2008-2009-2010

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2010 MEASURES No. 1) BILL 2010

EXPLANATORY MEMORANDUM

(Circulated by the authority of the
Treasurer, the Hon Wayne Swan MP)

Table of contents

Glossary 5

General outline and financial impact 7

Chapter 1 Approved superannuation clearing house...................13

Chapter 2 Forestry managed investment schemes 19

Chapter 3 Managed investment trusts: capital treatment and taxation of carried interests 27

Chapter 4 Restricting eligibility to the entrepreneurs' tax offset through an income test......................................47

Chapter 5 Consolidation 55

Chapter 6 Miscellaneous amendments......................................193

Index...215

Glossary

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

Abbreviation	***Definition***
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
Corporations Act	*Corporations Act 2001*
ETO	entrepreneurs’ tax offset
FHSA	first home saver account
HEFA	*Higher Education Funding Act 1988*
HESA	*Higher Education Support Act 2003*
ITAA 1936	*Income Tax Assessment Act 1936*
ITAA 1997	*Income Tax Assessment Act 1997*
MEC group	multiple entry consolidated group
MIS	managed investment scheme
MIT	managed investment trust
PAYG	pay as you go
POC Act	*Proceeds of Crime Act 2002*
RSA	retirement savings account
RSA Act 1997	*Retirement Savings Accounts Act 1997*
SG	superannuation guarantee
SGA Act 1992	*Superannuation Guarantee (Administration) Act 1992*
SIS Act 1993	*Superannuation Industry (Supervision) Act 1993*
TAA 1953	*Taxation Administration Act 1953*
TIES	Tax Issues Entry System

General outline and financial impact

Approved superannuation clearing house

Schedule 1 to this Bill amends various parts of the superannuation legislation to support the Government's 2008-09 Budget measure to provide a free superannuation clearing house service for small businesses. This measure is designed to reduce the cost to small businesses of complying with their superannuation obligations.

These amendments allow employers to meet their obligations to make compulsory superannuation contributions for the benefit of their employees, and to promptly remit superannuation amounts deducted from an employee's salary or wages, by paying to an approved clearing house.

These amendments also:

- extend the conditions under which superannuation contributions for the benefit of an employee will comply with the choice of fund requirements to accommodate contributions made through an approved clearing house; and
- allow taxpayer information to be disclosed to an approved clearing house for the purpose of performing its functions.

Date of effect: 1 July 2010.

Proposal announced: This measure was announced in the 2008-09 Budget on 13 May 2008. On 6 November 2009, the Minister for Human Services, Financial Services, Superannuation and Corporate Law announced that the Government's free superannuation clearing house service for small business will be delivered through Medicare Australia (Media Release No. 035 of 6 November 2009).

Financial impact: Nil. However, in the 2008-09 Budget the Government allocated funding of $16.1 million over three years (commencing in 2009-10) for the provision of a free superannuation clearing house service for small businesses.

Compliance cost impact: Low or nil.

Forestry managed investment schemes

Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* and the *Income Tax Assessment Act 1936* to protect the deductions of investors in forestry managed investment schemes where the four-year holding period rules are failed for reasons genuinely outside the investor's control.

This Schedule also amends the *Taxation Administration Act 1953* to maintain the capacity of the Commissioner of Taxation to apply for civil penalties against the promoters of affected schemes, notwithstanding the amendments to the four-year rules.

Date of effect: The amendments apply to capital gains tax (CGT) events happening on or after 1 July 2007.

Proposal announced: This measure was announced in the Assistant Treasurer's Media Release No. 074 of 21 October 2009.

Financial impact: Negligible.

Compliance cost impact: This measure is expected to have a low impact on compliance costs.

Managed investment trusts: capital treatment and taxation of carried interests

Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* to allow eligible managed investment trusts (MITs) to make an irrevocable election (that is, choice) to apply the capital gains tax (CGT) provisions as the primary code for the taxation of gains and losses on disposal of certain assets (primarily shares, units and real property). If a MIT is eligible to make an election and it has not done so, then any gains or losses on the disposal of eligible assets (excluding land, an interest in land, or an option to acquire or dispose of such an asset) will be treated on revenue account.

This Schedule also clarifies the taxation treatment of 'carried interest' units in MITs. These units will effectively be treated on revenue account in the hands of the unit holder.

Date of effect: These amendments broadly apply in relation to eligible CGT events that happen on or after the start of the 2008-09 income year.

The amendments which deem certain assets to be on revenue account when an election is not made, apply to disposals of assets, cessations of ownership of assets and other realisations of assets which take place on or after Royal Assent.

The amendments concerning 'carried interests' in MITs apply in relation to entitlements to distributions that arise on or after Royal Assent, or disposals of assets that happen on or after Royal Assent.

Proposal announced: This measure was announced in the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 049 of 12 May 2009.

Financial impact: This measure has unquantifiable revenue implications from the 2009-10 income year.

Compliance cost impact: Low.

Restricting eligibility to the entrepreneurs' tax offset through an income test

Schedule 4 to this Bill amends Subdivision 61-J of the *Income Tax Assessment Act 1997* by introducing an income test into the eligibility criteria for the entrepreneurs' tax offset (ETO). The income test will restrict the eligibility of individuals whose income is over a threshold amount of income for ETO purposes ($70,000 if they are single and $120,000 if they have a family).

Date of effect: This measure applies in relation to assessments for income years that commence on or after 1 July 2009.

Proposal announced: This measure was first announced in the Treasurer's Media Release No. 050 of 13 May 2008. The measure was initially announced to commence on 1 July 2008. This was deferred by 12 months and announced in the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 048 of 12 May 2009.

Financial impact: This measure will have the following revenue implications:

2009-10	***2010-11***	***2011-12***	***2012-13***
Nil	$22m	$22m	$22m

Compliance cost impact: This measure is expected to result in a low overall compliance cost impact, comprised of a low implementation impact and a low increase in ongoing compliance costs relative to the affected group.

Consolidation

Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* to

- clarify the operation of certain aspects of the consolidation regime; and
- improve interactions between the consolidation regime and other parts of the law.

Date of effect: Many of the amendments apply from 1 July 2002. Others apply from 1 July 2005, 27 October 2006, 8 May 2007, 1 July 2009 or from the date of introduction of this Bill into the House of Representatives. The amendments that are retrospective are beneficial to taxpayers.

Proposal announced: These amendments were announced jointly in the Treasurer's and the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs' Media Release No. 053 of 13 May 2008.

Financial impact: These amendments, other than those in Part 20, are expected to have a small but unquantifiable cost to revenue. The amendments in Part 20 are expected to result in the following revenue gain:

2009-10	***2010-11***	***2011-12***	***2012-13***
–	$25m	$50m	$75m

Compliance cost impact: Low.

Miscellaneous amendments

Schedule 6 to this Bill makes technical corrections and other miscellaneous amendments to the taxation laws. These amendments are part of the Government's commitment to the care and maintenance of the tax system.

Date of effect: These amendments commence from Royal Assent unless otherwise stated.

Proposal announced: These amendments were foreshadowed by release in draft form on the Treasury website on 30 November 2009.

Financial impact: The amendments to the small business retirement exemption, proposed by items 7 to 11, are expected to result in an unquantifiable but small cost to revenue.

The amendments to the administrative penalties for false or misleading statements, proposed by items 58 to 105, are expected to result in an unquantifiable but small gain to revenue.

The other miscellaneous amendments are expected to have a nil to minimal revenue impact.

Compliance cost impact: Nil to low.

Chapter 1
Approved superannuation clearing house

Outline of chapter

1.1 Schedule 1 to this Bill amends the *Superannuation Guarantee (Administration) Act 1992* (SGA Act 1992), the *Retirement Savings Accounts Act 1997* (RSA Act 1997), the *Superannuation Industry (Supervision) Act 1993* (SIS Act 1993), the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Taxation Administration Act 1953* (TAA 1953) to support the Government's 2008-09 Budget measure to provide a free superannuation clearing house service for small businesses. The measure is designed to reduce the cost and paperwork burden to small businesses of complying with their superannuation obligations.

Context of amendments

1.2 Under the superannuation guarantee (SG) arrangements, employers are required to pay a minimum level of superannuation contributions for the benefit of their eligible employees at least once a quarter to avoid liability to the SG charge. The minimum contribution level is 9 per cent of an employee's ordinary time earnings.

1.3 Some employers currently pay contributions in fulfilment of their SG obligations through a payroll provider or a superannuation clearing house. However, these contributions are only considered to have been made for SG purposes when they are paid into a complying superannuation fund or retirement savings account (RSA).

1.4 The choice of fund rules require most employers to provide their employees with a choice of superannuation fund. Employees are generally able to choose the fund into which their employer superannuation contributions are paid. Employers must provide a standard choice form to their new employees, and to their existing employees on request. Employees wishing to exercise choice of fund must complete the form with the required information and return it to their employer. An employee may also initiate the choice process by giving their employer written notice nominating a particular fund as their chosen fund. Employers must give effect to an exercise of choice by an employee within two months of receiving written notice from the employee.

1.5 Complying with the choice of fund rules, including the process of giving effect to an employee's exercise of choice and having to interact with different superannuation funds, can impose costs and divert effort away from a business's core activities. Smaller businesses, with fewer resources at their disposal, are less likely to be able to absorb this cost and inconvenience without impacting on the operation of the business.

1.6 The amendments contained in this Schedule support the Government's 2008-09 Budget measure to provide a free superannuation clearing house service for small businesses (those with fewer than 20 employees) to assist in meeting their superannuation obligations.

Summary of new law

1.7 The amendments to the SGA Act 1992 allow employers to meet their obligation to make compulsory superannuation contributions for the benefit of their employees by paying to an approved clearing house.

1.8 The amendments also extend the conditions under which contributions for the benefit of an employee are made in compliance with the choice of fund requirements to cover circumstances where contributions are made through an approved clearing house.

1.9 Amendments to the SIS Act 1993 and the RSA Act 1997 allow an employer to satisfy its obligation in relation to the prompt remittance of superannuation amounts deducted from an employee's salary or wages by making payments to an approved clearing house.

1.10 The secrecy provisions in the tax law are also amended to allow taxation officers to disclose information to an approved clearing house for the purpose of performing its functions.

Comparison of key features of new law and current law

New law	***Current law***
An employer is able to reduce its SG liability by making payments to an approved clearing house.	Where an employer makes contributions through a clearing house in fulfilment of its SG obligations, the contributions are only considered to have been made for SG purposes when they are paid into a complying superannuation fund or an RSA.

New law	***Current law***
A contribution to a fund by an employer for the benefit of an employee is also made in compliance with the choice of fund requirements if: • the contribution is made through an approved clearing house; • the employee has given the employer written notice choosing a fund; and • the employer passed the information contained on the written notice to the approved clearing house within 21 days of receiving it from the employee.	A contribution to a superannuation fund by an employer for the benefit of an employee is made in compliance with the choice of fund rules if the contribution is made to a chosen fund for the employee or, if there is no chosen fund, to an eligible choice fund for the employer. An employee can nominate a fund as their chosen fund by giving written notice to their employer. Contributions that are not made in compliance with the choice of fund requirements give rise to an SG shortfall for the employer and a resultant liability to the SG charge.
An employer is able to discharge its obligation in respect of the prompt remittance of superannuation amounts deducted from an employee's salary or wages by paying them to an approved clearing house within 28 days of the end of the month in which the deduction is made.	Where an employer is authorised to deduct amounts from an employee's salary or wages for the purpose of payment to a superannuation fund or an RSA provider, the amounts must be paid to the trustee of the fund or RSA provider within 28 days of the end of the month in which the deduction is made.
The secrecy provisions are extended to allow the Australian Taxation Office to disclose information to an approved clearing house for the purpose of performing its functions.	Secrecy provisions in the tax law allow the Australian Taxation Office to provide taxpayer information to certain bodies or officers for specified government purposes.

Detailed explanation of new law

Superannuation guarantee contributions

1.11 Part 3 of the SGA Act 1992 deals with liability of employers to the SG charge. An employer commences each quarter with an SG charge percentage of 9 per cent (the minimum contribution level under the SG arrangements) in respect of each employee. An employer can reduce its SG charge percentage for a quarter under section 23 by making contributions to a complying superannuation fund or an RSA by the 28th day following the end of the quarter. Section 23A allows late payments (payments made after the due date) to a complying superannuation fund or an RSA to be offset against the SG charge.

1.12 New section 23B provides that an employer who pays an amount to an approved clearing house for the benefit of an employee is taken to have contributed the amount to a complying superannuation fund or an RSA for the purposes of sections 23 and 23A. The payment would need to be accepted by the approved clearing house. This is to ensure that only small businesses registered with an approved clearing house will be able to discharge their SG obligations by paying to the approved clearing house. To ensure that a payment to an approved clearing house is not counted twice for SG purposes, any contribution the approved clearing house makes to a complying superannuation fund or an RSA as a result of the payment is disregarded. ***[Schedule 1, item 3, section 23B]***

1.13 ***Approved clearing house*** is defined in new subsection 79A(3) as meaning a body specified in the regulations for the purposes of that subsection. ***[Schedule 1, items 2 and 5, subsections 6(1) and 79A(3)]***

The choice of fund requirements

1.14 The choice of fund requirements are contained in Part 3A of the SGA Act 1992. A contribution to a fund by an employer for the benefit of an employee is made in compliance with the choice of fund requirements if the contribution is made to a chosen fund for the employee or, if there is no chosen fund, to an eligible choice fund for the employer. Contributions that are not made in compliance with the choice of fund requirements give rise to an SG shortfall for the employer under subsection 19(2A) and a resultant liability to the SG charge.

1.15 New subsection 32C(2B) provides that a contribution to a fund by an employer for the benefit of an employee is also made in compliance with the choice of fund requirements if:

- the contribution is made through an approved clearing house;
- the employee has given the employer written notice choosing a fund in accordance with Division 4 (Choosing a fund); and
- the employer passes the information provided by the employee in the written notice to the approved clearing house within 21 days of receiving it (and before or at the time of the contribution) and the approved clearing house accepts the information. The latter requirement is to ensure that only small businesses registered with an approved clearing house will be able to rely on subsection 32C(2B) to avoid an SG shortfall under subsection 19(2A).

A contribution made in accordance with new subsection 32C(2B) will not result in an SG shortfall for the employer under subsection 19(2A). ***[Schedule 1, item 4, subsection 32C(2B)]***

Example 1.1

> Ace Crash Repairs (ACR) is a small business which is registered with an approved clearing house to make superannuation contributions on behalf of its employees. ACR has recently taken on Mick as a new employee and he is given a standard choice form by ACR in compliance with its obligations under the choice of fund rules.
>
> Mick completes the choice form nominating XYZ superannuation fund as the fund into which his superannuation contributions are to be paid and returns the form to his employer. ACR forwards the information provided by Mick on the form to the approved clearing house one week after receiving it from Mick. XYZ fund is a fund which meets the requirements for a chosen fund in Division 4 of the SGA Act 1992.
>
> As the conditions prescribed in subsection 32C(2B) are satisfied, contributions made by ACR for the benefit of Mick through the approved clearing house are made in compliance with the choice of fund requirements.

1.16 Where a contribution by an employer to a fund through an approved clearing house is not made in accordance with subsection 32C(2B), the contribution can also comply with the choice of fund requirements provided it is made in accordance with the existing rules in Part 3A. In this context, new section 79A treats the contribution as having been made on the employer's behalf by the approved clearing house as the employer's agent. If the contribution is made in compliance with the choice of fund requirements, an SG shortfall will not arise. ***[Schedule 1, item 5, section 79A]***

Example 1.2

> ACR also makes contributions through the approved clearing house in respect of another of its employees, Kate. Because Kate has not chosen a fund, ACR has instructed the approved clearing house to make contributions on her behalf to ACR's default fund, ABC superannuation fund. The approved clearing house acts on these instructions and pays the contributions to ABC fund, which is an eligible choice fund.
>
> As the conditions set down in new subsection 32C(2B) are not satisfied (including because Kate has not chosen a fund), ACR cannot rely on that provision in order to avoid an SG shortfall arising under subsection 19(2A). However, subsection 19(2A) also looks to the underlying contribution by ACR to ABC fund in determining whether an SG shortfall arises. As Kate has no chosen fund, and because ABC

fund is an eligible choice fund, the contribution by ACR to ABC fund through the approved clearing house is made in compliance with the choice of fund requirements. Consequently, the contribution does not give rise to a shortfall under subsection 19(2A).

1.17 The above amendments do not affect an employer's obligations under the choice of fund rules to provide its employees with a standard choice form in the circumstances specified in Part 3A.

Prompt remittance of amounts deducted from salary or wages of an employee

1.18 Where an employer is authorised to deduct amounts from an employee's salary or wages for the purpose of payment to a superannuation fund, the SIS Act 1993 requires that the amounts be paid to the trustee of the fund within 28 days after the end of the month in which the deduction is made. An equivalent requirement in respect of RSAs is contained in the RSA Act 1997. These Acts are amended to allow employers to satisfy this obligation by making payments to an approved clearing house (within the meaning of the SGA Act 1992). ***[Schedule 1, items 1 and 6, subsection 183(2A) of the RSA Act 1997, subsection 64(2A) of the SIS Act 1993]***

Disclosure of information to an approved clearing house

1.19 Secrecy provisions in the tax laws allow for the provision of taxpayer information to certain bodies or officers for specified government administration purposes. The amendments extend these provisions to allow taxation officers to disclose information to an approved clearing house for the purposes of performing its functions in relation to superannuation contributions. The relevant secrecy provisions are currently contained in the ITAA 1936 but will be transferred to the TAA 1953 with the enactment of the Tax Laws Amendment (Confidentiality of Taxpayer Information) Bill 2009. ***[Schedule 1, items 7 and 8, paragraph 16(4)(hbb) of the ITAA 1936, subsection 355-65(3) of the TAA 1953]***

Application

1.20 The amendments made by Part 1 of this Schedule apply to a payment made to an approved clearing house on or after 1 July 2010. ***[Schedule 1, item 9]***

Chapter 2
Forestry managed investment schemes

Outline of chapter

2.1 Schedule 2 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Income Tax Assessment Act 1936* (ITAA 1936) to protect the deductions of investors in forestry managed investment schemes (MIS) where the four-year holding period rules are failed for reasons genuinely outside the investor's control.

