

EXPOSURE DRAFT

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TREASURY LAWS AMENDMENT (2017 MEASURES NO. 9) BILL 2017:  
CONSOLIDATION

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EXPLANATORY MEMORANDUM



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## **Glossary**

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
AASB	Australian Accounting Standards Board
ADI	authorised deposit-taking institution
April 2013 Report	Board of Taxation Report on the on the <i>Post-implementation review of certain aspects of the consolidation tax cost setting process</i> , finalised in April 2013
Commissioner	Commissioner of Taxation
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
June 2012 Report	Board of Taxation Report on the <i>Post-implementation review of certain aspects of the consolidation regime</i> , finalised in June 2012
MEC group	multiple entry consolidated group
TOFA	Taxation of Financial Arrangements



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# Chapter 1

## Consolidation

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### Outline of chapter

1.1 Schedule # to this Exposure Draft Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to improve the integrity of the consolidation regime by:

- removing a double benefit that can arise in respect of certain liabilities held by an entity that joins a consolidated group (the deductible liabilities measure);
- simplifying the operation of the entry and exit tax cost setting rules by ensuring that deferred tax liabilities are disregarded (the deferred tax liabilities measure);
- removing anomalies that arise when an entity joins or leaves a consolidated group where the entity has securitised an asset (the securitised assets measure);
- switching off the entry tax cost setting rules for a joining entity where a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded in certain circumstances (the churning measure);
- clarifying the operation of the Taxation of Financial Arrangements (TOFA) provisions when an intra-group asset or liability that is, or is part of, a Division 230 financial arrangement emerges from a consolidated group because a subsidiary member leaves the group (the TOFA measure); and
- removing anomalies that arise when an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group because the value of the asset taken into account for tax cost setting purposes is not always appropriate (the value shifting measure).

1.2 All legislative references in this Chapter are to the ITAA 1997 unless otherwise indicated.

## Context of amendments

1.3 The consolidation regime applies primarily to a wholly owned group of Australian resident entities that chooses to form a consolidated group for income tax purposes. A consolidated group generally consists of an Australian resident head company and all of its wholly owned resident subsidiaries.

1.4 Specific rules also allow certain resident wholly owned subsidiaries of a foreign holding company to consolidate by forming a multiple entry consolidated group (a MEC group). Unless otherwise specified, references in this Chapter to a consolidated group include a MEC group.

1.5 If a wholly owned group of entities chooses to form a consolidated group or MEC group, the group is treated as a single entity for income tax purposes.

1.6 The consolidation regime was introduced in 2002. The Board of Taxation commenced a post implementation review of certain aspects of the consolidation regime in 2009. As a result of its review, the Board presented two reports:

- the first report (*Post-implementation review of certain aspects of the consolidation regime*) was finalised in June 2012 (the June 2012 Report); and
- the second report (*Post-implementation review of certain aspects of the consolidation tax cost setting process*) was finalised in April 2013 (the April 2013 Report).

1.7 Schedule # to this Exposure Draft Bill implements recommendations made by the Board of Taxation in these Reports to improve the integrity of the consolidation regime. It also implements other changes which are consistent with the Board's recommendations.

1.8 In particular, the integrity of the consolidation regime will be improved by implementing the following measures:

- the deductible liabilities measure;
- the deferred tax liabilities measure;
- the securitised assets measure;
- the churning measure;

- the TOFA measure; and
- the value shifting measure.

1.9 These measures (except for the deferred tax liabilities measure and the securitised assets measure) were originally announced by the former Government in the 2013-14 Budget.

1.10 The application of the securitised assets measure to approved deposit-taking institutions (ADIs) and financial entities was announced by the Government in the 2014-15 Budget.

1.11 In the 2016-17 Budget, as part of the Tax Integrity Package, the Government announced:

- changes to the deductible liabilities measure to modify the approach for implementing the measure and to defer the start date for the measure until 1 July 2016;
- the deferred tax liabilities measure; and
- the extension of securitised assets measure to all entities.

## Summary of new law

1.12 Schedule # to this Exposure Draft Bill amends the ITAA 1997 to improve the integrity of the consolidation regime. In particular:

- the deductible liabilities measure removes a double benefit which can arise in respect of certain deductible liabilities held by an entity that joins a consolidated group by excluding the value of deductible liabilities from the entry allocable cost amount, with effect from 1 July 2016;
- the deferred tax liabilities measure simplifies the operation of the entry and exit tax cost setting rules by ensuring that deferred tax liabilities are disregarded, with effect from the date of introduction of the amending legislation;
- the securitised assets measure removes anomalies that arise when an entity that has securitised assets joins or leaves a consolidated group by modifying the tax cost setting rules to disregard liabilities relating to the securitised assets, with effect from:
  - for ADIs and financial entities — 13 May 2014; and

- for all other entities — 3 May 2016;
- the churning measure switches off the entry tax cost setting rules for a joining entity where a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded and there has been no change in the majority economic ownership of the joining entity for a period of at least 12 months before the joining time, with effect from 14 May 2013;
- the TOFA measure clarifies the operation of the TOFA provisions by setting a tax value for an intra-group asset or liability that is, or is part of, a Division 230 financial arrangement when the asset or liability emerges from a consolidated group because a subsidiary member leaves the group, with effect from 14 May 2013; and
- the value shifting measure removes anomalies that arise when an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group by ensuring that the amount taken into account under the exit tax cost setting rules for the asset is aligned with the tax cost setting amount for the corresponding asset of the leaving entity, with effect from 14 May 2013.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The deductible liabilities measure will remove a double benefit which can arise in respect of certain deductible liabilities held by an entity that joins a consolidated group by excluding the amount of deductible liabilities from the entry allocable cost amount.	When an entity that holds a deductible liability becomes a member of a consolidated group, a double benefit arises because: <ul style="list-style-type: none"> <li>• the liability increases the allocable cost amount for the joining entity; and</li> <li>• the head company can claim a deduction in respect of the liability when the relevant expenditure is incurred.</li> </ul>
The deferred tax liabilities measure will simplify the operation of the entry and exit tax cost setting rules by ensuring that deferred tax liabilities	For the purposes of working out the entry and exit tax cost setting amount, adjustments are made to take account of deferred tax liabilities of a joining

of a joining entity or leaving entity are disregarded.	entity or leaving entity.
<p>The securitised assets measure will modify the entry and exit tax cost setting rules to remove anomalies that arise when an entity that has securitised assets joins or leaves a tax consolidated group by ensuring that the corresponding liability is disregarded.</p> <p>The measure will generally apply in relation to an entity that joins or leaves a consolidated group under an arrangement that commences on or after the 2016 Budget time.</p> <p>However, if the joining or leaving entity has entered into a securitisation arrangement and is an ADI or financial entity, then, subject to transitional rules, the measure applies in relation an arrangement that commences on or after the 2014 Budget time.</p>	<p>If an entity that joins or leaves a tax consolidated group has securitised assets, a mismatch occurs under the entry and exit tax cost setting rules because the securitised asset and the corresponding liability are not recognised in the same way for tax consolidation purposes.</p>
<p>The churning measure will switch off the entry tax cost setting rules for a joining entity where a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded and there has been no change in the majority economic ownership of the joining entity for a period of at least 12 months before the joining time.</p>	<p>When an entity is acquired by a consolidated group from a foreign resident, the entry tax cost setting rules apply to reset the tax costs of the joining entity's assets even a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded.</p>
<p>The TOFA measure will set a tax value for an intra-group asset or liability that is, or is part of, a Division 230 financial arrangement when the asset or liability emerges from a consolidated group because a subsidiary member leaves the group. This will clarify the operation of the TOFA provisions to these financial arrangements.</p>	<p>The tax value for an intra-group asset or liability that is, or is part of, a Division 230 financial arrangement which emerges from a consolidated group because a subsidiary member leaves the group is unclear. As a result, the operation of the TOFA provisions to these financial arrangements is also unclear.</p>
<p>The value shifting measure will remove anomalies that arise when an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group</p>	<p>When an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group, the amount taken into account under the exit tax cost</p>

<p>by ensuring that the amount taken into account under the exit tax cost setting rules for the asset is aligned with the tax cost setting amount for the corresponding asset of the leaving entity.</p>	<p>setting rules for the asset is:</p> <ul style="list-style-type: none"><li>• the market value of the asset; or</li><li>• in limited circumstances, an amount that reflects the tax cost of the asset.</li></ul> <p>As a result, circumstances arise where economic gains made by the old group are sheltered from the appropriate tax consequences.</p>
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## Detailed explanation of new law

1.13 This Exposure Draft Bill implements some of the recommendations made by the Board of Taxation to improve the integrity of the consolidation regime. In particular:

- the deductible liabilities measure (Part 1 of Schedule # to this Exposure Draft Bill) removes a double benefit which can arise in respect of certain deductible liabilities held by an entity that joins a consolidated group by excluding the value of deductible liabilities from the entry allocable cost amount;
- the deferred tax liabilities measure (Part 2 of Schedule # to this Exposure Draft Bill) simplifies the operation of the entry and exit tax cost setting rules by ensuring that deferred tax liabilities are disregarded;
- the securitised assets measure (Parts 3 and 4 of Schedule # to this Exposure Draft Bill) removes anomalies that arise when an entity that has securitised assets joins or leaves a tax consolidated group by modifying the tax cost setting rules to disregard liabilities relating to the securitised assets;
- the churning measure (Part 5 of Schedule # to this Exposure Draft Bill) switches off the entry tax cost setting rules for a joining entity where a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded and there has been no change in the majority economic ownership of the joining entity for a period of at least 12 months before the joining time;
- the TOFA measure (Part 6 of Schedule # to this Exposure Draft Bill) clarifies the operation of the TOFA provisions by setting a tax value for an intra-group asset or liability that is,

or is part of, a Division 230 financial arrangement when the asset or liability emerges from a consolidated group because a subsidiary member leaves the group; and

- the value shifting measure (Part 7 of Schedule # to this Exposure Draft Bill) removes anomalies that arise when an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group by ensuring that the amount taken into account under the exit tax cost setting rules for the asset is aligned with the tax cost setting amount for the corresponding asset of the leaving entity.

### **Part 1 — The deductible liabilities measure**

1.14 The deductible liabilities measure in Part 1 of Schedule # to this Exposure Draft Bill removes a double benefit which can arise in respect of certain deductible liabilities held by an entity that joins a consolidated group by excluding the amount of deductible liabilities from the entry allocable cost amount.

1.15 One of the objects of the consolidation regime (as set out in section 700-10) is to prevent double taxation and a double tax benefit from being realised by a consolidated group.

1.16 The Board of Taxation raised concerns that a consolidated group can obtain a double benefit in respect of deductible liabilities held by a joining entity that is acquired by the group (see Chapter 2 of the Board's April 2013 Report). That is, when an entity joins a consolidated group holding a deductible liability:

- a benefit arises under the tax cost setting rules because the liability increases the allocable cost amount for the joining entity and therefore contributes to the tax cost that is set; and
- a second benefit arises because the head company can claim a deduction for the liability when the relevant expenditure is incurred.

1.17 To overcome these concerns, the Board initially recommended (Recommendation 2.1 of the Board's April 2013 Report) that, broadly, where a consolidated group obtains a double benefit because an acquired deductible liability is included in step 2 of the entry allocable cost amount, then:

- in the case of a deductible liability that is a current liability for accounting purposes — an equivalent amount should be included in the assessable income of the head company over the 12 month period following the joining time; and
- in the case of a deductible liability that is a non-current liability for accounting purposes — an equivalent amount should be included in the assessable income of the head company over the four year period following the joining time.

1.18 Following the release of exposure draft legislation to implement the Board's recommendation, stakeholders raised concerns that it would operate in circumstances where a double tax benefit may not necessarily arise in practice — for example, where the allocable cost amount contributes to the tax costs of certain intangible assets (such as goodwill) held by a joining entity that are retained permanently by the group.

1.19 Stakeholders also raised concerns about the complexity of the recommended approach because it would require different treatment to deductible liabilities that are 'acquired' and those that are 'owned'.

1.20 These concerns were raised with the Board and the approach for addressing the issue was reviewed. As a result of that review, the Board concluded that, in practice, the approach originally recommended could give rise to unfair tax outcomes in some circumstances. Therefore, although there is no perfect solution to address the integrity concerns, the Board concluded that a fairer approach would be to reduce the amount at step 2 of the entry tax cost setting amount by the amount of deductible liabilities.

1.21 This revised approach was announced as part of the 2016-17 Budget as a better targeted measure designed to prevent a consolidated group from obtaining a double taxation benefit when an entity joins a group. In addition, given the complexity of the issues involved and its impact on commercial arrangements, the start date of the measure was deferred until 1 July 2016.

1.22 The revised approach applies to accounting liabilities of a joining entity, irrespective of whether the joining entity becomes a member of the consolidated group because it is acquired by the group or because of the formation of a new group.

