

Aspect	Comment
JOINING ENTITY ASPECTS	
USE OF COST SETTING AMOUNT [Part 1 and Part 11] <i>Effective date: 1 July 2002</i>	<p>Future deductions – rights to future income assets</p> <p>This amendment proposes a new s.701-55(5C) which will allow a deduction for a cost setting amount allocated to an asset that is a ‘right to future income’.</p> <p>This measure was announced in 1 December 2005, and many taxpayers have been waiting for this legislation for some time to obtain relief for the tax cost setting amount allocated to these assets they have been arguing for over many years.</p> <p>Examples in the EM indicate that the new provision is intended to have a broad scope. For example it will apply to:</p> <ul style="list-style-type: none"> • the right to income under a long term construction contract; • the right to deferred management fees derived by a retirement village operator; • the right to unbilled income for the supply of gas; • trailing commissions earned by a financial services broker; and • land development rights. <p>The deduction will not be allowed upfront but will instead be matched to the assessable income as it is derived from the asset. If income derived from the asset ultimately falls short of the tax cost setting amount then the remainder of the deduction will be allowed at the time it is reasonable to expect that no further income will be derived.</p> <p>While it is “early days” , there are at least three significant interpretation issues that could arise under the proposed legislation.</p> <p>First, exactly what rights are covered by the provision? The proposed language is clear that ‘contingent rights’ to future income are included, but is unclear as to what contingencies are acceptable. Does it matter if, for example, the contingency is under the control of the person with the obligation to pay so that that person can effectively escape the obligation (eg perpetual service contracts)?</p> <p>Secondly, what is the correct approach if the right is embedded within a larger ‘asset’? For example, under a long term construction contract the right to income will be just one of many rights and obligations contained within the construction contract. Generally the overall contract would be considered to be the asset for ACA allocation purposes, yet the proposed legislation requires the asset to be ‘a right’. However, the EM indicates that rights embedded within contracts are intended to be covered.</p> <p>Thirdly, it is not clear whether the deduction to be permitted under the amendments will be limited to “revenue assets” (such as those listed above), or all rights to future income embedded in contracts. For example, on a literal reading of the proposed amendments, there is no reason why they could not apply to the tax cost setting amount of capital assets, such as the management rights in relation to investment trusts or shopping centres (both of which contain a right to future income by way of management/ performance fees). It is understood this is not the intention, but the words of the Bill do not seem to limit such an</p>

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	application.
	<p>Retained cost base assets – rights to future income</p> <p>The range of retained cost base assets will be extended in very limited circumstances to include ‘rights to future income’ if, at the time the right was created, the head company and the joining entity were members of the same ‘consolidatable group’ (ie only applicable where the joining entity was a 100% subsidiary but the head company had not elected at that time to form a consolidated group).</p> <p>Given that in these limited circumstances the retained cost base of rights to future income will be their ‘terminating value’, in most cases this amount will be nil, given the prior deductibility of associated costs. Therefore, when income from the right is subsequently derived the full amount will be assessable without additional consolidation deductions.</p>
	<p>Clarification of other consequences of tax cost setting</p> <p>This amendment also proposes to rewrite s.701-55(6) to overcome the restricted interpretation that the ATO has applied to the existing provision. That provision applies to determine the consequence of resetting the cost base of an asset other than for the capital allowance, trading stock, qualifying security and CGT provisions and where the asset is not a right to future income covered by the new s.701-55(5C) explained above. While the current provision resets the cost base of an asset it does not, for example, deem there to be an outgoing or expenditure that would be necessary to obtain a s.8-1 deduction. The new provision will deem the amount of the tax cost setting amount to have been incurred to acquire the asset.</p> <p>Hence it will confirm the deductibility of the tax cost setting amount in many cases, eg consumable stores.</p>
<p>FX INTERACTIONS [Part 1, Division 2]</p> <p><i>Effective dates</i></p> <ul style="list-style-type: none"> • <i>Electively from 1 July 2002</i> • <i>Compulsorily from Royal Assent</i> 	<p>This amendment affects the determination of FX gains and losses on assets denominated in a foreign currency which are held by a joining entity when it joins a consolidated group. The amendment clarifies that when the asset is subsequently realised the FX gain or loss must broadly be calculated under Division 775 by reference to the exchange rate at the joining time, rather than the earlier time when the asset was created. That is because any FX gain or loss incurred up to the joining time will already have been effectively taken into account as part of the tax cost setting process on joining.</p>
<p>FX RECEIVABLES – TRANSITIONAL [Part 1B]</p> <p><i>Effective date: 1 July 2002 (up to 22 August 2006)</i></p>	<p>This amendment, in effect, seeks to legislate <i>Draft Taxation Determination</i> TD 2004/D80, which stated that a CGT gain would arise when an amount received (converted to AUD) in relation to an FX denominated trade receivable exceeded its tax cost setting amount. This draft ruling was withdrawn on 22 August 2006 following the former Government’s announcement that it would modify the operation of s.701-55(6). As such, this amendment is only intended to have transitional operation for relevant events occurring prior to 22 August 2006.</p> <p>Importantly, this CGT treatment will not extend to any gain or loss ‘attributable to currency exchange rate fluctuations’ which will then be subject to Division 775. Corporate groups will no doubt have pragmatically applied various methods for making this CGT/Division 775 split.</p> <p>In addition, the provisions give no guidance as to the scope of the term ‘trade receivables’.</p>

