger the following CGT events for which roll-over relief cannot be chosen, even though they occur within a 100% group context:</p> <ul style="list-style-type: none"> <li>• CGT event C2 – cancellation of shares in a subsidiary (including liquidation of the subsidiary);</li> <li>• CGT event G1 – capital payments by a subsidiary that are not dividends eg capital returns;</li> <li>• CGT event K8 – direct value shifting events that can alter the value of shares in a subsidiary.</li> </ul> <p><b>Submission points</b></p> <ol style="list-style-type: none"> <li><b>1. Distortion or deferral of up-stream restructuring</b> If CGT gains in respect of CGT events of this nature could be triggered in the context of an intra-group restructure, this could substantially distort or lead to the permanent deferral the normal corporate restructuring of foreign owned groups. Alternatively, such groups could be exposed to an inequitable Australian tax imposts on a transaction within a wholly-owned group which was not in any way Australian tax motivated.</li> <li><b>2. These issues have been recognised and addressed for resident groups</b> One of the factors leading to the introduction of the Australian tax consolidation regime was the recognition that even with CGT roll-over relief, tax costs and distortions could otherwise arise in the context of the restructure of an Australian wholly-owned group. Therefore, while the Joint Submission Parties do not believe it would be feasible to extend the consolidation regime to encompass non-resident entities, these same underlying problems will now also need to be addressed in the context of non-resident group entities.</li> <li><b>3. Introduction of specific exemptions</b> The most efficient way of addressing these issues would be to introduce an exemption to CGT events C2, G1 and K8, where the relevant transaction only involves entities within a wholly-owned group. If Treasury believe that this would create some integrity issues, then the Joint Submission Parties would be able to work with Government to seek to address such issues in a practical and realistic manner.</li> <li><b>4. Potentially limited revenue cost</b> Implementing this proposal will provide critical clarity and certainty to taxpayers but the potential revenue costs to the Government may be limited (particularly in relation to CGT event G1 and K8). This is due to the fact that by virtue of section 3A of the <i>International Agreement's Act</i> and the associated definitions in relevant double tax treaties, Australia only has a taxing right in respect of the "alienation or disposition" of shares or a comparable interest in companies.  In the context of CGT events G1 and K8, relevant transactions are unlikely to involve an "alienation or disposition" of shares and, therefore, even under proposed Division 855 these gains may not be taxable in Australia. However, this may not be the case in relation to corporate liquidations etc to which CGT event C2 can apply.</li> <li><b>5. Other relevant amendments required</b> Specific amendments are also required to the share buy-back provisions of Division 116K of the 1936 Act. Without amendment, section 159GZZZQ would deem the full buy-back amount to be capital proceeds for CGT purposes because the normal "dividend" component of the buy-back would not otherwise be included in the assessable income of the non-resident shareholder in a non-resident company.</li> </ol>

**Necessary legislative modifications**

It should be relatively straightforward to introduce exemptions for CGT event C2, G1 and K8 gains in respect of transactions that involve one or more non-resident entities within a wholly-owned group. [It is not proposed that these exemptions should extend to transactions between wholly-owned Australian resident companies as they could otherwise obtain relief by way of the tax consolidation regime.]

Somewhat similar modifications to the share buy-back provisions of section 159GZZZQ should also not be overly complex.

However, as noted above, the Joint Submission Parties would be able to work with Government in addressing any potential integrity concerns.

## Issue 4

**Issue:** Market valuation requirements regarding underlying assets will in many cases introduce significant complexity and substantially add to compliance costs.

**Proposal:** Taxpayers should be able to choose to utilise book values in respect of underlying assets.

### Background

The enormity of the potential compliance burden imposed on non-residents to obtain market valuations for underlying directly and indirectly owned assets cannot be overstated.

Take, for example, a non-resident that through non-portfolio interests in interposed non-resident and/or resident entities has an interest in Australian real property that may be material from a proportional perspective. When the non-resident disposes of their shareholdings it will be necessary for them to obtain current market valuations for both the Australian real property assets and all other assets (including foreign assets) in the corporate structure in order to determine whether the proposed section 855-30 "principal asset test" is satisfied. This can be the case where the non-resident directly or indirectly only owns a 10% shareholding in an underlying entity holding Australian real property.

### Submission points

#### 1. *Choice to use book values for calculations*

The Joint Submission Parties propose that taxpayers be able to choose to use the book values of Australian real property assets and all other assets, both in undertaking section 855-30 principal asset test calculations and also in determining the proportion of a gain that should be subject to tax in Australia as proposed in Issue 2 above (refer page 4).