***Deductible liabilities excluded from step 2***

1.23 Step 2 of the entry allocable cost amount increases the amount of the allocable cost amount for a joining entity by, broadly, the amount of the joining entity's accounting liabilities.

1.24 The operation of the consolidation tax cost setting rules will be modified so that, with the exception of those liabilities that are specifically referred to in paragraphs 705-70(1AC)(a) or (b), an amount will not be added at step 2 for an accounting liability that is a deductible liability. *[Schedule #, Part 1, item 1, subsection 705-70(1AB)]*

1.25 An accounting liability is a deductible liability if, assuming that the head company had made a payment to discharge the accounting liability just after the joining time, that payment would result in an amount that reflects all or part of the accounting liability being a deduction to the head company of the group. *[Schedule #, Part 1, item 1, paragraph 705-70(1AA)(b)]*

1.26 Typical examples of accounting liabilities held by a joining entity at the joining time that are deductible liabilities are:

- an accounting provision that is expensed, where the deduction for tax purposes is allowed at a later time (such as an accrued leave liability);
- a derivative liability that is out of the money (and is not covered by TOFA); and
- a foreign currency liability that is in a net forex loss position.

1.27 The amount of these accounting liabilities is often based on an estimate of a future liability. Consequently, the quantum of the future deductible amount may be unclear.

1.28 However, for the purpose of working out the amount of an accounting liability that is a deductible liability, the head company must determine, based on the facts of the joining entity at the joining time, whether a deduction would arise in respect of all or part of the liability. The amount of the deductible liability is the amount that the head company of the group would need to pay to discharge the liability just after the joining time (even if there is no legal obligation to discharge the liability at that time). This outcome does not change if, after the joining time, it is established that, in fact:

- the liability does not give rise to a deduction; or

- the liability gives rise to a deduction but for a different amount.

1.29 If the head company would be entitled to a deduction as a result of the discharge of the accounting liability (or a part of the accounting liability) just after the joining time, the amount that would be deductible is not added for that liability at step 2 of the entry allocable cost amount.

### **Example 1.1**

Head Co acquires all of the membership interests in Joining Co on 30 September 2018. At the joining time, Joining Co holds an accounting liability that is a provision for long service leave of \$150,000. Under Joining Co's long service leave policy, employees accrue long service leave from the first day of their employment, but employees are not entitled to take the leave until they have completed five years of employment.

Joining Co's long service leave liability at the joining time is a mixture of long service leave entitlements for both:

- employees are entitled to take the leave because they have completed five years of employment; and
- employees are not entitled to take the leave because they have not yet completed five years of employment.

After the joining time, Head Co can deduct an amount for long service leave when it is paid to an individual to whom the leave relates (or, if the individual has died, to that individual's dependant or legal personal representative) (section 26-10).

For the purpose of working out whether the accounting liability is a deductible liability, and the amount of that liability, Head Co must assume that, just after the joining time:

- all of the conditions for making long service leave payments are met in relation to all employees;
- all of the conditions for claiming a deduction were met; and
- it makes a payment to discharge the full amount of the Joining Co's long service leave liability.

In this regard, Head Co would need to make a payment of \$150,000 to discharge the long service leave liability just after the joining time and, as the requirements in section 26-10 would be taken to be satisfied, the amount of the deductible liability would be \$150,000. Therefore, the amount of the long service leave liability (\$150,000) is not added at step 2 of the entry allocable cost amount for Joining Co.

1.30 If the head company would be entitled to a deduction for part of an accounting liability, the net amount of the accounting liability that would be deductible is not added for that liability under step 2 of the entry allocable cost amount.

### **Example 1.2**

Head Co acquires all of the membership interests in Joining Co on 1 July 2018. At the joining time, Joining Co holds an accounting liability that is a foreign currency loan payable of AUD\$100,000. The original loan amount was AUD\$75,000. The original loan matures on 1 July 2020.

The movement in the foreign currency loan is recognised as an accounting liability on the balance sheet of Joining Co. At the joining time the net increase in respect of the foreign currency loan is AUD\$25,000.

Head Co would be entitled to deduct an amount for the net foreign currency loss if the foreign currency loan obligation was discharged just after the joining time (under Division 775).

The amount of Joining Co's accounting liability that would be deductible to Head Co is AUD\$25,000. Therefore, the amount of AUD\$25,000 of the foreign currency loan is not added at step 2 of the entry allocable cost amount for Joining Co.

1.31 Where an accounting liability is not included at step 2 of the entry allocable cost amount, no adjustments are required in respect of that accounting liability under section 705-75 or section 705-80 — these sections adjust the amount of an accounting liability that is included in step 2 in certain circumstances.

1.32 Similarly, where an entity joins a consolidated group by way of a group acquisition under Subdivision 705-C, the deductible liabilities of the acquired group (which is treated as the joining entity) are not included at step 2 of the acquiring group's entry allocable cost amount.

### ***Certain deductible liabilities continue to be included at step 2***

1.33 An amount in relation to an accounting liability that is a deductible liability will not be added at step 2 of the entry allocable cost amount to the extent that the liability is covered by subsection 705-70(1AC). Subsection 705-70(1AC) covers all accounting liabilities other than those liabilities that are specifically referred to in paragraphs 705-70(1AC)(a) or (b). [*Schedule #, Part 1, item 1, subsection 705-70(1AC)*]

1.34 The existing tax cost setting rules will continue to apply to a liability to the extent that a liability is covered by a provision referred to in paragraph 705-70(1AC)(a), or arises under a contract of a type referred to in paragraph 705-70(1AC)(b). Consequently:

- an amount in respect of these liabilities will continue to be added at step 2 of the entry allocable cost amount; and
- the adjustments to the step 2 amount that are made by sections 705-75 and 705-80, to the extent that they are relevant, will continue to apply to these liabilities.

*[Schedule #, Part 1, items 1, 2 and 3, paragraph 705-70(1AA)(a), paragraphs 705-70(1AC)(a) and (b), and subsections 705-75(1A) and 705-80(1A)]*

1.35 The liabilities that are referred to in paragraphs 705-70(1AC)(a) or (b) are broadly:

- life insurance policy liabilities;
- policy liabilities of general insurance companies;
- accounting liabilities that are financial arrangements covered by the TOFA rules;
- outstanding claims liabilities of private health insurers; and
- liabilities relating to certain retirement village contracts.

1.36 In this regard, in its April 2013 Report (at paragraphs 2.9 to 2.11), the Board of Taxation concluded that the tax cost setting changes to deductible liabilities should not apply to insurance policy liabilities or to TOFA liabilities.

1.37 The Board also noted that the treatment of retirement village contract liabilities should be considered during the implementation of its recommendations (see footnote 17 of the April 2013 Report).

*Life insurance policy liabilities*

1.38 Section 713-520 applies when a life insurance company joins a consolidated group to set a value for the following types of policy liabilities for consolidation purposes:

- complying superannuation liabilities;
- exempt life insurance policy liabilities;

- liabilities under the net investment component of ordinary life insurance policies; and
- liabilities under the net risk component of life insurance policies.

1.39 If a life insurance company joins a consolidated group then, to the extent that section 713-520 applies in relation to its liabilities, the existing tax cost setting rules will continue to apply to those liabilities. *[Schedule #, Part 1, items 1, 2 and 3, paragraph 705-70(IAA)(a), subparagraph 705-70(1AC)(a)(i) and subsections 705-75(1A) and 705-80(1A)]*

1.40 However, if the liability is a deductible liability and the accounting value of the liability exceeds the value that is recognised under section 713-520, then the excess value will not be added to step 2 of the entry tax cost amount setting.

*Policy liabilities of general insurance companies*

1.41 Section 713-710 applies when a general insurance company joins a consolidated group to set a value for the following types of liabilities for taxation purposes:

- outstanding claims liabilities; and
- the unearned premium reserve.

1.42 The outstanding claims liabilities of a general insurance company are essentially a provision for future claims and are deductible liabilities for income tax purposes.

1.43 The unearned premium reserve of a general insurance company represents a proportion of gross premiums recognised as being earned in a subsequent accounting period. Unearned premiums are an accounting liability in the form of an obligation to provide insurance cover over a future period of risk and are deductible liabilities for income tax purposes.

1.44 If a general insurance company joins a consolidated group, then to the extent that section 713-710 applies in relation to its liabilities, the existing tax cost setting rules will continue to apply to those liabilities. *[Schedule #, Part 1, items 1, 2 and 3, paragraph 705-70(IAA)(a), subparagraph 705-70(1AC)(a)(ii) and subsections 705-75(1A) and 705-80(1A)]*

1.45 However, if the accounting value of the liability exceeds the value that is recognised under section 713-510, then the excess value will not be added to step 2 of the entry tax cost amount setting.

*Accounting liabilities that are financial arrangements covered by the TOFA rules*

1.46 Section 715-375 applies to an accounting liability that is taxed under the TOFA rules — that is, the section applies if:

- an accounting liability of a joining entity can or must be recognised in the entity's statement of financial position; and
- the accounting liability is, or is a part of, a Division 230 financial arrangement of the head company at the joining time.

1.47 If an accounting liability of a joining entity is, or is a part of, a Division 230 financial arrangement, then to the extent that the liability is covered by section 715-375, the existing tax cost setting rules (other than the section 705-80 adjustment) will continue to apply to those liabilities. *[Schedule #, Part 1, items 1, 2 and 3, paragraph 705-70(IAA)(a), subparagraph 705-70(IAC)(a)(iii) and subsections 705-75(IA) and 705-80(IA)]*

*Outstanding claims liabilities of private health insurers*

1.48 The outstanding claims liabilities of private health insurers are essentially a provision for the future payment of claims that have arisen from insured events that have already happened. Private health insurers can claim a deduction in relation to outstanding claims liabilities under the general deduction provision in the income tax law (section 8-1) when the claims are incurred for income tax purposes.

1.49 Therefore, if a *private health insurer* (within the meaning of the *Private Health Insurance (Prudential Supervision) Act 2015*) joins a consolidated group, then to the extent that a liability is an outstanding claims liability that the private health insurer has already deducted (under section 8-1), the existing tax cost setting rules will continue to apply to those liabilities. *[Schedule #, Part 1, items 1, 2 and 3, paragraph 705-70(IAA)(a), subparagraph 705-70(IAC)(a)(iv) and subsections 705-75(IA) and 705-80(IA)]*

1.50 However, if the accounting value of the liability exceeds the value that has already been deducted for income tax purposes, then the excess value will not be added to step 2 of the entry tax cost amount setting.

*Liabilities relating to retirement village contracts*

1.51 If a joining entity is a retirement village operator, then the existing tax cost setting rules will continue to apply to an amount in respect of an accounting liability of the joining entity to the extent that the liability arises under:

- a *retirement village residence contract* held by a joining entity — which is defined in paragraph 230-475(4)(a) to mean a contract that gives rise to a right to residential premises in a retirement village; or
- a *retirement village services contract* held by a joining entity — which is defined in paragraph 230-475(4)(a) to mean a contract under which a resident of a retirement village is provided with general or personal services in the retirement village.

*[Schedule #, Part 1, items 1, 2 and 3, paragraphs 705-70(1AA)(a) and 705-70(1AC)(b), and subsections 705-75(1A) and 705-80(1A)]*

### **Step 3 of the entry tax cost setting rules**

1.52 Step 3 of the entry tax cost setting amount (section 705-90) increases the allocable cost amount for a joining entity to take account of the undistributed, taxed profits of a joining entity that accrue to the group before the joining time. The purpose of the step 3 amount is to prevent double taxation of those profits.

1.53 The step 3 amount is worked out by reference to the undistributed retained profits of the joining entity (subsection 705-90(2)). In this regard, the deductible liabilities of the joining entity effectively reduce the amount of retained profits. Therefore, to the extent that deductible liabilities are excluded from step 2 of the allocable cost amount under new subsection 705-70(1AA), the allocable cost amount will be reduced twice by the same amount.

1.54 In this regard, section 705-62 operates to prevent double counting of amounts in the allocable cost amount. The section applies if, broadly, two or more provisions operate with the result of altering the allocable cost amount for the joining entity because of a particular economic attribute of the joining entity (subsection 705-62(2)). However, as there is no specific provision that captures the step 3 alteration for deductible liabilities, the alteration is not covered by this general rule.

1.55 Therefore, to the extent that an accounting liability that is a deductible liability is excluded from step 2 under new subsection 705-70(1AB), that liability is not to be taken into account for the purposes of working out the undistributed profits of the joining entity under subsection 705-90(2). *[Schedule #, Part 1, item 5, subsection 705-90(2B)]*

1.56 This will prevent the double counting of the same amount where step 3 of the allocable cost amount applies to a joining entity.

***Operation of the exit tax cost setting rules***

1.57 Step 4 of the exit tax cost setting amount (section 711-45) reduces the old group's allocable cost amount for a leaving entity by the amount of the accounting liabilities that the leaving entity takes with it.