2.2 This Schedule also amends the *Taxation Administration Act 1953* (TAA 1953) to maintain the capacity of the Commissioner of Taxation (Commissioner) to apply for civil penalties against the promoters of affected schemes, notwithstanding the amendments to the four-year rules.

Context of amendments

2.3 Investors in forestry MIS can claim an immediate tax deduction for expenditure incurred in the scheme, subject to certain conditions.

2.4 Division 394 of the ITAA 1997 covers schemes for which amounts are paid by investors on or after 1 July 2007, while section 82KZMG of the ITAA 1936, in conjunction with section 8-1 of the ITAA 1997, applies to schemes for which expenditure is incurred by investors on or after 2 October 2001 and on or before 30 June 2008.

2.5 During the overlapping period, deductions for investors in forestry MIS might have been claimed under either Division 394 or section 8-1 of the ITAA 1997.

Holding period rules

2.6 In order for an initial investor in a forestry MIS to claim and retain a deduction under Division 394 of the ITAA 1997, the law requires that a CGT event does not happen in relation to the investor's forestry interest within four years after the end of the income year in which an amount is first paid by the investor.

2.7 This is called the 'four-year holding rule', as it has the effect of requiring the initial investor to hold their forestry interest for at least four years. The minimum holding rule period is an integrity measure designed to prevent taxpayers from disposing of their interest shortly after claiming their upfront tax deduction.

2.8 If this condition is failed, the taxpayer's assessment may be amended to disallow the deduction. The Australian Taxation Office's (ATO) interpretation of the current law is that the Commissioner has no discretion to allow a deduction claimed under Division 394 in these circumstances, even where the reason for the capital gains tax (CGT) event happening is outside the taxpayer's control.

2.9 However, if the taxpayer is carrying on a business, they may be entitled to a deduction under section 8-1 of the ITAA 1997.

2.10 Initial investors who can claim a deduction under section 8-1 and who satisfy section 82KZMG of the ITAA 1936 are subject to a similar four-year holding rule under section 82KZMGA.

2.11 Unlike investors in schemes subject to Division 394 where the investors may still be carrying on a business under section 8-1, the ATO considers that these taxpayers do not have a fall-back position. Failing the conditions in section 82KZMGA of the ITAA 1936 results in a deduction being denied outright.

2.12 A CGT event (which would cause an investor to fail the four-year rule) may happen for many different reasons. Examples of such reasons include the sale or transfer of the interest by the investor, the transfer of the interest as a result of the investor's death or the winding-up or restructure of the MIS.

2.13 The Government has decided to amend the tax law to protect the deductions of investors in forestry MIS from being clawed back for reasons genuinely outside of the investor's control. For further information refer to the Assistant Treasurer's Media Release No. 074 of 21 October 2009.

Promoter penalties

2.14 Subdivision 290-B of the TAA 1953 contains the promoter penalties provisions, which are designed to discourage the implementation of schemes covered by a product ruling in a way that is materially different from the product ruling.

2.15 Currently, the Commissioner may apply to the Federal Court for penalties against the promoter if the scheme is implemented in a way that is materially different from that described in the product ruling.

2.16 The concept of material difference is very wide in that it covers conduct because of which any tax outcome is capable of being or likely to be different from that provided for in a product ruling, including future tax outcomes affected by conduct that is beyond an investor's control.

2.17 Despite this, it may be possible that the amendments to the four-year holding rule, without a corresponding amendment to the promoter penalty provisions, would mean there would be no material difference from that described in a product ruling. That is, there is a risk that the promoter penalty provisions would not apply in some circumstances where they were intended to apply.

2.18 The Government has decided to amend the promoter penalty provisions to ensure that they continue to operate as intended, notwithstanding the amendments to the four-year holding rule.

Summary of new law

2.19 Failing the four-year holding rule does not lead to the denial of a deduction where this failure is for reasons outside the investor's control. Furthermore, such reasons must not have been able to be reasonably anticipated by the investor at the time they acquired their interest. These two requirements ensure that the reasons for failing the four-year holding rule have been genuinely outside the investor's control. This applies to forestry MIS under both Division 394 of the ITAA 1997 and section 82KZMG of the ITAA 1936.

2.20 The promoter penalty provisions ensure that civil penalties may continue to apply to the promoters of forestry MIS in cases where the investors' deductions are allowed to stand because of the amendments to the four-year holding rule.

Comparison of key features of new law and current law

New law	*Current law*
Division 394 of the ITAA 1997 and section 82KZMG of the ITAA 1936 do *not* deny deductions to investors in forestry MIS who fail the four-year holding rule for reasons genuinely outside their control, provided failing the rule was not reasonably anticipated at the time the investor acquired their forestry interest.	Division 394 of the ITAA 1997 and section 82KZMG of the ITAA 1936 deny deductions to investors in forestry MIS who fail the four-year holding rule. However, investors in MIS subject to Division 394 may be entitled to deduct their expenditure under section 8-1 of the ITAA 1997.

Detailed explanation of new law

2.21 The four-year holding rule for initial investors in forestry MIS operates to disallow an initial investor's deduction if a CGT event happens in relation to their forestry interest within four years after the end of the income year in which an amount is first paid by the investor. Currently, this rule applies regardless of the circumstances of the CGT event, including if these circumstances are outside the investor's control.

2.22 Under the amendments, where the four-year holding rule is failed because of circumstances genuinely outside the control of the investor, the investor's deduction is allowed, provided that it was not reasonably anticipated at the time that the investor acquired their interest. ***[Schedule 2, items 1 and 2, subsection 82KZMG(1A) of the ITAA 1936 and subsection 394-10(5A) of the ITAA 1997]***

Four-year rule failed for reasons outside of investor's control

2.23 The four-year holding period rules are failed where a CGT event happens in relation to the investor's forestry interest within four years after the end of the income year in which the interest is acquired. There is a wide range of CGT events that can happen in relation to the forestry interest to cause an investor to fail the rule.

2.24 A CGT event can happen where an investor chooses to sell their interest in a scheme. In these circumstances, an investor's deduction will continue to be denied if this CGT event is within four years of the acquisition of the interest. This is consistent with the underlying policy intent of the four-year holding rule.

2.25 However, where a CGT event happens such that the four-year holding rule is failed in circumstances genuinely outside the initial investor's control, the deduction is allowed to stand. ***[Schedule 2, items 1 and 2, paragraph 82KZMG(1A)(a) of the ITAA 1936 and paragraph 394-10(5A)(a) of the ITAA 1997]***

2.26 Situations that could be 'genuinely outside the initial investor's control' include:

- the accidental death of the initial investor;
- the interest in the scheme being compulsorily transferred, because of marriage breakdown or compulsory acquisition by a government;
- the initial investor becoming insolvent;
- the interest in the scheme being cancelled, because of trees being destroyed by fire, flood or drought; and
- the insolvency of the manager of the scheme, leading to the winding up of the scheme.

Example 2.3: CGT event outside investor's control — MIS interest terminated

In June 2006, Frank incurred expenditure to purchase an interest in a forestry MIS operated by TreeGrow Ltd. He claimed a deduction for this expenditure in his 2005-06 tax return relying on section 82KZMG of the ITAA 1936.

In September 2009, TreeGrow encountered financial difficulties and went into voluntary administration. In response, TreeGrow's creditors appointed a liquidator to recover the funds that the creditors had lent to TreeGrow.

The liquidator sold TreeGrow's assets, including the trees in the forestry MIS that Frank owns an interest in and the land on which the trees were planted. As a result, Frank's forestry interest is terminated.

The termination of Frank's interest is a CGT event. The CGT event is genuinely outside of Frank's control because he had no control over the decision to sell the trees and land, which was the direct cause of the CGT event.

Example 2.4: CGT event outside investor's control — MIS interest swapped

In May 2006, Catherine invested in a forestry MIS that was operated by TreeGrow Ltd. She claimed a deduction for expenditure incurred in the MIS relying on section 82KZMG of the ITAA 1936.

In October 2009, the liquidator of TreeGrow sold the land used in the MIS that Catherine has an interest in. Rather than terminate the interests in this scheme, this involved swapping these interests for interests in an ongoing forestry MIS.

The loss of Catherine's original interest is a CGT event. This CGT event is genuinely outside of Catherine's control, because she had no control over the decision to sell the land on which her original interest was based.

The event could not have been reasonably anticipated

2.27 A further requirement is that the event that causes the CGT event could not have been reasonably anticipated at the time that the investor acquired the interest. ***[Schedule 2, items 1 and 2, paragraphs 82KZMG(1A)(b) of the ITAA 1936 and paragraph 394-10(5A)(b) of the ITAA 1997]***

2.28 This means that it could not have been anticipated by a reasonable person standing in the shoes of the investor.

Example 2.5: CGT event could not have been anticipated

Continuing the scenario in Example 1.1, at the time that Frank invested in the forestry MIS, TreeGrow's public statements and reports did not state that the company was experiencing financial difficulties. At the time, Frank could not have reasonably anticipated that TreeGrow would experience such difficulties in 2009.

Under the existing law, Frank's assessment for 2005-06 would be amended to disallow his deduction because a CGT event happened in relation to his forestry interest within four years of the end of the income year that Frank first incurred expenditure in the forestry MIS.

Under the amendments, the conditions for allowing the deduction to stand have been satisfied. That is, the CGT event happened for a reason that is genuinely outside Frank's control and the event was not able to be reasonably anticipated in June 2006 when Frank acquired the interest. This means that Frank's assessment will not be amended to deny his deduction.

Example 2.6: CGT event able to be reasonably anticipated — deduction denied

In June 2008, Ben invested in a forestry MIS. He claimed a deduction for his expenditure under Division 394 of the ITAA 1997.

The constitution under which the MIS operates allows the scheme manager to compulsorily buy back the interests in the MIS. In August 2009, the manager chooses to exercise this right and repurchases the interests in the MIS, including Ben's interest.

The sale of Ben's interest back to the MIS manager is a CGT event, which has happened within four years of when Ben first incurred expenditure in the MIS. This CGT event has happened as a result of the manager exercising a right that is conferred upon it by the scheme's constitution.

As the manager's right to repurchase the interest is set out in the constitution, Ben could have reasonably anticipated, at the time that he acquired the interest, that the manager could compulsorily reacquire his interest. Thus, his deduction is not allowed to stand under Division 394 of the ITAA 1997.

2.29 An investor acquires their forestry interest when they first incur expenditure in the forestry scheme. This can be before an amount is paid — an amount is usually incurred when there is a definitive obligation to pay it.

Promoter penalties

2.30 The Commissioner can apply to the Federal Court for penalties against the promoter of a forestry MIS covered by an ATO product ruling, if the scheme is implemented in a way that is materially different to that described in the product ruling.

2.31 When considering whether to order the promoter of a forestry MIS to pay that penalty, the Federal Court must disregard the amendments to the four-year holding rules. This ensures that the law continues to deter schemes covered by product rulings from being implemented in a way that is materially different from that described in the product ruling. ***[Schedule 2, item 3, subsection 290-50(2A) of Schedule 1 to the TAA 1953]***

2.32 No other changes are made to the promoter penalties provisions. That is, the operation of the promoter penalties otherwise continues to be subject to the existing principles.

Application and transitional provisions

2.33 Schedule 2 applies to CGT events happening on or after 1 July 2007. This aligns the Schedule with the application of the four-year rules, which apply to CGT events happening on or after 1 July 2007. ***[Schedule 2, item 4]***

2.34 Schedule 2 contains a transitional provision for taxpayers who have previously had their tax assessment amended to remove the deductions but who would have been allowed the deduction if these amendments had been passed at the time. This transitional provision allows the investor's tax return to be amended for up to four years after the CGT event happened. ***[Clause 4]***

Chapter 3
Managed investment trusts: capital treatment and taxation of carried interests

Outline of chapter

3.1 Schedule 3 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to allow eligible Australian managed investment trusts (MITs) to make an irrevocable election (that is, choice) to apply the capital gains tax (CGT) provisions as the primary code for the taxation of gains and losses on disposal of certain assets held as passive investments (primarily shares, units and real property). If a MIT is eligible to make an election and it has not done so, then any gains or losses on the disposal of eligible assets (excluding land, an interest in land, or an option to acquire or dispose of such an asset) will be treated on revenue account.

3.2 This Schedule also clarifies the taxation treatment of 'carried interest' units in MITs. These units will effectively be treated on revenue account in the hands of the unit holder.

3.3 All of the legislative references in this chapter are to the ITAA 1997 unless otherwise specified.

Context of amendments

3.4 The existing definition of a MIT (for the purpose of pay as you go (PAYG) withholding on certain fund payments to foreign residents) is contained in section 12-400 in Subdivision 12-H in Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953). Broadly, a MIT is a public unit trust that is listed, widely held or publicly offered managed investment scheme (MIS). To retain trust taxation, a public unit trust cannot at any time during an income year operate, or control operations of, an entity that carries on activity that is not eligible investment business. Otherwise, the unit trust is taxed like a company. ***Eligible investment business*** is broadly defined under Division 6C of the *Income Tax Assessment Act 1936* (ITAA 1936) as investing in land for the purpose, or primarily for the purpose, of deriving rent, or investing or trading in certain financial instruments, including shares in a company and units in a unit trust.

3.5 Gains and losses on disposals of assets by MITs may be on revenue or capital account. Gains and losses that are treated on capital account are taxed under the CGT regime. Beneficiaries who are individuals or superannuation funds are entitled to the CGT tax concessions on distributions of capital gains. Foreign resident beneficiaries of a MIT, generally are not subject to tax on a MIT distribution attributable to a CGT gain, unless the gain relates to taxable Australian property.

3.6 In the 2009-10 Budget the Government announced that it would allow eligible Australian MITs that are not taxed like companies to make an irrevocable election to treat gains and losses on the disposal of certain assets (primarily shares, units and real property) on capital account for taxation purposes, subject to appropriate integrity rules. This measure is an important part of the Government's reforms to provide a more certain and competitive Australian tax regime for attracting foreign funds under management.

Summary of new law

3.7 Eligible MITs can make an irrevocable election/choice to apply the CGT provisions as the primary code for assessing gains and losses on disposal of certain assets (primarily shares, units and real property), subject to integrity rules. Eligible MITs include retail and wholesale entities that are MITs as defined in section 12-400 of Schedule 1 to the TAA 1953 and other retail and wholesale entities that are treated in the same way as a MIT due to the extended concept of a MIT established for the purposes of this measure.

3.8 If a MIT is eligible to make a choice but has not done so, then any gains or losses on the disposal of eligible assets (other than land, an interest in land, or an option or right to acquire or dispose of land) will be treated on revenue account. Land is not subject to this deemed revenue account treatment and whether land is treated on capital or revenue account will be based on an application of the general principles of the tax law.

3.9 The CGT provisions do not apply to distributions on 'carried interest' units in an eligible MIT; these amounts are included in the assessable income of the carried interest holder to the extent that they are not already included in their assessable income other than under the CGT provisions and are not a return of contributed capital on the carried interest.

3.10 Where a capital account choice is in force for the 2008-09 income year, the Commissioner of Taxation (Commissioner) is not able to amend prior year assessments, in respect of a re-characterisation of amounts from capital to revenue or vice versa, without the consent of the taxpayer.

Comparison of key features of new law and current law

New law	*Current law*
Eligible MITs can make an irrevocable choice to apply the CGT provisions as the primary code for assessing gains and losses on disposal of certain assets (primarily shares, units and real property), subject to integrity rules.	The treatment of gains and losses on disposals of investment assets by MITs may be on revenue or capital account depending on the individual facts and circumstances.
If a MIT is eligible to make a choice and they have not done so, then any gains or losses on the disposal of eligible assets (excluding land, an interest in land, or an option to acquire or dispose of such an asset) will be on revenue account.	No equivalent.
Distributions on 'carried interest units', and gains from the disposal of such units, are included in assessable income, to the extent that they are neither already included in the assessable income of the unitholder (other than under the CGT provisions) nor represent a return of contributed capital.	There is some doubt as to whether distributions and gains made on carried interest units are on revenue or capital account for unit holders of MITs.
Where capital account treatment is in force for the 2008-09 income year, the Commissioner is not able to amend prior year assessments, in respect of a re-characterisation of amounts from capital to revenue or vice versa, without the consent of the taxpayer.	The Commissioner may amend prior year assessments in accordance with section 170 of the ITAA 1936.

Detailed explanation of new law

Scope and meaning of a managed investment trust

3.11 A trust may be a MIT or be treated in the same way as a MIT in relation to an income year if it meets:

- the definition of 'managed investment trust' in Subdivision 12-H in Schedule 1 to the TAA 1953; or
- one of the other provisions that allow the trust to be treated in the same way as a MIT for the purposes of Division 275 of the ITAA 1997.

3.12 The extended concept of MIT ensures that certain widely held trusts (including certain wholesale trusts) that do not meet the requirements in Subdivision 12-H will, subject to the satisfaction of the relevant requirements of Division 275, be treated in the same way as a MIT for the purposes of this measure. (Broadly, a wholesale trust is a MIS that has wholesale clients and is not required to be registered under the *Corporations Act 2001* (Corporations Act)). These other widely held trusts will therefore be entitled to capital account treatment on the disposal, cessation of ownership or other realisation of certain investments.

3.13 A widely held trust that would not satisfy Subdivision 12-H solely because the trustee does not make a fund payment in relation to the income year will be able to meet the extended concept of a MIT. ***[Schedule 3, item 4, section 275-20 of Division 275 of Part 3-25]***

Managed investment trust

3.14 Broadly under Subdivision 12-H a trust is a MIT if all of the following requirements are satisfied at the test time in an income year:

- the trust is an Australian resident (connected with Australia);
- the trust is a MIS under the Corporations Act that satisfies licensing requirements for MISs; and
- the trust is either listed, widely held or a specified widely held entity is a member of the trust.