Where market valuation information is not readily available, the use of book values would obviously significantly reduce compliance costs for taxpayers (and the Australian Taxation Office when undertaking audits). Otherwise, where a non-resident disposes of shares in a company that directly or indirectly holds Australian real property interests that could potentially exceed the 50% section 855-30 principal asset test, full valuations would be required of every asset directly or indirectly owned by that company. In many international mining groups, this could require valuations of substantial mining rights and other assets in a large number of countries.

Where the non-resident does not have a controlling interest in the relevant underlying subsidiary, in many cases it will simply not be possible to obtain market valuations of relevant underlying assets. This is recognised in paragraphs 4.79 to 4.83 of the Explanatory Memorandum related to proposed Division 855. However, due to the limitations of the provisions as currently drafted, the practical proposals contained in the Explanatory Memorandum will have limited application.

#### 2. *Consistency with other similar provisions*

Adopting this book value proposal would be consistent with the way in which calculations can be undertaken under the relatively recently introduced participation exemption provisions (Subdivision 768-G). These provisions also operate in an international context in relation to CGT calculations and recognise that broadly equivalent policy objectives can still be satisfied where taxpayers have the choice to use book values of underlying assets in calculations in order to minimise compliance costs.

#### 3. *Other associated compliance aspects*

The following additional points are noted in regard to this proposal:

- (i) where the book value method was utilised, it would have to be utilised for all purposes of the calculation (ie market valuations could not be used for some assets while book values were used for other assets);
- (ii) as per the approach adopted in Subdivision 768-G (refer 2 above), book valuations could only be used where there are 'recognised company accounts' of the relevant underlying companies as defined in section 995-1; and
- (iii) as full recognised company accounts are not prepared daily, an "averaging" mechanism as per sections 768-510 and 768-525 should be able to be utilised, based on two recent sets of relevant accounts.

**Submission points (continued)**

**4. *Interaction with other proposals in this submission***

It is proposed that if book values are used for section 855-30 principal asset test purposes, then these same values should also be used in determining the percentage of the relevant gain to be taxed in Australia (refer Issue 2 above).

At Issue 1 above (page 2), it is proposed that as a transitional measure, unrealised gains in respect of indirect Australian real property interests as at 1 July 2006 should not be subject to Australian tax on the ultimate disposal of these interests. This transitional mechanism would require market valuations to be obtained for relevant interests as at 1 July 2006. There is no inconsistency in the proposals of the Joint Submission Parties in this regard. First, the transitional proposal would only require market valuations to be obtained in respect of relevant shares in a resident or non-resident company, rather than specific valuations being required in relation to each underlying asset. Secondly, the transitional proposal would only require market valuations as at 1 July 2006, whereas proposed section 855-30 would require market valuations for underlying assets every time there was a disposal of a relevant interest in a non-resident or resident company.

Further, if a non-resident did not obtain the necessary market valuations to satisfy the proposed transitional exemption mechanism, the default would be the use of historic cost base data. Under proposed section 855-30 there is no default mechanism and, as such, but for the book value method proposed, a taxpayer would be unable to avoid incurring the expense of obtaining market valuations.

**Necessary legislative modifications**

This proposal should be able to be readily implemented as a full suite of provisions facilitating a choice to use book values for not dissimilar CGT calculations already exists in Subdivision 768-G.

## Issue 5

**Issue:** Avoiding the imposition of double taxation

**Proposal:** A credit mechanism should be introduced to avoid double taxation exposures where an Australian tax impost resulting from proposed Division 855 is not creditable against the equivalent gain taxed in a foreign jurisdiction.

### Background

Where Australia imposes and collects tax under proposed Division 855, it cannot be assumed that the home country of the non-resident will provide relief for this Australian tax impost where it itself imposes tax on the same transaction. This issue is particularly pertinent to a disposal of “indirect Australian property interest”, where the actual asset being disposed of by the non-resident is a membership interest in a non-Australian entity, such as a “home country” entity.

Under some of Australia’s double tax treaties (**treaties**), such gains are deemed to have an Australian source for tax purposes in the home country and, therefore, the home country will be obliged to provide tax credit relief, eg. the UK. However, under the US treaty, for example, the position is not as clear. It is also unclear what relief will be given by home countries whose treaties with Australia have been overridden by section 3A of the International Tax Agreements Act. Australia also does not have a tax treaty with a number of other countries, in which case no tax credit relief in the home country to avoid double taxation could be anticipated.

The issue of tax credit relief being provided in a foreign jurisdiction is likely to be most problematic in circumstances where the disposal by a non-resident of a non-resident company is taxed under Division 855 but the relevant underlying gain primarily relates to an increase in the value of non-Australian assets. For example, this could occur where a company resident in a foreign jurisdiction sells a subsidiary resident in that same jurisdiction which directly or indirectly owns Australian real property, albeit that the capital gain relates to the increase in value of non-Australian assets.