1.58 When an accounting liability that a leaving entity takes with it was brought into the consolidated group by a joining entity (and was therefore taken into account under the entry tax cost setting rules), the step 4 amount needs to be worked out having regard to the treatment of the liability on entry.

1.59 In working out the step 4 amount for an accounting liability that is a deductible liability:

- subsection 711-45(3) applies to reduce the step 4 amount of the liability by the value of the future tax deduction;
- if the liability is taken into account for income tax purposes at a later time than it is for accounting purposes, subsection 711-45(5) applies to adjust the step 4 amount of the liability (sometimes to nil); and
- if the liability was taken into account in working out the entry allocable cost amount, subsections 711-45(8) to (10) apply to adjust the step 4 amount of the liability so that, generally, it is equal to the entry amount.

1.60 The changes to prevent deductible liabilities (other than excluded liabilities) from being added to step 2 of the entry allocable cost amount generally apply to a joining entity that becomes a member of a consolidated group under an arrangement entered into on or after 1 July 2016. Therefore, following those changes, there are four categories of liabilities that need to be considered for the purposes of working out the exit step 4 amount:

- deductible liabilities (other than liabilities that are specifically referred to in paragraphs 705-70(1AC)(a) or (b) of the leaving entity brought into a group by a joining entity after 1 July 2016 (post-July 2016 joining time deductible liabilities);
- liabilities that are specifically referred to in paragraphs 705-70(1AC)(a) or (b) brought into a group by a joining entity after 1 July 2016 (post-July 2016 joining time excluded deductible liabilities);

- deductible liabilities of the leaving entity brought into a group by a joining entity before 1 July 2016 (pre-July 2016 joining time deductible liabilities); and
- deductible liabilities of the leaving entity that come into existence in the group (group deductible liabilities).

1.61 Section 711-45 will operate to produce the appropriate outcome for each category of deductible liabilities of the leaving entity, as outlined in Table #.1. As a consequence, no changes are being made to the exit tax cost setting rules.

**Table 1.1: Deductible liabilities of a leaving entity**

<i>Category of deductible liabilities</i>	<i>Application of step 2 of entry allocable cost amount</i>	<i>Application of step 4 of exit allocable cost amount</i>
Post-July 2016 joining time deductible liabilities	Not included subsection 705-70(1AB)	Subsection 711-45(3) reduces step 4 amount Subsection 711-45(5) adjusts step 4 amount (generally to nil) Subsection 711-45(8) to (10) do not apply to the extent that the deductible liability is not added at step 2 of the entry allocable cost amount
Post-July 2016 joining time excluded deductible liabilities	Included paragraph 705-70(1AC)(a) and (b)	Subsection 711-45(3) may reduce the step 4 amount Subsection 711-45(5) may adjust step 4 amount Subsection 711-45(8) to (10) may apply to adjust the step 4 amount to the amount added at step 2 of the entry allocable cost amount
Pre-July 2016 joining time deductible liabilities	Included section 705-70	Subsection 711-45(3) reduces step 4 amount Subsection 711-45(5) may adjust step 4 amount Subsection 711-45(8) to (10) may apply to adjust the step 4 amount to the amount added at step 2 of the entry allocable cost amount

Deductible liabilities that come into existence in the group	Not included	Subsection 711-45(3) reduces step 4 amount Subsection 711-45(5) may adjust step 4 amount Subsection 711-45(8) to (10) do not apply
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***Consequential amendments***

1.62 Section 705-80 adjusts the entry step 2 amount for a liability that is recognised for accounting purposes but is taken into account at a later time for income tax purposes. The section refers to accrued employee leave liabilities and foreign exchange gains and losses as examples of the types of liabilities affected by the adjustment.

1.63 As accrued employee leave liabilities and foreign exchange gains and losses are deductible liabilities that will not be added to the step 2 amount because of new section 705-70(1AA), a consequential amendment removes the examples from section 705-80. *[Schedule #, Part 1, item 4, section 705-80]*

***Application***

1.64 The deductible liabilities measure applies in relation to an entity that becomes a subsidiary member of the group under an arrangement that commences on or after 1 July 2016. *[Schedule #, Part 1, item 13]*

1.65 The time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. *[Schedule #, Part 8, item 31]*

**Part 2 — The deferred tax liabilities measure**

1.66 The deferred tax liabilities measure in Part 2 of Schedule # to this Exposure Draft Bill will simplify the operation of the entry and exit tax cost setting rules by disregarding deferred tax liabilities.

1.67 Deferred tax liabilities are an accounting concept that measures a future tax liability. In essence, they represent the amount of income tax payable by an entity in future periods on temporary differences between accounting and tax.

1.68 When an entity joins a consolidated group, the accounting liabilities of the joining entity are recognised under step 2 of the entry tax cost setting rules. The step 2 amount is adjusted for any deferred tax liabilities of the joining entity (subsection 705-70(1A)).

1.69 Similarly, when an entity leaves a consolidated group, the accounting liabilities that the leaving entity takes with it are recognised under step 4 of the exit tax cost setting rules. There is no specific exit tax cost setting rule to adjust the step 4 amount for any deferred tax liabilities of the leaving entity.

1.70 The Board of Taxation considered issues that arise with the recognition of deferred tax liabilities under the entry and exit tax cost setting rules in Chapter 3 of its April 2013 Report. The Board recommended that the adjustments relating to deferred tax liabilities in the entry and exit tax cost setting rules be removed (Recommendation 3.1 of the Board's April 2013 Report). In this regard, at paragraph 3.19 of the Report, the Board concluded that:

‘this will reduce the circumstances in which tax outcomes will differ from commercial outcomes. It will also reduce the complexity of the consolidation regime and overcome integrity concerns that arise with the recognition of deferred tax liabilities.’

***Deferred tax liabilities disregarded under entry tax cost setting rules***

1.71 When an entity joins a tax consolidated group, the value of the joining entity's accounting liabilities increase the entry allocable cost amount (step 2 of the entry allocable cost amount worked out under section 705-70).

1.72 In working out the value of the joining entity's accounting liabilities, deferred tax liabilities will be disregarded. That is, an amount will not be added at step 2 for an accounting liability that is an amount recorded in a deferred tax liability account in accordance with the joining entity's accounting principles for tax cost setting. [*Schedule #, Part 2, item 7, subsection 705-70(1B)*]

1.73 The joining entity's accounting principles for tax cost setting are the accounting principles that the joining entity would use if it were to prepare its financial statements just before the joining time (subsection 705-70(3)).

1.74 Currently, subsection 705-70(1A) applies to adjust the step 2 amount for a liability where an accounting liability of the joining entity would be different when it became a member of the joined group. This adjustment primarily applies where the accounting liability is a deferred tax liability.

1.75 As the amendment repeals subsection 705-70(1A), the entry step 2 amount will no longer be adjusted by the amount worked out under that subsection. As the calculations required to work out this adjustment were very complex, this modification will reduce the complexity of the

consolidation regime and overcome integrity concerns that arise with the recognition of deferred tax liabilities.

***Deferred tax liabilities disregarded under exit tax cost setting rules***

1.76 When an entity leaves a tax consolidated group, the value of the joining entity's accounting liabilities reduce the exit allocable cost amount (step 4 of the exit allocable cost amount worked out under section 711-45).

1.77 In working out the value of the leaving entity's accounting liabilities, deferred tax liabilities will be disregarded. That is, an amount will not be added at step 4 for an accounting liability that is an amount recorded in a deferred tax liability account in accordance with the leaving entity's accounting principles for tax cost setting. *[Schedule #, Part 2, item 8, subsection 711-45(1B)]*

1.78 The leaving entity's accounting principles for tax cost setting are the accounting principles that the consolidated group would use if it were to prepare its financial statements just before the leaving time (subsection 711-45(1A)).

***Application***

1.79 The deferred tax liabilities measure applies in relation to an accounting liability of entity that becomes a subsidiary member of a consolidated group under an arrangement that commences on or after the start of the day on which this Exposure Draft Bill is introduced into the House of Representatives. *[Schedule #, Part 2, subitem 9(1)]*

1.80 The time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. *[Schedule #, Part 8, item 31]*

1.81 In addition, the deferred tax liabilities measure generally applies in relation to an accounting liability of entity that ceases to be a subsidiary member of a consolidated group under an arrangement that commences on or after the start of the day on which this Exposure Draft Bill is introduced into the House of Representatives. *[Schedule #, Part 2, subitem 9(2)]*

1.82 However, the measure does not apply in relation to an accounting liability of entity that ceases to be a subsidiary member of a consolidated group if, under an arrangement that commenced before the start of the day on which this Exposure Draft Bill is introduced into the House of Representatives, the accounting liability was taken into account for the purposes of working out the entry tax cost setting amount for a joining entity. *[Schedule #, Part 2, subitem 9(3)]*

1.83 Therefore, if a deferred tax liability of a leaving entity was brought into a consolidated group by a joining entity, then:

- if the deferred tax liability was disregarded for the purposes of working out step 2 of the entry allocable cost amount because of new section 705-70(1A), it will also be disregarded for the purposes of working out step 4 of the exit allocable cost amount; or
- if the deferred tax liability was taken into account for the purposes of working out step 2 of the entry allocable cost amount, it will continue to be taken into account for the purposes of working out step 4 of the exit allocable cost amount.

### **Parts 3 and 4 — The securitised assets measure**

1.84 The securitised assets measure in Parts 3 and 4 of Schedule # to this Exposure Draft Bill removes anomalies that arise when an entity that has securitised assets joins or leaves a tax consolidated group by modifying the tax cost setting rules so that liabilities relating to the securitised assets are disregarded, with effect from:

- for ADIs and financial entities — 13 May 2014; and
- for all other entities — 3 May 2016.

1.85 The Board of Taxation considered issues that arise where an asset is not recognised for tax consolidation purposes but a related accounting liability is recognised (or vice versa) in Chapter 5 of its April 2013 Report. In practice, the main scenario where this issue arises is when an entity joins or leaves a tax consolidated group holding assets that are subject to a securitisation arrangement.

1.86 In this regard, at paragraphs 5.13 to 5.15 of its April 2013 Report, the Board stated that:

For example, in the case of a mortgage loan securitisation arrangement, where a financial institution's interest in mortgages is equitably assigned:

- the consideration received for the assignment is recognised as an accounting liability and therefore is taken into account under the entry and exit tax cost setting rules; and
- the mortgage loan asset (being the assigned mortgage loan), which is recognised as an asset for accounting purposes, may not be

recognised as an asset for tax purposes and therefore may have no tax cost allocated to it under the entry or exit tax cost setting rules.

As a result, in the case of a securitised asset held by an entity that joins a consolidated group, a mismatch that is beneficial to the group may arise because the accounting liability increases the entry tax cost setting amount but no tax cost is allocated to the securitised asset (the value of the accounting liability is instead allocated to other reset cost base assets held by the joining entity).

However, in the case of a securitised asset held by an entity that leaves a consolidated group, a mismatch that is detrimental to the group may arise because the accounting liability reduces the exit tax cost setting amount, so that the tax cost allocated to the leaving entity's shares is understated (with the result that the group makes a higher capital gain on the disposal of those shares).

1.87 Securitisation is a financing arrangement that typically involves the interest held by an ADI or financial entity in certain financial assets (such as residential mortgages) being equitably assigned to a special purpose vehicle.

1.88 Typically, the special purpose vehicle raises the funds to purchase the assets from the ADI or financial entity by issuing debt securities to investors.

1.89 The ADI or financial entity holds the residual income rights in the special purpose vehicle and gets a return equal to, broadly, the difference between the payments due on the notes and the amounts receivable on the assets, net of fees associated with the securitisation arrangement. This has the advantage of allowing the ADI or financial entity to diversify its funding.

1.90 While securitisation arrangements are common in the financial industry, such arrangements can also be entered into as a means of financing by entities that are not ADIs or financial entities in some circumstances.

1.91 A problem arises under the consolidation tax cost setting rules when an entity that holds securitised assets joins or leaves a consolidated group. In certain circumstances, the relevant Australian accounting standard issued by the Australian Accounting Standards Board (AASB) requires an entity to continue to recognise the underlying securitised assets on its balance sheet despite the equitable assignment of those assets to the special purpose vehicle for valuable consideration (see Accounting Standard AASB 139). In addition, the entity is required to recognise an accounting liability for the consideration received from the special purpose vehicle.

1.92 In these circumstances a mismatch can arise because the consolidation tax cost setting rules recognise the value of the associated accounting liability, but the underlying securitised assets may not be recognised as assets. This is because the assets do not have economic value in the hands of the joining entity as a result of being equitably assigned to the special purpose vehicle.

1.93 As a result of this mismatch, when an entity that has securitised assets joins a tax consolidated group, the value of the accounting liability is allocated to other assets held by the joining entity. This outcome arises because the underlying securitised assets have no or little value. As a result:

- the tax costs of those other assets are overstated; and
- to the extent that there are insufficient assets to absorb the increased tax value, the head company may realise an artificial capital loss.

