

BNR/SG

25 February 2009

Board of Taxation Secretariat
Post-implementation Review into Certain Aspects of the Consolidation Regime
C/- The Treasury
Langton Crescent
PARKES ACT 2600

E-mail: taxboard@treasury.gov.au

Dear Sir/madam,

POST-IMPLEMENTATION REVIEW INTO CERTAIN ASPECTS OF THE CONSOLIDATION REGIME

We refer to the Board of Taxation's December 2009 Discussion Paper in relation to the post-implementation review into certain aspects of the consolidation regime, and welcome the opportunity to provide our comments for the Board's consideration.

Specifically, our comments focus on Chapter 6 of the Discussion Paper, titled Operation of the consolidation regime for small business. We make the following comments to each of the questions asked in Chapter 6 of the Discussion Paper.

1. Are there any aspects of the consolidation regime causing particular difficulties for small business?

From our practical experience in working with the consolidations regime in the SME and larger family business sector, there are three main aspects of the consolidation regime which cause particular difficulties:

- The complexity of the legislation;
- The tax cost setting rules on entry and exit; and
- The ability of the head company to utilise losses bought into the consolidated group.

Due to these particular difficulties, many of our clients would only consider entering into the consolidations regime in limited circumstances. These circumstances are primarily:

- Where a restructure of existing entities is required;
- Where a corporate entity is required to be purchased when acquiring a business.

Many of our clients who were eligible to form a consolidated group under the transitional rules (which provided simpler options for forming the group, utilizing losses, etc.) did not do so, due to there being little benefit being obtained for the cost of entering the regime. The costs we refer to

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here relate to consulting fees in advising how the consolidations regime would impact these clients. The amount of work required to be performed for the SME and larger family business sector would be similar for larger corporate groups.

1.1 The complexity of the legislation

The consolidations regime consists of approximately 800 pages of legislation, together with numerous Australian Taxation Office guidance publications (taxation rulings, determinations, interpretive decisions, etc.)

This amount of information is very difficult for practitioners who provide services to small business to understand and apply to their clients. As a result, the tax practitioner for a small business is less likely to advise their clients to form a tax consolidated group.

Another issue surrounding the complexity of the legislation is the amount of unresolved issues that have arisen from the legislation, and the time it has taken (and takes) to get these issues resolved. An example of this is Tax Laws Amendment (2010 Measures No. 1) Bill 2010, which contains various retrospective announcements. Whilst many of the amendments contained within this Bill were previously announced, it is very hard for any practitioner, let alone a practitioner in the small business area to confidently advise their clients when the full legislation has not been released, without relying on press releases, etc.

1.2 The tax cost setting rules on entry and exit

There are various issues surrounding the tax cost setting rules which provide difficulties for the SME and larger family business sector.

The tax cost setting rules are complex, and many in the SME and larger family business sector cannot afford to pay advisors to advise on the impact of these rules.

Of particular concern for many group in the SME and larger family business sector which have been in existence for a long period of time is the detrimental impacts that the tax cost setting process can have to the tax cost of the underlying assets. This is particularly an issue where their shares in the relevant subsidiaries were acquired a long time ago and have a low cost base, compared to the value of the underlying assets (unrealised goodwill). On formation of a consolidated group, in some circumstances this may result the tax cost of assets being eroded, and even a capital gain being made.

These issues also apply to SME and larger family business entities that utilise rollovers in order to restructure to form a corporate group. This arises due to the difference between the market value of the shares in the relevant companies to the tax cost of those shares, which is determined under the relevant rollover provisions.

Also, the valuation requirements under the tax cost setting rules are onerous for the SME and larger family business sector. Whilst shortcuts are available, these shortcuts do not provide much assistance to the SME and larger family business sector. The cost involved in performing the required valuations for the tax cost setting process are high, and are seen as an impediment to entering the regime by the SME and larger family business sector.

1.3 The ability of the head company to utilise losses bought into the consolidated group.

The ability of a head company to utilise losses bought into the consolidated group also causes issues, particularly for the SME and larger family business sector.

Again, the rules surrounding the ability to use these losses are complex, and no shortcuts are available. The ability for advisors to the SME and larger family business sector to understand these rules and the ability of the SME and larger family business sector to afford to pay their advisors to determine whether the losses are available makes the consolidations regime unattractive to the SME and larger family business sector.

The available loss utilization rules (available fraction rules) also prevent losses being utilised where a subsidiary has ceased trading. Under the group loss transfer rules which applied prior to the introduction of the consolidations regime, it was possible to still transfer losses to these subsidiaries, provided the losses were available.

2. Should the consolidation regime be simplified for small business? If so, how?

We believe that there are two options for the SME and larger family business sector that operate as corporate groups (or want to restructure to form a corporate group):

- Reintroduce the previous rules that applied to corporate groups, but making these only available to SME and larger family business sector (e.g. loss transfer rules, inter-corporate dividend rebate for unfranked dividends, etc.); and
- Introduce a broader range of shortcuts which the SME and larger family business sector can utilise in order to form and operate within the consolidations regime.

In relation to these shortcuts, we believe that the following shortcuts should be available to small business:

- The head company should have the ability to retain the existing tax values for a subsidiary's assets instead of applying the cost setting rules;
- The head company should have the ability to utilise losses of subsidiaries over three years, instead of applying the available fraction rules;
- More appropriate valuation short cuts be made available to the SME and larger family business sector; and
- Concessions be made available to the SME and larger family business sector who utilise rollovers in order to form a tax consolidated group so that adverse taxation consequences (i.e. no immediate capital gain, and tax costs of reset cost base assets are not eroded).

Should you have any queries in relation to the above, please do not hesitate to contact either myself or Stuart Glasgow of our office.

Yours faithfully,
MGI MELBOURNE PTY LTD



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