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<p>NO DOUBLE COUNTING – ACA [Part 4]</p> <p><i>Effective dates</i></p> <ul style="list-style-type: none"> • <i>Electively from 1 July 2002 to 10 February 2010</i> • <i>Compulsorily from 10 February 2010</i> 	<p>Where a particular amount has been taken into account more than once in calculating the ACA of a joining entity, this 'doubling up' is to be eliminated with only the most 'appropriate' (as determined by the taxpayer) single impact being utilised.</p> <p>For example, in a number of circumstances tax losses of a joining entity on formation may indirectly have reduced the ACA step 1 amount, and also reduced the ACA via either step 3 or step 5 – hence there is a quite clear and beneficial application of this proposed measure.</p> <p>One interpretation issue that has come to light in respect of the proposed amendment is whether a liability that gives rise to a future deduction (and thus causes the ACA to be adjusted downwards under s.705-75(1)), also causes an upwards ACA adjustment under s 705-80 (being the reversal of the s.705-75(1) adjustment), will mean that only one of those adjustments is taken into account. The proposed amendment states that where 2 provisions apply to adjust the ACA, the taxpayer may choose the most appropriate, which would indicate that only one of these adjustments would be taken into account. However, the adjustments both occur in one single ACA step (Step 2). Clarification may be needed on this point.</p> <p>This measure will have far-reaching implications as double ACA impacts, in some shape or form, were inherent in formation ACA calculations for many corporate groups.</p>
<p>PRE-JOINING TIME ROLL-OVERS [Part 5]</p> <p><i>Effective date: 1 July 2002</i></p>	<p>In most cases this amendment should not significantly extend the scope of ACA adjustments related to prior and future CGT roll-overs. In effect, this amendment mainly operates to re-word s.705-93 and to incorporate the operation of the associated s.705-105.</p>
<p>OVER-DEPRECIATION ADJUSTMENT [Part 6]</p> <p><i>Effective date: Repealed from 1 July 2009 (also reduced impact from 9 May 2007)</i></p>	<p>The over-depreciation entry ACA provisions of s.705-50 have always been extremely problematic from a conceptual and compliance perspective, in that they could reduce the ACA of a joining entity in respect of certain unfranked rebateable dividends previously paid by the joining entity.</p> <p>As a result, the s.705-50 over-depreciation reduction of a joining entity's ACA will be modified so that from joining times on and after 9 May 2007 regard will only need to be had to unfranked rebateable dividends paid by the joining entity in the 5 years immediately prior to the joining time. Then for joining times from 1 July 2009 the provisions will be totally repealed.</p>
<p>RETAINED COST BASE ASSETS – CASH MANAGEMENT TRUST UNITS [Part 11]</p> <p><i>Effective dates:</i></p> <ul style="list-style-type: none"> • <i>Electively from 1 July 2002 to 10 February 2010</i> • <i>Compulsorily from 10 February 2010</i> 	<p>Units in a cash management trust for which the redemption value is expressed in Australian dollars and cannot be increased will also be regarded as a retained cost base asset. It is expected that many corporate groups would have already anticipated this amendment/clarification in undertaking previous ACA allocation calculations.</p>