Trusts treated in the same way as a managed investment trust

Wholesale trusts

Not subject to the requirement to be operated or managed by financial services licensee

3.15 A unit trust will be treated in the same way as a MIT in relation to an income year if it is an Australian resident trust and every member of the trust is a MIT (or treated as a MIT) in relation to the income year. ***[Schedule 3, item 4, subsection 275-15(1) of Division 275 of Part 3-25]***

Example 3.7

Bennett Trust is an Australian resident unit trust. Bennett Trust has two beneficiaries — Aaron Trust (a MIT under Subdivision 12-H) and Liz Trust (a trust treated the same as a MIT).

As all members of Bennett Trust are either MITs because of Subdivision 12-H, or treated the same as a MIT under this measure, Bennett Trust will be treated the same as a MIT in relation to the income year.

Operated or managed by a financial services licensee

3.16 An Australian resident trust will also be treated in the same way as a MIT if it is managed or operated by a financial services licensee holding an Australian financial services licence whose licence covers the provision of financial services to wholesale clients or by an authorised representative of such a financial services licensee, and the trust satisfies one of the following:

- the only members of the trust are MITs (or treated as MITs); life insurance companies; or complying superannuation funds, complying approved deposit funds or foreign superannuation funds with at least 50 members;
- the trust has at least 50 members (the term ‘member’ being used in a defined sense, see paragraphs 3.18 and 3.19);
- the members of the trust that are entities listed in subsection 12-400(2) in Schedule 1 to the TAA 1953 directly or indirectly:
  - hold (or have the right to acquire) interests representing at least 75 per cent of the value of the interests in the trust;

  - have the control of, or the ability to control, 75 per cent or more of the rights attaching to membership interests in the trust; or
  - have the right to receive 75 per cent or more of any distribution of income that the trustee may make; or
- the trust is created, or was a MIT (or treated the same as a MIT except because it was created during the income year) in relation to the previous income year and ceases to exist, during the income year.

[Schedule 3, item 4, subsections 275-5(1) to (5) of Division 275 of Part 3-25]

3.17 The terms 'financial services', 'wholesale clients' and 'authorised representative' are terms defined by the Corporations Act.

Example 3.8

INS Trust is wholly-owned by a life insurance company. INS Trust is an Australian resident trust and is operated by the holder of an Australian financial services licence.

As INS Trust is not a MIS (as defined in section 9 of the Corporations Act) and as a result it does not meet the definition of MIT in section 12-400 in Schedule 1 to the TAA 1953.

However, as every member of the trust is either a MIT or an entity specified in Subdivision 12-H (for example, a life insurance company), the trust is an Australian resident trust and is managed or operated by the holder of an Australian financial services licence, INS Trust will be treated in the same way as a MIT for the purposes of this measure (as it meets the requirements in subsection 275-5(1) and (2) of Division 275 of Part 3-25 in item 1 of this Schedule).

3.18 A member of a trust for the purposes of the 50 member test includes an entity (that is, not a trust) that holds an interest in the trust indirectly through a chain of trusts. When determining the number of members the following rules apply:

- An individual that is a member of the trust, any of his or her relatives that are members of the trust, and any entity that is a member of the trust in the capacity of a nominee of the individual or his or her relatives are treated as a single member.
- A member of the trust that is not an individual and its nominees are treated as a single member.

[Schedule 3, item 4, subparagraph 275-5(4)(a)(i) and paragraphs 275-5(4)(b) and (c) of Division 275 of Part 3-25]

3.19 The following entities are not treated as members of a trust when applying the 50 member test:

- an interposed trust.
- an object of the trust.
- an individual (other than an individual who became a member of the trust because a financial product or financial service was provided to, or acquired by, the individual as a wholesale client under section 761A of the Corporations Act).

[Schedule 3, item 4, subparagraph 275-5(4)(a)(ii) and paragraph 275-5(4)(d) of Division 275 of Part 3-25]

Example 3.9

Hyde Trust is an Australian resident trust that is managed by a financial services licensee whose licence covers the provision of financial services to wholesale clients. Hyde Trust is owned by two wholesale trusts (Maree Trust and Tyler Trust) and an individual, Larry, a wholesale client.

Sally and her brother, Tom, are unitholders, along with 25 other non-related individuals in Maree Trust. ABC Pty Ltd and 25 non-related individuals are beneficiaries of Tyler Trust.

For the purposes of the 50 member test:

- Sally, Tom and the 25 other non-related individuals of Maree Trust represent 26 members of Hyde Trust (Sally and Tom are counted as one member because they are related).
- ABC Pty Ltd and the 25 non-related individuals of Tyler Trust will be counted as 26 members of the Hyde Trust.
- Maree Trust and Tyler Trust would not be counted as members.

As such, under this look through rule, Hyde Trust has 53 members and it will be treated the same as a MIT.

Unregistered Retail trusts

3.20 A trust will be treated in the same way as a MIT if:

- it would be a MIT in relation to the income year if the licensing requirement in item 2 in the table in subsection 12-400(1) in Schedule 1 to the TAA 1953 is disregarded; and
- the trust is a MIS and would be required under the Corporations Act to be operated by a financial services licensee, but for the fact that it is not required to be so registered as it is a Crown entity or because any instrument issued by the Australian Securities and Investments Commission has effect in relation to the entity and the operation of the scheme.

[Schedule 3, item 4, subsection 275-10(1) of Division 275 of Part 3-25]

3.21 This extension will allow MISs operated by certain Government-owned entities that are not required or able to register, to be eligible to make the choice for capital account treatment.

Other requirements

3.22 Certain requirements that are required to be met at a particular time (in order for a trust to be treated in the same way as a MIT for the purposes of this measure) must be met at either the time the trustee of the MIT makes the first fund payment in relation to the income year or, in cases where a trustee does not make the first fund payment, at both the start and the end of the income year. ***[Schedule 3, item 4, subsections 275-5(6), 275-10(2) and 275-15(2) and section 275-20 of Division 275 of Part 3-25]***

3.23 A trust will not be treated the same as a MIT in relation to an income year, if it is a closely held trust at any time during the income year. Broadly, this will be the case where 20 or fewer individuals, directly or indirectly:

- hold or have the right to acquire interests representing 75 per cent or more of the value of the interest in the trust;
- have the control of, or the ability to control, 75 per cent or more of the rights attaching to membership interests in the trust; or
- have the right to receive 75 per cent or more of any distribution of income that the trustee may make.

[Schedule 3, item 4, section 275-25 of Division 275 of Part 3-25]

Example 3.10

Cleary Trust is an Australian resident trust (but not a registered MIS) that is managed by a financial services licensee whose licence covers the provision of financial services to wholesale clients. Cleary Trust is not a MIT under Subdivision 12-H. JJJ Trust (a wholesale trust with 50 members) and 10 individuals that hold different levels of membership in the trust are beneficiaries of Cleary Trust.

Cleary Trust would meet the 50 member test, however, the 10 individual beneficiaries hold interests totalling 80 per cent of the value of the interest in the trust.

Therefore, Cleary Trust would not be treated as a MIT as it is a closely held trust.

Temporary circumstances

3.24 If, apart from a particular circumstance, a trust would be treated the same as as a MIT, the trust may still be treated the same as a MIT if, the circumstance is temporary and arose outside the control of the trustee of the trust, and it is fair and reasonable to the treat the trust the same as a MIT, having regard to a number of factors. These factors include: the nature of the circumstance, the actions (if any) taken by the trustee of the trust to address or remove the circumstance, the speed with which such actions were taken, and the tax impact of such a decision. ***[Schedule 3, item 4, section 275-30 of Division 275 of Part 3-25]***

Example 3.11

AAA Trust is a wholesale trust and is treated as a MIT for the purposes of this measure by reason of satisfying the 50 member requirement (directly or indirectly) and hence the extended definition of MIT contained in Division 275.

Five members redeem their units in the AAA Trust, so that the trust no longer meets the 50 member requirement. The trustee, however, is actively marketing units to attract new unitholders.

Depending on the facts and circumstances, AAA Trust may still be an eligible MIT if this circumstance is temporary and arose outside the control of the trustee of the trust, and it is fair and reasonable to treat the AAA Trust as an eligible MIT, having regard to certain factors.

The fact that the trust is actively seeking new unitholders would be evidence which demonstrates that action is being taken to address the temporary circumstance.

3.25 Subsections 102L(15) and 102T(16) provide that the meaning of trust estate and trustee in certain contexts does not include a trust estate that is a corporate unit trust or a trustee of a corporate unit trust, nor a public trading trust or a trustee of a public trading trust. Therefore corporate unit trusts and public trading trusts may not meet the requirement to be an Australian resident trust and subsequently not be treated the same as a MIT for the purposes of this measure. To avoid doubt, section 275-9B clarifies that subsections 102L(15) and 102T(16) in Part III of the ITAA 1936 do not apply for the purposes of Division 275 (the Division inserted via this measure). ***[Schedule 3, item 4, section 275-35 of Division 275 of Part 3-25]***

Example 3.12

> XYZ Trust is a MIT that is a trading trust within the meaning of Division 6C of the ITAA 1936. Despite being a public trading trust, XYZ Trust is eligible to make the choice to have capital account treatment apply, however the deemed capital account treatment will not apply while XYZ Trust is a trading trust.

Choice

3.26 If an eligible MIT makes a choice in the approved form for the this measure to apply, then the CGT provisions will be the primary code for taxing gains or losses made by a MIT on eligible assets if certain requirements are satisfied. ***[Schedule 3, item 4, subsections 275-100(1) and 275-115(1) of Division 275 of Part 3-25]***

Eligible assets — gains and losses

3.27 The gain or loss must result from the disposal, cessation of ownership or other realisation of one of the following types of assets:

- shares, shares in a foreign hybrid company and non-share equity interests in a company;
- units in a unit trust;
- land (including an interest in land); and
- a right or option to acquire or dispose of one of the assets listed directly above.

[Schedule 3, item 4, subsection 275-105(1) of Division 275 of Part 3-25]

3.28 An asset will not, however, be covered if it is a financial arrangement to which Division 230 of the ITAA 1997 applies or is a debt interest. ***[Schedule 3, item 4, subsection 275-105(2) of Division 275 of Part 3-25]***

Example 3.13

Wilson Trust was created in the 2009-10 income year. The trust is an eligible MIT for the purposes of the capital account choice. The trust made an irrevocable choice in the 2009-10 income year to apply deemed capital account treatment. (The choice is in force for the 2009-10 income year and later income years.)

The trust invests primarily in units and shares. The trust also invests in land for rent used as a shopping centre. Disposals of these assets will be assessed under the CGT provisions.

In addition to these investments, the trust holds investments in the Australian Securities Exchange SPI 200®1 Futures (a derivative product). These investments are not eligible investments and will not attract deemed capital treatment. These assets would be subject to Division 230.

Example 3.14

Bell Trust was created in the 2009-10 income year. The trust is an eligible MIT for the purposes of the capital account choice. The trust makes an irrevocable choice to have capital account treatment in the 2009-10 income year, which is in force for the 2009-10 income year and later income years.

The trust holds redeemable preference shares in Kennedy Limited, a listed company. The redeemable preference shares satisfy the debt test under Division 974 of the ITAA 1997 and are characterised as a debt interest. Therefore, these shares constitute a non-equity share holding in Kennedy Limited. Gains or losses from disposal of this debt interest will not be deemed to be treated on capital account.

The MIT must not be a corporate unit trust or a trading trust

3.29 The MIT must *not* be a trading trust (within the meaning of Division 6C of the ITAA 1936) or a corporate unit trust (within the meaning of Division 6B of the ITAA 1936) in relation to the income year in which it owned the CGT asset and the relevant CGT event happens.

3.30 The MIT may still meet this requirement if:

- the circumstance that led to it being a trading trust is temporary and arose outside the control of the trustee of the trust;

- the trustee is not liable to pay income tax under section 102S of the ITAA 1936 on the net income of the trust; and

- it is fair and reasonable that the eligible MIT meet this requirement, having regard to a number of factors. These factors include: the nature of the circumstance, the actions (if any) taken by the trustee of the trust to address or remove the circumstance, the speed with which such actions were taken, and the tax impact of such a decision .

[Schedule 3, item 4, subsections 275-110(1) and (2) of Division 275 of Part 3-25]

Choices must be in force

3.31 A choice for capital account treatment must be in force for the income year in which the CGT event happens. ***[Schedule 3, item 4, subsection 275-100(1) of Division 275 of Part 3-25]***

3.32 For trusts that become MITs in the 2009-10 or later income years, the choice must be made on or before the day it is required to lodge its income tax return for the income year in which it became a MIT or a later day allowed by the Commissioner for the MIT, whichever occurs later. For all other MITs the choice must be made on or before the latest of the following dates:

- the last day in the three-month period from the commencement of this Schedule;
- the last day of the 2009-10 income year; or
- if the Commissioner allows a later day for the MIT — then on a later day.

[Schedule 3, item 4, subsection 275-115(3) of Division 275 of Part 3-25]

3.33 The choice must be made in the approved form. ***[Schedule 3, item 4, subsection 275-115(2) of Division 275 of Part 3-25]***

3.34 For trusts that become MITs in the 2009-10 income year or later income year, the choice is in force for the income year in which the trust became a MIT and later income years. For all other MITs the choice is in force for the 2008-09 income year and later income years. ***[Schedule 3, item 4, subsection 275-115(5) of Division 275 of Part 3-25]***

Example 3.15

Page Trust is an eligible MIT for the purposes of the capital account choice and has existed for many years. On the last day of the 2009-10 income year (assuming that is the latest date on which it can make the choice), Page Trust makes an irrevocable choice to have capital account treatment.

Despite the fact that the actual choice was made in the 2009-10 income year, capital account treatment will be in force for the 2008-09 income year and later income years.

In this case, if Page Trust had disposed of shares in the 2008-09 income year it would treat the disposal on capital account.

Consequences of making a choice

3.35 A choice once made cannot be revoked. ***[Schedule 3, item 4, subsection 275-115(4) of Division 275 of Part 3-25]***

3.36 The effect of making a choice is that certain ordinary and statutory income and deduction provisions in the income tax law will no longer apply in respect of gains or losses from any eligible assets of the MIT. ***[Schedule 3, item 4, section 275-100 of Division 275 of Part 3-25]***

3.37 However, those income and deduction provisions may apply in certain situations, including where:

- a capital gain or capital loss from the event is disregarded because of certain provisions;
- the asset is land that is trading stock or was acquired before 20 September 1985 and is part of a profit-making undertaking or plan; or
- the asset is a unit or share (acquired in an income year in which the choice to apply the CGT provisions was not in force) and is treated by the MIT as trading stock in its financial report and tax return in the income year preceding the income year in which the disposal occurs and in the most recent income year ending before the start of the income year in which the choice first came into force.

[Schedule 3, item 4, subsections 275-100(3) and (4) of Division 275 of Part 3-25]

Example 3.16

TJC Trust is an eligible MIT for the purposes of the capital account choice. TJC Trust makes an irrevocable choice to have capital account treatment, which is in force for the 2008-09 income year and later income years.

In the 2009-10 income year, TJC Trust decides to dispose of units in a unit trust, which it had been treating as trading stock (in its financial report and tax return for the 2007-08 and 2008-09 income years). The units were acquired in 2007.

Despite the fact that TJC Trust has made the capital account choice, which would ordinarily mean that the disposal of the units would be treated on capital account, given the situation, an exception would apply to treat the disposal of the units on revenue account as the units were acquired before the choice was in force and they have previously been treated by the MIT on revenue account as trading stock.

Example 3.17

Swain Trust is an eligible MIT for the purposes of the capital account choice. Swain Trust makes an irrevocable choice to have capital account treatment, which is in force for the 2008-09 income year and later income years.

In the 2010-11 income year, Swain Trust decides to dispose of units in a unit trust, which it did not treat as trading stock in its financial report and tax return for the 2007-08 income year, but treated as trading stock in the 2009-10 income year. The units were acquired in 2007.

As Swain Trust did not treat the units as trading stock in the year before it made the choice for capital account treatment, the units would be treated on capital account. Given the situation, the exception does not apply.

3.38 If an eligible MIT (which is not a trading trust) acquires a CGT asset that is trading stock and incurs an outgoing in connection with the acquisition, and the choice to apply the CGT provisions is in force, then certain income and deduction provisions in the income tax law will no longer apply in relation to the asset and the acquisition. As such, the asset will not be treated as trading stock and the acquisition of the asset will not be treated on revenue account. ***[Schedule 3, item 4, subsections 275-100(5) and (6) of Division 275 of Part 3-25]***

Consequences of not making a choice

3.39 In situations where a MIT (which is not a trading trust) is eligible to make a choice for capital account treatment and it has not done so, then any gain or loss from the disposal of, ceasing to own, or other realisation of an eligible asset will be treated on revenue account, to the extent that it has not already been so treated. ***[Schedule 3, item 4, paragraphs 275-120(1)(a), (c) and (d) and subsection 275-120(2) of Division 275 of Part 3-25]***

3.40 However, this deemed revenue treatment does not apply to eligible land, an interest in land, or an option to acquire or dispose of such an asset. The characterisation of any gain or loss will depend on general law principles. ***[Schedule 3, item 4, paragraph 275-120(1)(b) of Division 275 of Part 3-25]***

Example 3.18

Rutherford Trust is an eligible MIT for the purposes of the capital account choice and has existed for many years. The trust *does not make* an irrevocable choice to treat its investments in shares, units and land on capital account.

The trust invests primarily in shares and units. The trust also invests in land for rent which is used as a shopping centre. For the 2007-08 income year, consistent with general tax law principles, the trust treats its investments in units, shares and land on capital account.

As the trust has not made a capital account choice, the disposal of units and shares after commencement of this Schedule will be treated on revenue account. However, any disposal of its investment in land may still be on capital account if this result follows from an application of general tax law principles.

Example 3.19

Bennett Trust is an eligible MIT for the purposes of the capital account choice and has existed for many years. The trust does not make an irrevocable choice to treat its investments in shares, units and land on capital account. In income years prior to the 2008-09 income year the trust trades in shares and units and holds these assets on revenue account consistent with general tax law principles.

