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Board of Taxation  
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Dear Sir/Madam

**Re: Post-implementation Review into Certain Aspects of the Consolidation Regime**

We refer to the request of the Board of Taxation (the Board) request for submissions on its position paper (the Position Paper) under the abovementioned review and hereby attach our submission for the Board's consideration.

CPA Australia represents the diverse interests of around 130,000 members in over 100 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. This submission is made not only on behalf of our members but also for the accounting profession and in the broader public interest.

Please contact Garry Addison (ph. 03 9606 9771) in the first instance if you have any queries in relation to the submission.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Paul Drum'.

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# **Post-Implementation Review on Certain Aspects of the Consolidation Regime**

## **Comments on questions raised in the Position Paper**

### **Question 2.1**

***(a) Do you agree with the Board's view to adopt the asset acquisition approach? If not, why not?***

We support the Board's view to adopt the asset acquisition model. An asset acquisition model would remove many of the uncertainties associated with the inherited history rule. It would also be expected to reduce compliance costs in the long-term.

***(b) Should the asset acquisition approach be modified for formation cases, or in cases where there is a change in ownership of a joining entity? If so, how?***

The asset acquisition approach should be modified for formation cases or in cases where there is a change in ownership of a joining entity.

Formation cases may involve groups that have been in existence for some time. As noted in Chapter 5 of the Position Paper (at paragraphs 5.27 and 5.28), stakeholder feedback and ATO statistical analysis demonstrates that a significant proportion of potentially eligible wholly-owned corporate groups have chosen to remain outside of the consolidation rules. Furthermore, many of these groups would appear to be small businesses that are closely-held. These types of groups are likely to have been in existence for many years and, therefore, a disposal of assets within those groups may attract the application of concessions such as pre-CGT status or the small business CGT concessions. A wholesale application of an asset acquisition approach would, therefore, adversely affect those groups relative to other groups.

More generally, the same factors that resulted in the decision not to proceed with a clean slate approach (which would apply to assets under an asset acquisition approach) when the consolidation rules were introduced would be of continued relevance to formation cases. That is, it would not be appropriate for the character of assets to change merely due to formation of a consolidated group, particularly where there has been no change in the underlying ownership of the consolidated group. Another issue that will require clarification in due course is when the asset acquisition approach will apply. That is, guidance will be required on what constitutes a formation cases and an acquisition case. For example, consider the following variations of an inbound acquisition by a foreign resident of a wholly-owned corporate group:

- The foreign resident may set up an Australian resident holding company that acquires the wholly-owned corporate group and then chooses to form a consolidated group. The formation of the consolidated group happens after the acquisition but it would appear that this should be treated as an acquisition case, not a formation case
- The foreign resident may directly acquired the wholly-owned corporate group. In this case, there will have been a change in the beneficial ownership of the group (assuming the foreign resident is unrelated to the vendor). If the wholly-owned corporate group then consolidates, consideration will need to be given to whether this should be treated as an acquisition or formation case
- The wholly-owned group may be consolidated just prior to the acquisition by the foreign resident. The foreign resident incorporates a new Australian resident holding company to make the acquisition. The consolidated group ceases to exist at the time when the Australian resident holding company acquires the shares in the parent company. A choice is then made by the Australian resident holding company to form a consolidated group. It appears that this should be treated as an acquisition case.

Similarly, if there has been a change of ownership in a joining entity, the appropriateness of an asset acquisition approach would seem to depend on factors such as the length and proportion of ownership. For example, if 99% of the shares in a joining entity were held by a consolidated group for several years and the entity joined the group upon the head company acquiring the remaining 1%, we consider that it would not be appropriate to disregard the history of assets in the joining entity through the application of an asset acquisition approach.

***(c) Do you consider that there are other circumstances in which the asset acquisition approach should be modified? If so, what are the issues?***

As the asset acquisition approach is intended to replicate a direct acquisition of assets to the extent possible, it will be necessary to take account of any provisions that require attributes of assets in the hand of a vendor to be transferred to the purchaser. While such provisions are not commonplace, we note that the under Division 40, where the vendor and purchaser of a depreciating asset are associates, the purchaser inherits the same method of working out the decline in value of the asset as the vendor.

