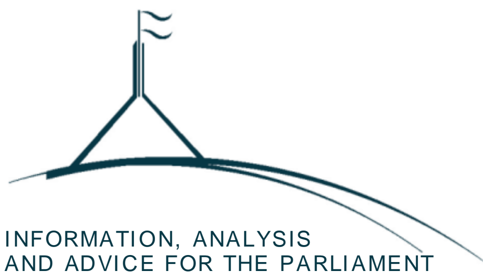

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 122 2002–03

New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002

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ISSN 1328-8091

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New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002

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5 March 2003

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New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002

Date Introduced: 12 December 2002

House: House of Representatives

Portfolio: Treasury

Commencement: The amendments contained in the Bill have numerous commencement dates depending on the time of commencement of previous Acts dealing with the consolidation regime. However, the measures will effectively apply from 1 July 2002, the date of the commencement of the consolidation regime.

Purpose

The Bill will make a number of technical amendments to the consolidation and demerger regimes, principally associated with the value to be assigned to assets of entities entering or leaving a consolidated group.

The Bill will also extend the simplified imputation regime to payments made by venture capital entities to superannuation providers.

Background

This Bill is the fourth part of a package of Bills dealing with the consolidation of company groups. The consolidation regime involves some very technical and complex rules, particularly regarding the valuation of assets in a consolidated company group. The consolidation measures have applied since 1 July 2002 and this Bill will, as noted above, generally apply from that date.

There has been a substantial degree of consultation with industry on the measures being introduced. Industry support is based on the reduced costs in complying with taxation requirements by being able to treat group companies as a single consolidated entity rather than each company member of the group having to submit individual tax information.

Warning:
This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

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The Parliament's response to the consolidation regime can perhaps be best summarised in the Senate's Economic Legislation Committee's report on an earlier consolidation Bill. (New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002.) In it's report on that Bill the Senate Committee noted that there was strong industry support for the measures to be enacted and it's commencement from 1 July 2002, but also found that there were concerns about some of the details contained in that legislation. The Committee noted the technicality of the legislation and that while 'The Committee is reluctant to endorse legislation that it knows needs rectification'[1] it recommended that the Bill be passed but that:

> ….the Government give a clear undertaking that it will continue to monitor and review the operation of this legislation and, in particular, in consultation with the business sector address the problems that have been documented in this report.[2]

Given the very technical nature of the consolidation legislation and the willingness of the Parliament to pass previous consolidation legislation while noting that it would need later rectification, some of which is contained in this Bill, this Digest will only provide a broad overview of the measures contained in the Bill. It may also be noted that the 30 Schedules to the Bill contain no major changes to the consolidation or demerger rules, and that the changes being made to the simplified imputation system (see below) also do not introduce new policy.

For a general background on the consolidation regime refer to the Bills Digests for the New Business Tax System (Consolidation) Bill 2002 (No. 173, of 2001–02) and the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002 (No. 56, of 2002–03).

Main Provisions

Consolidation

Where an initial consolidation occurs or an entity joins an existing consolidated group, it is necessary to set a tax value (known as the tax cost) on the assets transferred to the consolidated group principally for capital gains tax purposes (largely to be able to set a cost base for the calculation of a capital gain or loss on subsequent disposal). The rules for setting the tax cost are contained in Division 705 of the *Income Tax Assessment Act 1997* (ITAA97) which contains a number of complex formulas dealing with the various methods in which assets may be transferred into a consolidated group. **Schedule 1** will amend various provisions of Division 705 to ensure consistency in the valuation calculations and correct some technical anomalies.

Schedule 4 inserts a new subdivision 705-E into the ITAA97, which deals with cases where an error has been made in calculating the tax cost of an asset. If it would be unreasonable for the tax cost to be recalculated for the reasons contained in **proposed**

section 705-315 (eg the miscalculation is relatively small and it would be difficult to make the recalculation) and the error was not due to evasion or fraud, then:

- a capital gains tax (CGT) event will be taken to have occurred and
- if the amount has been overstated a capital gains will be taken to have occurred and
- if the amount has been understated a capital loss will be taken to have occurred (**proposed section 104-525**).

