

Aspect	Comment	Part
<b>A JOINING ENTITY ASPECTS</b>		
Use of cost setting amount <i>Effective date: 1 July 2002</i>	<p>It is proposed that subsection 701-55(6) be totally reworded. This redrafted provision would apply such that for purposes other than for the capital allowance, trading stock, qualifying security and CGT provisions, the tax cost setting amount attributable to an asset will be taken to be either: the cost of the asset; the outgoings incurred or amount paid in respect of the asset; or expenditure in respect of the asset, for the purposes of determining the joined group's assessable income and allowable deductions. However, Division 43 building allowance deductions will not be impacted.</p> <p>Hence, this redrafted provision seeks to overcome the restricted interpretation that the ATO had applied to the existing subsection 701-55(6). While the existing provision reset the cost of an asset, it did not similarly deem there to be an outgoing or expenditure at that time in respect of the asset necessary for the purposes of obtaining section 8-1 deductions, etc.</p> <p>As illustrated in the examples contained in the draft Explanatory Memorandum, by way of this new provision additional deductible amounts could become available in relation to the following types of assets held by a joining entity: trade receivables, consumable stores, long-term construction contracts, deferred management fees, traditional securities, other assets held on revenue account, and afforestation assets. Therefore, it is apparent that this amendment could have some very significant tax impacts.</p> <p>However, the redrafted provision continues to evidence some tension and possible ambiguity, in that a specific note to this section indicates that this deemed acquisition does not affect the operation of the entry history rule; ie that the entry history rule must still apply for other purposes, including in determining the revenue or capital status of the asset, etc.</p>	1A
FX receivables – transitional <i>Effective date: 1 July 2002 (up to 22 August 2006)</i>	<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 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 This draft ruling was withdrawn on 22 August 2006 following the former Government's announcement that it would modify the operations of subsection 701-55(6).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 <u>not</u> extend to any gain or loss 'attributable to currency exchange rate fluctuations' which will then be subject to Division 775. The proposed method for determining the amount of the ultimate gain that falls into this category, as outlined in the ED Explanatory Memorandum at paragraph 1.28, has regard to movements in exchange rates from the joining time. However, many corporate groups will no doubt have pragmatically applied alternative methods for making this CGT/Division 775 split.</p> <p>In addition, the proposed provisions in no way seek to provide any guidance as to the scope of the term 'FX trade receivables'.</p>	1B

Aspect	Comment	Part
No double counting – ACA <i>Effective date: 1 July 2002</i>	<p>Where a particular amount has been taken into account twice in calculating the ACA of a joining entity, this ‘doubling up’ is to be eliminated with only the most ‘appropriate’ single impact being utilised.</p> <p>In a number of circumstances tax losses of a joining entity may indirectly have reduced the ACA step 1 amount, and also reduced the ACA via either step 3 or step 5 – hence a quite clear and beneficial application of this proposed measure. It is also apparent that this measure will address the entry ACA issue whereby a subsection 705-75(1) reduction of a liability amount due to its future deductibility (eg employee leave provisions) could in many cases have otherwise been negated by an offsetting section 705-80 adjustment.</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 most corporate groups.</p>	4
Pre-joining time roll-overs <i>Effective date: 1 July 2002</i>	<p>This amendment will significantly extend the scope of ACA adjustments related to prior CGT roll-overs by broadening the application of section 705-93 (and also, in effect, incorporating section 705-150 which is then to be repealed). This extended scope involves including in a section 705-93 ACA adjustment pre-joining time asset roll-overs from ‘stick’ entities, a transitional foreign-held subsidiary, a head company, an ET-1 entity or a non-resident.</p> <p>The pre-existing provisions only encompassed roll-overs from non-residents and a head company.</p> <p>In particular, the inclusion of prior roll-overs from ‘stick’ entities could in some cases have very significant and adverse ACA implications.</p>	5
Over-depreciation phase-out <i>Effective date: 8 May 2007</i>	<p>The section 705-50 over-depreciation reduction of a joining entity’s ACA will be modified so that 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.</p> <p>While eligibility for dividend rebates generally terminated at 1 July 2002, in certain limited circumstances rebates continued to apply until 1 July 2004 (section 46AC). Therefore, by only having to have regard to rebateable dividends paid within 5 years of the joining time, these difficult section 705-50 adjustments will cease to be relevant in all circumstances for joining times occurring on or after 1 July 2009 – but in most circumstances, the adjustment will cease to be relevant from 1 July 2007.</p>	6
Retained cost base assets <i>Effective date: 1 July 2002</i>	<p>The range of retained cost base assets will be extended 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’ (eg the joining entity was a 100% subsidiary but the head company had not elected at that time to form a consolidated group).</p> <p>This new retained cost base asset category will only apply to rights to receive a payment for work or goods (other than trading stock) if, at the joining time, a recoverable debt has not arisen but it is reasonable to expect that a recoverable debt will arise in relation to the right.</p> <p>Given that the retained cost base of such 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 this income is subsequently derived the full amount will be assessable.</p>	11