1.94 When an entity that has securitised assets leaves a tax consolidated group, the accounting liability reduces the tax value that is allocated to the membership interests held by the group in the leaving entity. As a result, the group will make a higher capital gain on the disposal of the membership interests in the leaving entity because:

- the tax costs of membership interests are understated; and
- to the extent that the accounting liabilities exceed the value of the leaving entity's assets, the tax costs of the membership interests will be nil and the head company will make a capital gain equal to the amount of the excess.

1.95 To overcome this anomaly, an accounting liability arising from the transfer or equitable assignment of the securitised assets will effectively be disregarded for entry and exit tax cost setting purposes. This outcome is consistent with Recommendation 5.1 of the Board's April 2013 Report.

1.96 These changes apply from the 2014 Budget time where a member of the relevant group is an ADI or a financial entity.

1.97 The changes apply to all groups from the 2016 Budget time. That is, from the 2016 Budget time, the requirement that a member of the relevant group is an ADI or a financial entity will no longer apply.

1.98 Securitisation arrangements typically involve ancillary agreements, such as agreements that relate to swap arrangements, liquidity

facilities and other standby facilities. Any accounting liabilities arising from ancillary agreements do not arise from the transfer or equitable assignment of the underlying securitised assets and therefore are not securitisation liabilities covered by these amendments.

***Securitisation liabilities disregarded under entry tax cost setting rules***

1.99 When an entity joins a tax consolidated group, the value of the joining entity's accounting liabilities increase the entry allocable cost amount (step 2 of the entry allocable cost amount worked out under section 705-70). However, no amount is added at step 2 for the liability if the accounting liability is a securitisation liability (as defined in section 705-76). *[Schedule #, Part 3, item 10, subsection 705-70(4)]*

1.100 An accounting liability is a securitisation liability if:

- the liability:
  - arose from the transfer or equitable assignment of one or more assets (the underlying securitised assets) by the joining entity to another entity before the joining time; and
  - is a liability of the joining entity at the joining time according to the accounting principles that the joining entity would use if it were to prepare financial statements just before the joining time;
- the other entity was established for the purpose of securitising assets — this will be determined by applying ordinary commercial principles;
- the underlying securitised assets were securitised in accordance with that purpose before the joining time; and
- at the joining time, the market value of the joining entity's interest in the underlying securitised assets was nil (so that the interest in underlying securitised assets is not recognised as an asset for tax consolidation purposes), or was substantially less than the amount of the securitisation liability — this requirement ensures that, regardless of what the entity recognised, at law there is a mismatch between the value of the joining entity's interest in the securitised assets recognised for tax consolidation purposes and the value of the securitisation liability.

*[Schedule #, Part 3, item 11, section 705-76]*

1.101 The underlying securitised assets will be transferred or equitably assigned for these purposes if those assets are taken to be transferred or equitably assigned for the purposes of the relevant Australian accounting standards. This ensures that the full range of circumstances that can give rise to the current anomaly in the law are covered by these amendments.

1.102 In addition, if the joining entity was a member of another tax consolidated group (the old group) prior to the joining time, the single entity rule (section 701-1) applied to the joining entity when it was a member of the old group. However, that rule has no effect for the purpose of determining whether the joining entity transferred or equitably assigned the underlying securitised assets to another entity before the joining time. In this regard:

- the single entity rule applies to the old group only for the purpose of determining the old group's income tax liability or loss for an income year; and
- the single entity rule does not affect the joined group's ability to determine whether, in fact, a transfer or assignment took place while the joining entity was a member of the old group.

1.103 If an entity becomes a member of a tax consolidated group under an arrangement that commenced between the 2014 Budget time and the 2016 Budget time, an accounting liability of the joining entity will be a securitisation liability only if, at the joining time, a member of the joined group is an ADI or a financial entity (as defined in subsection 995-1(1)). *[Schedule #, Part 3, item 11, paragraph 705-76(a)]*

1.104 In this regard, when the measure was announced as part of the 2014 Budget, it was restricted to circumstances where a member of the joined tax consolidated group is an ADI or a financial entity because securitisation arrangements are primarily undertaken by these types of entities.

1.105 However, securitisation arrangements are also entered into as a means of financing by entities that are not ADIs or financial entities in some circumstances. Therefore, as part of the 2016 Budget, the scope of the measure was extended so that it applies to all securitisation arrangements.

1.106 Consequently, from the 2016 Budget time, paragraph 705-76(a) will be removed so that an accounting liability of a joining entity will be a securitisation liability if the requirements in paragraphs 705-76(b) to (g) are satisfied, regardless of whether a member of the joined tax consolidated group is an ADI or a financial entity. *[Schedule #, Part 4, item 16]*

***Securitisation liabilities disregarded under exit tax cost setting rules***

1.107 When an entity leaves a tax consolidated group, the value of the joining entity's accounting liabilities decrease the exit allocable cost amount (step 4 of the exit allocable cost amount worked out under section 711-45). However, no amount is added at step 4 for the liability if the accounting liability is a securitisation liability (as defined in section 711-46). [*Schedule #, Part 3, item 12, subsection 711-45(11)*]

1.108 An accounting liability is a securitisation liability if:

- the liability:
  - arose from the transfer or equitable assignment of one or more assets (the underlying securitised assets) by the member of the old group to another entity before the leaving time; and
  - is a liability of the leaving entity at the leaving time according to the accounting principles that the leaving entity would use if it were to prepare financial statements just before the leaving time;
- the other entity was established for the purpose of securitising assets — this will be determined by applying ordinary commercial principles;
- the underlying securitised assets were securitised in accordance with that purpose before the leaving time; and
- at the leaving time, the market value of the leaving entity's interest in the underlying securitised assets was nil (so that the interest in the underlying securitised asset is not recognised as an asset for tax consolidation purposes), or was substantially less than the amount of the securitisation liability — this requirement ensures that, regardless of what the entity recognised, at law there is a mismatch between the value of the leaving entity's interest in the securitised assets recognised for tax consolidation purposes and the value of the securitisation liability.

[*Schedule #, Part 3, item 13, section 711-46*]

1.109 The underlying securitised assets will be transferred or equitably assigned for these purposes if those assets are taken to be transferred or equitably assigned for the purposes of the relevant Australian accounting

standards. This ensures that the full range of circumstances that can give rise to the current anomaly in the law are covered by these amendments.

1.110 If an entity leaves a tax consolidated group under an arrangement that commenced between the 2014 Budget time and the 2016 Budget time, an accounting liability of the leaving entity will be a securitisation liability only if, at the leaving time, a member of the old group is an ADI or a financial entity (as defined in subsection 995-1(1)). *[Schedule #, Part 3, item 13, paragraph 711-46(a)]*

1.111 Consistent with the joining case, from the 2016 Budget time, paragraph 711-46(a) will be removed so that an accounting liability of a leaving entity will be a securitisation liability if the requirements in paragraphs 711-46(b) to (g) are satisfied, regardless of whether a member of the tax consolidated group is an ADI or a financial entity. *[Schedule #, Part 4, item 17]*

#### ***Application to tax consolidated ADI groups***

1.112 If a member of a tax consolidated group is an ADI or a financial entity (a tax consolidated ADI group), the securitised assets measure applies in relation to an entity that joins or leaves the group under an arrangement that commences after the 2014 Budget time. The 2014 Budget time is 7.30 pm, by legal time in the Australian Capital Territory, on 13 May 2014 (the time of announcement of the measure). *[Schedule #, Part 3, subitems 14(1) and (7), and 15(1) and (6)]*

1.113 The time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. *[Schedule #, Part 8, item 31]*

1.114 Under the transitional rules, the securitised assets measure also applies in relation to an entity that:

- became a member of a tax consolidated ADI group under an arrangement that commenced before the 2014 Budget time in certain circumstances; or
- ceased to be a member of a tax consolidated ADI group under an arrangement that commenced before the 2014 Budget time in certain circumstances.

*[Schedule #, Part 3, subitems 14(2) to (7) and 15(2) to (6)]*

1.115 The transitional rules are consistent with observations made by the Board of Taxation directed at ensuring equitable outcomes for tax consolidated groups affected by anomalies that arise under the current law in relation to securitised assets and have been developed in consultation

with key stakeholders to ensure that taxpayers are not disadvantaged by the amendments. However, the transitional rules are also designed to prevent taxpayers from obtaining unexpected windfall gains.

***Transitional rules — Entity that became a member of a tax consolidated ADI group under a pre-2014 Budget time arrangement***

1.116 Under the joining case transitional rules, the securitised assets measure applies in relation to an entity that became a member of a tax consolidated ADI group under an arrangement that commenced before the 2014 Budget time in certain circumstances. [*Schedule #, Part 3, subitems 14(2) to (7)*]

1.117 The joining case transitional rules ensure that the position taken by the head company of a tax consolidated ADI group under the entry tax cost setting rules in relation to an arrangement entered into before the 2014 Budget time is maintained.

1.118 In addition, the joining case transitional rules ensure that the current law will apply to an arrangement entered into before the 2014 Budget time where the head company of the group first works out the entry allocable cost amount for a joining entity between the 2014 Budget time and the commencement of this measure.

1.119 The outcome that arises under the joining case transitional rules depends on whether or not, under the entry tax cost setting rules, the head company recognised:

- the securitisation liability held by the joining entity; or
- the securitised asset held by the joining entity.

*Securitisation liability recognised under the entry tax cost setting rules*

1.120 Where, under an arrangement that was entered into before the 2014 Budget time, the head company of a tax consolidated ADI group recognised the full securitisation liability held by the joining entity under the entry tax cost setting rules, the joining case transitional rules confirm this position.

1.121 Consequently, the securitisation liability is not removed from the entry allocable cost amount for a joining entity under an arrangement that was entered into before the 2014 Budget time if the Commissioner of Taxation (the Commissioner) considers that it is reasonable to conclude that:

- the circumstances in section 705-76 existed — that is, broadly:
  - at the joining time, a member of the joined group is an ADI or financial entity;
  - the joining entity was holding an accounting liability that is a securitisation liability; and
  - the market value of the joining entity's interest in the underlying securitised asset was nil, or was substantially less than the amount of the securitisation liability;
- the head company of the group worked out the group's allocable cost amount for the joining entity before the 2014 Budget time; and
- for the purpose of working out the step 2 amount, the head company added the full amount for the securitisation liability.

*[Schedule #, Part 3, subitem 14(3)]*

1.122 If the Commissioner is not satisfied that the circumstances in subitem 14(3) exist, the joining case transitional rules apply to ensure that the securitisation liability is not included in the entry allocable cost amount for the joining entity. *[Schedule #, Part 3, subitem 14(2)]*

*Securitised asset recognised under the entry tax cost setting rules*

1.123 In some cases, under an arrangement that was entered into before the 2014 Budget time, the head company of a tax consolidated ADI group that recognised a securitisation liability for the purpose of working out the step 2 amount for a joining entity may have worked out a tax cost setting amount for the interest in the securitised asset in order to eliminate or reduce the mismatch that would otherwise arise.

1.124 As the interest in the securitised asset is not recognised as an asset under the tax consolidation regime, the joining case transitional rules apply to reduce the tax consolidated ADI group's allocable cost amount for the joining entity by the tax cost setting amount allocated to the interest in the underlying securitised assets. *[Schedule #, Part 3, items 14(4) and (5)]*

1.125 This transitional rule applies only if the Commissioner considers that it is reasonable to conclude that, before the 2014 Budget time, the head company of the group worked out a tax cost setting amount for that interest. *[Schedule #, Part 3, items 14(4) and (5)]*

1.126 The purpose of this transitional rule is to prevent affected tax consolidated ADI groups from obtaining an unintended benefit by revising the tax cost setting calculations for a joining entity and allocating the value of the securitisation liability to the tax cost setting amounts of other assets.

1.127 However, the transitional rule minimises compliance costs for affected tax consolidated ADI groups as it ensures that the tax cost setting amounts for assets other than the interest in the securitised asset remain the same.

*Securitisation liability not recognised under the entry tax cost setting rules*

1.128 In some cases, under an arrangement that was entered into before the 2014 Budget time, the head company of a tax consolidated ADI group may not have recognised a securitisation liability under the entry allocable cost amount for a joining entity in order to eliminate or reduce the mismatch that would otherwise arise.

1.129 The joining case transitional rules apply to protect affected tax consolidated ADI groups that took this position. In addition, these tax consolidated ADI groups are prevented from obtaining an unintended benefit by revising the tax cost setting calculations for a joining entity to change the position that they took — that is, these groups are unable to revise the tax cost setting calculations for a joining entity by recognising a securitisation liability under the entry allocable cost amount for the joining entity. *[Schedule #, Part 3, items 14(2) and (3)]*

*No position taken prior to the 2014 Budget time*

1.130 The joining case transitional rules ensure that the current law will apply to an arrangement entered into before the 2014 Budget time where the head company of the tax consolidated ADI group first works out the entry allocable cost amount for a joining entity between the 2014 Budget time and the commencement of this measure. This will protect taxpayers that relied on the current law when they entered into a commercial transaction before the 2014 Budget time.