Aspect	Comment
<p>REPEAL OF CGT EVENT L7 [Part 12]</p> <p><i>Effective dates:</i></p> <ul style="list-style-type: none"> • <i>CGT gains from 1 July 2002</i> • <i>CGT losses from 10 February 2010</i> 	<p>CGT event L7 applies where a liability used in determining the entry ACA step 2 amount is ultimately discharged for a lesser amount (CGT gain triggered) or a greater amount (CGT loss triggered). This provision has always been plagued with compliance and conceptual problems.</p> <p>CGT event L7 will be totally repealed retrospectively back to 1 July 2002 where a CGT gain would otherwise have arisen, or from 10 February 2010 where a CGT loss has arisen (ie no taxpayer detriment by way of these effective date arrangements).</p>
<p>CGT EVENT L3: DOUBTFUL DEBTS [Part 13]</p> <p><i>Effective dates:</i></p> <ul style="list-style-type: none"> • <i>Electively from 1 July 2002 to 10 February 2010</i> • <i>Compulsorily from 10 February 2010</i> 	<p>By way of this proposed amendment, the tax cost setting amount of an impaired debt held by a joining entity may be reduced by the amount of CGT gain that would otherwise have arisen under CGT event L3 (but not below zero), and in such circumstances the CGT gain arising under CGT event L3 will be reduced by an equivalent amount. The scope of these provisions is modified where the impaired debt is an intra-group debt (eg a liability of the head company).</p> <p>This amendment recognises the inequitable outcomes that could otherwise arise when a head company acquires an entity with substantial doubtful debts, in that without this amendment an immediate CGT event L3 gain may have arisen. However, where this provision applies, future bad debt deductions and/or CGT losses in respect of impaired debts will be correspondingly reduced.</p>
<p>TRANSITIONAL CONCESSIONS: SAPs [Part 15]</p> <p><i>Effective date: Electively from 1 July 2003</i></p>	<p>The transitional concessions relating to ACA step 3 retained earnings generally only applied to groups electing to consolidate between 1 July 2002 and 30 June 2004. The relevant transitional provisions will be slightly amended to address an anomaly which proved to be unduly restrictive for certain groups with substituted accounting periods.</p>
<p>LEAVING ENTITY ASPECTS</p>	
<p>PRE-CGT PROPORTIONS [Part 3]</p> <p><i>Effective date: 1 July 2002 (unless a choice is made, in which case the provisions commence to operate from 10 February 2010)</i></p>	<p>This long-awaited amendment will only be of relevance where the holding company's shareholding in the joining entity had a pre-CGT status (ie not of relevance to public company groups). The pre-existing 'pre-CGT factor' provisions that applied where such an entity joined and then left a consolidated group were unduly complex and anomalous.</p> <p>Under these totally revised provisions where a portion of the shares in the joining entity have a pre-CGT status, then when that entity leaves the group an equivalent portion of the shares in the leaving entity will similarly be regarded as having a pre-CGT status. Associated amendments will be made to totally negate or reduce this pre-CGT proportion on exit and to make other ACA adjustments where, on or prior to the exit date, the pre-CGT status of the shares has or would otherwise have been impacted by CGT event K6 or Division 149.</p>