As the trust has not made a capital account choice, disposal of units and shares after commencement of this Schedule will continue to be on revenue account. As the trust is already treating its investments in units and shares on revenue account, the deemed revenue account rule will not alter the treatment of these assets. The land would not be deemed to be on revenue account and would be subject to general tax law principles.

Consequences of a change in status

3.41 If a trust that was an eligible MIT in a previous income year fails to meet eligibility requirements in a subsequent year, the deemed capital account rules will no longer apply to disposals of covered assets in any year in which the eligibility requirements are not met. These disposals will be subject to the ordinary rules, which may include the trading stock rules in Division 70 of the ITAA 1997. If the trust meets the eligibility requirements once again, the initial choice for capital account treatment will remain in force as the choice is irrevocable. ***[Schedule 3, item 4, subsection 275-115(4) and section 275-5 of Division 275 of Part 3-25]***

Example 3.20

Stella Trust is an eligible MIT for the purposes of the capital account choice. Stella Trust makes an irrevocable choice to have capital account treatment, which is in force for the 2008-09 income year and later income years.

In the 2010-11 income year, Stella Trust fails to meet the requirements to be a MIT and as such the deemed capital treatment rule does not apply in that year. Stella Trust decides to dispose of units in a unit trust. As the capital account choice no longer applies the disposal of the units will be subject to the ordinary and statutory income rules including the trading stock rules in Division 70.

3.42 If the asset is land which is not covered by the trading stock rule in Division 70 of the ITAA 1997 and therefore is eligible to be included in the choice for CGT treatment and a choice has not been made, then the ordinary and other statutory income provisions will apply.

Taxation of carried interests

3.43 Distributions of amounts to a carried interest holder and proceeds from CGT events of a carried interest held in an entity that is an eligible MIT or was an eligible MIT in a prior income year will be included in the assessable income of the holder, to the extent that amounts are not already included in their assessable income, other than under the CGT provisions, and is not a return of contributed capital on the carried interest. ***[Schedule 3, item 4, section 275-200 of Division 275 of Part 3-25]***

3.44 The amounts to be included in assessable income, by virtue of distributions of amounts to a carried interest holder and proceeds from CGT events of a carried interest held in a MIT, are taken for the purposes of the income tax laws to have a source in Australia. ***[Schedule 3, item 4, subsection 275-200(4) of Division 275 of Part 3-25]***

3.45 A loss on CGT events of the carried interest is deductible. Losses on the carried interest may be deductible under the ordinary deduction provisions.

3.46 For the purposes of this Schedule, carried interest relates to a CGT asset held in an income year in relation to an entity that is an eligible MIT (or was an eligible MIT in relation to a previous income year) acquired because of services to be provided to the entity by the holder of the CGT asset or an associate, as a manager of the entity, an employee of a manager or an associate of such a manager or employee. A carried interest holder is entitled to distributions contingent on the profits of the entity. ***[Schedule 3, item 4, section 275-200 of Division 275 of Part 3-25]***

3.47 The carried interest rule that applies in respect of an interest acquired in an eligible MIT continues to apply after an entity ceases to be an eligible MIT. ***[Schedule 3, item 4, paragraph 275-200(1)(c) of Division 275 of Part 3-25]***

3.48 The carried interest amount is not subject to Subdivision 115-C if the amount of the distribution is attributable in whole or in part to a capital gain of the MIT. However, to the extent that a carried interest unit comprises a component of contributed capital on the carried interest, then that portion of the distribution will receive normal CGT treatment. ***[Schedule 3, item 4, subsection 275-200(7) of Division 275 of Part 3-25]***

Example 3.21

As a result of the manager services Tony provides to the ABC private equity trust (which is a MIT), Tony is rewarded with free units in the MIT, the number being based on the performance of the fund's investments.

Tony has a carried interest in ABC Trust.

Tony receives a distribution of $1,000 on his carried interest. He will be required to treat the $1,000 distribution on revenue account.

Example 3.22

The ABC Trust (which is a MIT) contracts with Anna to provide investment manager services to the trust. In 2010, Anna is issued with free units in ABC Trust. Anna has a carried interest in ABC Trust.

In 2013, ABC Trust no longer meets the definition of MIT or the extended concept of MIT.

In 2015, Anna disposes of her units and as such she will be required to treat the disposal on revenue account, even though ABC Trust is no longer an eligible MIT.

Example 3.23

Hayden holds carried interest units in Hayden Trust.

Hayden disposes of the units and makes a profit of $120 on the sale (after taking into account the return of the contributed capital). The $120 profit is included in Hayden's assessable income. The disposal of the units also gives rise to a capital gain of $120 under the CGT provisions.

However, the capital gain is reduced (but not below zero) by the amount of the profit otherwise assessable, including under Division 275 in accordance with section 118-20 of Subdivision 118-A of the ITAA 1997. This results in Hayden's capital gain being reduced to zero.

Restrictions on prior year amendments

3.49 In respect of income years prior to the 2008-09 income year, the Commissioner cannot amend assessments (of the trustee, beneficiary or an entity that holds interests in the eligible MIT indirectly through a chain of trusts) where an eligible MIT has made a choice for capital account treatment that applies in the 2008-09 income year, and:

- a previous assessment was made on the basis that a CGT event happened in relation to a CGT asset (owned by the eligible MIT) and a gain or loss was realised for income tax purposes;
- the assessment was made on the basis that a gain or loss should be reflected in the net income, a tax loss, or net capital loss of the eligible MIT and that the CGT asset was (or was not) a revenue asset; and
- the disposal (CGT event) would have been treated on capital account if the measure had applied in the prior income years.

[Schedule 3, item 8, section 275-10 of Division 275 of Part 3-25 of the Income Tax (Transitional Provisions) Act 1997]

3.50 However, the Commissioner is able to amend prior year assessments where the taxpayer gives written consent, such as where the taxpayer requests a relevant amendment. ***[Schedule 3, item 8, subsection 275-10(4) of Division 275 of Part 3-25 of the Income Tax (Transitional Provisions) Act 1997]***

Example 3.24

Cleary Unit Trust is an eligible MIT that makes the irrevocable capital account choice.

In the previous income year to the year in which the capital account treatment was in force, Cleary Trust made a gain on the disposal of shares. The disposal was treated as giving rise to a capital gain which was then distributed to the beneficiaries of the trust. Each beneficiary accounted for the distribution received as a capital receipt. If the capital account choice had applied when Cleary Trust had disposed of the shares, the disposal would have been deemed to be on capital account.

In this situation, the Commissioner cannot amend the previous assessment relating to the treatment of the gain on disposal of the shares, on the basis that the disposal of shares should have been treated on as a revenue account. However, Cleary Trust may give the Commissioner written consent to amend the assessment to treat the gain on the disposal of the shares on revenue account.

Application and transitional provisions

3.51 These amendments broadly apply in relation to eligible CGT events that happen on or after the start of the 2008-09 income year. ***[Schedule 3, subitem 10(1)]***

3.52 The amendment which provides for modifications when the acquisition of trading stock is treated on capital account when a choice is in force, applies in relation to the acquisition of assets on or after the start of the 2008-09 income year. ***[Schedule 3, subitem 10(2)]***

3.53 The amendments which deem certain assets to be on revenue account when a choice is not made, apply to disposals of assets, cessations of ownership of assets and other realisations of assets which take place on or after Royal Assent. ***[Schedule 3, subitem 10(3)]***

3.54 The amendments concerning 'carried interests' in MITs apply in relation to entitlements to distributions that arise on or after Royal Assent, or CGT events that happen on or after Royal Assent. ***[Schedule 3, subitem 10(4)]***

Consequential amendments

3.55 An amendment is made to insert section 45-286 in Schedule 1 to the TAA 1953 to include in a taxpayer's 'instalment income' for a period trust income or trust capital of an eligible MIT that the MIT distributes to, or applies for the benefit of, the taxpayer during that period. The trust income or trust capital is only included in the taxpayer's instalment income in cases where the income or capital is not already included in a taxpayer's instalment income and the eligible MIT is an Australian resident trust and meets the requirements of section 275-110 of the ITAA 1997. ***[Schedule 3, item 9, section 45-286 in Schedule 1 to the TAA 1953]***

3.56 These amendments apply in relation to distributions or applications of benefits that are made on or after the Royal Assent. ***[Schedule 3, subitem 10(5)]***

3.57 An additional amendment is made to amend the definition of 'instalment income' in subsection 995-1(1) to account for the amendment described in paragraph 3.56, which includes certain amounts in a taxpayer's instalment income. ***[Schedule 3, item 7, definition of 'instalment income' in subsection 995-1(1)]***

3.58 Amendments are made to section 840-805 to exclude any fund payment part that is a carried interest distribution under this measure from MIT withholding tax obligations and liabilities. ***[Schedule 3, items 5 and 6, subsection 840-805(7)]***

Chapter 4
Restricting eligibility to the entrepreneurs' tax offset through an income test

Outline of chapter

4.1 Schedule 4 to this Bill amends Subdivision 61-J of the *Income Tax Assessment Act 1997* (ITAA 1997) by introducing an income test into the eligibility criteria for the entrepreneurs' tax offset (ETO). The income test will restrict the eligibility of individuals whose income is over a threshold amount of income for ETO purposes ($70,000 if they are single and $120,000 if they have a family).

4.2 All of the legislative references in this chapter are to Subdivision 61-J of the ITAA 1997 unless otherwise specified.

Context of amendments

4.3 The ETO was introduced into the ITAA 1997 by the *Tax Laws Amendment (2004 Measures No. 7) Act 2005* and applies to assessments for income years commencing on or after 1 July 2005. The ETO was introduced to provide an incentive for very small, micro and home-based businesses in the very early stages of business development.

4.4 The ETO provides eligible taxpayers with a maximum tax offset of 25 per cent of their income tax liability that is attributable to their net small business income for the income year. The ETO begins to phase out at aggregated turnovers of $50,000 and eligibility ceases when aggregated turnover reaches $75,000.

4.5 Eligibility for the ETO is not currently restricted for taxpayers who have other significant sources of income (income not referable to the relevant small business).

4.6 As part of the 2008-09 Budget the Government announced that the ETO would be income tested, reducing the offset that could be claimed by those taxpayers with other significant sources of income (income not referable to the relevant small business). In the 2009-10 Budget the Government deferred the income test's start date from 1 July 2008 to 1 July 2009 to ensure that the proposed income test

commences at the same time as, and is consistent with, the Government's broader means testing reforms, also announced in the 2008-09 Budget and enacted in the *Tax Laws Amendment (2009 Measures No. 1) Act 2009*.

Summary of new law

4.7 The ETO calculated after applying the aggregated turnover test will phase out at 20 cents for every $1 of income for ETO purposes over the threshold amount. For singles the threshold amount of income for ETO purposes is $70,000 and for families the threshold amount is $120,000. This reduction will operate in addition to the current eligibility requirements applicable to the ETO (in particular, the aggregated turnover test phase-out where aggregated turnover of the small business exceeds $50,000).

4.8 The income for ETO purposes will include both the claimant's and their spouse's (if they had a spouse at the end of the income year) taxable income, reportable fringe benefits total, reportable superannuation contributions and total net investment loss for the year. However, the claimant's net small business income (or share of that income) that has already been considered in determining eligibility for the ETO under the existing law is not taken into consideration for the purposes of the income test.

Comparison of key features of new law and current law

New law	***Current law***
The ETO calculated after applying the aggregated turnover test will phase out for singles at 20 cents for every $1 of income over $70,000.	No equivalent.
The ETO calculated after applying the aggregated turnover test will phase out for families at 20 cents for every $1 of income over $120,000.	No equivalent.

Detailed explanation of new law

Taxpayers required to meet the income test

4.9 In addition to the eligibility requirements currently contained in Subdivision 61-J, individuals will also be required to meet an income test, which will restrict the ETO for singles with incomes for ETO purposes over $70,000 and families with incomes over $120,000. ***[Schedule 4, item 8, section 61-523]***

4.10 Broadly, small business sole-traders, partners in small business partnerships, and beneficiaries of small business trusts will be required to meet the income test requirement to be entitled to claim the ETO.

Example 4.25

> Jared carries on a tax agent business as a sole-trader. In the 2009-10 income year this business had an aggregated turnover of $70,000. Jared also has other sources of income. Applying the turnover test, Jared is able to claim the ETO in respect of the small business income attributable to his tax agent business. However, Jared will also be required to apply the ETO income test (in relation to his other income) in determining the amount of ETO, if any, he is entitled to.

4.11 As the intent of the measure is to ensure that individual recipients of the ETO with other, significant sources of income, are ineligible for the ETO, company and trustee claimants of the ETO will not be required to meet the income test. Companies are unable to fully pass on the benefit of the ETO to individual shareholders due to the dividend imputation system. Moreover, trustees can only claim the ETO in limited circumstances (where they are liable to pay tax on the small business income of the trust). However, they are only liable in their capacity as a trustee and their own income (non-trust income) is not relevant.

Income thresholds

4.12 The ETO will begin to phase out for single individuals when their income for ETO purposes exceeds $70,000. The ETO will begin to phase out for 'members of a family' when the combined income for ETO purposes of the taxpayer and their spouse (where applicable) exceeds $120,000. A taxpayer will be a member of a 'family' (and can therefore take advantage of the higher income threshold) if they have a spouse on the last day of an income year, or a dependant on any day in an income year. ***[Schedule 4, item 8, definition of 'threshold amount' in section 61-523]***

4.13 Broadly, a dependant is a child less than 21 years of age (not being a student), a student, an invalid relative and a parent of the taxpayer

or the taxpayer's spouse. A spouse includes a wife or husband; someone (whether of the same sex or a different sex) who, although not legally married to the taxpayer, lives with them on a genuine domestic basis in a relationship as a couple; and someone (whether of the same sex or a different sex) with whom the taxpayer is in a relationship that is registered under a state law or territory law prescribed for the purposes of section 22B of the *Acts Interpretation Act 1901*. ***[Schedule 4, item 8, definitions of 'non-ETO small business income' and 'threshold amount' in section 61-523]***

Definition of income for the purposes of the ETO income test

4.14 Income for ETO purposes is defined as 'non-ETO small business income' and consists of the taxpayer's taxable income, reportable fringe benefits total, total net investment loss and reportable superannuation contributions for the relevant income year. ***[Schedule 4, item 8, definition of 'non-ETO small business income' in section 61-523]***

4.15 If a taxpayer has a spouse on the last day of the income year their income for the purposes of the ETO income test will also include their spouse's taxable income, reportable fringe benefits total, total net investment loss and reportable superannuation contributions for the relevant income year. ***[Schedule 4, item 8, definition of 'non-ETO small business income' in section 61-523]***

Example 4.26

The only income Daniel receives for the 2009-10 income year is from a computer supply business he carries on as a sole-trader from an office in his house. This business has aggregated turnover of $45,000 for the 2009-10 income year. Applying the turnover test Daniel is able to claim the ETO in respect of the small business income attributable to his computer supply business.

Elizabeth is Daniel's spouse on the last day of the 2009-10 income year. For the 2009-10 income year Elizabeth has taxable income, reportable fringe benefits total, total net investment loss and reportable superannuation contributions of $100,000. This amount will be taken into account in determining whether or not Daniel's ETO claim is affected by the income test.

Example 4.27

In the 2009-10 income year, Aaron runs a bookkeeping business from his home. The net income from his business is $20,000 (that is, $32,000 turnover less $12,000 business expenses). This amount is Aaron's net small business income. In addition he works as an accountant and receives salary and wages of $75,000. Aaron has no dependants and he is in a defacto relationship with Lisa. Lisa works

part-time and earns $15,000 per annum. Aaron and Lisa have no other income. On 3 June 2010 Aaron and Lisa legally separate.

Applying the existing eligibility criteria, Aaron would be entitled (before the application of the income test) to an ETO of $1239.32.

As Aaron does not have a spouse as at 30 June 2010 the lower threshold amount will apply for the purposes of the ETO income test. The relevant threshold amount will be $70,000. Aaron's salary and wages ($75,000) are taken into consideration in determining the amount of non-ETO small business income. Aaron's net small business income of $20,000 is not included in this amount. Lisa's income is not included as she was not his spouse on the last day of the income year.

As Aaron's non-ETO small business income is above the $70,000 threshold, the income test will reduce Aaron's ETO of $1239.32 for the 2009-10 income year by $1,000. As a result, Aaron is entitled to an ETO of $239.32 ($1239.32 − $1000) for the 2009-10 income year.

4.16 In determining a taxpayer's income for the purposes of the ETO income test, the 'net small business income' of the ETO claimant which has given rise to their ETO entitlement will be excluded.

4.17 In respect of beneficiaries of trusts and partners of partnerships, it will be their share of the net small business income (rather than the entire net small business income) of the trust or partnership that is excluded. Such income would already have been taken into account when determining eligibility for, and the quantum of, the ETO under the turnover test, so its exclusion will prevent double counting of the income in the ETO turnover test and the income test. However, any net small business income of the claimant which has not given rise to an ETO entitlement will not have been subject to the turnover test and will not be excluded from a taxpayer's income for the purpose of the ETO income test. Further, any net small business income of a taxpayer's spouse will not be excluded from the spouse's taxable income, reportable fringe benefits total, total net investment loss and reportable superannuation contributions for the relevant income year. ***[Schedule 4, item 8, definition of 'non-ETO small business income' in section 61-523]***

Example 4.28

Michael is a partner of a partnership that is a small business entity with aggregated turnover of $70,000 for the 2009-10 income year. Applying the turnover test, Michael is eligible to claim the ETO in respect of any distribution from this partnership. Michael receives a partnership distribution of $25,000 for the 2009-10 income year.

Michael is also a beneficiary of a small business trust with an aggregated turnover of $120,000 for the 2009-10 income year. As the trust's turnover is more than $75,000, its income (including that

distributed to beneficiaries) will not be eligible for the ETO. Michael is required to include a $30,000 trust distribution in his assessable income for the 2009-10 income year.

