



Australian Government

The Board of Taxation

26 April 2013

The Hon David Bradbury
Assistant Treasurer and
Minister Assisting for Deregulation
Parliament House
CANBERRA ACT 2600

Dear Minister

**POST-IMPLEMENTATION REVIEW OF CERTAIN ASPECTS OF THE
CONSOLIDATION TAX COST SETTING PROCESS**

We are writing to provide you with the Board of Taxation's report on the post-implementation review of certain aspects of the consolidation tax cost setting process.

On 3 June 2009, the Government announced that it had asked the Board to undertake a post-implementation review of certain aspects of the consolidation regime.

During the course of this review, on 30 March 2011, the Government requested that the Board conduct a review of the consolidation rights to future income and residual tax cost setting rules. The Board concluded this review and provided its findings to the Government in a report dated 31 May 2011.

The Board provided its report on the first stage of the post-implementation review into certain aspects of the consolidation regime to you in June 2012 (the 2012 Consolidation Report). The first stage focused on the policy framework for the consolidation regime, the operation of the single entity rule, interactions between the consolidation regime and other parts of the law, and the operation of the consolidation regime for small business corporate groups.

The Board noted in the 2012 Consolidation Report that the Board considers that the consolidation regime has delivered substantial efficiency and integrity improvements to the Australian tax system when compared with the income tax grouping rules which wholly-owned groups previously had to apply. However, the Board also acknowledged that there is substantial complexity in the operation of the consolidation regime and its implementation has been attended by some difficulties.

In the second stage of this post-implementation review, the Board reviewed the tax treatment of liabilities and the tax cost setting treatment of goodwill in the consolidation regime. The Board also looked further into the treatment of deferred tax liabilities and the interaction between the consolidation regime and certain parts of the CGT rules.

The Board has made a number of recommendations regarding these aspects of the consolidation regime.

First, the Board recommends that rules should be introduced to include the amount of deductible liabilities added at step 2 of the entry tax cost setting process in assessable income (either over a 12 month period or over a 48 month period following joining time, depending on whether the liability is a current or non-current liability for accounting purposes).

Second, the Board recommends removal of deferred tax liabilities from the entry and exit tax cost setting process.

Third, the Board recommends removal of the adjustment which applies if the head company's accounting value of a liability is different to the joining entity's accounting value of the liability from the entry tax cost setting process. The Board also recommends removal of the adjustment for unrealised gains and losses on liabilities from the entry tax cost setting process in full acquisition cases.

Fourth, the Board recommends modifications to the entry and exit tax cost setting rules where there is asymmetry in the recognition of assets and related liabilities.

Finally, the Board recommends simplified or systemic CGT rules for small to medium sized business groups to reduce the complexity and high compliance costs they face when entering the consolidation regime (further comments in this regard are in the attachment to this letter), as well as amendments to the CGT event J1 rules to rectify the duplication of capital gains and losses on certain disposals.

This report has included references to some of the Board's comments and recommendations in the 2012 Consolidation Report. This may need to be taken into account when considering the release of the reports.

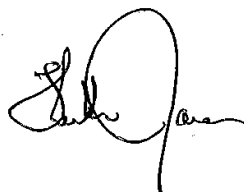
The Secretary to the Treasury, Martin Parkinson PSM, the Commissioner of Taxation, Chris Jordan AO, and the First Parliamentary Counsel, Peter Quiggin PSM, have reserved their final views on the issues canvassed in the attached report for advice to Government.

A copy of this letter is also being provided to the Deputy Prime Minister and Treasurer.

Yours sincerely



Teresa Dyson
Chair
Board of Taxation



Keith James
Chairman of the Board's Working Group
Deputy Chairman, Board of Taxation

Threshold test

Chapter 7 of the Board's report is in relation to the Board's recommendations with regard to some CGT issues identified during the course of the post-implementation review into certain aspects of the consolidation regime.

The chapter refers to the Board's 2012 Consolidation Report, where the Board recommended ongoing simplified formation rules for small to medium sized corporate groups that have an aggregated turnover of less than \$50 million in the prior income year to assist them with entering the consolidation regime (Recommendation 6.1 of the 2012 Consolidation Report).

The rationale underlying these recommendations is that small to medium sized groups that are growing would be able to consolidate at an appropriate time without significant tax consequences. The \$50 million turnover threshold was chosen because data suggested that corporate groups with a higher turnover are already able to enter consolidation without the need for special formation rules.

The Board notes in Chapter 7 that, if these recommendations are implemented, the CGT rollover issues become significantly less prevalent for small to medium sized corporate groups.

Nevertheless, it is inevitable that some corporate groups will fail to consolidate before reaching the \$50 million turnover and therefore will still be disadvantaged due to the various outcomes that arise under the different CGT rollovers.

To reduce this concern, if the Government agrees to the recommendations in the Board's 2012 Consolidation Report, the Board considers that the threshold should be increased to a \$100 million turnover threshold (originally considered in the Board's October 2010 Position Paper¹). This would be sufficient to capture business groups which had failed to consolidate before reaching the \$50 million turnover and is consistent with the small and medium sized business threshold contained in the Taxation of Financial Arrangements provisions.²

¹ Board of Taxation, *Post Implementation Review into Certain Aspects of the Consolidation Regime* Position Paper (October 2010)

² Section 230-5 of the *Income Tax Assessment Act 1997*