Aspect	Comment
LEAVING TIME LIABILITIES [Part 7] <i>Effective date: 10 February 2010</i>	<p>In calculating the exit ACA step 4 amount in respect of liabilities, the amendments can have the following 2 impacts. First, they clarify that the liabilities taken into account in working out the exit ACA step 4 amount are liabilities just before the leaving time (confirmed in the recent Full Court decision of <i>Handbury Holdings</i>).</p> <hr/> <p>Secondly, they adjust the step 4 amount if:</p> <ul style="list-style-type: none"> • there is a leaving accounting liability that will only subsequently have a tax impact (eg employee leave provisions or accounting liabilities with unrealized forex gains or losses); • that same liability was present at a joining time; and • the <i>prima facie</i> exit ACA step 4 amount in respect of that liability (i.e. the exit liability amount) would otherwise differ from the prior entry ACA step 2 amount in respect of that liability (i.e. the entry liability amount). <p>The quantum of this exit ACA step 4 adjustment is the difference between the exit liability amount and the entry liability amount. The calculation of the entry liability amount can be a complex process involving adjustments for any intervening payments and associated tax effects during the period from the entry time to the leaving time.</p> <p>In recognition of the impracticality of attempting to undertake such “tracking” calculations, the provisions contain some compliance safe harbours for annual leave or long service leave provisions and provisions for contingent liabilities. In such cases, the amendments will only apply if the leaving event occurs less than 4 years after the initial joining time. In addition, where these provisions were classified as ‘current liabilities’ at the initial joining time, the tracking period is further reduced to 12 months.</p>

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BOTH ENTITY AND LEAVING ASPECTS

CGT STRADDLE
TRANSACTIONS [Part 17]
Effective date: 8 May 2007

The general CGT event disposal timing rules that focus on the time of entering into of the relevant contract (rather than the time of the subsequent change in legal ownership of the asset) caused a host of technical and practical problems in the context of their interaction with entities that are joining or leaving a consolidated group. The ATO attempted to patch over these problems by the release of a series of tax determinations, but a range of problems remained.

Where a CGT disposal of an asset by an entity straddles the period when the entity joins a consolidated group ('entry-sell case') or leaves a consolidated group ('exit-sell case') then the CGT timing rules will be amended such that, broadly, the CGT event is taken to be deferred until the change in the legal ownership of the asset being disposed of.

In the context of a normal disposal/acquisition of an asset under a contract (e.g. CGT event A1), the following table summarises outcomes as compared to the ATO's views in their earlier series of tax determinations.

CGT straddles – CGT event A1

	Asset sale	Asset acquisition
	Event sequence: 1 Asset sale contract 2 Consolidation event (joining or leaving) 3 Legal ownership of asset changes	Event sequence: 1 Asset acquisition contract 2 Consolidation event (joining or leaving) 3 Legal ownership of asset changes
Contracting entity leaves group	Exit – Sell case Bill: CGT gain/loss to the leaving entity after the leaving time (at s.716-860(2)) <i>Existing TDs: CGT gain/loss to vendor group</i>	Exit – Buy case Bill: no amendment <i>Existing TDs: CGT acquisition by leaving entity back to contract date</i>
Contracting entity joins group	Entry – Sell case Bill: CGT gain/loss to the joined group (at s.716-860(1)) <i>Existing TDs: CGT gain/loss to joining entity before the joining time</i>	Entry – Buy case Bill: no amendment <i>Existing TDs: CGT acquisition by joined group (not joining entity) back at contract date</i>

SUBDIVISION 165-CD [Part 16]
Effective date: 1 July 2002

For many widely held groups, the scope of the loss integrity provisions of Subdivision 165-CD are to be significantly reduced back from 1 July 2002. These amendments will have consolidation impacts in overcoming the inequitable erosion of capital losses that may otherwise have arisen on the disposal of subsidiaries; but also, these amendments can apply more generally where Subdivision 165-CD may otherwise have operated to erode reduced cost bases in inter-entity debt and equity links.