The adjustments will compensate for any under or over payment of CGT which would subsequently occur on disposal of the asset.

The provisions will reduce the costs involved in adjusting for relatively minor over or under estimation of the tax cost of an asset.

The ITAA97 contains special rules for life insurance companies, with differing categories of income taxed at different rates and some income being exempt. Under the consolidation rules as they currently stand, if a life insurance company became a subsidiary member of a consolidated group the head company of the group would lose the benefits available to the life insurance company unless it was also a life insurance company. This effectively greatly restricts the ability of life insurance companies to join consolidated groups. **Schedule 6** provides that the head company is to be treated as a life insurance company if one or more life insurance companies are subsidiary members of the group. The Schedule also provides that an entity cannot be in the same consolidated group as a life insurance company if the life insurance company has an interest in the entity and some of those interests fall within a category which would be exempt income for the life insurance company. The latter measure is designed to prevent the earlier change from being exploited.

Schedule 7 of the Bill deals with the interaction of the consolidation regime and other tax laws. The main feature of the Schedule is determining how the general value shifting (GVS) rules apply to the consolidation regime in order to minimise the opportunity for tax effective arrangements as part of a consolidation. The Schedule deals with a number of situations where the calculation of the tax cost, transferred losses and other issues could be used to produce a more favourable tax result for the consolidating, or consolidated, group. More specifically:

- the situations where losses are transferred and the same business test has not been met (where, depending on the circumstances, adjustments can be made to the tax cost of transferred assets), and
- the value of assets when an entity leaves a consolidated group.

The provisions are very technical and largely address the CGT implications of the GVS rules in the above circumstances. They also contain de minimus rules so that they do not apply until a threshold value is reached to minimise compliance costs.

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The consolidation regime is based on the concept that the head entity bears the taxation consequences for the consolidated group. **Schedule 9** will strengthen this regime by providing that only the head company can hold a foreign dividend account and that foreign dividend account credits and debits held by subsidiary companies are to be transferred to the head company, which will maintain the single account for the group. The head company will also be responsible for any withholding tax implications involved with foreign dividend accounts.

Other measures relating to consolidation are of a more specialised and technical nature and include provisions relating to:

- Modification of the loss provisions for the treatment of MEC (multiple entry consolidated) groups (groups of resident companies all of which are wholly-owned by a foreign company and which have consolidated) – **Schedule 13**.
- Who may claim franking credits or debits when a subsidiary leaves a group – **Schedule 14**.
- Modification of transitional rules – **Schedules 16 to 18**, and
- Modification of the pay as you go rules applicable to head companies of consolidated groups and MEC groups – **Schedule 24**.

Venture Capital Franking

For a general background of the activities of venture capital entities and their taxation treatment, refer to the Bills Digest for the Taxation Laws Amendment (Venture Capital) Bill 2002 (No. 78, of 2002–03).

Franking credits form part of the dividend imputation system and, to the extent of the franking credits available, allows companies to pass dividends to investors which then have their taxation reduced by the amount of the franking. Pooled development funds (PDF) are the vehicles used for investing in venture capital opportunities. Under the existing imputation rules, superannuation providers receive franking credits directly from the relevant PDF while other investors receive concessional tax treatment on returns from their investments. As superannuation providers are already subject to concessional tax treatment on their income, without the franking credits they would have no incentive to invest in the riskier venture capital operations.

The simplified imputation regime (SIR) was introduced for most entities from 1 July 2002, but the new rules for venture capital entities were delayed and are contained in this Bill. However, they will also apply from 1 July 2002. The SIR does not introduce new policy or substantial changes to the operation of the imputation system but simplifies its administration.

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Schedule 28 introduces the SIR for venture capital PDFs. As the rules do not introduce new policy and extend the implementation of the existing SIR, the provisions will not be discussed in this Digest.

Endnotes

1 Senate Legislation Committee, New Business Taxation System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, October 2002.

2 Ibid.

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