***(d) What compliance cost implications would arise from the adoption of the asset acquisition approach?***

The asset acquisition approach would remove the need to consider the entry and exit history rules when an entity joins or leaves a consolidated group. The uncertainty associated with these rules has been a significant driver of compliance costs since the consolidation rules were introduced. Accordingly, the removal of the need to consider these rules in respect of assets should result in a reduction in compliance costs.

Factors that may increase compliance costs, at least initially, will be the form of any amendments, based on our responses to the questions above, the potential need to include exceptions to the asset acquisition approach or rules to determine what constitutes an acquisition or a formation case. On balance, however, we would consider that compliance costs should reduce in the long-term.

### Questions 3.1 – 3.3

No comment.

### Question 3.4

#### ***(a) Do stakeholders agree with Position 3.4? If not, why not?***

We agree with Position 3.4. This will resolve various anomalous outcomes that arise under provisions such as Division 7A and the small business CGT concessions where a shareholder does not 'see' the tax consolidated group since the single entity rule does not apply from the shareholder's perspective. In the context of Division 7A, it will confirm that loans by subsidiary members of a consolidated group to a shareholder of the head company may give rise to deemed dividends. It will also confirm that the distributable surplus is to be calculated by reference to the assets and liabilities of the consolidated group, not just the head company.

In relation to the CGT discount in Division 115, the integrity rule in section 115-45 will be applied by reference to the consolidated group rather than just the head company.

Turning to the small business CGT concessions, the extension of the single entity rule (**SER**) to a shareholder would allow the 80% threshold test to determine if shares in a company are active assets to be performed by reference to all of the assets of a consolidated group. The extension of the SER to shareholders, however, may not overcome the position in TD 2004/47 in which the ATO takes the view that the SER does not affect the application of the controlling individual test in paragraph 152-10(2)(a). This test has now been replaced with a CGT concession stakeholder test, which takes into account direct and indirect small business participation interests. However, we consider that the SER should be extended such that any direct small business participation interests in the head company will be treated as direct small business participation interests in any subsidiary members. This would simplify the application of these rules.

As a final point, we note that that the Position Paper refers to shareholders. In some circumstances, a trust can be the head company of a consolidated group. Any extension of the SER to shareholders should apply equally to the beneficiaries of such a trust.

#### ***(b) Are there circumstances where an exception should be made to the principles proposed in Position 3.4?***

No comment.

#### ***(c) Do stakeholders agree with the proposal to extending the SER so that it applies to the dealings of a related third party with a consolidated group?***

We agree with an extension of the SER to related third parties may be required in some circumstances. In this case of Division 7A, consideration should be given to extending the SER to associates of shareholders as they may also be subject to those rules.

### Question 4.1

#### ***Do stakeholders agree with Position 4.1? If not, why not?***

We agree with Position 4.1 subject to clarification of how a reasonable attribution of a trust's income and expenses to a non-membership period will be determined.

### Question 4.2

#### ***Do stakeholders agree with Position 4.2? If not, why not?***

We agree with Position 4.2.

### **Question 4.3**

#### ***Do stakeholders agree with Position 4.3? If not, why not?***

We agree with Position 4.3.

### **Question 4.4**

#### ***Do stakeholders agree with Position 4.4? If not, why not?***

We do not believe that Position 4.4 is necessary.

Under subsection 703-15(2), item 2, an entity that is a trust can be a subsidiary member provided that all the membership interests in the trust are beneficially owned by members of the consolidated group. Section 960-135 defines membership interests to include interests held by the members of a trust, which includes beneficiaries, unit holders or objects of the trust. The general law position is that a trust is not a person distinct from the trustee. A trust represents the relationship between a trustee and beneficiaries where the trustee owns property for the benefit of others. Accordingly, we do not believe it is necessary to make a trustee a member of the same consolidated group as the trust.

### **Question 4.5**

#### ***Do stakeholders agree with Position 4.5? If not, why not?***

We agree with Position 4.5.