Aspect	Comment	Part
CGT event L7: pre-8 May 2007 <i>Effective date: 1 July 2002</i>	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) or a greater amount (CGT loss). This provision has always been plagued with compliance and conceptual problems.  As a result, CGT event L7 will be totally repealed with effect from 8 May 2007, but for potential CGT event L7 events occurring prior to that time the CGT gain/loss will be reduced if the discharge of the relevant liability has directly or indirectly otherwise been included in the consolidated group's taxable income or tax losses.	13
CGT event L7: post-8 May 2007 <i>Effective date: 8 May 2007</i>	Unfortunately, there is still some ambiguity as to the operation of these new 'anti-double impact' amendments to apply up to 8 May 2007. For example, will the fact that an employee leave provision is subsequently extinguished for a lesser amount qualify for this CGT event L7 exemption, given that otherwise the section 8-1 deductions available to the group would have been greater?	14
CGT event L3: doubtful debts <i>Effective date: 8 May 2007</i>	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.  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.	15
Transitional concessions: SAPs <i>Effective date: 1 July 2002</i>	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.	17
<b>B LEAVING ENTITY ASPECTS</b>		
Pre-CGT proportions <i>Effective date: 1 July 2002</i>	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.  Therefore, 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 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.	2

Aspect	Comment	Part
Leaving time liabilities <i>Effective date: 1 July 2002</i>	<p>In calculating the exit ACA step 4 amount in respect of liabilities, the proposed amendments can have the following 2 impacts:</p> <ul style="list-style-type: none"> <li>• clarifying that the liabilities taken into account in working out the step 4 amount are liabilities <u>just before</u> the leaving time (being an issue addressed in the recent Court decision of <i>Handbury Holdings</i> 2008 ATC 20-071); and</li> <li>• where a leaving accounting liability will only subsequently be deductible (eg employee leave provisions) then if that same liability was present at the joining time an exit ACA adjustment is to be made if the exit ACA step 4 amount in respect of that liability would otherwise differ from the prior entry ACA step 2 amount in respect of that liability.</li> </ul> <p>This 'leaving' and 'joining' parity adjustment is also to be extended to certain other ACA elements including employee share interests, certain ADI preference shares and equity interests that are regarded as debt under Division 974.</p> <p>No legislative recognition is proposed to be given to the total impracticality of attempting to undertake such calculations in respect of employee leave provisions and other accounting provisions (although in the context of the proposed amendment to CGT event L7, the draft Explanatory Memorandum does note that seeking to trace such liability amounts over a period of time 'places a significant compliance cost burden on affected groups').</p>	7
Subdivision 165-CD <i>Effective date: 1 July 2002</i>	<p>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.</p> <p>Generally, by way of these proposed 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.</p> <p>Therefore, for most <u>Australian listed entities</u> 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>Importantly, however, this new blanket Subdivision 165-CD exemption does not extend to an Australian sub-group of a foreign listed company.</p>	18

Aspect	Comment	Part
<b>C BOTH ENTITY AND LEAVING ASPECTS</b>		
Group restructures <i>Effective date: 27 October 2006</i>	<p>These proposed new provisions are to address anomalous outcomes that can arise where, as a result of a group restructure, a consolidated group converts to a MEC group or a MEC groups converts to a consolidated group. Unfortunately, these amendments are to only apply to such restructures occurring on or after 27 October 2006.</p> <p>In such circumstances, in most respects the tax attributes (including the tax value of assets) of continuing (ie pre-existing) group entities will remain unchanged. In particular, exit ACA impacts and entry ACA resetting of the tax value of assets will not be triggered. 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 ET-1 or ceases to become an ET-1 (including the application of the cost base pooling rules and Subdivision 719-K).</p> <p>Various other provisions can also potentially apply in relation to any tax or CGT losses of the group.</p>	2
Accounting principles – ACA <i>Effective date: 1 July 2002</i>	<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 (2008 ATC 20-012).</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>	8
Inherited deductions – ACA <i>Effective date: 1 July 2002</i>	<p>This amendment clarifies the impact of future Division 43 capital allowance deductions (ie 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 <u>after 13 May 1997</u> these ACA adjustments did not arise because Division 43 deductions reduce the CGT cost base of the associated asset (section 110-45), but the position in relation to such assets acquired <u>before 13 May 1997</u> was problematic.</p> <p>By way of this proposed amendment, it will be confirmed that in respect of Division 43 buildings and capital works acquired <u>before 13 May 1997</u>, there should similarly be no amount included in the entry ACA step 7 amount or the exit ACA step 2 amount.</p> <p>In addition, amendments are proposed such that on exit, the inherited deduction amount in exit ACA step 2 will be the deduction amount multiplied by the corporate tax rate; ie 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>There will also be further technical refinements to entry ACA step 7 such that inherited deductions will also not include deductions for expenditure that form part of or reduce the cost base of an asset because of the operations of the entry history rule (as well as the single entity rule as currently stated in the relevant provision).</p>	9
General insurance companies <i>Effective date: 1 July 2002</i>	<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>	10

Aspect	Comment	Part
<b>D OTHER ASPECTS</b>		
Nil available fraction <i>Effective date: 1 July 2002</i>	<p>Where the liabilities of a joining entity exceed the market value of its assets, then any losses of the joining entity will enter the group with a nil available fraction (and as such, they will be of no ongoing use to the group). If in such circumstances these same joining time liabilities subsequently trigger adverse tax implications for the group either via either the commercial debt forgiveness provisions (Division 245 in Schedule 2C), the limited recourse debt provisions (Division 243) or on the subsequent exit of a group entity under CGT event L5 (section 104-520), then the head company can choose to reduce or eliminate this adverse impact by an amount up to the quantum of the associated nil available fraction losses.</p> <p>An important proviso is that the head company has continued to satisfy the COT or SBT in respect of these nil available fraction losses. In addition, this important concession will not apply if the losses obtain even a very low available fraction.</p>	12
MECs and black holes <i>Effective date: 1 July 2005</i>	<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 affecting CGT assets of the group can be added to the CGT cost base of the asset as an incidental cost (section 110-35).</p>	16

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