In addition to the income received from the partnership and trust, Michael also earns $41,000 in the 2009-10 income year from investments he holds. As such, for the 2009-10 income year Michael has income of $96,000. However, for the purpose of the ETO income test Michael will be regarded as having income of $71,000.

Calculation of the ETO following the introduction of the income test

4.18 The calculation of the ETO applying the current turnover test involves the application of a five step process to arrive at a taxpayer's offset. Step by step examples and guidance on how the ETO is calculated under the existing law can be found in the explanatory memorandum to the Tax Laws Amendment (2004 Measures No. 7) Bill 2004 (Chapter 1). The income test will operate in addition to the current eligibility requirements (namely, the turnover test) and will operate to reduce the offset amount as currently calculated (but will not operate to reduce the offset amount below zero). As a consequence, if the initial turnover test is not satisfied, the income test does not need to be applied. ***[Schedule 4, item 8, section 61-523]***

4.19 While, under the Bill, the income test operates to reduce the offset already calculated under the existing provisions, it nonetheless acts as an additional eligibility criteria as it can operate to reduce the amount of the offset to nil.

4.20 Under the ETO income test the amount of the offset worked out under the current turnover test is then reduced by the amount calculated under the following formula:

$$\frac{\begin{array}{c}\text{Non-ETO small business income}\\ \text{for the income year}\end{array} - \text{Threshold amount}}{5}$$

[Schedule 4, item 8, section 61-523]

Example 4.29: Income test for a sole trader

In the 2009-10 income year, Jenny runs a physiotherapy practice from her home. The net income from her practice is $20,000 (that is, $30,000 turnover less $10,000 business expenses). This amount is Jenny's net small business income. In addition she has a part-time job as a shop assistant from which she receives salary and wages of

$25,000. She is married to Geoff who works as a pharmacist and earns $98,000 per annum. Geoff has no other income.

Applying the existing eligibility criteria, Jenny would be entitled (before the application of the income test) to an ETO of $816.67.

As she is married as at 30 June 2010, the 'family' threshold will apply for income test purposes. Both Jenny's and Geoff's salary and wages ($25,000 + $98,000 = $123,000) are taken into consideration in determining the amount of non-ETO small business income. Jenny's net small business income of $20,000 *is not* included in this amount.

Jenny's ETO will therefore be reduced by:

$$\frac{\$123{,}000 - \$120{,}000}{5} = \$600$$

As a result, Jenny will be entitled to an ETO of $216.67 ($816.67 − $600) for the 2009-10 income year.

Example 4.30: Income test for a beneficiary of a trust

ABC Trust is a small business entity, with an aggregated turnover of $50,000 in the 2009-10 income year.

Marylyn is a beneficiary of ABC Trust and receives a distribution of $20,000 for the 2009-10 income year. She also receives salary and wages of $75,000 from her job as an accountant. She has no dependants and no spouse.

Applying the existing eligibility criteria Marylyn would be entitled (before the application of the income test) to an ETO of $1,239.47.

Marylyn's non-ETO small business income for the purposes of the income test is $75,000. As she is single with no dependants the relevant threshold amount is $70,000.

Marylyn's ETO will therefore be reduced by:

$$\frac{\$75{,}000 - \$70{,}000}{5} = \$1,000$$

As a result, Marylyn will be entitled to an ETO of $239.47 ($1239.47 − $1,000) for the 2009-10 income year.

Example 4.31: Income test for a partner in a partnership

Lina and Geoff are equal partners in Partnership A which runs a costume-making business. The partnership has an aggregated turnover of $58,000 and net income of $50,000 in the 2009-10 income year. In addition to her costume-making business Lina has a part-time job. She earns $60,000 from this job and a further $15,000 from various investments. Lina has two young children and no spouse.

Applying the existing eligibility criteria, Lina is entitled (before the application of the income test) to an ETO of $1,081.63.

Lina's non-ETO small business income is $75,000 (her wages and investment income). While this amount would be above the $70,000 threshold for singles, as Lina has two dependant children the higher 'family' threshold of $120,000 applies. As Lina's non-ETO small business income is below this threshold, the income test does not impact on Lina's claim and she will be entitled to an ETO of $1,081.63 for the 2009-10 income year.

Application and transitional provisions

4.21 The amendments made by this Schedule apply in relation to assessments for income years that commence on or after 1 July 2009.

Chapter 5
Consolidation

Outline of chapter

5.1 Schedule 5 to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to:

- clarify the operation of certain aspects of the consolidation regime; and
- improve interactions between the consolidation regime and other parts of the law.

Context of amendments

5.2 The consolidation regime applies primarily to a group of Australian resident entities wholly-owned by an Australian resident company that choose to form a consolidated group. Specific rules provide for the membership of certain resident wholly-owned subsidiaries of a foreign holding company (a multiple entry consolidated group (MEC group)).

5.3 Unless otherwise specified, references in this chapter to a consolidated group include a MEC group.

5.4 Following a choice to consolidate, members of a consolidated group are treated as a single entity for income tax purposes. Subsidiary entities lose their individual income tax identity on entry into the group and are treated as part of the head company.

5.5 A number of issues have arisen from the practical operation of the consolidation regime since its introduction in 2002. These amendments respond to those issues by clarifying the operation of certain aspects of the consolidation regime and improving interactions with other parts of the law.

Summary of new law

5.6 Schedule 5 to this Bill amends the consolidation provisions in the income tax law to clarify the operation of certain aspects of the consolidation regime and improve interactions between the consolidation regime and other parts of the law. In particular, the amendments will:

- ensure that the tax cost that is set for an asset of a joining entity can be used for the purposes of applying other provisions of the income tax law;
- subject to certain integrity rules, allow consolidated groups to convert to MEC groups, and vice versa, with minimal tax consequences;
- improve the treatment of pre-capital gains tax (CGT) membership interests held in a joining entity;
- clarify and improve the operation of various aspects of the tax cost setting rules that apply when an entity joins or leaves a consolidated group;
- treat units in cash management trusts and certain rights to future income held by a joining entity as retained cost base assets;
- repeal CGT event L7;
- reduce the tax cost setting amount of a joining entity that has impaired debts at the joining time;
- ensure the blackhole expenditure provisions that apply to consolidated groups also apply to MEC groups;
- ensure that certain consolidation transitional rules apply to the head company of a group which has a substituted accounting period where the group consolidated after 30 June 2003 on a day before the first day of its income year;
- improve the operation of the inter-entity loss multiplication rules for widely held companies;
- modify the CGT timing rules where:
  - an entity which holds a CGT asset joins or leaves a consolidated group; and

   – a CGT event happens in relation to the asset which straddles the joining or leaving time;

- modify the mechanism for making various choices relating to the formation of, or changes to, a consolidated group or MEC group;
- modify the mechanism for working out the taxable income of consolidated groups that have life insurance company members in respect of intra-group transactions; and
- modify the tax cost setting rules where an entity that has issued non-membership equity interests joins or leaves a consolidated group.

Comparison of key features of new law and current law

New law	*Current law*
Use of the tax cost setting amount	
The head company can use the tax cost setting amount of an asset for the purpose of working out the amount included in assessable income or allowed as a deduction when applying other provisions of the income tax law.	The tax cost setting rules set the tax cost setting amounts for assets held by an entity that joins a consolidated group. When a tax consequence arises in relation to an asset for a head company, the tax cost setting amount is intended to be used by the head company to determine those tax consequences. However, for the purposes of applying certain provisions in the income tax law, the head company is unable to use the tax cost setting amount of an asset.
Group restructures	
Subject to certain integrity rules, minimal tax consequences will arise for the ongoing members of the group when: • a consolidated group converts to a MEC group; or • a MEC group converts to a consolidated group.	Significant tax consequences arise for the on-going members of a group when: • a consolidated group converts to a MEC group; or • a MEC group converts to a consolidated group.

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Pre-capital gains tax proportions</td></tr>
<tr><td>The pre-CGT status of membership interests held in a joining entity will be preserved by:
• working out the proportion of pre-CGT membership interests in the joining entity; and
• subject to integrity rules, attaching pre-CGT status to an equivalent proportion of membership interests when the entity leaves the group.</td><td>When an entity joins a consolidated group its membership interests cease to be recognised for income tax purposes. If the membership interests are pre-CGT assets, this status is preserved by attributing a pre-CGT factor to the underlying assets of the joining entity.</td></tr>
<tr><td colspan="2">Modifications to the tax cost setting rules of a joining entity</td></tr>
<tr><td>When an entity joins a consolidated group, the amendments will, broadly:
• ensure adjustments to the allocable cost amount are not double counted;
• clarify the operation of the adjustment to the allocable cost amount in respect of certain pre-joining time CGT roll-overs that applied to a joining entity's assets; and
• phase out the over-depreciation adjustment to the allocable cost amount.</td><td>Under the tax cost setting rules, the tax costs of a joining entity's assets are generally reset by allocating the joining entity's allocable cost amount to each of the joining entity's assets in proportion to their market value. This allocation process ensures that, broadly, the costs incurred by the head company to acquire the joining entity's membership interests are pushed down into the tax costs of the underlying assets of the joining entity.
The allocable cost amount is basically the sum of the cost bases of the head company's membership interests in the joining entity held by members of the joined group and the joining entity's liabilities. Several adjustments are made to this amount.</td></tr>
</table>

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Modifications to the tax cost setting rules of a leaving entity</td></tr>
<tr><td>When an entity leaves a consolidated group, the amendments will, broadly:
clarify that the liabilities taken into account in working out the old group’s allocable cost amount are the liabilities held just before the leaving time; and
ensure that an appropriate adjustment is made to the old group’s allocable cost amount in respect of a liability when that liability was taken into account in working out the allocable cost amount for an entity that joined the group.</td><td>When an entity leaves a consolidated group, the tax costs of the membership interests in the leaving entity needs to be reconstructed.
Under the tax cost setting process that applies when an entity leaves a consolidated group, the old group’s allocable cost amount is worked out to determine the tax costs of the membership interests in the leaving entity.</td></tr>
<tr><td colspan="2">Modifications to the tax cost setting rules of a joining or leaving entity</td></tr>
<tr><td>When an entity joins or leaves a consolidated group, the amendments will, broadly:
clarify the accounting principles that apply to determine the accounting liabilities which are recognised under the tax cost setting rules;
clarify the scope and amount of the adjustment to the allocable cost amount in respect of inherited deductions; and
if the joining or leaving entity is a general insurance company, ensure that the tax cost setting rules apply appropriately to its deferred acquisition costs, deferred reinsurance expenses and recoveries receivable.</td><td>Some elements of the tax cost setting rules apply both:
when an entity joins a consolidated group; and
when an entity leaves a consolidated group.</td></tr>
</table>

New law	***Current law***
Retained cost base assets	
The range of assets that are treated as retained cost base assets will include: • units in cash management trusts held by a joining entity; and • certain rights to future income assets held by a joining entity.	Under the tax cost setting rules some assets are treated as retained cost base assets. The tax cost of a retained cost base asset is generally set at an amount that is equal to the joining entity's cost of the asset.
CGT event L7	
CGT event L7 will be repealed.	CGT event L7 happens when: • a liability that was taken into account in working out the allocable cost amount is discharged for a different amount; and • the allocable cost amount would have been different if the discharged amount was used at the joining time.
Reduction in the tax cost setting amount that exceeds the market value of certain retained cost base assets	
The tax cost setting amount of an impaired debt held by a joining entity will be reduced by the amount of the capital gain arising under CGT event L3 (but not below zero). As a result, the capital gain arising under CGT event L3 will be reduced by an equivalent amount.	A capital gain arises under CGT event L3 if the total tax cost setting amounts for all retained cost base assets exceed the joining entity's allocable cost amount. Impaired debts qualify as retained cost base assets. The tax cost setting amount of impaired debts is the face value of those debts at the joining time. As the face value of impaired debts is likely to be higher than the amount that could be recovered, the capital gain arising under CGT event L3 is overstated.

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Blackhole expenditure for MEC groups</td></tr>
<tr><td>The cost base of a CGT asset held by a MEC group will include certain expenditure paid to a third party in relation to the asset.</td><td>A capital gain arises if the capital proceeds received by a taxpayer when a CGT event happens to an asset exceed the asset's cost base.
Under the blackhole expenditure provisions, the cost base of a CGT asset held by a consolidated group (but not by a MEC group) includes certain expenditure paid to a third party in relation to the asset.</td></tr>
<tr><td colspan="2">Transitional concessions for groups with substituted accounting periods</td></tr>
<tr><td>The transitional concession will apply where the head company of a consolidated group has a substituted accounting period and the group consolidated between 1 July 2003 and 30 June 2004 on a day that is on or before the first day of its income year.</td><td>A transitional concession that allows the allocable cost amount of a joining entity to be increased by the undistributed, untaxed profits accrued to the group before 1 July 2003 applies to:
• a consolidated group that came into existence before 1 July 2003; or
• a consolidated group that came into existence between 1 July 2003 and 30 June 2004, provided that it came into existence on the first day of the income year of the head company starting after 30 June 2003.</td></tr>
</table>

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Loss multiplication rules for widely held companies</td></tr>
<tr><td>A widely held company will not have a relevant equity interest or relevant debt interest in a loss company at a particular time under the inter-entity loss multiplication rules unless an entity has a controlling stake in the loss company and that entity has a direct or indirect interest in, or is owed a debt by, the widely held company in respect of which, broadly:
• the entity could, if a CGT event happened to the interest or debt, make a capital loss that reflects any part of the loss company's overall loss; or
• the entity has deducted an amount in respect of the interest or debt, where the deduction reflects any part of the loss company's overall loss.</td><td>The inter-entity loss multiplication rules apply to an entity that has a relevant equity interest or relevant debt interest in a loss company at a particular time.
Subject to certain exceptions, an entity has a relevant equity interest or relevant debt interest in a loss company at a particular time if, broadly, the entity has a controlling stake in the loss company and satisfies certain other tests.
Widely held companies have difficulty in satisfying the exceptions to these tests. As a result, in some circumstances the losses of a loss company receive no tax recognition at all.</td></tr>
<tr><td colspan="2">CGT straddles</td></tr>
<tr><td>When a CGT event straddles the time that an entity joins or leaves a consolidated group, the CGT event will be taken to happen at the time that the circumstances which gave rise to the CGT event occurred — that is, for example, at the time of settlement of the relevant contract.</td><td>Under the CGT rules, a capital gain or loss arises when a CGT event happens to an asset. A CGT event will usually happen at a time which is different to the time that the capital proceeds are received.
For example, if a contract is entered into for the disposal of a CGT asset, the CGT event happens at the time the contract is entered into (rather than at the time of settlement).
Difficulties arise where the period between the time that the contract is entered into and the time of settlement straddles the period an entity joins or leaves a consolidated group. In these circumstances, the entity that entered into the contract (and makes a capital gain or loss) will be different to the entity that holds the asset at the time of settlement (and receives the capital proceeds).</td></tr>
</table>

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td colspan="2">Choice to consolidate</td></tr>
<tr><td>The choices relating to the formation of, or changes to, a consolidated group or MEC group will need to be made in writing but will not need to be given to the Commissioner of Taxation (Commissioner). However, the head company of the group must still advise the Commissioner of relevant information relating to the choice in writing in the approved form.</td><td>Choices relating to the formation of, or changes to, a consolidated group or MEC group must be made in the approved form which is given to the Commissioner. These are the choices to:
• consolidate a consolidatable group;
• consolidate a potential MEC group;
• consolidate a potential MEC group following a special conversion event;
• make a new eligible tier-1 company a member of a MEC group; and
• appoint a new provisional head company to a MEC group.
Difficulties have arisen where a choice has been ineffective because of a technical deficiency in completing the approved form.</td></tr>
<tr><td colspan="2">Life insurance companies</td></tr>
<tr><td>Intra-group transactions of a consolidated group that has a life insurance company member will be recognised for the purposes of:
• determining the amount of a head company’s complying superannuation/FHSA class income and segregated exempt asset income; and
• determining the value of the head company’s complying superannuation/FHSA asset pool and segregated exempt assets.</td><td>Life insurance companies essentially carry on three different types of business:
• ordinary business — which is taxed at 30 per cent;
• complying superannuation/FHSA business — which is taxed at 15 per cent; and
• immediate annuity business — which is non-assessable non-exempt income.
If a life insurance company joins a consolidated group, difficulties arise in identifying the income that relates to each class in respect of intra-group transactions.</td></tr>
</table>

New law	*Current law*
Non-membership equity interests	
Non-membership equity interests issued by an entity that joins or leaves a consolidated group will be appropriately recognised under the tax cost setting rules. As a result, the allocable cost amount for a joining entity will be increased to reflect the amount received by the joining entity from the issue of non-membership equity interests. In addition, when an entity leaves a consolidated group: • if the leaving entity has issued non-membership equity interests to entities that are members of the old group, a tax cost will arise for those membership interests; and • if the leaving entity has issued non-membership equity interests to entities that are not members of the old group, the old group's allocable cost amount for the leaving entity will be reduced to reflect the amount received by the old group from the issue of the non-membership equity interests.	Non-membership equity interests issued by an entity that joins or leaves a consolidated group are not recognised under the tax cost setting rules. Consequently, when an entity joins a consolidated group, the allocable cost amount for the joining entity is understated. When an entity leaves a consolidated group: • if the leaving entity has issued non-membership equity interests to entities that are members of the old group, no tax cost arises for those membership interests; and • if the leaving entity has issued non-membership equity interests to entities that are not members of the old group, the old group's allocable cost amount for the leaving entity is overstated.

Detailed explanation of new law

Part 1 — Use of the tax cost setting amount

5.7 When an entity joins a consolidated group, the cost of each asset of the joining entity is given a new tax cost setting amount under the tax cost setting rules in Division 705.