Generally, by way of these amendments, a widely held company will not be taken to have a 'relevant equity interest' or 'relevant debt interest' (being interests that could otherwise be impacted by a Subdivision 165-CD adjustment) in a 'loss company'. However, this concession will not apply if another entity has a controlling stake in the loss company and a direct or indirect equity interest in, or a debt owed by, the widely held company where this interest is within the Australian tax net.

Aspect	Comment
GROUP RESTRUCTURES (MEC RELATED) [Part 2]	<p>Therefore, for most Australian listed entities Subdivision 165-CD should have ceased to be relevant on the divestment of a wholly owned subsidiary since 1 July 2002. Even without these amendments, in some cases this outcome could have been achieved but it required specific fact patterns to apply.</p> <p>The application of this Subdivision 165-CD exemption will in some cases also apply to MEC group entities where the ultimate overseas holding company is widely held.</p> <p>From an entry ACA perspective, given that a head company must assume a CGT event occurs to the shares of a joining company it holds before the joining time, and apply Subdivision 165-CD to adjust the cost base in the shares of that company (if Subdivision 165-CD would require such adjustment), then this relaxation of Subdivision 165-CD may provide increases to the ACA of some entities that have joined consolidated groups since 1 July 2002.</p>
<p><i>Effective date:</i></p> <ul style="list-style-type: none"> • <i>Electively from 1 July 2002 to 27 October 2006</i> • <i>Compulsorily from 27 October 2006</i> 	<p>These new provisions are to address anomalous outcomes that can arise where a consolidated group converts to a MEC group and vice versa.</p> <p>Currently, when a group conversion event occurs, significant tax consequences could arise, including the cumbersome exit tax cost setting process required on the members of the old group (and risking triggering CGT event L5 gains) and the equally onerous entry tax cost setting process required on the head company of the new group (and associated adverse ACA 'skewing' consequences). In addition, any tax losses of the old group must satisfy the ownership or same business tests before they can be transferred to the new group, and the new group's utilisation of these transferred losses will be subject to ongoing available fraction limitations, often with a significantly reduced available fraction due to a technical glitch in the consolidation provisions.</p> <p>The new group conversion provisions aim to ensure that there will be minimal tax consequences on group conversion and in most aspects the tax attributes (including asset tax values) of continuing group entities will remain unchanged. This is achieved by firstly allowing the head company of the new group to retain the history of the head company of the old group, secondly, switching off certain provisions that would otherwise apply, such as the entry asset cost setting rules, exit share cost setting rules and the loss transfer rules. Moreover, the deemed COT failures that ordinarily occur when a MEC group ceases to exist also do not apply upon conversion.</p> <p>However, normal CGT consequences in respect of shares will arise if, as a result of such a restructure, a group member either commences to become an eligible tier-1 company or ceases to become an eligible tier-1 company (including the application of the cost base pooling rules and Subdivision 719-K).</p>
<p>ACCOUNTING PRINCIPLES – ACA [Part 8]</p> <p><i>Effective date: 10 February 2010</i></p>	<p>These amendments will confirm that in respect of identifying and quantifying liabilities to be used in entry and exit calculations, an accounting principle cannot be utilised if it had not been adopted by the relevant entity in recognising and measuring the liability for financial recording purposes. As such, this amendment now confirms and supports the decision in the <i>Envestra Limited</i> case.</p> <p>In addition, the phrase 'can or must be recognised in an entity's financial statement' is to be deleted from relevant provisions, and this, in effect, legislates the ATO's interpretation of this phrase as per TR 2006/6, paragraph 21.</p>
<p>INHERITED DEDUCTIONS – ACA [Part 9]</p> <p><i>Effective dates:</i></p> <ul style="list-style-type: none"> • <i>Div 43 impacts on entry – 1 July 2002</i> • <i>Div 43 impacts on exit –</i> 	<p>Division 43 related ACA impacts</p> <p>This amendment clarifies the impact of future Division 43 capital allowance deductions (i.e. buildings and capital works expenditure) on the entry ACA step 7 amount and the exit ACA step 2 amount.</p> <p>It was already clear that in respect of such assets acquired after 13 May 1997 these ACA adjustments did not arise because Division 43 deductions reduce the CGT cost base of the associated asset (s.110-45), but the position in relation to such assets acquired before 13 May 1997 was problematic.</p>

