

TAX BULLETIN

An update publication for our clients

November 2011

Retrospective tax consolidation changes to 1 July 2002

Many things can, and undoubtedly will, be said and written about the retrospective changes to the tax consolidation regime that were announced by the Government on 25 November 2011. There is however, only one key question that needs to be answered. Will the announced changes impact deductions that have been claimed by your tax consolidated group?

There are two groups of taxpayers that will be protected from the announced changes. The first is a taxpayer that has received a private binding ruling or written advice under an Advance Compliance Agreement issued before 31 March 2011 in respect of the deduction. The second is a taxpayer that chose the “stick option” when the consolidated group was formed. If the claim for a deduction is covered by either of the above, then the announcement will have no effect on those claims.

However, if your claim for deductions is not covered by either of the above, then the announcement is likely to have implications for claims made in respect of the tax costs allocated to assets and (in the words of the Government’s press release) you “should seek expert advice.”

The extent of the proposed changes depends on the time when the relevant entity joined a tax consolidated group and when the deduction is claimed. If the deduction resulted in carry forward losses, the time of the claim is when the loss is utilised.

Given that the proposed rules can apply to a broad range of assets, including:

- rights to future income assets;
- consumables;
- swap contracts;
- traditional securities;
- work in progress assets;
- construction contracts;
- accounting intangibles;
- mine site improvements; and
- life / business insurance contracts,

it is expected that all consolidated groups will be affected by these changes to some degree.

If you believe you may be impacted by these amendments, please contact your Pitcher Partners representative.

Background

On 25 November 2011 the Government announced changes to the tax consolidation regime that will have retrospective effect to 1 July 2002. The proposed changes will seek to undo many of the changes that were made by the Government in 2010 which allowed tax consolidated groups to claim deductions for amounts allocated to “rights to future income” assets and residual assets [**the 2010 amendments**].



While Pitcher Partners do not (and have not) supported these retrospective law changes, Pitcher Partners represented one of the professional bodies in the consultation with Government on these measures. It was made clear to the professional bodies by the Government that retrospective changes to the law were required due to the significant revenue costs of the 2010 amendments (that were not anticipated when those measures were originally introduced in 2010).

As reported by the Board of Taxation [**the Board**], the ATO had received ruling requests by 60 taxpayers for claims totalling \$30.1 billion dollars under the 2010 amendments. The Board's report notes that there were at least 2,700 entities that joined a consolidated group in only the 9 months to 30 March 2011. Given that the 2010 amendments could be applied retrospectively to 1 July 2002 by all consolidated groups and entities that jointed for the past 9 years, it is not surprising that the Government has proposed significant amendments to cap the revenue cost of those measures.

An attachment has been provided by the Government with the announcement (being some 14 pages in length) outlining a complex array of changes that are proposed to occur ([click here](#)).

However, to ensure some degree of fairness for some taxpayers, where taxpayers have relied on announcements and tax legislation (then in force) in entering into transactions, certain levels of protection will be provided. This means that certain (pre-existing) rules will be restored and will apply where assessments and amended assessments have (generally) issued before 30 March 2011. Furthermore, taxpayers covered by rulings and advanced compliance agreements will be protected and there will be reductions in interest and penalties to nil.

The Government has also stated that interest and penalties will not be applied to any changes required under the retrospective measures. However, for the pre-30 March 2011 period, where interest is to be received by a taxpayer for a refund in relation to these measures this will not be paid (unless it has already been received by the taxpayer).

That being said, the above does not mean that some taxpayers will not be affected in a material way. For example, a taxpayer that has carry-forward tax losses as at 30 March 2011 may likely have to apply significant retrospective legislation when the claim for the loss (deduction) is made after that date.

What are the changes to the tax cost setting rules?

When an entity joins a tax consolidated group, the tax cost of its assets are reset. These amendments will deal with how such costs are to be treated for tax purposes. The specific changes contained in the announcement are dependent on the time when:

- (1) the entity joined the tax consolidated group; and
- (2) an assessment or amended assessment covers the deduction being claimed.

It is noted that if the deduction simply results in a carry forward loss, then the relevant time for determining the assessment or amended assessment will be when those losses are utilised.

Generally, there are three time periods being containing different proposed rules, being: a pre-12 May 2010 period; the period between 12 May 2010 and 30 March 2011 (inclusive); and the post 30 March



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2011 period. Where a deduction spans multiple periods, it is possible that the deduction will have different rules applying at the various different times. For example, a right to future income deduction may have been claimed in each of the three time periods – therefore giving rise to different rules that will apply to each period under the announcement.

It is noted that while there are three periods covered by the announcement, there are effectively five different sets of rules that can apply during those three periods. The following paragraphs summarise these three periods (generally) and how the law is proposed to apply during those periods. However, as there is a lot of detail in the 14 page announcement which is not contained below, we have provided a summary table (as an attachment to this Tax Bulletin – [click here](#)) that summarises how we believe the five different set of rules could apply during the various periods for the different asset classes. We have cross referenced this summary table to the Government's attachment to the press release. However, due to its complexity, you should seek advice where the amounts are material.

1. The Pre-12 May 2010 period

On 12 May 2010, the 2010 amendments were passed by Parliament. Accordingly, the Government has used this date to rule off the first period. During this period (i.e. from 1 July 2002 to 12 May 2010), the 2010 amendments will not apply. Instead, new provisions will be inserted to deal with rights to future income, consumables and residual assets. These provisions significantly change what could otherwise be claimed as a deduction for this period.