5.8 Section 701-55 ensures the new tax cost setting amount for an asset is used by the head company as the basis for applying other provisions in the income tax law. In this regard:

- subsection 701-55(2) applies to treat the asset as if it were acquired by the head company at the joining time for an amount equal to its tax cost setting amount for the purposes of applying certain depreciating asset provisions;

- subsection 701-55(3) applies to an asset that is trading stock for the purposes of Division 70 and deems the head company to have held the trading stock from the start of the income year in which the joining time occurs with a value equal to its tax cost setting amount;

- subsection 701-55(4) applies to an asset that is a qualifying security for the purposes of Division 16E of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) and deems the head company to have acquired the asset at the joining time for a payment equal to its tax cost setting amount;

- subsection 701-55(5) applies to adjust the cost base or reduced cost base of an asset so that it equals the asset's tax cost setting amount where the CGT provisions apply to the asset;

- subsections 701-55(5A) and (5B) apply to an asset that is a financial arrangement and specifies the use of the tax cost setting amount for the purposes of applying Division 230; and

- new subsection 701-55(5C), which is being inserted by this Bill, applies to an asset that is a right to future income covered by new section 716-410.

5.9 Subsection 701-55(6) is a residual or catch all provision that operates to treat the tax cost setting amount as the cost of an asset when any provision of the income tax law not specifically mentioned in section 701-55 applies to the asset.

5.10 The purpose of subsection 701-55(6) is to ensure that the tax cost setting amount of an asset (rather than its original tax cost) is used when applying a provision of the income tax law that is not specifically covered by subsections 701-55(2) to (5C). The determination of which provision in the income tax law is to apply to an asset is a question of fact that will depend on the particular circumstances of each case.

5.11 Subsection 701-55(6) is modified to ensure that it gives effect to its policy intent. Under these modifications, subsection 701-55(6) will apply where a provision of the income tax law, other than a provision specifically mentioned in subsections 701-55(2) to (5C), is to apply in relation to an asset by including an amount in assessable income, or by allowing an amount as a deduction, in a way that brings into account (directly or indirectly) any of the following amounts:

- the cost of the asset;
- outgoings incurred, or amounts paid, in respect of the asset;
- expenditure in respect of the asset; or
- an amount of a similar kind in respect to the asset.

[Schedule 5, item 3, subsection 701-55(6)]

5.12 In these circumstances, the other provision of the income tax law applies for the purposes of determining the amount included in assessable income or determining the amount of the deduction as if the cost, outgoing, expenditure or other amount had been incurred or paid to acquire the asset at the particular time for an amount equal to the tax cost setting amount. ***[Schedule 5, item 3, subsection 701-55(6)]***

5.13 The deemed acquisition in subsection 701-55(6) solely facilitates the application of a provision of the income tax law to the tax cost setting amount for the purposes of determining the amount included in assessable income or allowed as a deduction. In this regard, the deemed acquisition does not affect the operation of the entry history rule (section 701-5) where pre-joining time facts may be relevant in determining which provision of the income tax law is to apply to the tax cost setting amount of an asset. ***[Schedule 5, item 3, note to subsection 701-55(6)]***

5.14 These facts may include, for example:

- the original acquisition date of an asset;
- whether an asset is held on revenue account or capital account; and
- whether the tax cost setting amount for an asset that is a reset cost base asset has been reduced to the asset's market value or terminating value under section 705-40.

5.15 The scope of the operation of subsection 701-55(6) is clarified by section 701-56, which specifies that:

- subsection 701-55(6) does not override history (other than cost);
- subsection 701-55(6) does not apply to trading stock; and
- subsection 701-55(6) does not apply to certain capital expenditure provisions.

Subsection 701-55(6) does not override history (other than cost)

5.16 First, if subsection 701-55(6) applies in relation to an asset at a time an entity joins a consolidated group, the things that are taken to have happened in relation to the head company under the entry history rule (section 701-5) do not include:

- the cost, outgoing, expenditure or other amount incurred or paid to acquire the asset by the joining entity; or
- whether the cost, outgoing, expenditure or other amount incurred or paid by the joining entity to acquire the asset has been deducted by the joining entity before the joining time.

[Schedule 5, item 3, subsection 701-56(1)]

Example 5.32: Consumable stores

Company J operates a transport business and pays $100,000 to acquire a quantity of fuel on 25 June 2009. The fuel is for use in its transport business.

Taxation Ruling No. IT 333 specifies that a deduction for consumables is allowed on either an incurred or usage basis, depending on the circumstances.

- Where consumables are acquired to meet immediate requirements, deductions may be claimed in the income year in which the expenditure was incurred (the incurred basis).
- Where the taxpayer builds up a store or stockpile of consumables in excess of immediate requirements, deductions may be claimed only as the consumables are used up (the usage basis).

Company J applies the incurred basis to deduct the amount paid to acquire the fuel ($100,000) in the 2008-09 income year.

On 1 July 2009, Head Co acquires all the membership interests in Company J. As a result, Company J joins Head Co's consolidated group.

Company J still holds 70 per cent of the fuel that it acquired on 25 June 2009 at the joining time. Under the tax cost setting rules, consumable stores are a reset cost base asset and the tax cost setting amount for the fuel is $70,000.

Company J continues to apply the incurred basis to its transport business fuel acquisitions. Therefore, Head Co can deduct the tax cost setting amount for the fuel ($70,000) in the 2009-10 income year.

The fact that another member of the consolidated group may be applying the usage basis to its consumables does not affect this outcome.

However, if Company J had applied the usage basis to its fuel acquisitions, Head Co would generally deduct the tax cost setting amount for the fuel ($70,000) as the fuel is used.

The consumable store of fuel is a CGT asset. However, subsection 701-55(5) does not apply to increase the cost base of the CGT asset by the tax cost setting amount for the fuel. In this regard, as Head Co can deduct the tax cost setting amount for the fuel under section 8-1, subsection 110-45(2) applies to prevent the tax cost setting amount from being included in the cost base of the CGT asset.

Example 5.33: Assets held on revenue account

Company J is an investment company with a significant share portfolio. Company J regularly switches between investments to maximise dividend yields and any profit made on the sale of its shares constitutes ordinary income (per *London Australia Investments Co Ltd v. FC of T* (1977) 138 CLR 106). The shares are therefore held as revenue assets (as defined in section 977-50).

Company J acquired two parcels of shares to add to its share portfolio:

- parcel A for a cost of $100,000; and
- parcel B for a cost of $80,000.

Company J subsequently joins Head Co's consolidated group. Under the tax cost setting rules:

- the tax cost setting amount for the parcel A shares is $105,000; and
- the tax cost setting amount for the parcel B shares is $82,000.

Head Co also holds the two parcels of shares on revenue account. It subsequently sells the parcel A shares for $120,000. The gain on the disposal of the shares is the difference between the disposal proceeds ($120,000) and the tax cost setting amount ($105,000) — that is, $15,000. Therefore, Head Co will include $15,000 in its assessable income as ordinary income (section 6-5) in respect of the disposal of the parcel A shares.

The parcel A shares are a CGT asset. Therefore, subsection 701-55(5) applies to increase the cost base of the CGT asset by the tax cost setting amount for the parcel A shares. Consequently, Head Co makes a capital gain of $15,000 on the disposal of the shares. However, section 118-20 applies to reduce this capital gain to nil.

Head Co also sells the parcel B shares for $75,000. The loss on the disposal of the shares is the difference between the disposal proceeds ($75,000) and the tax cost setting amount ($82,000) — that is, $7,000. Therefore, Head Co's can deduct $7,000 as a general deduction (section 8-1) in respect of the disposal of the parcel B shares.

The parcel B shares are a CGT asset. Therefore, subsection 701-55(5) applies to increase the cost base of the CGT asset by the tax cost setting amount for the parcel B shares. However, Head Co does not make a capital loss on the disposal of the shares because Head Co can deduct the amount of the loss under section 8-1.

Example 5.34: Traditional securities

Company J acquires two assets that are traditional securities (as defined in subsection 26BB(1) of the ITAA 1936) on 1 July 2005 — asset A was acquired for a cost of $10,000 and asset B for a cost of $20,000.

Head Co acquires all of Company J's membership interests. Consequently, Company J joins Head Co's consolidated group.

Under the tax cost setting rules, the traditional securities held by Company J are a reset cost base asset and:

- the tax cost setting amount for asset A is $11,000; and
- the tax cost setting amount for asset B is $19,000.

Head Co subsequently disposes of asset A for $13,000. Therefore, it makes a gain of $2,000 on the disposal of the asset — that is, the amount received on the disposal of the asset ($13,000) less the tax cost setting amount ($11,000). The amount of this gain is included in Head Co's assessable income under subsection 26BB(3).

Head Co also disposes of asset B for $15,000. Therefore, it makes a loss of $4,000 on the disposal of the asset — that is, the amount

received on the disposal of the asset ($15,000) less the tax cost setting amount ($19,000). Head Co can deduct the amount of this loss under subsection 70B(2).

Note that if the securities are financial arrangements that are taxed under the taxation of financial arrangements provisions (Division 230), subsections 701-55(5A) and (5B) will apply to specify the use of the tax cost setting amount for the securities.

Subsection 701-55(6) does not apply to trading stock

5.17 Second, subsection 701-55(6) does not apply in relation to an asset that is trading stock. In this regard, if an asset is trading stock, subsection 701-55(3) applies to determine the use of the tax cost setting amount of the asset (even though a deduction may be allowed under section 8-1 in respect of the asset). ***[Schedule 5, item 3, subsection 701-56(2)]***

Subsection 701-55(6) does not apply to certain capital expenditure provisions

5.18 Third, subsection 701-55(6) does not apply in relation to an asset if any of the following provisions apply to the asset:

- Subdivision 40-F (Primary production depreciating assets);
- Subdivision 40-G (Capital expenditure of primary producers and other landholders);
- Subdivision 40-H (Capital expenditure that is immediately deductible);
- Subdivision 40-I (Capital expenditure that is deductible over time), other than section 40-880 (Business related costs);
- Subdivision 40-J (Capital expenditure for the establishment of trees in carbon sink forests);
- Division 41 (Additional deduction for new business investment); and
- Division 43 (Capital works).

[Schedule 5, item 3, subsection 701-56(3)]

5.19 The deductions allowed under these capital expenditure provisions are, in most cases, based on:

- the original capital expenditure incurred by a taxpayer to construct or create the asset, rather than on the amount paid (by a subsequent or different taxpayer) to acquire the asset; or

- the amount of capital expenditure incurred that is not associated with an asset.

5.20 Section 40-880 is excepted because it does not have this limitation. However, the tests in section 40-880 need to be satisfied for an amount to be deducted for business related costs. If those tests are satisfied, the amount of the deduction will be based on the tax cost setting amount for the relevant asset.

5.21 If a joining entity is entitled to a deduction under the capital expenditure provisions, the head company of the group may be entitled to a deduction because of the operation of the single entity rule (subsection 701-1(1)) and the entry history rule (section 701-5). The amount of the deduction is based on the remaining balance of the capital expenditure, rather than the tax cost setting amount allocated to the asset.

Example 5.35: Capital works

> Company J holds a building at the time it joins Head Co's consolidated group. At the joining time, Company A has undeducted construction expenditure of $75,000 in relation to the building.
>
> Under the tax cost setting rules, the building is a reset cost base asset. The tax cost setting amount allocated to the building is $300,000.
>
> Generally, a taxpayer can deduct an amount for undeducted construction expenditure in relation to capital works under Division 43. The amount that can be deducted is the undeducted construction expenditure in relation to the capital works.
>
> The deduction under Division 43 is based on the construction costs of the capital works. Therefore, Head Co can deduct the balance of the undeducted construction expenditure ($75,000) under Division 43 by applying the entry history rule (section 701-5).
>
> Head Co cannot claim deductions for undeducted construction expenditure in relation to the building based on the tax cost setting amount allocated to the building.

Assets that give rise to bad debts

5.22 A deduction is allowed under section 25-35 for a debt, or part of a debt, that is written off as bad during an income year if, broadly:

- the debt was included in the taxpayers' assessable income for an income year;
- the debt is in respect of money that the taxpayer lent in the ordinary course of their business of lending money; or
- the taxpayer bought the debt in the ordinary course of their business of lending money.

5.23 To overcome difficulties in applying section 25-35 to the tax cost setting amount for a debt, the operation of section 25-35 is modified to ensure that the head company can claim a deduction if the debt goes bad. ***[Schedule 5, item 4, subsection 716-400(1)]***

5.24 The modifications apply if:

- the tax cost of an asset was set at the time that an entity joins a consolidated group at the asset's tax cost setting amount;
- the asset is a debt;
- any of the following apply in relation to the asset:
  - the debt was included in the joining entity's assessable income before the joining time;
  - the debt was in respect of money that the joining entity lent before the joining time in the ordinary course of a business of lending money; or
  - the joining entity bought the debt before the joining time in the ordinary course of a business of lending money; and
- the asset is not an intra-group asset (that is, section 701-58 does not apply to the asset).

[Schedule 5, item 4, subsection 716-400(2)]

5.25 In these circumstances, subsection 716-400(3) clarifies that, in determining the extent to which the head company of the group can deduct an amount under section 25-35 in relation to the asset, the entry history rule (section 701-5) and subsection 701-55(6) have the effect that:

- in a case where the debt was included in the joining entity's assessable income before the joining time — the head company is taken to have included an amount equal to the tax cost setting amount in its assessable income in respect of the debt before the joining time;
- in a case where the debt was in respect of money that the joining entity lent before the joining time in the ordinary course of a business of lending money — the head company is taken to have lent an amount of money equal to the tax cost setting amount in the ordinary course of a business of lending money before the joining time; or
- in a case where the joining entity bought the debt before the joining time in the ordinary course of a business of lending money — the head company is taken to have incurred expenditure equal to the tax cost setting amount in buying the debt in the ordinary course of a business of lending money before the joining time.

[Schedule 5, item 4, subsection 716-400(3)]

Example 5.36: Australian dollar trade receivables

Company J sells trading stock valued at $20,000 to a customer on credit (30 day terms) on 25 June 2009. As Company J is taxed on an accruals basis, it includes the amount derived ($20,000) in its assessable income for the 2008-09 income year. Therefore, on 30 June 2009, Company J holds an Australian dollar trade receivable of $20,000.

On 1 July 2009, Head Co acquires all the membership interests in Company J. As a result, Company J joins Head Co's consolidated group.

Under the tax cost setting rules, the Australian dollar trade receivable is a right to receive an amount of Australian currency, and therefore is a retained cost base asset (paragraph 705-25(5)(b)). The tax cost setting amount is the amount of Australian currency concerned — that is, $20,000.

Head Co eventually collects $18,000 in respect of the Australian dollar trade receivable and writes off the balance of $2,000.

Head Co can deduct the amount of the Australian dollar trade receivable written-off as a general deduction under section 8-1 or as a bad debt deduction under section 25-35.

In this regard, for the purpose of applying section 25-35, as the debt was included in the Company J's assessable income before the joining time, Head Co is taken to have included an amount equal to the tax cost setting amount ($20,000) in its assessable income in respect of the debt before the joining time.

Example 5.37: Foreign currency trade receivables

On 1 May 2003 Company J derives ordinary income of $100 by selling trading stock to Entity Z on credit for US$80. At that time, A$1 is equivalent to US$0.80.

Company J joins Head Co's consolidated group on 1 July 2003 when A$1 is equivalent to US$0.75 and the trade receivable translates to A$106.67. Under the tax cost setting rules, a tax cost setting amount of A$106.67 is allocated to the trade receivable. As the trade receivable is a revenue asset in the hands of Company J, subsection 701-55(6) applies to the tax cost setting amount.

Entity Z pays US$75 to Company J in settlement of its trade debt on 30 November 2003. At that time, under the exchange rate, A$1 is equivalent to US$0.78 and A$96.15 cash is received by Head Co.

Head Co writes of the remainder of the US$5 owed as a bad debt.

The amount that can be deducted under section 25-35 in respect of a foreign currency debt that was included in assessable income is the amount translated to Australian currency at the exchange rate applicable at the time of translating the income (Item 8A of Regulation 960.50.01 of the *Income Tax Assessment Regulations 1997*).

Head Co is taken to have included an amount equal to the tax cost setting amount (A$106.67) in its assessable income in respect of the debt (paragraph 716-400(3)(a)). As section 715-370 applies to the debt, the exchange rate applicable at the time of translating the US$80 to A$106.67 is A$1 equals US$0.75 (being the rate applying at joining time).

Consequently, Head Co can deduct an amount of A$6.67 (that is, A$106.67 − A$100) under section 25-35 for the US$5 written-off as a bad debt.

As the amount received by Head Co (A$96.15) is less than the portion of the tax cost setting amount that relates to the US$75 received (A$100), a capital loss of A$3.85 (that is, A$96.15 − A$100) arises under CGT event C2.

> However, this difference is wholly attributable to the movement in the exchange rate from 1 July 2003 to 30 November 2003. Therefore, Head Co can deduct the amount of the difference (A$3.85) under section 8-1 (reducing the capital loss to nil).
>
> Division 775 does not apply to the right to receive foreign currency as, under the entry history rule, Head Co is taken to have acquired the right prior to 1 July 2003 and has not made an election under section 775-150 for the Division to apply to the right.
>
> However, if Division 775 did apply, the combined operation of subsection 701-55(6) and section 715-370 in respect of the tax cost setting amount for the debt would result in a forex realisation loss of A$3.85 arising under forex realisation event 2 (ceasing to have a right to receive foreign currency (section 775-45)).

5.26 In some cases a deduction for bad debts is allowed under the general deduction provision (section 8-1). If that provision applies to allow a deduction for a bad debt, the amount of the deduction will be based on the tax cost setting amount for the asset.

Deduction for tax cost setting amount for assets that are rights to future income assets

5.27 A joining entity may hold an asset at the joining time that represents:

- a right to receive income for things it has already provided or done, but for which it is not yet entitled to bill (such as work-in-progress under a long-term construction contract); or
- a right to receive income for things that are to be provided or done after the joining time.

5.28 The market value of the asset at the joining time will derive from the expected future income reduced by associated future outlays.

5.29 Where the joining entity was a wholly-owned subsidiary of the head company at the time the contract or agreement giving rise to the future income asset was created, the asset will be treated as a retained cost base asset and its tax cost setting amount will be limited to its terminating value, which in most cases is expected to be nil (see the amendments in Part 11 of this Schedule).

