Consolidation integrity measures introduced into Parliament

16 February 2018

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In brief

Legislation was introduced into Federal Parliament on 15 February 2018 to give effect to the long-awaited tax consolidation integrity measures. Following consultation on these measures over the last few years, tax consolidated groups now have certainty in relation to the manner in which these integrity measures affect the tax cost setting rules in respect of entities that either join or leave their group.

The measures broadly apply in the same manner as they were previously reflected in the exposure draft law that was released for comment in September 2017, but there has been some welcome changes.

In detail

The Bill, *Treasury Laws Amendment (Income Tax Consolidation Integrity) Bill 2018*, includes all of the previously announced integrity measures that impact the tax cost setting rules when an entity joins and/or leaves a tax consolidated or multiple entry consolidated (MEC) group. These integrity measures are summarised in the table below.

New integrity measures	Arrangements which commence on or after…
Disregard certain deductible liabilities (for example, employee leave entitlements) from the tax cost setting calculation when an entity joins the group (the 'deductible liabilities' measure).	1 July 2016
Ensure that deferred tax liabilities (DTLs) are disregarded in both entry and exit tax cost setting calculations.	15 February 2018
Remove anomalies that arise when an entity holding securitised assets joins or leaves the group (the 'securitised assets' measure).	• for ADIs or financial entities - 7.30pm (AEST) 13 May 2014, subject to transitional rules; • for all other entities - 7.30pm (AEST) 3 May 2016.

Prevent the tax cost setting of assets in certain circumstances when a foreign resident ceases to hold certain membership interests in a joining entity (the 'anti-churn' measure).	14 May 2013
Clarify the outcomes that arise when an entity holding an intra-group financial arrangement leaves the group (the 'TOFA' measure).	the commencement of the TOFA regime (in most cases, income years commencing on or after 1 July 2010), subject to a transitional rule
Clarify the treatment of intra-group liabilities when an entity leaves the group (the 'value-shifting' measure).	14 May 2013

It is important to note that these measures broadly apply based on the time that an arrangement under which an entity has joined or left a group has commenced. This is not necessarily the same time that the entity has actually become or ceased to be a subsidiary member of the group.

Further background in relation to the effect of each of these measures is summarised in our TaxTalk Alert released on 14 September 2017.

Some welcome changes which have been made to the last exposure draft law are noted below.

Clarifying the deductible liabilities measure

The deductible liabilities measure operates in the broad manner in which it was announced in the 2016-17 Federal Budget (i.e. disregarded from step two of the entry allocable cost amount (ACA) calculation). The Bill lists those accounting liabilities of insurance companies that will continue to be recognised in the entry tax cost setting process.

The Explanatory Memorandum (EM) to the Bill includes some welcome clarifications. Firstly, it clarifies that an amount of an unearned income liability that may be reflected in financial statements is 'not typically' a deductible liability. In addition, in relation to the adjustment made to step three of the entry ACA calculation to ensure that any excluded deductible liability is also not taken into account when working out the accrued undistributed taxed profits of the joining entity, the EM includes an example which confirms that the tax-effected amount of the deductible liability is applicable.

Disregarding all DTLs on exit

The Bill ensures that DTLs are disregarded under the exit tax cost setting rules for all arrangements under which an entity ceases to be a subsidiary member that commence on or after 15 February 2018. There is no longer the qualification that the leaving entity had its DTLs excluded on entry under the amending law.

This is a welcome change as it means that existing groups will not have to monitor the time at which a subsidiary member joins the group when seeking to exclude DTLs from the exit calculation.

Limited deferral of anti-churn measure

The anti-churn measure continues to apply with retrospective effect to 14 May 2013. However, in recognition of the fact that the scope of the measure was expanded in the September 2017 exposure draft law, the Bill provides a transitional rule that ensures that participation interests of associates are only to be taken into account when determining the control entity in the joining subsidiary in respect of

arrangements that commence on or after 15 February 2018. This ensures that taxpayers who have undertaken transactions in the past are not unfairly disadvantaged by what was an unforeseen extension of this provision.

The Bill also ensures that there is no double counting of participation interests in working out the requisite level of control in the joining entity.

The anti-churn measure is perhaps the most complex of the new integrity measures. The law in this respect is drafted very broadly. It can clearly apply when the joining entity was not initially part of a wholly-owned global group, and it can potentially apply to transactions that are not merely internal reorganisations involving a foreign parent.

The takeaway

All of the measures included in this Bill are critical to understand for any future M&A deals.

As the majority of the measures included in this Bill have retrospective effect, it is also imperative that all tax consolidated groups that have had an entity join or leave their group in the past few years consider the effect of the rules, and whether there is a need to revisit past tax cost setting calculations and if so, whether any prior year income tax assessments are affected.

There may be financial reporting implications as a result of the new measures, in particular deferred tax balances, which will need to be taken into account when preparing financial reports once the measures are substantively enacted.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

Wayne Plummer, Sydney
+61 (2) 8266 7939
wayne.plummer@pwc.com

Lisa Steadman, Sydney
+61 (2) 8266 3493
lisa.j.steadman@pwc.com

Jason Karametos, Melbourne
+61 (3) 8603 6233
jason.karametos@pwc.com

Kirsten Arblaster, Melbourne
+61(3) 8603 6120
kirsten.arblaster@pwc.com

Robert Bentley, Perth
+61 (8) 9238 5202
robert.k.bentley@pwc.com

Julian Myers, Brisbane
+61 (7) 3257 8711
julian.myers@pwc.com

Lynda Brumm, Brisbane
+61 (7) 3257 5471
lynda.brumm@pwc.com

Alistair Hutson, Adelaide
+61 (8) 8218 7467
alistair.hutson@pwc.com

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