1.131 Consequently, the amendments will not apply where an entity entered into an arrangement before the 2014 Budget time and the Commissioner considers that it is reasonable to conclude that:

- the circumstances in section 705-76 existed — that is, broadly:

- at the joining time, a member of the joined group is an ADI or financial entity;
- the joining entity was holding an accounting liability that is a securitisation liability; and
- the market value of the joining entity's interest in the underlying securitised asset was nil, or was substantially less than the amount of the securitisation liability; and
- the head company of the group first worked out the group's allocable cost amount for the joining entity:
  - after the 2014 Budget time; and
  - before the date of Royal Assent for this Exposure Draft Bill.

*[Schedule #, Part 3, item 14(6)]*

1.132 If the Commissioner is not satisfied that the circumstances in subitem 18(6) exist, the joining case transitional rules apply to ensure that the securitisation liability is not included in the entry allocable cost amount for the joining entity. *[Schedule #, Part 3, subitem 14(2)]*

***Transitional rules — Entity that ceased to be a member of a tax consolidated ADI group under a pre-2014 Budget time arrangement***

1.133 Under the leaving case transitional rules, the securitised assets measure applies in relation to an entity that ceased to be a member of a tax consolidated ADI group under an arrangement that commenced before the 2014 Budget time in certain circumstances. *[Schedule #, Part 3, subitems 15(2) to (6)]*

1.134 The leaving case transitional rules ensure that the position taken by the head company of a tax consolidated ADI group under the exit tax cost setting rules in relation to an arrangement entered into before the 2014 Budget time is maintained.

1.135 However, under these transitional rules, the securitised assets measure will apply to disregard a securitisation liability when working out the exit allocable cost amount for a leaving entity if the head company:

- entered into an arrangement before the 2014 Budget time; and
- has not taken a position in relation to the treatment of the securitisation liability prior to that time.

1.136 Therefore, the outcome that arises under the leaving case transitional rules depends on whether or not, under the exit tax cost setting rules, the head company of the old group recognised:

- the securitisation liability that leaves the old group with a leaving entity; or
- the securitised asset that leaves the old group with a leaving entity.

*Securitisation liability recognised under the exit tax cost setting rules*

1.137 Where, under an arrangement that was entered into before the 2014 Budget time, the head company of a tax consolidated ADI group recognised a securitisation liability held by the leaving entity under the exit tax cost setting rules, the leaving case transitional rules confirm this position.

1.138 Consequently, the securitisation liability is not removed from the exit allocable cost amount for a leaving entity under an arrangement that was entered into before the 2014 Budget time if the Commissioner considers that it is reasonable to conclude that:

- the circumstances in section 711-46 existed — that is, broadly:
  - just before the leaving time, a member of the old group is an ADI or financial entity;
  - the leaving entity was holding an accounting liability that is a securitisation liability; and
  - the market value of the leaving entity's interest in the underlying securitised asset was nil, or was substantially less than the amount of the securitisation liability;
- the head company of the group worked out the old group's allocable cost amount for the leaving entity before the 2014 Budget time; and
- for the purpose of working out the step 4 amount, the head company added an amount for the securitisation liability.

*[Schedule #, Part 3, item 15(3)]*

1.139 If the Commissioner is not satisfied that the circumstances in subitem 19(3) exist, the leaving case transitional rules apply to ensure that

the securitisation liability is not included in the exit allocable cost amount for the leaving entity. *[Schedule #, Part 3, subitem 15(2)]*

*Securitised asset recognised under the exit tax cost setting rules*

1.140 In some cases, under an arrangement that was entered into before the 2014 Budget time, the head company of a tax consolidated ADI group that recognised a securitisation liability under the exit allocable cost amount for a leaving entity may have also recognised the tax cost setting amount for the interest in the securitised asset in order to eliminate or reduce the mismatch that would otherwise arise.

1.141 In these circumstances, the leaving case transitional rules apply so that the old group's allocable cost amount for the leaving entity is increased by the amount included for the interest in the securitised asset at step 1 of the exit allocable cost amount. *[Schedule #, Part 3, items 15(4) and (5)]*

1.142 However, the transitional rule applies only if the Commissioner considers that it is reasonable to conclude that, before the 2014 Budget time, the head company of the old group worked out a tax cost setting amount for the leaving entity's interest in the underlying securitised assets and included an amount at step 1. *[Schedule #, Part 3, items 15(4) and (5)]*

1.143 As a result of this transitional rule, the tax cost setting amounts for the membership interests held by the old group in the leaving entity will remain unchanged. Therefore, affected tax consolidated ADI groups will not incur additional compliance costs that would be required to recalculate the tax cost setting amounts for those membership interests if the interest in the securitised asset ceased to be recognised as an asset for the purposes of applying step 1 of the exit allocable cost amount.

*No position taken prior to the 2014 Budget time*

1.144 The leaving case transitional rules ensure that the securitisation measure will apply to an arrangement entered into before the 2014 Budget time where the head company of the old tax consolidated ADI group first works out the entry allocable cost amount for a leaving entity after the 2014 Budget time. *[Schedule #, Part 3, subitem 15(2)]*

1.145 This will ensure that affected tax consolidated ADI groups are protected from adverse outcomes that arise under the existing law.

***Transitional rules — When is the allocable cost amount worked out?***

1.146 The joining case and leaving case transitional rules are largely intended to ensure that affected tax consolidated ADI groups do not have to change what they actually did under the current law. Therefore, some of

the transitional rules apply based on way that a tax consolidated ADI group worked out the allocable cost amount for a joining entity or a leaving entity.

1.147 When an entity joins a tax consolidated ADI group, the tax costs of each asset of the joining entity is set at the joining time at an amount equal to the asset's tax cost setting amount (subsection 701-10(4)).

1.148 Similarly, when an entity leaves a tax consolidated ADI group, the tax costs of each membership interest held by old group in the leaving entity is set at the leaving time at an amount equal to the interest's tax cost setting amount (subsection 701-15(3)).

1.149 Subsections 701-10(4) and 701-15(3) set the tax costs of assets and membership interests at a particular time. However, the application of the transitional rules depends on the time when the head company of a tax consolidated ADI group actually calculated the tax cost setting amounts.

1.150 The head company of a tax consolidated ADI group may calculate multiple draft permutations of an allocable cost amount. Although these calculations may be based on the entry and exit allocable cost amount rules, they are merely draft calculations.

1.151 Only the amount used to determine the tax costs of the joining entity's assets, or to calculate the tax costs of the old group's membership interests in the leaving entity, constitute the allocable cost amount. None of the other draft calculations constitute an allocable cost amount and therefore are insufficient alone to evidence the time at which a tax consolidated ADI group has 'worked out' its allocable cost amount.

1.152 To determine if an allocable cost amount is 'worked out' before a particular time, for the purpose of applying the transitional rules, the Commissioner will assess each situation according to the facts of each case. However, it is expected that the Commissioner will have regard to the following factors:

- information supplied by the affected tax consolidated ADI group — the group may need to supply the Commissioner with electronic copies of its allocable cost amount calculations, with an electronic timestamp showing the time of the calculation;
- information available in the affected tax consolidated ADI group's income tax return — it is expected that the Commissioner will cross-check an allocable cost amount calculation with, for example, capital allowance deductions, or a net capital gain or loss, claimed in the group's income

tax return to determine the authenticity of their allocable cost amount calculation; and

- any other information that the Commissioner considers to be relevant.

***Application to all tax consolidated groups***

1.153 The securitised assets measure was originally announced as part of the 2014 Budget. At that time, the measure was restricted to circumstances where a member of the joined tax consolidated group is an ADI or a financial entity because securitisation arrangements are primarily undertaken by these types of entities.

1.154 However, securitisation arrangements are also entered into as a means of financing by entities that are not ADIs or financial entities in some circumstances. Therefore, as part of the Tax Integrity Package announced in the 2016-17 Budget, the scope of the measure was extended so that it applies to all securitisation arrangements.

1.155 Therefore, the requirement that a member of the relevant group is an ADI or a financial entity will no longer apply to an arrangement that commences after the 2016 Budget time. The 2016 Budget time is 7.30 pm, by legal time in the Australian Capital Territory, on 3 May 2016 (the time of announcement of the measure). *[Schedule #, Part 4, items 18 and 19]*

1.156 The time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. *[Schedule #, Part 8, item 31]*

**Part 5 — The churning measure**

1.157 The churning measure in Part 5 of Schedule # to this Exposure Draft Bill switches off the entry tax cost setting rules for a joining entity where a capital gain or capital loss made by a foreign resident owner when it ceases to hold membership interests in the joining entity is disregarded and there has been no change in the majority economic ownership of the joining entity for a period of at least 12 months before the joining time.

1.158 The churning measure is consistent with Recommendation 5.6 of the Board of Taxation's June 2012 Report.

***When do the modifications to the tax cost setting rules apply?***

1.159 The operation of the tax cost setting rules will be modified when:

- an entity (the joining entity) becomes a subsidiary member of a consolidated group;
- another entity (the disposing entity) ceased to hold membership interests in the joining entity during the period (the test period) that:
  - started 12 months before the joining time; and
  - ended immediately after the joining time;
- a CGT event happened because the disposing entity ceased to hold the membership interests;
- a capital gain or capital loss of the disposing entity from the CGT event was disregarded because of the operation of Division 855;
- the tax costs of the joining entity's assets would ordinarily be set at their tax cost setting amounts because the joining entity becomes a subsidiary member of the group — that is, section 701-10 would ordinarily apply to the joining entity's assets;
- it is reasonable to conclude that, throughout the test period, an entity (the control entity) had a total participation interest in the joining entity of 50 per cent or more; and
- if the control entity is not the disposing entity, it is reasonable to conclude that the control entity had a total participation interest in the disposing entity of 50 per cent or more at the time the CGT event happened.

*[Schedule #, Part 5, item 20, subsection 716-440(1)]*

1.160 For the purposes of determining whether paragraph 716-440(1)(b) is satisfied, the reference to membership interests in the joining entity is taken to include membership interests in another entity (the higher level entity) if:

- the higher level entity holds membership interests in the joining entity (whether directly or indirectly through one or more interposed entities) at any time during the test period;
- the higher level entity becomes a subsidiary member of the consolidated group at the joining time.

*[Schedule #, Part 5, item 20, subsection 716-440(3) and(4)]*

1.161 This ensures that the modifications to the operation of the tax cost setting rules will apply to all joining entities in cases where:

- a consolidated group is acquired by another consolidated group — that is, Subdivision 705-C cases; and
- multiple entities that are linked by membership interests are acquired by a consolidated group — that is, Subdivision 705-D cases.

1.162 Paragraph 716-440(1)(d) is satisfied if a capital gain or capital loss of the disposing entity from a CGT event was disregarded because of the operation of Division 855. This requirement can be satisfied even if, under a double tax agreement, Australia does not have a right to tax the capital gain of the disposing entity.

1.163 Paragraph 716-440(1)(f) is satisfied if it is reasonable to conclude that, throughout the test period, an entity (the control entity), together with its associates, had a total participation interest in the joining entity of 50 per cent or more. Broadly, this test ensures that the churning measure will apply in respect of a joining entity only where that joining entity has been majority owned (directly or indirectly) by the control entity for a period of at least 12 months ending immediately after the joining time.

1.164 Paragraph 716-440(1)(g) is satisfied if, where the control entity is not the disposing entity, it is reasonable to conclude that the control entity, together with its associates, had a total participation interest in the disposing entity of 50 per cent or more at the time of the CGT event which gave rise to the capital gain or capital loss that was disregarded because of Division 855. This test requires the control entity and the disposing entity to be the same or to be related at the time of the CGT event.

1.165 Where a capital gain is disregarded, this ensures that the churning measure applies only where the entity that ultimately benefits from the application of Division 855 would also ultimately benefit from the uplift in the tax cost of the joining entity's assets at the joining time if the churning measure did not apply.

1.166 An entity's *total participation interest* in another entity, as defined in section 960-180, at a particular time is the sum of:

- the entity's direct participation interest in the other entity at that time; and

- the entity's indirect participation interest in the other entity at that time.

1.167 An entity's *direct participation interest* is the total interest that an entity directly holds in another entity and is worked out under section 960-190.

1.168 An entity's *indirect participation interest* is the participation interest held by an entity in another entity through intermediate entities and is worked out in the way set out in section 960-185.