5.30 Where the joining entity was not a wholly-owned subsidiary of the head company at the time the contract or agreement giving rise to the future income asset was created, the asset will be a reset cost base asset

and will receive a tax cost setting amount based on its relative market value at the joining time.

5.31 Uncertainties arise regarding when and how the tax cost setting amount allocated to such an asset may be recognised for the head company's tax purposes.

5.32 To overcome these uncertainties, if section 716-410 covers an asset, section 716-405 may apply in relation to the tax cost setting amount allocated to the asset. ***[Schedule 5, item 3, subsection 701-55(5C)]***

5.33 Section 716-410 covers an asset if:

- the asset is a right (including a contingent right) to receive an amount for the doing of a thing;
- the asset is held by an entity just before the time it becomes a subsidiary member of a consolidated group; and
- it is reasonable to expect that an amount will be included in the assessable income of the head company of the group after the joining time in relation to the right.

[Schedule 5, item 4, section 716-410]

5.34 Section 716-405 allows a deduction for the tax cost setting amount for an asset if:

- an entity became a subsidiary member of a consolidated group; and
- subsection 701-55(5C) applies in relation to the asset — that is, the asset is a 'right to future income' asset covered by section 716-410 that is held by the joining entity.

[Schedule 5, item 4, subsection 716-405(1)]

5.35 An asset covered by section 716-410 may be solely comprised of a right to future income. Alternatively, the asset may be a right that is embedded in a contract or agreement that includes a range of rights and associated obligations.

5.36 Where the right to future income asset is embedded in a contract or agreement that includes a range of rights and associated obligations, section 716-405 will apply to allow a deduction for that part of the tax cost setting amount for the asset that relates to the right to future income.

5.37 The deduction will be available to the entity that is qualified for a deduction under subsection 716-405(5) for the right to future income asset. In most cases this will be the head company of a consolidated group that holds the asset because of the single entity rule (subsection 701-1(1)). However, if an entity ceases to be a member of the consolidated group and takes the right to future income asset with it, the leaving entity will be entitled to the deduction. ***[Schedule 5, item 4, subsections 716-405(2) and (5)]***

5.38 The amount that can be deducted in a particular income year is generally the unexpended tax cost setting amount for the right to future income asset, to the extent that an amount is included in the entity's assessable income for that income year in respect of the right to future income asset. ***[Schedule 5, item 4, paragraph 716-405(2)(a)]***

5.39 However, unless subsection 716-405(3) applies, if the right to future income asset ceases to exist in an income year or it is reasonable to expect that no amount will be included in the assessable income of any entity for a later income year in respect of the asset, the amount that can be deducted in that income year by the entity that holds the asset at the time it ceases to exist or have any value is the unexpended tax cost setting amount for the asset. ***[Schedule 5, item 4, paragraph 716-405(2)(b)]***

5.40 Subsection 716-405(3) applies to prevent the head company from being able to deduct the unexpended tax cost setting amount for the asset in an income year if:

- another entity ceased to be a subsidiary member of the group in that income year; and
- that other entity can deduct an amount for the right to future income asset because it is also qualified for a deduction under subsection 716-405(5) for the asset for that income year.

[Schedule 5, item 4, subsection 716-405(3)]

5.41 If the asset is disposed of, section 716-405 will not apply to allow a deduction for the unexpended tax cost setting amount. The income tax treatment of the asset on disposal will depend on the particular facts in each case. For example:

- if the asset is a CGT asset that is taxed under the CGT provisions, subsection 701-55(5) will apply so that, in working out the amount of any capital gain or loss, the cost base or reduced cost base is increased by the unexpended tax cost setting amount; or

- if the asset is taxed on revenue account, subsection 701-55(6) will apply so that, in working out the amount of any profit or loss, the tax cost of the asset is the unexpended tax cost setting amount.

5.42 The ***unexpended tax cost setting amount*** for the right to future income asset for an income year is the tax cost setting amount for the asset reduced by the amounts (if any) of all deductions under section 716-405 in respect of the asset for previous income years. ***[Schedule 5, items 4 and 5, paragraph 716-405(4)(a) and the definition of 'unexpended tax cost setting amount' in subsection 995-1(1)]***

5.43 In addition, in determining the amount of a deduction for a right to future income asset for an income year for an entity that ceased to be a subsidiary member of the group in that income year, the tax cost setting amount is reduced by the amount (if any) that the head company of the group can deduct under section 716-405 in respect of the asset for that income year. ***[Schedule 5, items 4 and 5, paragraph 716-405(4)(b) and the definition of 'unexpended tax cost setting amount' in subsection 995-1(1)]***

5.44 An amount that is deducted under section 716-405 for the tax cost setting amount for the right to future income asset:

- cannot be deducted under any other provision in the income tax law;
- is not taken into account in determining the amount included in assessable income of the head company or an entity that has ceased to be a member of the group for any income year for the asset;
- is not taken into account in determining the amount of a deduction for the head company or an entity that has ceased to be a member of the group for any income year for the asset; and
- is not taken into account in working out any of the elements of the CGT cost base of the asset.

[Schedule 5, item 4, subsection 716-405(6)]

5.45 As a consequential amendment, the table of deductions in section 12-5 is modified to refer to the deduction that is allowed under section 716-405. ***[Schedule 5, item 1, section 12-5]***

Example 5.38: Right to future income under a long-term construction contract

Head Co acquires all of Company J's membership interests on 1 July 2010. Consequently, Company J joins Head Co's consolidated group.

Company J has a partially completed construction contract at the joining time — that is, broadly, it has partially performed some work under the contract that has not yet been completed to a stage where a recoverable debt has arisen. For accounting purposes, Company J has estimated the amount of partly earned unbilled income as $15,000.

Substantial gross revenues are expected to be generated under the contract with an estimated profit over the period of the contract of $500,000.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the construction contract is identified as a separate asset, the market value of the asset must be determined using a recognised market valuation methodology.

A valuer will typically have regard to a number of factors in determining the market value of the asset, such as:

- the value of future work yet to be performed;
- the remaining life of the asset;
- forecast revenue;
- the cost and charges of other assets that are related to the work that is yet to be performed; and
- appropriate discount rates.

Having regard to these factors, the market value of the asset is determined to be $215,000.

The construction contract is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $180,000.

Head Co can deduct the tax cost setting amount for the asset ($180,000) under section 716-405 because:

- the asset is solely a right to receive an amount for the doing of a thing (being the unbilled work already done and the work yet to be done); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the right.

During the 2010-11 income year, invoices issued in respect of the contract totalled $100,000. As a result, Head Co includes $100,000 in assessable income in that year. The contract is 10 per cent completed as at 30 June 2011.

Taxation Ruling IT 2450 specifies two methods that are acceptable for accounting for the taxable income from long-term construction contracts — the basic approach and the estimated profits basis.

If Company J uses the basic approach for income tax purposes, Head Co will be able to deduct $100,000 of the tax cost setting amount for the asset under section 716-405 in the 2010-11 income year. The unexpended tax cost setting amount ($80,000) will be deductible in the 2011-12 income year, provided that invoices equal to or exceeding that amount are issued, and a corresponding amount is included in assessable income, in that income year.

If Company J uses the estimated profit (percentage of completion) basis for income tax purposes, Head Co will include $50,000 (10 per cent of the $500,000 total estimated profit) in its assessable income in the 2010-11 income year. Therefore Head Co will be able to deduct $50,000 of the tax cost setting amount for the asset under section 716-405 in the 2010-11 income year. The unexpended tax cost setting amount ($130,000) will be deductible in subsequent years as the assessable income is derived by Head Co under the contract.

If the contract is completed and actual total profit is less than the tax cost setting amount for the asset ($180,000), then the balance of the unexpended tax cost setting amount would generally be deductible under section 716-405 at that time.

Example 5.39: Right to receive trailing commissions

Head Co acquires all of Company J’s membership interests on 1 July 2010. Consequently, Company J joins Head Co’s consolidated group.

Company J is a commission agent and reasonably expects to receive trailing commissions from an insurance company in respect of insurance products sold in the 2008-09 income year, provided customers do not terminate their insurance cover. Although no

recoverable debt exists at the joining time, it is reasonable to expect that trailing commissions of $40,000 will be received during the 2010-11 and 2011-12 income years ($20,000 per year) from the sales in the 2008-09 income year.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the right to trailing commissions is identified as a separate asset, the market value of the asset must be determined using a recognised market valuation methodology. The market value of the asset is determined to be $30,000.

The asset is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $30,000.

Head Co can deduct the tax cost setting amount for the right to receive trailing commissions ($30,000) under section 716-405 because:

- the asset is solely a contingent right to receive an amount for the doing of a thing (being the sale of insurance products prior to the joining time); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the asset.

In the 2010-11 income year, Head Co derives trailing commissions of $19,000 which are included in assessable income. Therefore, Head Co will be able to deduct $19,000 of the tax cost setting amount for the asset in that income year.

In the 2011-12 income year, Head Co derives trailing commissions of $17,000 which are included in assessable income. Therefore, Head Co will be able to deduct the balance of the unexpended tax cost setting amount for the asset ($11,000) in that income year.

Example 5.40: Land development agreement

Head Co acquires all of Company J’s membership interests on 1 July 2010. Consequently, Company J joins Head Co’s consolidated group.

Company J is a land development company that has acquired a development agreement over land owned by a third party. Under that right, Company J is entitled to develop and sell the land to customers as agent for the owner. It is also entitled to retain a proportion of the sale proceeds as its fee.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the development agreement is identified as a separate

asset, the market value of the asset must be determined using a recognised market valuation methodology. The market value of the asset is determined to be $6 million.

The asset is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $5 million.

Head Co can deduct the tax cost setting amount for the development right ($5 million) under section 716-405 because:

- the asset is solely a right to receive an amount for the doing of a thing (being the development and sale of land); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the asset.

Each time Head Co sells, as agent, a subdivided block of land, it will include a proportion of the sale proceeds that is its fee in assessable income. Therefore, Head Co can progressively deduct the tax cost setting amount for the development right ($5 million) under section 716-405 over the income years it receives the fees and includes them in assessable income.

Example 5.41: Right to deferred management fees

Company J operates a retirement village business and has a right to deferred management fees in respect of each resident's unit — that is, a right to fees that accrue over a resident's tenure in a retirement village unit but are not payable until the time the resident ceases to reside at the retirement village.

Head Co acquires all of Company J's membership interests on 1 July 2010. Consequently, Company J joins Head Co's consolidated group.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the right to deferred management fees is identified as a separate asset, the market value of the asset must be determined using a recognised market valuation methodology. The market value of the asset is determined to be $80,000.

The asset is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $80,000.

Head Co can deduct the tax cost setting amount for the asset ($80,000) under section 716-405 because:

- the asset is solely a contingent right to receive an amount for the doing of a thing (being the management of the retirement village); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the asset.

Head Co derives management fees of $70,000, and includes this amount in its assessable income, when the resident ceases to reside in the retirement village in the 2015-16 income year. Therefore, Head Co can deduct part of the tax cost setting amount for the right to deferred management fees ($70,000) in the 2015-16 income year.

The tax cost setting amount allocated to the right to deferred management fees ($80,000) exceeds the total management fees included in Head Co's assessable income ($70,000). However, as the right to deferred management fees comes to an end in the 2015-16 income year, Head Co can deduct the balance of the unexpended tax cost setting amount for the right ($10,000) in that income year.

Example 5.42: Rights to unbilled income for the supply of gas

Company J carries on the business of supplying gas to its customers (being both domestic and commercial gas consumers) in very similar circumstances to those in *FC of T v Australian Gas Light Co* 83 ATC 4800; (1983) 15 ATR 105.

In its profit and loss statement for the income year ended 30 June 2010, Company J recorded unbilled gas income of $25,000. Its balance sheet contained an unbilled gas asset of the same amount. The unbilled gas income is recognised as income for accounting purposes but has not yet been recognised as assessable income for income tax purposes in accordance with Taxation Ruling No. IT 2095.

On 1 July 2010, Head Co acquires all of Company J's membership interests. As a result, Company J joins Head Co's consolidated group.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the right to unbilled gas income is identified as a separate asset, the market value of the asset must be determined using a recognised market valuation methodology. The market value of the asset is determined to be $25,000.

The asset is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $20,000.

Head Co can deduct the tax cost setting amount for the asset ($20,000) under section 716-405 because:

- the asset is solely a contingent right to receive an amount for the doing of a thing (being the supply of gas); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the asset.

Head Co derives assessable income for gas supplied in excess of $20,000 in the 2010-11 income year. This includes amounts derived for gas supplied by Company J as at 30 June 2010. Therefore, Head Co will be able to deduct the tax cost setting amount for the asset ($20,000) in that income year.

Land carrying trees and rights to fell trees

5.46 When a taxpayer fells trees for sale or manufacture, a deduction is available under section 70-120 for so much of the capital costs of acquiring land carrying trees as is referable to trees that have been felled in the income year.

5.47 A deduction is also available under section 70-120 for the capital cost of acquiring rights to fell trees, but only to the extent the amount paid is attributable to the trees that are felled in the income year. The amount that is attributable to the trees that are felled in the income year is generally worked out based on the relative market value of the trees that are felled to the land or rights.

5.48 Currently, if the trading stock provisions in Division 70 apply in relation to an asset, subsection 701-55(3) specifies the use of the tax cost setting amount. The provisions in the income tax law that allow a deduction for the capital costs relating to land carrying trees and to rights to fell trees (section 70-20) are in Division 70. However, the use of the tax cost setting amount specified in subsection 701-55(3) does not work appropriately for the purposes of applying section 70-120.

5.49 To avoid confusion, a technical amendment will clarify that subsection 701-55(6), rather than subsection 701-55(3), applies to specify how the head company uses the tax cost setting amounts allocated to land carrying trees and to rights to fell trees for the purpose of applying section 70-120. ***[Schedule 5, item 2, subsection 701-55(3)]***

5.50 The joining entity's history relating to the deduction of amounts under section 70-120 is not inherited by the head company under the entry history rule (section 701-5) for the purpose of determining whether the head company is entitled to deductions under section 70-120 for the tax

cost setting amount allocated to an asset that is land carrying trees.
[Schedule 5, item 3, subsection 701-56(1)]

Example 5.43: Land carrying trees

Company J paid $850,000 to acquire land carrying trees. At that time $50,000 is set out in the contract as being attributable to the trees.

Before the joining time, Company J fells 50 per cent of the trees, claiming a deduction of $25,000. Company J then replants trees on the land.

Head Co acquires all of Company J's membership interests. Consequently, Company J joins Head Co's consolidated group.

At the joining time, Head Co obtains a valuation of the land which documents that the market value of the land (including the trees) at the joining time is $900,000. The value attributable to the remaining trees is $25,000.

Under the tax cost setting rules, the tax cost setting amount for the land (including the trees) is $850,000. Therefore, the tax cost setting amount attributable to the trees is $23,611 (that is, $25,000 / $900,000 × $850,000).

Head Co subsequently fells the trees, and sells the timber for $50,000. Head Co will include the amount received on the sale of the timber ($50,000) in its assessable income and can deduct the tax cost setting amount attributable to the trees ($23,611) under subsection 70-120(4).

Interactions with Division 775 (Foreign currency gains and losses)

5.51 The primary purpose of Division 775 is to ensure that foreign currency gains and losses are recognised for income tax purposes.

5.52 The amendments clarify the time for determining the currency exchange rate effect where:

- an entity becomes a subsidiary member of a consolidated group at a time;
- taking into account the operation of the single entity rule (subsection 701-1(1)), the head company of the group held an asset at the joining time because the joining entity became a subsidiary member of the group;

- the asset is a reset cost base asset at the joining time; and
- in working out the asset's tax cost setting amount, the currency exchange rate of a particular foreign currency is taken into account in determining the market value of the asset.

[Schedule 5, item 6, subsection 715-370(1)]

5.53 In these circumstances, for the purposes of Division 775, the extent of any currency exchange rate effect after the joining time in relation to the asset is determined by reference to the currency exchange rate for the foreign currency at the joining time. ***[Schedule 5, item 6, subsection 715-370(2)]***

Example 5.44: Foreign currency trade receivable and forex realisation event 2

On 1 May 2010 Company J derives ordinary income of $100 by selling trading stock to Company Z on credit for US$80. At that time, A$1 is equivalent to US$0.80.

Company J joins Head Co's consolidated group on 1 July 2010 when A$1 is equivalent to US$0.75 and the trade receivable translates to A$106.67. Under the tax cost setting rules, a tax cost setting amount of A$106.67 is allocated to the trade receivable.

As Division 775 is to apply to the foreign currency trade receivable, subsection 701-55(6) applies to deem the tax cost setting amount to be an amount paid by the head company to acquire the asset at the joining time.

As the trade receivable is a reset cost base asset and the US$ currency exchange rate applying at the joining time has been taken into account in working out its tax cost setting amount, section 715-370 also applies to the asset for the purpose of Division 775.

The combined operation of subsection 701-55(6) and section 715-370 in respect of the asset results in the A$106.67 tax cost setting amount becoming the forex cost base of the debt (section 775-85) for the purpose of forex realisation event 2 (ceasing to have a right to receive foreign currency (section 775-45)).

Subsection 701-55(6) and section 715-370 operate to treat the tax cost setting amount as an amount paid by Head Co at the joining time to acquire a right to receive US$80 for the purpose of forex realisation event 2.

Company Z pays US$80 to Company J in settlement of its trade debt on 30 November 2010. At that time the exchange rate is A$1 equals US$0.78 and A$102.56 cash is received by Head Co.

As the forex cost base of the debt is A$106.67, Head Co makes a forex realisation loss of A$4.11 under forex realisation event 2.

Application of Part 1

5.54 The amendments in Division 1 of Part 1 (that is, the amendments other than those which clarify interactions with the foreign currency gains and losses provisions (Division 775)) apply on or after 1 July 2002. ***[Schedule 5, item 7]***

5.55 These amendments, which have been sought by taxpayers, are beneficial as they ensure that the head company of a consolidated group receives appropriate recognition for the tax cost setting amount allocated to an asset under the tax cost setting rules.

