Consolidation: Potential risk areas

1 March 2014

The tax consolidation rules should remain high on any group's assessment of potential tax risks - specifically, the looming deadline for amending assessments to give effect to 'unwind' the rights to future income (RTFI) and residual tax cost setting rules; as well as the proposed, but still unenacted, legislative changes which may apply back to 14 May 2013.

Retrospective law - deadline looming

In recent times the Australian Taxation Office has been very active in issuing detailed questionnaires to companies which it believes may have made claims affected by the RTFI and residual tax cost setting rule amendments.

No doubt such activity is due to the fact that there is little more than three months to go before the 29 June 2014 deadline expires for amending assessments (where otherwise out of time) as a consequence of the provisions enacted in 2012 to 'unwind' the RTFI and residual tax cost setting rules.

As previously reported, the ATO has only recently issued a series of Draft Taxation Determinations which outline the Commissioner's preliminary view as to the operation of the 'application provisions' to the 2012 amendments. For joining times after 30 March 2011, the application provisions are relatively clear. However for joining times on or before that time, it is necessary to determine which of the 'pre-rules', 'interim rules' or even the 'original 2002' law applies. The recently issued draft determinations address various scenarios that relate to whether or not an assessment/amended assessment has issued in the context of determining which of the particular amendments apply.

Here is a list of some of some of the issues which we recommend warrant particular consideration:

- Deductions claimed for non-contractual intangibles such as 'over-burden removal' and 'customer relationships' held by entities on joining the tax consolidated group. The ability to claim these deductions was removed with retrospective effect by the 2012 amendments.
- Deductions for 'in-the-money' derivatives that are not subject to the specific taxation of financial arrangements rules. Many groups have claimed deductions for the reset tax cost of such derivatives (including commodity, interest rate and currency swaps and options). The ATO has released Interpretative Decisions (ATO ID 2013/46 and ATO ID 2013/47) adopting a position that deductions are not available for the reset tax cost of commodity swap contracts.
- For all joining times since 2002, deductions can be claimed for the tax cost setting amount for consumables.
- Utilising a cost base (for capital gains tax purposes) for the reset tax cost of non-deductible RTFI assets (under the 'pre-rules'). When the dust settled after the 2012 'unwind' amendments, we ended up not only without a deduction for RTFI assets, but with no direct CGT cost base for assets such as customer contracts. According to TD 2014/D2, the tax cost setting amount of such an asset that was worked out under the original 2002 law and which

has not been used to calculate a net capital gain included in any assessment issued before 12 May 2010 will not be preserved.

- An RTFI deduction claimed under the 'interim rules' should be carefully reviewed to adjust the claim for any value attributable to a period beyond the time the relevant contract could be unilaterally cancelled by the customer.
- Any RTFI deduction claimed under the interim rules that contributed to a tax loss. According to TD 2014/D3, the utilisation of the tax loss in a subsequent year will not be subject to the same protection that applied under the interim rules and may need to be reduced.

Note that where a tax shortfall arises from applying the 2012 amendments, legislative protection against interest and penalties has been provided to taxpayers, but only in respect of joining times which occurred before 30 March 2011.

More consolidation amendments on the way

The Government confirmed on 6 November 2013 that it will be proceeding with the following consolidation measures announced in the 2013-14 Federal Budget which are proposed to apply to transactions that take place after 7.30pm AEST on 14 May 2013:

- Future deductible liabilities (e.g. employee leave entitlements) of a joining entity will result in the head company of the joined group including a corresponding amount in its assessable income
- Non-residents will not be able to buy and sell membership interests between consolidated groups to allow the same ultimate owner 'to claim double deductions' through the resetting of the tax cost of the assets of the relevant joining entity without any recognition under the non-resident capital gains tax (CGT) rules
- Intra-group assets will no longer be recognised for purposes of applying 'principal asset test' in working out whether an indirect Australian real property interest held by a foreign resident is subject to CGT
- Consolidated groups will not be able to access double deductions by shifting the value of assets between entities, i.e. when an encumbered asset, whose market value has been reduced due to the intra-group creation of rights over the encumbered asset, is sold by a consolidated group
- Only net gains and losses will be recognised for tax purposes for certain intra-group liabilities and assets that are subject to the taxation of financial arrangements (TOFA) regime, upon exit of a member from a consolidated group.

Further details of these measures can be found in our Federal Budget alert.

At this stage it is unknown when we will see the legislative detail to give effect to these proposals, but given the element of retrospectivity and in many cases, the lack of detail, it is hoped that they will receive top priority in terms of public consultation/exposure draft legislation and subsequent passage of the amending legislation through Parliament.

These measures largely originated from the Board of Taxation's post-implementation review of the consolidation regime. The remaining recommendations from the Board's review which the former Government agreed to 'in principle' are expected to be considered as part of a broader review of consolidation issues to be undertaken by Treasury in 2015. Also proceeding is last year's tripartite review, chaired by Treasury and involving the ATO and the private sector, to examine and implement policies to ensure that multiple entry consolidated groups and Australian consolidated groups compete on a level playing field. Any changes resulting from that review are intended to apply from 1 July 2014, although we expect the Government has reserved the right to take earlier legislative action, including with effect from the date of Federal Budget announcement (i.e. 14 May 2013), if it becomes aware of aggressive tax minimisation practices over the course of its review.

It is also worth noting that on 14 December 2013, as part of the Government's commitment to clear the backlog of tax

measures, it indicated that the following consolidation-related measures are no longer proceeding:

- address minor technical deficiencies in respect to calculation and collection of income tax liabilities for consolidated groups
- application of the consolidation rules to a demerger
- change the depreciation rates so as to prevent access to the 200 per cent diminishing value 'uplift factor' for depreciating assets acquired by the joining entity before 10 May 2006
- clarify the tax outcome for the beneficiaries of a trust that joins or leaves a consolidated group part way through the income year, and
- modify the CGT integrity rules to address interactions with the consolidation regime.

Some of these issues were addressed by the Board of Taxation's post-implementation review and as such may again be considered in next year's Treasury review. In the interim, it will be relevant to see the Government's proposed legislative measure to protect taxpayers who may have self-assessed on the basis of any announced measure that will no longer proceed.

Let's talk

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

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

Derek Ivers
+61 (2) 8266 8451
derek.ivers@au.pwc.com

Paul Abbey
+61 (3) 8603 6733
paul.abbey@au.pwc.com

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

© 2014 PricewaterhouseCoopers. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers a partnership formed in Australia, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity. This publication is a general summary. It is not legal or tax advice. Readers should not act on the basis of this publication before obtaining professional advice. PricewaterhouseCoopers is not licensed to provide financial product advice under the Corporations Act 2001 Cth). Taxation is only one of the matters that you need to consider when making a decision on a financial product. You should consider taking advice from the holder of an Australian Financial Services License before making a decision on a financial product.

Liability limited by a scheme approved under Professional Standards Legislation.