However, this view will produce an inconsistency between the membership rules for companies and trusts. The note to section 960-135 states that in conjunction with section 960-130(3), section 960-135 operates to ensure that a debt interest is not a membership interest. Accordingly, the cost of acquiring the debt interest would not be included in the step 1 amount used to determine the ACA of the trust. Where such interests are taken into account in determining the membership of trusts, a trust that has a financing arrangement through an equity instrument with debt characteristics will be ineligible to be a member of a tax consolidated group. This position is inconsistent with the position applying to companies.

### **Question 4.6**

#### ***Do stakeholders agree with Position 4.6? If not, why not?***

We agree that foreign hybrids should be eligible to become members of a consolidated group. This is consistent with the drafting of section 703-15. The explanatory memorandum to the *New Business Tax System (Consolidation) Bill (No. 1) 2002* makes it clear that the residence of partnerships is irrelevant for consolidation purposes.

A foreign hybrid is eligible to become a member of a tax consolidated group where all of the partners in the relevant non-resident partnership satisfy the residency requirements. Since it is the partners of the partnership to whom any income and capital gains will flow and who will be subject to tax on these amounts, the residence status of the partnership is irrelevant.

This is also consistent with the ATO's position in ATO ID 2009/149, which confirms that a US limited liability company that satisfies the foreign hybrid provisions can join a tax consolidated group. We are unaware of any integrity risks arising from foreign hybrids being eligible to become members of a consolidated group. However, we note that various issues have been raised with the ATO such as the interaction between the cost setting provisions under the foreign hybrid rules and those under the consolidation rules. These should be considered to determine if there are any integrity risks.

#### **Question 4.7**

##### ***Do stakeholders agree with Position 4.7? If not, why not?***

We do not agree with Position 4.7. It is not appropriate for all the assets of a MEC group or consolidated group to be taken into account for the purpose of applying the principal asset test in Division 855. As noted in our submission dated 9 March 2010 on the Board's discussion paper, we consider that existing integrity measures adequately address the Board's concerns. These include Part IVCA and subsection 855-30(5).

We also note that requiring the valuation of all of the assets of the MEC group or consolidated group rather than just those of the leaving entity would significantly increase compliance costs, particularly where these groups have many entities and significant asset bases.

#### **Question 4.8**

##### ***Do stakeholders agree with Position 4.8? If not, why not?***

We disagree with Position 4.8. Any integrity concerns can be addressed through Part IVA. Provided such restructures are done for commercial reasons, and do not have the sole or dominant purpose of obtaining a tax benefit, we do not consider that the benefit of the tax cost setting rules should be denied.

#### **Questions 4.9 – 4.13**

No comments.

#### **Question 4.14**

##### ***(a) The Board seeks stakeholder's comments on whether the inclusion of deferred tax assets and deferred tax liabilities in the tax cost setting process results in unnecessary complexity?***

It is apparent from the submissions in response to the Board's discussion paper on this matter as well as concerns previously highlighted by the National Tax Liaison Group's Consolidation Sub-Committee that there is some degree of complexity associated with the inclusion of deferred tax balances in the tax cost setting process. Very often deferred tax assets (**DTAs**) and deferred tax liabilities (**DTLs**) will be taken into account in the tax cost setting process but may ultimately have no implications. For example, a DTL in respect of an asset such as plant and equipment or a foreign currency receivable can sometimes be reduced to nil under the reiteration process required by subsection 705-70(1A). In these circumstances, the complexity that arises from taking into account deferred tax balances into account would appear to be unnecessary.

Having said that, it is necessary for DTLs to be taken into in some scenarios to achieve an appropriate outcome. It, therefore, appears that as long as deferred tax balances need to be taken into account in the tax cost setting process, some degree of complexity will be required in order to ensure appropriate outcomes.

##### ***(b) How can the tax treatment of deferred tax assets and deferred tax liabilities be simplified?***

We consider that a broad-brush approach to dealing with deferred tax balances (i.e. their removal from the tax cost setting process) would, on balance, lead to inappropriate outcomes in some circumstances. As we have noted earlier, there are various types of DTAs and DTLs that may arise in respect of asset, liabilities or tax attributes and these can be taken into account on entry or exit and, in some cases, the recognition of these may be required to achieve appropriate outcomes. In recognising the multitude of ways in which deferred tax balances may arise, we consider that it would be most appropriate to consider the development of a set of new rules dealing with the specific circumstances in which deferred tax balances may potentially interact with the tax cost setting process.