***Tax cost setting rules do not apply***

1.169 If the modifications apply to the head company of a consolidated group, the tax cost setting rules do not apply to reset the tax costs of the joining entity's assets. That is, the following provisions do not apply:

- section 701-10 — which is about the cost to the head company of the joining entity's assets;
- subsection 701-35(4) — which is about setting the value of trading stock at a tax neutral amount; and
- subsection 701-35(5) — which is about setting the value of registered emissions units at a tax neutral amount.

*[Schedule #, Part 5, item 20, subsection 716-440(2)]*

1.170 The consequence of switching off these tax cost setting rules is that, broadly, the tax costs of the joining entity's assets are retained.

**Example 1.3**

On 1 July 2018, FP Co (a foreign resident company) beneficially owns all of the membership interests in Target Co and Head Co respectively. Head Co, in turn, beneficially owns all of the membership interests in Acquirer Co.

Target Co, Head Co and Acquirer Co are all Australian resident companies.

Head Co and Acquirer Co are members of a consolidated group (the Head Co consolidated group).

On 1 September 2019, FP Co disposed of all of its membership interests in Target Co to Acquirer Co. As a result, CGT event A1 happened and FP Co makes a capital gain which is disregarded under Division 855 of the ITAA 1997.

Upon Acquirer Co becoming the beneficial owner of all of the membership interests in Target Co, Target Co became a subsidiary member of the Head Co consolidated group.

The churning conditions in subsection 716-440(1) are satisfied in this example. That is:

- paragraph 716-440(1)(a) is satisfied as Target Co became a subsidiary member of a consolidated group (the Head Co consolidated group) at a time (1 September 2019);
- paragraph 716-440(1)(b) is satisfied as FP Co ceased to hold membership interests in Target Co on 1 September 2019, which is during the test period — the test period is a period of 12 months ending just after the joining time (1 September 2019);
- paragraphs 716-440(1)(c) and (d) are satisfied as CGT event A1 happened as a result of FP Co ceasing to hold membership interests in Target Co and the resulting capital gain was disregarded under Division 855;
- paragraph 716-440(1)(e) is satisfied because, if the churning measure did not apply, the tax cost of Target Co's assets would be reset under the consolidation entry tax cost setting rules;
- paragraph 716-440(1)(f) is satisfied as, throughout the test period, FP Co (the control entity) maintained a total participation interest of at least 50 per cent in Target Co — that is, FP Co maintained a total participation interest of 100 per cent in Target Co throughout the test period, taking the following factors into account:
  - at the beginning of the test period, FP Co had a direct participation interest, and consequently a total participation interest, of 100 per cent in Target Co; and
  - at the end of the test period, FP Co had an indirect participation interest; and consequently a total participation interest, of 100 per cent in Target Co (FP's indirect participation interest in Target Co represents the total interest held in Target Co by FP through intermediary entities Head Co and Acquirer Co); and
- paragraph 716-440(1)(g) is not relevant in this example as FP Co is the disposing entity.

All of the relevant churning conditions in subsection 716-440(1) are met in this example. Therefore, subsection 716-440(1) applies, with the effect that the existing tax values of Target Co's assets are inherited by Head Co when Target Co joins the Head Co consolidated group.

#### Example 1.4

On 1 July 2019, the Head Co consolidated group consists of two Australian resident companies, Head Co and Acquirer Co. Acquirer Co beneficially owns all of the membership interests in Foreign Co (a foreign resident company) who, in turn, beneficially owns all of the membership interests in Target Co (an Australian resident company).

Target Co is not a subsidiary member of the Head Co consolidated group as it does not qualify as a transitional foreign held subsidiary under Division 701C of the *Income Tax (Transitional Provisions) Act 1997*.

On 1 December 2020, Foreign Co disposes of all of its membership interests in Target Co to Acquirer Co. As a result, CGT event A1 happens and Foreign Co makes a capital gain which is disregarded under Division 855 of the ITAA 1997.

At the time Acquirer Co became the beneficial owner of all of the membership interests in Target Co, Target Co became a subsidiary member of the Head Co consolidated group.

The churning conditions in subsection 716-440(1) are satisfied in this example. That is:

- paragraph 716-440(1)(a) is satisfied as Target Co became a subsidiary member of a consolidated group (the Head Co consolidated group) at a time (1 December 2020);
- paragraph 716-440(1)(b) is satisfied as Foreign Co ceased to hold membership interests in Target Co on 1 December 2020, which is during the test period — the test period is a period of 12 months ending just after the joining time of 1 December 2020;
- paragraphs 716-440(1)(c) and (d) are satisfied as CGT event A1 happened as a result of Foreign Co ceasing to hold membership interests in Target Co and the resulting capital gain was disregarded under Division 855;
- paragraph 716-440(1)(e) is satisfied as, if the churning measure did not apply, the tax cost of Target Co's assets would be reset under the consolidation entry tax cost setting rules;
- paragraph 716-440(1)(f) is satisfied as, throughout the test period, Head Co (a control entity) maintained a total participation interest of at least 50 per cent in Target Co — that is, Head Co maintained a total participation interest of 100 per cent in Target Co throughout the test period, taking the following factors into account:
  - at the beginning of the test period, Head Co had an indirect participation interest, and consequently a total participation

interest, of 100 per cent in Target Co — Head Co's indirect participation interest in Target Co represents the total interest held in Target Co by Head Co through intermediary entities Acquirer Co and Foreign Co; and

- at the end of the test period Head Co had an indirect participation interest, and consequently a total participation interest, of 100 per cent in Target Co — Head Co's indirect participation interest in Target Co represents the total interest held in Target Co by Head Co through intermediary entity Acquirer Co; and
- paragraph 716-440(1)(g) is satisfied as Head Co (a control entity) had a total participation interest in Foreign Co (the disposing entity) of at least 50 per cent at the time of the CGT event which gave rise to the disregarded capital gain — this is because Head Co had an indirect participation interest in Foreign Co of 100 per cent at this time.

All of the relevant churning conditions in subsection 716-440(1) are met in this example. Therefore, subsection 716-440(1) applies, with the effect that the existing tax values of Target Co's assets are inherited by Head Co when Target Co joins the Head Co consolidated group.

### **Example 1.5**

On 1 July 2018, the Head Co consolidated group consists of two Australian resident companies, Head Co and Acquirer Co. Acquirer Co beneficially owns 70 per cent of the membership interests in Target Co. The remaining 30 per cent of the membership in Target Co are beneficially owned by X Co, a foreign resident entity which is unrelated to the two members of the consolidated group.

On 1 June 2020, X Co disposes of its membership interests in Target Co to Acquirer Co. As a result CGT event A1 happens and X Co makes a capital gain which is disregarded under Division 855 of the ITAA 1997.

At the time Acquirer Co became the beneficial owner of all of the membership interests in Target Co, Target Co became a subsidiary member of the Head Co consolidated group.

The churning conditions in paragraph 716-440(1)(a) to (f) are satisfied in this example. That is:

- paragraph 716-440(1)(a) is satisfied as Target Co became a subsidiary member of a consolidated group (the Head Co consolidated group) at a time (1 June 2020);
- paragraph 716-440(1)(b) is satisfied as X Co ceased to hold membership interests in Target Co on 1 June 2020, which is during

the test period — the test period is a period of 12 months ending just after the joining time of 1 June 2020;

- paragraphs 716-440(1)(c) and (d) are satisfied as CGT event A1 happened as a result of X Co ceasing to hold membership interests in Target Co and the resulting capital gain was disregarded under Division 855;
- paragraph 716-440(1)(e) is satisfied because, if the churning measure did not apply, the tax cost of Target Co's assets would be reset under the consolidation entry tax cost setting rules; and
- paragraph 716-440(1)(f) is satisfied as, throughout the test period, Head Co (a control entity) maintained a total participation interest of at least 50 per cent in Target Co — that is, Head Co maintained a total participation interest of at least 70 per cent in Target Co throughout the test period (which exceeds the minimum 50 per cent requirement in paragraph 716-440(1)(f)), taking the following factors into account:
  - at the beginning of the test period, Head Co has an indirect participation interest, and consequently a total participation interest, of 70 per cent in Target Co — Head Co's indirect participation interest in Target Co represents the total interest held in Target Co by Head Co through Acquirer Co; and
  - at the end of the test period, Head Co had an indirect participation interest, and consequently a total participation interest, of 100 per cent in Target Co — Head Co's indirect participation interest in Target Co at that time represents the total interest held in Target Co by Head Co through Acquirer Co.

However, the conditions in paragraph 716-440(1)(g) are not met because, at the time of the CGT event which gave rise to the disregarded capital gain, Head Co (a control entity) had a total participation interest of nil in X Co. Therefore, the minimum requirement of 50 per cent is not satisfied.

As all of the relevant churning conditions in subsection 716-440(1) are not met, the churning measure does not apply in the circumstances set out in this example. Therefore, the consolidation entry tax cost setting rules will apply to reset the tax cost of Target Co's assets when it joins the Head Co consolidated group.

### ***Application***

1.171 The churning measure applies in relation to an entity that joins a consolidated group under an arrangement that commences on or after the 2013 Budget time. The 2013 Budget time is 7.30 pm, by legal time in the

Australian Capital Territory, on 14 May 2013 (the date of announcement of the measure by the former Government). [*Schedule #, Part 5, item 21*]

1.172 The time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. [*Schedule #, Part 8, item 31*]

## **Part 6 — The TOFA measure**

1.173 The TOFA measure in Part 4 of Schedule # to this Exposure Draft Bill clarifies the operation of the TOFA provisions by setting a tax value for an intra-group asset or liability that is, or is part of, a Division 230 financial arrangement when the asset or liability emerges from a consolidated group because a subsidiary member leaves the group.

1.174 This will, for example, ensure that:

- a lender is not assessed on a return of the principal of a loan; and
- a borrower cannot claim deduction for the repayment of that principal.

1.175 The broad objective of the TOFA measure is to make the tax treatment of intra-group TOFA financial arrangements consistent with the economic substance of the transactions.

1.176 Similar rules currently exist for TOFA financial arrangements that are not intra-group financial arrangements (sections 715-375 and 715-378).

### ***Setting a tax cost for intra-group liabilities that are Division 230 financial arrangements***

1.177 New section 715-379 sets a tax cost for an intra-group liability that is, or is part of, a Division 230 financial arrangement. This is necessary for the operation of the TOFA provisions so that the entity that holds the Division 230 financial arrangement after the leaving time can determine gains and losses relating to the arrangement.

1.178 The tax cost for an accounting liability that is, or is part of, a Division 230 financial arrangement is set for an entity (the leaving entity) that ceases to be a member of a consolidated group at a time (the leaving time) if:

- a thing (the accounting liability) is, in accordance with accounting standards or statements of accounting concepts

made by the AASB, a liability of the leaving entity just before the leaving time that can or must be recognised in its statement of financial position;

- because the single entity rule (subsection 701-1(1)) ceases to apply to the leaving entity at the leaving time:
  - the accounting liability becomes a liability of the leaving entity; and
  - an asset (the corresponding asset) that consists of the liability becomes an asset of the head company; and
- the corresponding asset's tax cost is set under section 701-20.

*[Schedule #, Part 6, item 24, paragraph 715-379(1)(a), subparagraphs 715-379(1)(b)(i), (c)(i) and (d)(i), and paragraph 715-379(1)(e)]*

1.179 In these circumstances, for the purposes of Division 230 and Schedule 1 to the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009*, the leaving entity is taken to have started to have the accounting liability at the leaving time for receiving a payment equal to the tax cost setting amount of the corresponding asset. *[Schedule #, Part 6, item 24, paragraph 715-379(2)(a)]*

1.180 Similarly, the tax cost for an accounting liability that is, or is part of, a Division 230 financial arrangement is set for the head company of a consolidated group when an entity (the leaving entity) ceases to be a member of a consolidated group at a time (the leaving time) if:

- a thing (the accounting liability) is, in accordance with accounting standards or statements of accounting concepts made by the AASB, a liability of the head company of the group at the leaving time that can or must be recognised in its statement of financial position;
- because the single entity rule (subsection 701-1(1)) ceases to apply to the leaving entity at the leaving time:
  - the accounting liability becomes a liability of the head company; and
  - an asset (the corresponding asset) that consists of the liability becomes an asset of the leaving entity; and

- the corresponding asset's tax cost is set under section 701-45.

*[Schedule #, Part 6, item 24, paragraph 715-379(1)(a), subparagraphs 715-379(1)(b)(ii), (c)(ii) and (d)(ii), and paragraph 715-379(1)(e)]*

1.181 In these circumstances, for the purposes of Division 230 and Schedule 1 to the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009*, the head company is taken to have started to have the accounting liability at the leaving time for receiving a payment equal to the tax cost setting amount of the corresponding asset. *[Schedule #, Part 6, item 24, paragraph 715-379(2)(b)]*

1.182 The tax cost setting amount of the corresponding asset is worked out under sections 701-60 and 701-60A — the operation of these sections is outlined in the explanation relating to the value shifting amendments in Part 7 of Schedule # to this Exposure Draft Bill.