Generally, the scope of rights to future income assets will be limited to unbilled income for works, goods or services that have already been provided. All other amounts will be treated as goodwill. A special deduction provision will be inserted for consumables and the residual asset rule will be restored to its original state with some amendments. The law will clarify that certain accounting intangibles that are not CGT assets (e.g. customer relationships) will be treated as goodwill. Other proposed amendments will also apply retrospectively.

However, to reduce the scope of the retrospective application of these amendments, the Government will allow a taxpayer to apply the law as it stood before the 2010 amendments (with an amendment to exclude accounting intangibles that are not CGT assets) if the amount was deductible under that previous provision and the taxpayer had received an assessment or amended assessment for the deduction before 12 May 2010 in relation to the claim. That is, such assessments will not be disturbed. Furthermore, taxpayers covered by rulings and advanced compliance agreements will also be protected from the retrospective amendments. However, if the deduction simply resulted in a carry forward loss at 30 March 2011, such claims will not be protected.

2. The 12 May 2010 to 30 March 2011 period

As outlined earlier, the 2010 amendments were passed by Parliament on 12 May 2010. On 30 March 2011, the Government made an announcement that it would amend those provisions. Accordingly, this period represents a time when the Government will accept that taxpayers can apply the 2010 amendments (with minor amendments) [the transitional period]. The 2010 amendments can be applied in two circumstances.



The first is where an entity (essentially) joined during the transitional period. However, this is done in a very complex way. As the law was introduced into Parliament on 10 February 2010, the Government believes that the provisions can only apply if the entity joined on or after 12 May 2010 under an arrangement entered into after 10 February 2010 but before 30 March 2011. Where this occurs, the 2010 amendments will apply to entities that joined on or after 12 May 2010 - even if the taxpayer actually joins the group after 30 March 2011. In this case, the law applies to the whole deduction.

The second circumstance where the 2010 amendments may apply is where an assessment covers a deduction claimed during the transitional period, where the entity joined before 12 May 2010 (or under an arrangement entered into before 10 February 2010). This may occur where the taxpayer received an amended assessment during the transitional period covering the deduction claimed. It may also cover a "tail" end of a claim, where a claim spanned the 30 June 2009 and 30 June 2010 income years.

The main changes to the 2010 amendments will be to remove contract renewals and cancellable contracts from being "rights to future income" assets. Furthermore, accounting intangible assets that are not capital gains tax assets will be treated as goodwill.

3. The post-30 March 2011 period

From 30 March 2011 the Government has announced new rules to deal with rights to future income assets and residual assets. The provisions will generally apply to an entity that joins a tax consolidated group after 30 March 2011 (unless they are covered by one of the earlier periods).

Under the proposed rules, the extent of the "rights to future income" provisions are narrowed to work in progress amounts. All other rights to future income assets are treated as retained assets, whereby a taxpayer will only be able to claim a deduction for amounts that were "unclaimed" by the newly acquired entity at the time of joining.

The tax costs will only be allocated to tax assets, meaning that accounting intangibles will effectively be treated as goodwill unless they are a capital gains tax asset. The new rules also outline a proposed specific deduction provision for consumables. One of the bigger changes proposed is the new "business acquisition" model, which will apply to assets covered by the residual rules. The rule will require one to determine whether the cost of acquiring the asset is revenue or capital - i.e. by comparing the situation to a business acquisition of those asset types. The current system employs a mix of a history model, together with a single asset acquisition model (whereby most assets would be considered on revenue account).

What other changes are covered by the announcement

The announcement also contains a few proposed amendments to the TOFA rules, to ensure that the tax consolidation provisions apply appropriately to TOFA liabilities and to amounts "transitioned" into TOFA. These changes will fix a number of minor technical anomalies, dating back to the start of the TOFA provisions.

Furthermore, the announcement outlines a number of other changes that may occur in the future, once the Board of Taxation finalises its post-implementation review of the tax consolidation provisions. This

includes the treatment of liabilities and the capping of capital gains tax assets. These changes may also have a dramatic impact on the tax consolidation provisions in the future.

Closing comments

The changes to the tax consolidation provisions contained in the announcement are substantial. They not only can change what has happened in the past but will also change what it means for an entity joining a tax consolidated group from 30 March 2011. Taxpayers will need to understand whether they are impacted by the retrospective changes and determine what the impact may be.

Going forward, it also important to bear in mind that the proposed treatment of “rights to future income” assets under the new measures means that taxpayers may be worse off if they acquire assets indirectly through tax consolidation, rather than buying the underlying assets of the target entity (where in cases, the acquisition of such amounts may be deductible). Accordingly, it is important to understand these new proposed amendments where the consolidated group is considering an acquisition of a target entity.

Further Information

Please ask either your regular Pitcher Partners tax contact or any of the contacts in the Pitcher Partners firms below for further details on the issues raised in this Tax Bulletin:

Melbourne

Alexis Kokkinos
alexis.kokkinos@pitcher.com.au
+61 3 8610 5170

Sydney

John Ross
jross@pitcher-nsw.com.au
+61 2 9228 2508

Adelaide

Richard Brooks
richard.brooks@pitcher-sa.com.au
+61 8 8179 2800

Perth

Leon Mok
mokl@pitcher-wa.com.au
+61 8 9322 2022

Brisbane (Johnston Rorke)

Chris Ball
cball@jr.com.au
+61 7 3222 8444