For example, legislative remedies could be introduced to prevent the taxpayer from facing a potential inappropriate outcome where a DTL is included in respect of an asset on exit – as in certain circumstances the vendor can be exposed to tax on double taxation.

***(c) Should deferred tax assets and deferred tax liabilities be recognised in the tax cost setting process?***

While we advocate the inclusion of additional rules to reduce the complexity associated with deferred tax balances, we would suggest that if the Board recommends their removal from the tax cost setting process, that this be complimented by the recommendation of some other means of recognising these amounts as part of the consolidation process.

***(d) If not, in what circumstances should deferred tax assets and liabilities be recognised in the tax cost setting process?***

Please refer to our response to Question 4.14(c).

## Question 5.1

### ***(a) Do stakeholders agree with the Board's Position 5.1? If not, why not?***

We agree with the Board's position. We note that many small to medium enterprises (SMEs) that were eligible to consolidate chose not to do so because of the complexity and uncertainty surrounding the consolidation rules. Further, since many SMEs have very small corporate groups with limited intra-group transactions, the compliance cost savings that would have been achieved through consolidation do not outweigh the additional compliance costs incurred in applying the rules.

As highlighted in our previous submission, we believe that the reintroduction of a transitional period may provide an incentive for SMEs to form consolidated groups. Therefore, we agree with the proposal that on-going formation concessions should be available for wholly-owned corporate groups that fall below specified thresholds. However, we identify two issues with this proposal.

Firstly, the Board proposes to adopt a turnover threshold of \$100 million based on aggregated turnover. However, given that the definition of 'aggregated turnover' in subsection 328-115(2) of the ITAA 97 would include the annual turnover of connected entities and affiliates, we believe that it would not be appropriate to take into account the annual turnover of entities that will not be members of the consolidatable group. Further, the assets threshold turnover of \$300 million may require annual independent valuations since many SMEs do not prepare accounts in accordance with accounting standards. Currently, under the TOFA rules, assets are valued in accordance with commercially accepted valuation principles if accounts are not prepared in accordance with accounting standards. We do not consider that an asset threshold test is, therefore, consistent with Position 5.1 and it should not be introduced.

Secondly, the Board proposes to reintroduce only two of the original formation concessions – the ability to retain existing tax values for a joining entity's assets and to claim losses over three years instead of by reference to an available fraction. The Board suggests that the other formation concessions such as the value and loss donor rules will only generate greater compliance costs for the small business groups. Nevertheless, some groups, especially larger ones, may be able to utilise these other concessions. Therefore, we submit that the Board should consider replicating some of the other concessions.

### ***(b) Do stakeholders agree with the removal of the 'entity-by-entity' election for eligible wholly-owned groups? Are there situations where such an approach may unfairly disadvantage these groups?***

We agree that the removal of the 'entity-by-entity' election would arguably reduce the overall complexity and compliance costs of entering into the consolidation regime. However, there may be circumstances where an 'entity-by-entity' election would result in a more advantageous outcome rather than applying the tax cost setting rules. Therefore, we submit that it would be preferable if eligible corporate groups are given the choice to either stick to existing tax values or apply the tax cost setting rules.

## Question 5.2

### ***(a) Do stakeholders agree with the Board's Position 5.2? If not, why not?***

If the formation concessions are made available to the small business groups for a limited period of time to all eligible consolidatable groups, we agree that this would create an incentive for more groups to elect into the consolidation regime. Further, we consider that a 12-month transitional period is sufficient due to the increased certainty of the consolidation regime.



***(b) Are stakeholders concerned about the increased complexity and additional compliance costs caused by the adoption of Position 5.2?***

Should Position 5.2 be adopted, we consider that stakeholders would not be concerned about increased complexity or compliance costs upon entering the consolidation regime under the formation concessions. Since the original transitional rules can be replicated, we do not expect an increase in complexity and compliance costs caused by the adoption of Position 5.2.