### Submission points

#### 1. *The need to avoid double taxation exposures*

To the extent that the relevant proposed Division 855 gain is also taxed in a foreign jurisdiction without credit for the Australian tax on the gain, legislative amendment is required to provide a credit in Australia for the foreign tax that is also imposed on the gain. Otherwise, in many cases proposed Division 855 could result in double taxation of the same gain which would clearly be inequitable and a significant disincentive to investing in Australia from countries potentially impacted.

#### 2. *Consistent with Government’s policy objectives*

This proposal should be seen as consistent with the Government’s policy objective that Division 855 gains are exposed to tax at the relevant Australian tax rate, albeit that some or all of this tax may be imposed by the home country of the non-resident.

#### 3. *Provides certainty/confident while treaty outcomes confirmed*

It is anticipated that many of Australia’s tax treaties partners will provide credit relief in such circumstances, in which case this proposed Australian “default” credit mechanism will not be triggered. However, until the policy that will be adopted by each of Australia’s tax treaty partners has been clarified and confirmed, this measure would provide foreign investors with a guarantee that under proposed Division 855 there is no risk of double taxation on gain on shareholdings in companies with direct and indirect Australian real property interests.

#### 4. *Establishes international benchmark*

Introducing this foreign tax credit mechanism would set a more appropriate international bench-mark for tax measures of this nature where two countries can claim “source” in relation to the same gain. This could be of assistance to Australian companies investing in foreign jurisdictions if other countries seek to introduce a regime similar to proposed Division 855.



**Necessary legislative modifications**

The implementation of this proposal should be relatively straightforward. In broad terms, it would only be necessary deem those Division 855 CGT gains that were taxed in a foreign jurisdiction (without relief for the Australian tax imposed) to be foreign source income for the purposes of the foreign tax credit provisions of Division 18 of the *Income Tax Assessment Act 1936*. Some other associated definitional amendments etc may be required.

## Issue 6

**Issue:** Providing grouping relief for CGT losses

**Proposal:** Allowing grouping access to CGT losses and tax losses of wholly-owned companies

### Background

Without legislative amendment, a CGT gain triggered by a non-resident company could only be reduced by a carry-forward CGT loss of that same company, as a CGT loss grouping mechanism does not currently operate.

Associated with the introduction of consolidation regime, the group loss transfer mechanisms in respect of revenue and CGT losses were repealed. However, even when these group loss transfer mechanisms were operative, they only applied where the transferor and transferee entities were both **resident** members of a wholly-owned corporate group.

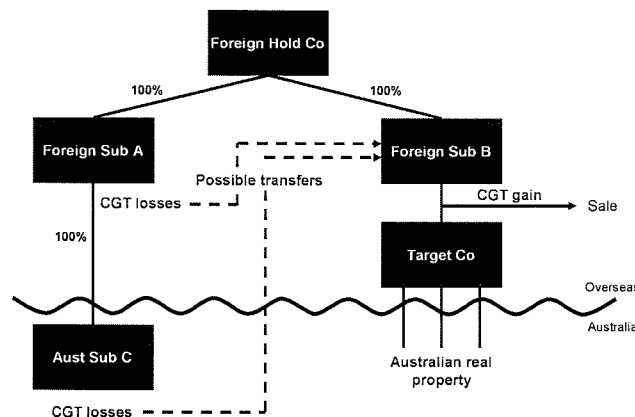
### Submission points

#### 1. Reactivating and extending group loss transfer mechanisms

Given that the scope of the Australian CGT provisions is being significantly expanded to encompass the disposal by a non-resident of shares in a non-resident entity, the CGT loss and tax loss grouping rules should be reactivating and extending so that they can be utilised by wholly-owned non-resident companies.

#### 2. Scope of loss grouping mechanism

This grouping mechanism should also operate to allow CGT losses of resident entities that continue to remain in the wholly-owned corporate group to be transferred to be utilised by a non-resident entity and vice versa as illustrated below. This includes losses within 100% owned consolidated and MEC groups.



#### 3. Integrity measures

The pre-existing loss integrity adjustment mechanism contained in Subdivisions 170-B and 170-C could apply to CGT loss and tax loss transfers of this nature. As per the above example, on a transfer of CGT losses from Aust Sub C to Foreign Sub B, there would be reductions in the reduced cost base of Foreign Hold Co's shareholding in Foreign Sub A and in Foreign Sub A's shareholding in Aust Sub C. Similarly, in respect of the CGT loss transfer from Foreign Sub A to Foreign Sub B there would be an additional reduction in the reduced cost base of Foreign Hold Co's shareholding in Foreign Sub A.

Further, the normal continuity of ownership test and same business test rules would apply to CGT losses of non-resident entities.

### Necessary legislative modifications

It would be straightforward to implement this proposal, in that it would simply require the reactivation of the relevant loss provisions in Division 170 with minor modifications such that they also apply to non-resident entities.