***Application of Division 230 to intra-group financial arrangements when an entity leaves a consolidated group***

1.183 Under TOFA provisions, a taxpayer has a financial arrangement if, broadly, the taxpayer has a right to receive or an obligation to provide financial benefits under an arrangement (section 230-45).

1.184 Section 230-60 deems a taxpayer to have a right to receive or an obligation to provide a financial benefit under an arrangement if the financial benefit plays an integral role in determining whether there is a gain or loss from the arrangement or the amount of such a gain or loss.

1.185 New section 715-379A ensures that section 230-60 operates appropriately when an entity starts to have an asset or liability that is, or is part of, a Division 230 financial arrangement which emerges from a consolidated group when an entity leaves the group. This ensures that the TOFA provisions apply after the leaving time to gains and losses on the financial arrangement.

1.186 An entity (the leaving entity) that ceases to be a member of a consolidated group at a time (the leaving time) will be taken to have an obligation to provide or a right to receive a financial benefit under an arrangement in relation to an asset or liability if:

- because the single entity rule (subsection 701-1(1)) ceases to apply to the leaving entity after the leaving time, the asset or liability emerges from the group and becomes an asset or liability of the leaving entity;
- in the case of an asset, subsection 701-55(5A) applies in relation to the asset at the leaving time because of

section 701-45 — that is, the tax cost of the asset is set at the leaving time;

- in the case of a liability, subsection 715-379(2) applies in relation to the liability at the leaving time — that is, the tax cost of the liability is set at the leaving time; and
- the asset or liability is, or is part of, a Division 230 financial arrangement.

*[Schedule #, Part 6, item 24, paragraph 715-379A(1)(a), subparagraph 715-379A(1)(b)(i), and paragraph 715-379A(1)(c) and (e)]*

1.187 In these circumstances, in the case of an asset that is, or is part of, a Division 230 financial arrangement held by the leaving entity after the leaving time, for the purpose of section 230-60, the leaving entity is taken to have acquired the asset at the leaving time (as mentioned in subsection 701-55(5A)) in return for it starting to have an obligation to provide the payment mentioned in that subsection. *[Schedule #, Part 6, item 24, paragraph 715-379A(2)(a)]*

1.188 In this regard, the payment mentioned in subsection 701-55(5A) is the tax cost setting amount for the asset (paragraph 701-55(5A)(a)). Paragraph 701-55(5A)(b) has no operation in this context as that paragraph applies only when an entity becomes a member of a consolidated group.

1.189 If a liability is, or is part of, a Division 230 financial arrangement held by the leaving entity after the leaving time, then, for the purposes of section 230-60, the leaving entity is taken to have started to have the liability at the leaving time in return for it starting to have a right to receive the payment mentioned in subsection 715-379(2). *[Schedule #, Part 6, item 24, paragraph 715-379A(2)(b)]*

1.190 The tax cost setting amount of the corresponding asset is worked out under sections 701-60 and 701-60A — the operation of these sections is outlined in the explanation relating to the value shifting amendments in Part 7 of Schedule # to this Exposure Draft Bill.

1.191 Similarly, the head company of a consolidated group will be taken to have an obligation to provide or a right to receive a financial benefit under an arrangement in relation to an asset or liability where an entity (the leaving entity) ceases to be a member of a consolidated group at a time (the leaving time) if:

- because the single entity rule (subsection 701-1(1)) ceases to apply to the leaving entity after the leaving time, the asset or

liability emerges from the group and becomes an asset or liability of the head company;

- in the case of an asset, subsection 701-55(5A) applies in relation to the asset at the leaving time because of section 701-20 — that is, the tax cost of the asset is set at the leaving time;
- in the case of a liability, subsection 715-379(2) applies in relation to the liability at the leaving time — that is, the tax cost of the liability is set at the leaving time; and
- the asset or liability is, or is part of, a Division 230 financial arrangement.

*[Schedule #, Part 6, item 24, paragraph 715-379A(1)(a), subparagraph 715-379A(1)(b)(ii), and paragraph 715-379A(1)(c) and (e)]*

1.192 In these circumstances, in the case of an asset that is, or is part of, a Division 230 financial arrangement, held by the head company after the leaving time, for the purpose of section 230-60, the head company is taken to have acquired the asset at the leaving time (as mentioned in subsection 701-55(5A)) in return for it starting to have an obligation to provide the payment mentioned in that subsection. *[Schedule #, Part 6, item 24, paragraph 715-379A(3)(a)]*

1.193 If a liability that is, or is part of, a Division 230 financial arrangement held by the head company after the leaving time, then, for the purpose of section 230-60, the head company is taken to have started to have the liability at the leaving time in return for it starting to have a right to receive the payment mentioned in subsection 715-379(2). *[Schedule #, Part 6, item 24, paragraph 715-379A(3)(b)]*

1.194 In this regard, the payment mentioned in subsection 701-55(5A) is the tax cost setting amount for the asset (paragraph 701-55(5A)(a)). Paragraph 701-55(5A)(b) has no operation in this context as it applies only when an entity becomes a member of a consolidated group.

1.195 The tax cost setting amount of the corresponding asset is worked out under sections 701-60 and 701-60A — the operation of these sections is outlined in the explanation relating to the value shifting amendments in Part 7 of Schedule # to this Exposure Draft Bill.

### **Example 1.6**

Head Co is the head company of a consolidated group and is subject to the TOFA provisions in Division 230. Company A and Company B are subsidiary members of the group.

On 1 July 2018, Company A enters into an Australian dollar denominated loan arrangement with Company B. Under the arrangement, Company B lends an amount of \$100,000 to Company A on interest free terms. The term of the loan is 4 years.

On 1 December 2018, Company A repays \$20,000 of the loan.

On 1 July 2019, another entity (which is not a member of a consolidated group) acquires all of the membership interests in Company A. As a result, Company A leaves the consolidated group.

At the leaving time, the market value of the corresponding loan asset held by Company B is \$80,000.

Prior to the leaving time, the intra-group loan arrangement between Company A and Company B was not recognised for income tax purposes (due to the operation of the single entity rule).

At the leaving time, the single entity rule ceases to apply to the loan arrangement. Therefore, Division 230 starts to apply to the loan arrangement. As a result, for the purposes of applying Division 230:

- Head Co is taken to have acquired the loan asset at the leaving time in return for it starting to have an obligation to provide a payment of \$80,000 (section 701-20, item 3 of the table in section 701-60, paragraphs 701-55(5A)(a) and 715-379A(3)(a)); and
- Company A is taken to have the loan liability at the leaving time in return for it starting to have a right to receive the payment of \$80,000 (paragraphs 715-379(2)(a) and 715-379A(2)(b)).

Therefore, for the purposes of working out any gain or loss on the loan arrangement under Division 230:

- Head Co will take into account the payment of \$80,000; and
- Company A will take into account the receipt of \$80,000.

### **Example 1.7**

Head Co is the head company of a consolidated group and is subject to the TOFA provisions in Division 230. Company A and Company B are subsidiary members of the group.

On 1 July 2018, Company A enters into a cash-settlable swap transaction with Company B for nil consideration. The term of the swap is 4 years.

On 1 July 2018, another entity (which is not a member of a consolidated group) acquires all of the membership interests in Company A. As a result, Company A leaves the consolidated group.

At the leaving time, both the swap asset held by Company A and the corresponding swap liability held by Company B have a fair value of \$100.

Prior to the leaving time, the intra-group swap arrangement between Company A and Company B was not recognised for income tax purposes (due to the operation of the single entity rule).

At the leaving time, the single entity rule ceases to apply to the swap arrangement. Therefore, Division 230 starts to apply to the swap arrangement. As a result, for the purposes of applying Division 230:

- Company A is taken to have acquired the swap asset at the leaving time in return for it starting to have an obligation to provide a payment of nil (section 701-45, item 3A of the table in section 701-60, paragraphs 701-55(5A)(a) and 715-379A(2)(a)); and
- Head Co is taken to have the swap liability at the leaving time in return for it starting to have a right to receive the payment of \$0 (paragraphs 715-379(2)(b) and 715-379A(3)(b)).

Therefore, for the purposes of working out any gain or loss on the swap arrangement under Division 230:

- Company A will take into account the payment of \$0; and
- Head Co will take into account the receipt of \$0.

### ***Consequential amendments***

1.196 Consequential amendments are made to clarify the headings to sections 715-375 and 715-378. [*Schedule #, Part 6, items 22 and 23, sections 715-375 and 715-378*]

### ***Application***

1.197 The TOFA measure applies in the same way as Part 2 of Schedule 1 to the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009* applies — that is, from the commencement of the TOFA regime. [*Schedule #, Part 6, subitem 25(1)*]

1.198 However, as a transitional rule, the Commissioner is prevented from amending an assessment of an entity for an income year in a particular way if:

- the entity lodged its income tax return for the income year before the 2013 Budget time — that is, before 7.30 pm, by

legal time in the Australian Capital Territory, on 14 May 2013 (the date of announcement of the measure);

- the Commissioner could not amend the assessment in that way if these amendments were disregarded; and
- the entity has not requested the Commissioner to amend the assessment in that way.

*[Schedule #, Part 6, subitems 25(2) and (3)]*

1.199 This transitional rule ensures that taxpayers who took a position under the current law will not be disadvantaged by the amendments. However, it also prevents taxpayers from obtaining a windfall gain by amending prior year assessments in a way that takes advantage of a deficiency in the law.

## **Part 7 — The value shifting measure**

1.200 The value shifting measure in Part 7 of Schedule # to this Exposure Draft Bill removes anomalies that arise when an entity leaves a consolidated group holding an asset that corresponds to a liability owed to it by the old group by ensuring that the amount taken into account under the exit tax cost setting rules for the asset is aligned with the tax cost setting amount for the corresponding asset of the leaving entity.

1.201 Step 3 of the exit tax cost setting rules (section 711-40) increases the old group's allocable cost amount by the value of intra-group liabilities owed to the leaving entity.

1.202 Generally, the step 3 amount is the market value of the corresponding asset of the leaving entity (subsection 711-40(1)). However, this amount is reduced if, ignoring the single entity rule, a member of the group would have made a capital gain or capital loss when the liability arose. In these circumstances, the step 3 amount is, broadly, what would have been the cost base of the asset if that cost is less than the market value (subsections 711-40(2) and (3)).

1.203 When a leaving entity holds an asset that consists of a liability owed to it by a member of the old group, the asset's tax cost is set at the leaving time, for the entity's income tax purposes, at the asset's tax cost setting amount (section 701-45). The tax cost setting amount is the market value of the asset (table item 3 in section 701-60).

1.204 The value shifting problem arises because:

- subsections 711-40(2) and (3) do not appropriately identify all of the circumstances in which the step 3 amount should be less than the market value of the corresponding asset; and
- in some cases, the tax cost setting amount for the corresponding asset should be less than the market value of that asset.

1.205 To overcome the value shifting problem:

- the exit tax cost setting rules will be modified so that the step 3 amount included for an intra-group liability owed to the leaving entity by the old group is equal to the tax cost setting amount for the corresponding asset; and
- the tax cost setting amount for the corresponding asset is set at:
  - in the case of an asset that corresponds to a debt owed to the leaving entity by the old group — the market value of the asset;
  - otherwise — an amount that reflects the cost of the asset.

***Modification to step 3 of the exit tax cost setting rules***

1.206 Under the exit tax cost setting rules that apply when an entity leaves a consolidated group, step 3 increases the old group's allocable cost amount when an intra-group liability is owed to the leaving entity by the old group.

1.207 The amendments modify section 711-40 so that the amount that is included at step 3 of the exit tax cost setting rules in relation to an intra-group liability that is owed to the leaving entity by the old group is the tax cost setting amount for the corresponding asset. [*Schedule #, Part 7, item 28, section 711-40*]

***Modification to the tax cost setting amount***

1.208 If an entity leaves a consolidated group holding an asset that consists of a liability owed to it by a member of the old group, the asset's tax cost is set at the leaving time at the asset's tax cost setting amount (section 701-45).

1.209 The asset's tax cost setting amount is set out in the Table #.2 and depends on whether the asset is a right to recover an intra-group liability that:

- is a debt owed to the leaving entity — that is, broadly, because money has been borrowed, or credit obtained, by a member of the old group from the leaving entity;
- arose in the old group or was acquired by the group and is not a debt owed to the leaving entity; or
- was brought into the group by a joining entity and is not a debt owed to the leaving entity.