Aspect	Comment
<p>10 February 2010</p> <ul style="list-style-type: none"> Reduction of exit ACA – 10 February 2010 	<p>By way of this proposed amendment, it will be confirmed that in respect of Division 43 buildings and capital works acquired before 13 May 1997, there should similarly be no amount included in the entry ACA step 7 amount or the exit ACA step 2 amount.</p>
	<p>Reducing exit ACA</p> <p>In addition, amendments are proposed such that on exit, the inherited deduction amount added in exit ACA step 2 will be the deduction amount multiplied by the corporate tax rate; i.e. 30% of the deduction amount. This will reduce the total exit ACA amount (and hence reduce the recalculated cost base of the shares in the leaving entity) below what it otherwise would have been.</p>
<p>GENERAL INSURANCE COMPANIES [Part 10]</p> <p>Effective date: 1 July 2002</p>	<p>For general insurance companies, these amendments will dove-tail entry and exit ACA calculations with the specific Schedule 2J provisions dealing with unearned premium reserves, outstanding claimed liabilities, deferred acquisition costs and reinsurance expenses, etc.</p>
<p>NON-MEMBERSHIP EQUITY INTERESTS [Part 20]</p> <p>Effective dates:</p> <ul style="list-style-type: none"> Electively from 1 July 2002 to 10 February 2010 Compulsorily from 10 February 2010 	<p>This measure had not previously been announced, but will alter entry ACA and exit ACA calculations where the relevant joining entity or leaving entity has on issue non-membership equity interests that are not otherwise recognised as a liability of the entity for accounting purposes.</p> <p>If such non-membership equity interests are on issue by a joining entity, then the entry ACA will be increased in relation to such interests, and conversely, in a leaving entity situation, the exit ACA (and the recalculated cost base of membership interests in the leaving entity) will be reduced.</p> <p>An example of such a non-membership equity interest can be a convertible note if it is not recognised under accounting standards as a liability and is also not a Division 974 'debt interest'. Similarly, a right or option to acquire a membership interest in the joining or leaving entity can also fall into this category.</p>
<p>OTHER ASPECTS</p>	
<p>CHOICES [Part 18]</p> <p>Effective date: 1 July 2002</p>	<p>This amendment will change the way in which the following consolidation choices will be made:</p> <ul style="list-style-type: none"> the choice to form a consolidated or MEC group (including conversion of consolidated group to a MEC group under a special conversion event); the choice for a new eligible tier-1 company to become a member of a MEC group; and the choice for a new provisional head company to be appointed when the previous provisional head company becomes ineligible. <p>Under current law, those choices must be made in the 'approved form' and the requirements have been interpreted strictly by the ATO. That has led to the ATO arguing in some situations that, for example, consolidated groups have not validly formed due to clerical errors or other defects in the form. The new law will simply require the choice to be made 'in writing' and the choice will not be required to be given to the ATO.</p> <p>The new law will also make it explicit that the Commissioner does not have the power to extend the time in which the choices listed above may be made. This addition entrenches the decision of the Full Federal Court in <i>McIntosh</i>.</p>
<p>MECs AND BLACK HOLES [Part</p>	<p>This is a technical amendment that will ensure that consistent treatment applies to the head company of a MEC group that currently applies to other consolidated groups, such that costs paid to third parties in respect of intra-group transactions</p>

Greenwoods & Freehills

Aspect	Comment
14]	affecting CGT assets of the group can be added to the CGT cost base of the asset as an incidental cost (s.110-35).

Effective date: 1 July 2005