[Schedule #, Part 7, items 26 and 27, table item 3A in sections 701-60 and 701-60A]

**Table 1.2: Tax cost setting amount for an asset that is a right to recover an intra-group liability**

<i>Nature of asset</i>	<i>Tax cost setting amount</i>
Right to recover an intra-group liability that is a debt owed to the leaving entity	Market value of the asset at the leaving time
Right to recover a liability that is not a debt owed to the leaving entity where: <ul style="list-style-type: none"> <li>• at the time the liability arose, the entity to whom the liability was owed and the entity owing the liability were both members of the old group; or</li> <li>• after the time the liability arose, a member of the old group acquired the corresponding asset</li> </ul>	Nil
Right to recover a liability that is not a debt owed to the leaving entity where: <ul style="list-style-type: none"> <li>• at the time the liability arose, the entity to whom the liability was owed and the entity owing the liability were not both members of the old group; and</li> <li>• the tax cost of the corresponding asset was set under section 701-10 at the time an entity became a subsidiary member of the old group (whether or not the asset became an intra-group asset at the joining time or at a later time)</li> </ul>	The lesser of: <ul style="list-style-type: none"> <li>• the tax cost setting amount for the asset;</li> <li>• if the head company was entitled to a deduction in respect of the asset for an income year ending on or before the leaving time — the tax cost setting amount for the asset reduced by the amount of the deduction; and</li> <li>• the market value of the asset at the leaving time</li> </ul>

[Schedule #, Part 7, item 27, subsections 701-60A(2), (3) and (4)]

1.210 If the asset is a right to recover a liability that is not a debt owed to the leaving entity and, at the time the liability arose, the entity to whom the liability was owed and the entity owing the liability were both members of the old group, the tax cost setting amount of the asset is nil. As a result, any incidental costs incurred by a consolidated group on the creation of the intra-group asset will not be prevented from being deducted as business capital expenditure under section 40-880.

1.211 If the asset is a right to recover a liability that is not a debt owed to the leaving entity and, after the time the liability arose, a member of the old group acquired the corresponding asset, the tax cost setting amount of the asset is also nil. As a result, the cost incurred by a consolidated group to acquire the intra-group asset may also be deductible as business capital expenditure under section 40-880.

1.212 If the asset is a right to recover a liability that is not a debt owed to the leaving entity and, after the time the liability arose, the asset's tax cost was set because it was held by an entity that became a subsidiary member of the old group, the tax cost setting amount of the asset the lesser of:

- the tax cost setting amount for the asset — that is, the cost to the old group of acquiring the asset;
- the tax cost setting amount for the asset, reduced to the extent of any deduction claimed in respect of the asset for an income year ending at or before the leaving time; or
- the market value of the asset at the leaving time.

### **Example 1.8**

In 2005, a company granted a right over one of its assets to a subsidiary member of its wholly owned group. The market value of the right at that time was \$5,000.

In 2006, the company formed a consolidated group (Group A). As a result, the subsidiary member became a member of Group A. The tax cost setting amount for the right was set at \$5,000 (reflecting the market value of the right at that time). However, this tax cost setting amount was disregarded due to the operation of section 701-58.

During the time that the right was held by Group A, the value of the right increased. As a result, there was a corresponding decrease in the value of the asset over which the right was created. This decrease in the value of the asset was not recognised for tax purposes.

In 2018, Group A sold the subsidiary member to Group B (another consolidated group) for \$1 million. The right was the subsidiary member's only asset.

Under the current law, the step 3 amount is the market value of the right — that is \$1 million. In this regard, subsection 711-40(3) does not apply to reduce the step 3 amount because the right was created before the formation of the consolidated group. Therefore, Group A will not make a capital gain on the disposal of the subsidiary member.

The amendments change this outcome so that the step 3 amount is \$5,000 — that is, the lesser of:

- the tax cost setting amount for the right that was disregarded at the joining time (\$5,000); and
- the market value of the right (\$1 million).

Therefore, Group A will make a capital gain on the disposal of the subsidiary member which reflects the economic gain made by the group (being the difference between the amount the group receives on the disposal of the right (\$1 million) and the cost of acquiring the right (\$5,000)).

The tax cost setting amount of the right for the leaving subsidiary member will be \$5,000. However, under the entry tax cost setting rules, the tax cost of the right will be reset at its market value (\$1 million) when the subsidiary becomes a member of Group B.

#### ***Modification to step 4 of the exit tax cost setting rules***

1.213 Step 4 of the exit tax cost setting rules (section 711-45) reduces the old group's allocable cost amount by the value of liabilities that the leaving entity takes with it. In the case of intra-group liabilities owed by the leaving entity to a member of the old group, the step 4 amount is the market value of the corresponding asset (subsection 711-45(4)).

1.214 To improve the structure of the current law, the amendments modify the step 4 amount in relation to an intra-group liability that is owed to the old group by the leaving entity so that it refers to the tax cost setting amount for the corresponding asset (rather than the market value of the corresponding asset). [*Schedule #, Part 5, item 29, subsection 711-45(4)*]

1.215 In this regard, when the head company of a consolidated group holds an asset that consists of a liability owed to it by the leaving entity, the asset's tax cost is set at the leaving time at the asset's tax cost setting amount (section 701-20). The tax cost setting amount for the asset is the market value of the asset (table item 3 in section 701-60). [*Schedule #, Part 7, item 26, table item 3 in section 701-60*]

1.216 The amendment to subsection 711-45(4) does not change the outcomes that arise under the current law but make it clear that there is alignment between:

- the amount that is included at step 4 of the exit tax cost setting rules for intra-group liabilities owed by the leaving entity to the old group; and
- the tax cost of the corresponding asset of the old group.

### ***Application***

1.217 The value shifting measure applies if an entity ceases to be a subsidiary member of a consolidated group under an arrangement that commences on or after the 2013 Budget time — that is, at or after 7.30 pm, by legal time in the Australian Capital Territory, on 14 May 2013 (the date of announcement of the measure by the former Government). *[Schedule #, Part 7, subitems 30(1) and (5)]*

1.218 In this regard, the time that an arrangement commences depends on the nature of the arrangement, as outlined in paragraph #.243. *[Schedule #, Part 8, item 31]*

1.219 The changes to section 701-61A in the value shifting measure amendments to determine the tax cost setting amount of an asset are relevant for the operation of the TOFA measure.

1.220 Therefore, as the TOFA measure applies from the commencement of the TOFA regime, the changes to section 701-61A also apply from the commencement of the TOFA regime (as outlined in the paragraphs #.197 to #.199). *[Schedule #, Part 7, subitems 30(2), (3) and (4)]*

## **Application and transitional provisions**

1.221 The dates of effect of the various measures are, broadly, as follows:

- the deductible liabilities measure applies from 1 July 2016;
- the deferred tax liabilities measure applies from the date of introduction of the amending legislation;
- the securitised assets measure generally applies to ADIs and financial entities from 13 May 2014, and to all other entities from 3 May 2016; and

- the churning measure, the TOFA measure and the value shifting measure apply from 14 May 2013.

1.222 Where appropriate, transitional rules ensure that taxpayers who have entered into arrangements prior to commencement are not disadvantaged, are not able to obtain windfall gains, or do not have to change a position they have taken under the current law.

1.223 The application of these measures from a date prior to the introduction of the amendments is necessary to:

- prevent taxpayers from structuring their affairs to obtain unintended tax benefits or to obtain windfall gains; and
- protect a significant amount of revenue that otherwise would be at risk.

1.224 The application of the amendments for each measure and the associated transitional rules are explained in more detail below and at the end of the detailed explanation of the new law for each Part.

### **Part 1 — The deductible liabilities measure**

1.225 The amendments in Part 1 (the deductible liabilities measure), apply in relation to an entity that becomes a subsidiary member of a consolidated group under an arrangement that commences on or after 1 July 2016. [*Schedule #, Part 1, item 6*]

1.226 The application of this measure from 1 July 2016 is necessary to prevent corporate groups that elect to consolidate from obtaining an unintended tax advantage over other corporate entities. The measure will also protect a significant amount of revenue that otherwise would be at risk.

### **Part 2 — The deferred tax liabilities measure**

1.227 The amendments in Part 2 (the deferred tax liabilities measure) apply in relation to an accounting liability of entity that becomes a subsidiary member of a consolidated group under an arrangement that commences on or after the start of the day on which this Exposure Draft Bill is introduced into the House of Representatives. [*Schedule #, Part 2, subitem 9(1)*]

1.228 These amendments also apply in relation to an accounting liability of entity that ceases to be a subsidiary member of a consolidated group if:

- the entity ceases to be a subsidiary member of the group under an arrangement that commences on or after the start of the day on which this Exposure Draft Bill is introduced into the House of Representatives; and
- either:
  - the amendments made by Part 1A previously applied in relation to the accounting liability because of subitem 9(1); or
  - at the time the accounting liability arose, it was a liability owed by one member of the consolidated group to another member of the group — that is, the liability was an intra-group liability.

*[Schedule #, Part 2, subitem 9(2)]*

1.229 These amendments were recommended by the Board of Taxation and will reduce compliance costs that arise when an entity joins or leaves a consolidated group.

### **Parts 3 and 4 — The securitised assets measure**

1.230 The amendments in Part 3 (the securitised assets measure) apply in relation to an ADI or financial entity that joins or leaves a consolidated group under an arrangement that commences either before or after the 2014 Budget time — that is, 7.30 pm, by legal time in the Australian Capital Territory, on 13 May 2014 (the time of announcement of this measure). *[Schedule #, Part 3, items 14 and 15]*

1.231 Transitional rules ensure that taxpayers are not disadvantaged, are not able to obtain windfall gains, or do not have to change a position they have taken under the current law.

1.232 The amendments in Part 4 extend the scope of the securitised assets measure so that it applies to all entities that join or leave a consolidated group. These amendments apply in relation to an entity that joins or leaves a consolidated group under an arrangement that commences after the 2016 Budget time — that is, 7.30 pm, by legal time in the Australian Capital Territory, on 3 May 2016 (the time of announcement of the extension of this measure). *[Schedule #, Part 4, items 18 and 19]*

1.233 The application of this measure to arrangements entered into before the date of announcement in some circumstances, together with the transitional rules, are consistent with observations made by the Board of

Taxation directed at ensuring equitable outcomes for consolidated groups affected by anomalies that arise under the current law in relation to securitised assets.

1.234 In this regard, the measure is necessary to prevent consolidated groups from structuring their affairs to obtain unintended tax benefits and windfall gains. The measure will also ensure that significant unintended tax liabilities do not arise when an entity that is a party to a securitisation arrangement leaves a consolidated group.

### **Part 5 — The churning measure**

1.235 The amendments in Part 5 (the churning measure) apply to arrangements that commence on or after the 2013 Budget time — that is, 7.30 pm, by legal time in the Australian Capital Territory, on 14 May 2013 (the date of announcement of the measure by the former Government). [*Schedule #, Part 5, item 21*]

1.236 The application of this measure from the date of announcement is necessary to prevent foreign resident taxpayers from structuring their affairs to obtain unintended tax benefits and will protect a significant amount of revenue that otherwise would be at risk.

### **Part 6 — The TOFA measure**

1.237 The amendments in Part 6 (the TOFA measure) apply in the same way as Part 2 of Schedule 1 to the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009* applies — that is, from the commencement of the TOFA regime. [*Schedule #, Part 6, item 25*]

1.238 The TOFA regime generally commenced from the start of the 2010-11 income year.

1.239 Transitional rules prevent the Commissioner from amending an assessment of an entity for an income year that is issued prior to the 2013 Budget time to ensure that taxpayers are not disadvantaged by the amendments and cannot obtain a windfall gain.

1.240 The application of this measure from the commencement of the TOFA regime is necessary to provide certainty to taxpayers and prevent consolidated groups from structuring their affairs to obtain unintended tax benefits and windfall gains. The measure will also protect a significant amount of revenue that otherwise would be at risk.

## Part 7 — The value shifting measure

1.241 The amendments in Part 7 (the value shifting measure) apply to arrangements that commence on or after the 2013 Budget time.

*[Schedule #, Part 7, item 30]*

1.242 The application of this measure from the date of announcement is necessary to prevent consolidated groups from structuring their affairs to obtain unintended tax benefits and will protect a significant amount of revenue that otherwise would be at risk.

## Part 8 — Commencement of an arrangement

1.243 The time that an arrangement commences depends on the nature of the arrangement, as outlined Table #.3.

**Table 1.3: Commencement of an arrangement**

<i>Type of arrangement</i>	<i>Time that the arrangement commences</i>
Off-market takeover bid	The day on which the bidder lodged with the Australian Securities and Investments Commission a notice stating that the bidder's statement and offer document have been sent to the target — that is, step 4 of the table in subsection 633(1) of the <i>Corporations Act 2001</i> is completed
On-market takeover bid	The day on which the bidder announces a bid to the relevant financial market — that is, step 2 of the table in subsection 635(1) of the <i>Corporations Act 2001</i> is completed
Scheme of arrangement	The day on which a court orders, under subsection 411(1) of the <i>Corporations Act 2001</i> , a meeting of the company's members, or one or more classes of the company's members, about the arrangement
Other arrangement	The day on which the decision to enter into the arrangement (including an initial public offering) was made

*[Schedule #, Part 8, item 31]*