5.56 The amendments in Division 2 of Part 1, which clarify interactions with the foreign currency gains and losses provisions (Division 775) when an entity joins a consolidated group, apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins a consolidated group on or after that date. ***[Schedule 5, item 7]***

5.57 However, the head company of a consolidated group can make a choice to apply the amendments in Division 2 of Part 1 in relation to an entity that joins a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 7]

5.58 This option to apply the amendments from 1 July 2002 will ensure that taxpayers do not need to disturb past practices. However, it will allow consolidated groups to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

Transitional treatment of foreign currency trade receivables

5.59 In Draft Taxation Determination TD 2004/D80 the Australian Taxation Office (ATO) advised that a capital gain would arise when an

amount received in payment of a foreign currency denominated trade receivable exceeds its tax cost setting amount.

5.60 The ruling was withdrawn on 22 August 2006 following the former government's announcement to modify the operation of subsection 701-55(6).

5.61 To ensure taxpayer's are not disadvantaged by the withdrawal of Draft Taxation Determination TD 2004/D80, a transitional modification will be made to preserve the CGT character of the gain or loss that arises when the amount received in payment of a foreign currency denominated trade receivable exceeds its tax cost setting amount, provided the amount was derived between 1 July 2002 and 23 August 2006.

5.62 The transitional modification will apply if:

- the tax cost of a joining entity's asset was set at the joining time at the asset's tax cost setting amount;
- the asset is a trade receivable that is denominated in foreign currency;
- CGT event C2 happens to the asset between the joining time and 23 August 2006;
- just before the CGT event, the head company of the group held the asset because of the operation of the single entity rule (subsection 701-1(1));
- disregarding section 118-20, there is a capital gain or capital loss from the event; and
- the head company makes a choice (which is reflected in the way that it completed its income tax return) to apply the transitional provision.

[Schedule 5, item 8]

5.63 In these circumstances, except to the extent that any capital gain or capital loss from the event is attributable to currency exchange rate fluctuations, the following provisions do not apply to the CGT event:

- section 6-5 (about ordinary income);
- any other provision that includes an amount in assessable income (other than a CGT provision);

- section 8-1 (about amounts that can be deducted);
- any other provision that allows a deduction for the amount; and
- section 118-20 (which reduces a capital gain by the amount that it is otherwise assessable).

[Schedule 5, item 8]

5.64 This transitional provision will preserve the position set out in Draft Taxation Determination TD 2004/D80 until 23 August 2006. After that date, an asset that is a trade receivable denominated in foreign currency may be treated as being on revenue account.
Subsection 701-55(6) will apply to ensure that the tax cost setting amount for the asset can be used to determine the amount that is included in assessable income or allowed as a deduction.

Part 2 — Group restructures

5.65 In this Part, references to a consolidated group do not include a MEC group.

5.66 Under the consolidation regime wholly-owned groups are treated as single taxpaying entities for their income tax purposes. Wholly-owned groups that have an Australian resident head company can form a consolidated group. Resident wholly-owned subsidiaries of a foreign holding company can form a MEC group.

5.67 When a change in the group structure occurs, it can result in:

- a consolidated group converting to a MEC group (section 719-40); or
- a MEC group converting to a consolidated group (section 703-55).

5.68 Currently, when a group conversion occurs, the old group ceases to exist and a new group comes into existence. As a result, significant tax consequences inappropriately arise for members of the old group that become members of the new group — that is, for entities that are ongoing members of the group. For example:

- the tax cost setting rules that apply when an entity ceases to be a member of a consolidated group or MEC group operate to set the tax costs of the membership interests in each

subsidiary member that leaves the old group, potentially causing a capital gain to arise if CGT event L5 happens; and

- the tax cost setting rules that apply when an entity becomes a member of a consolidated group or MEC group operate to reset the tax costs of the assets of each subsidiary member that becomes a member of the new group.

Minimal tax consequences for ongoing members

5.69 Subdivision 719-BA will ensure that there will be minimal tax consequences when, at a particular time (the conversion time):

- a consolidated group is created from a MEC group; or
- a MEC group is created from a consolidated group.

[Schedule 5, item 15, subsection 719-120(1)]

New group retains the history of the old group

5.70 When Subdivision 719-BA applies, the head company of the new group will retain the history of the head company of the old group. That is, everything that happened in relation to the head company of the old group before the conversion time is instead taken to have happened in relation to:

- if the head company of the old group is the same entity as the head company of the new group, that entity in its role as the head company of the new group; or
- otherwise, the head company of the new group (just as if the head company of the new group had been the head company of the old group at all times before the conversion time).

[Schedule 5, item 15, subsection 719-125(1)]

5.71 The history that is retained by the head company of the new group includes everything that, immediately before the conversion time, was taken to have happened in relation to the head company of the old group because of:

- the single entity rule (subsection 701-1(5));
- the entry history rule (section 701-5);

- the effects of a choice under section 703-75 to continue a consolidated group or MEC group after an interposed company becomes a new head company;
- the effects under section 719-90 that arise because of a change in the head company of a MEC group; and
- any previous applications of Division 719.

[Schedule 5, item 15, subsection 719-125(2)]

5.72 Consequently, if, for example, the old group is a MEC group and there has been one or more changes to the head company of the group prior to the conversion time, the entity that is the head company of the old MEC group at the conversion time is taken to have inherited all of the group's previous history just as if it had always been the head company of the group (section 719-90). The head company of the new consolidated group will retain all the relevant history of the old MEC group, including the history obtained because of the effects under section 719-90 that arise because of a change in the head company of the old MEC group.

5.73 The provisions that ensure the head company of the new group retains the history of the head company of the old group (subsections 719-125(1) and (2)) have effect for:

- the head company core purposes in relation to an income year ending after the conversion time;
- the entity core purposes in relation to an income year ending after the conversion time; and
- the purpose of determining the balance of the franking account of the head company, or provisional head company, of the new group at or after the conversion time.

[Schedule 5, item 15, subsection 719-125(3)]

5.74 Therefore, for example, for the purposes of applying the joint and several liability provisions in Division 721, a tax-related liability that is a group liability of the head company of the old group will be a group liability of the head company of the new group. In addition, an entity that was a subsidiary member of the old group for part of the period to which the liability relates will be taken to be a subsidiary member of the new group in respect of that period.

5.75 Subsections 719-125(1) and (2) do not override:

- the exit history rule (section 701-40); and
- a provision of the income tax law to which the exit history rule is subject because of exceptions to the core rules (section 701-85).

[Schedule 5, item 15, subsection 719-125(4)]

5.76 Consequently, if, for example, the old group is a transitional group, the new group will also be a transitional group. Similarly, if an entity that is an ongoing member is a transitional entity or chosen transitional entity, the entity will retain that status. Therefore, sections 701-40, 701-45 and 701-50 of the *Income Tax (Transitional Provisions) Act 1997* will apply when these entities leave the new group.

Certain provisions do not apply when an entity joins the new group

5.77 The provisions that ordinarily apply when an entity joins a consolidated group or MEC group, other than the single entity rule (subsection 701-1(1)), do not apply to an ongoing member that joins the group because of a group conversion. In particular, the following provisions do not apply:

- CGT events L1, L2, L3, L4 and L8, which may apply when an entity joins a consolidated group or MEC group (Subdivision 104-L);
- the modification to the operation of the same business test that ordinarily applies when an entity becomes a subsidiary member of a consolidated group or MEC group (section 165-212E);
- the consolidation provisions in Part 3-90 that ordinarily apply when an entity joins a consolidated group or MEC group (other than the single entity rule and Subdivision 719-BA); and
- the transitional consolidation provisions in Part 3-90 of the *Income Tax (Transitional Provisions) Act 1997* that ordinarily apply when an entity joins a consolidated group or MEC group.

[Schedule 5, item 15, subsections 719-130(1), (2) and (5)]

5.78 An entity is an ongoing member (and therefore obtains the benefit of section 719-130) only if it was a member of the old group just

before the conversion time and becomes a member of the new group at that time. ***[Schedule 5, item 15, subsection 719-120(2)]***

5.79 Therefore, section 719-130 does not apply to:

- entities that are members of the new group but were not members of the old group just before the conversion time — that is, entities that are new members of the group; or
- entities that were members of the old group before the conversion time that cannot be members of the new group at that time, such as entities that were transitional foreign-held subsidiaries or transitional foreign-held indirect subsidiaries (see sections 701C-10 and 719-10 of the *Income Tax (Transitional Provisions) Act 1997*).

5.80 Some key impacts of switching-off the consolidation provisions in Part 3-90 that ordinarily apply when an entity joins a consolidated group or MEC group (other than the single entity rule and Subdivision 719-BA) are that:

- the tax cost setting rules in Division 705 do not apply when an entity that is an ongoing member becomes a member of the new group as a result of a group conversion — consequently, the tax costs of the ongoing member's assets are not reset;
- the loss transfer rules in Subdivision 707-A do not apply when an ongoing member becomes a member of the new group as a result of a group conversion — as a result, losses transferred from ongoing member to the head company of the old group are taken to be transferred to the head company on the new group.

Certain provisions do not apply when an entity leaves the old group

5.81 Similarly, unless the entity becomes an eligible tier-1 company in respect of the new MEC group, the following provisions that ordinarily apply when an entity leaves a consolidated group or MEC group will not apply when an ongoing member ceases to be a member of the group because of a group conversion:

- CGT event L5, which ordinarily applies when an entity leaves a consolidated group or MEC group (Subdivision 104-L);

- the consolidations provisions in Part 3-90 that ordinarily apply when an entity leaves a consolidated group or MEC group (other than Subdivision 719-BA); and
- the transitional consolidation provisions in Part 3-90 of the *Income Tax (Transitional Provisions) Act 1997* that ordinarily apply when an entity leaves a consolidated group or MEC group.

[Schedule 5, item 15, subsections 719-120(2) and 719-130(3) to (5)]

5.82 A key impact of switching-off the consolidation provisions in Part 3-90 that ordinarily apply when an entity leaves a consolidated group or MEC group (other Subdivision 719-BA) is that the tax cost setting rules in Division 711 do not apply when an the entity that is an ongoing member ceases to be a member of the old group as a result of a group conversion. Consequently, the tax costs of the membership interests in the on-going member are not reconstructed.

Certain provisions continue to apply

5.83 Where an on-going member becomes an eligible tier-1 company in respect of a new MEC group because a foreign resident company acquires all the membership interests, tax consequences will arise for the head company of the old consolidated group in respect of the disposal of the membership interests in the ongoing member to the foreign resident company. Therefore, the tax cost setting amount of those membership interests will be worked out under Division 711.

5.84 Where this eligible tier-1 company holds membership interests in another ongoing subsidiary member (that is, a lower tier subsidiary member) of the group, the old group's allocable cost amount for this lower tier subsidiary member will need to be worked out to determine the tax costs for the membership interests in the eligible tier-1 company. However, section 719-130 will ensure that CGT event L5 is not triggered in relation to the lower tier subsidiary member.

5.85 The disposal of the membership interests in the on-going member that becomes an eligible tier-1 company to a foreign resident company may result in the head company of the old group making:

- a capital gain or loss under CGT event A1; or
- a capital gain under CGT event L5.

5.86 However, if a capital gain arises under CGT event A1 and these membership interests are taxable Australian property (as defined in

section 855-20) both before and after the CGT event, the CGT roll-over for companies in the same wholly-owned group (Subdivision 126-B) may apply.

5.87 The disposal of the membership interests has no effect on the underlying tax attributes of the old group, such as the tax cost and tax history of its assets. These attributes are transferred to the head company of the new MEC group under section 719-125.

5.88 Despite subsections 719-130(1) and (3), where a consolidated group is created from a MEC group as result of a conversion, Subdivision 719-K (sections 719-550 to 719-570), together with any other provision to the extent that it is necessary for the application of Subdivision 719-K, will continue to apply to an ongoing member of the group. ***[Schedule 5, item 15, subsection 719-120(2) and section 719-135]***

5.89 Subdivision 719-K determines the tax cost setting amount for pooled interests when, among other things, an eligible tier-1 company ceases to be a member of a MEC group. Subject to the limitations set out in subsection 719-560(2), a pooled interest is a membership interest that an entity, other than an entity that is a member of the MEC group, holds in an eligible tier-1 company of the MEC group.

5.90 The following provisions will continue to apply when a MEC group is created from a consolidated group as result of a conversion:

- sections 719-300 and 719-325, which will apply only if the conversion involves (or is due to) the acquisition of a new eligible tier-1 company (that is an expansion) and have the effect of:
  - deeming prior group losses to be transferred losses; and
  - if the group has existing bundles of transferred losses, adjusting the available fraction for each of those bundles and for prior group loss bundles; and
- sections 719-700 and 719-720, which apply to set the reference time for the head company of the new MEC group at the time the group comes into existence for any future application of the loss integrity rules in Subdivisions 165-CC and 165-CD.

5.91 Section 719-130 does not affect the operation of these provisions because they are not triggered by an ongoing member joining a MEC group or leaving a consolidated group.

Certain provisions do not apply because a MEC group ceases to exist

5.92 If the new group is a consolidated group, the following provisions that ordinarily apply when a MEC group ceases to exist at the conversion time, or which apply merely because the potential MEC group of which the old group consisted ceases to exist at that time, do not apply:

- section 719-280, which deems a continuity of ownership test failure to happen to the head company of the MEC group in relation to unused losses because a MEC group or potential MEC group ceases to exist;
- section 719-465, which deems a continuity of ownership test failure to happen to the head company of the MEC group in relation to bad debts because a MEC group or potential MEC group ceases to exist;
- sections 719-705 and 719-725, which deem a changeover time and an alteration time under the loss integrity rules for the head company of the group at the time a MEC group or potential MEC group ceases to exist; and
- any other provision in Part 3-90, to the extent that the application of the provision is necessary for the application of any of those sections — this would include, for example, other provisions in Subdivisions 719-F, 719-I and 719-T.

[Schedule 5, item 15, section 719-140]

5.93 As a group conversion may not result in an actual change of ultimate beneficial ownership, it is inappropriate to deem a continuity of ownership test failure when a MEC group or potential MEC group ceases to exist because of a group conversion.

5.94 Section 719-125 ensures that the head company of the new consolidated group inherits the history of the old MEC group or potential MEC group just as if the head company of the new group had been the head company of the old group at all times before the conversion time (including the history obtained because of the effects under section 719-90 that arise when there is a change in the head company of the old MEC group). Therefore:

- continuity of ownership test losses made by the old MEC group are taken to have been made by the head company of the new consolidated group at the time they were made;

- continuity of ownership test losses transferred to the old MEC group are taken to have been transferred to the head company of the new consolidated group at the time they were transferred to the head company of the old MEC group under Subdivision 707-A; and

- for the purposes of applying the continuity of ownership test after the conversion time, the head company of the new consolidated group inherits the history of any ownership changes to the old MEC group — this will override the ownership history of the company prior to the time that it became the head company of the old MEC group.

5.95 In addition, as the new group is a consolidated group, the provisions in Subdivision 719-F which modify the continuity of ownership test for MEC groups will not apply to the group after the conversion time.

Consequential amendments

5.96 Sections 703-65 to 703-80 contain special rules if a shelf company is interposed into a consolidated group or MEC group and becomes the head company of the group. When the special rules apply, everything that happened in relation to the original head company before the completion time is taken to have happened in relation to the interposed company instead of in relation to the original head company.

5.97 A consequential amendment will clarify that everything that happened in relation to the original head company because of a group conversion involving a MEC group is also taken to have happened in relation to the interposed company (which becomes the new head company). ***[Schedule 5, items 9 and 10, paragraph 703-75(2)(d)]***

5.98 Similarly, sections 719-90 and 719-95 set out the consequences that arise when there is a change in the head company of a MEC group since the previous income year. In these circumstances, everything that happened in relation to the original head company before the start of the income year for which there is a new head company is taken to have happened in relation to the new head company.

5.99 A consequential amendment will clarify that everything that happened in relation to the original head company because of a group conversion involving a MEC group is also taken to have happened in relation to the new head company. ***[Schedule 5, item 14, paragraph 719-90(2)(ca)]***

5.100 In addition, consequential amendments will clarify that:

- the members of a MEC group are the head company of the group and the subsidiary members of the group; and
- the members of a potential MEC group are, broadly, the eligible tier-1 companies of the group and the subsidiary members of the group.

[Schedule 5, items 11, 12 and 16, subsection 719-25(3) and the definition of 'member' in subsection 995-1(1)]

Circumstances in which a company is eligible to be appointed as the provisional head company of a MEC group

5.101 Where the provisional head company of a MEC group ceases to be wholly-owned by its foreign holding company (that is, a cessation event happens), it is no longer eligible to be the head company of the group. In these circumstances, the MEC group will need to appoint a new provisional head company so that the group can continue to exist.

5.102 Where a MEC group is created part way through an income year and a cessation event happens to the original provisional head company in the same income year as the MEC group was created, the new provisional head company must have been a member of the MEC group from the start of the original provisional head company's income year (subparagraph 719-65(3)(d)(ii)).

5.103 Therefore, if the MEC group comes into existence after the start of the original provisional head company's income year because, for example, a MEC group is created from a consolidated group, and the cessation event happens before the end of that income year, the MEC group is effectively prevented from appointing a new provisional head company because no company is capable of satisfying the requirements in subparagraph 719-65(3)(d)(ii).

5.104 To overcome this difficulty, a company will be eligible to be appointed as the new provisional head company of a MEC group in these circumstances provided the company was a member of the MEC group from the time the MEC group came into existence. ***[Schedule 5, item 13, subparagraph 719-65(3)(d)(i)]***

Application of Part 2

5.105 The amendments in Part 2 (other than the amendment in item 13 to modify the circumstances in which a company is eligible to be appointed as the provisional head company of a MEC group) apply from 27 October 2006. That is, the amendments will apply to:

- a consolidated group that is created from a MEC group on or after 27 October 2006; or
- a MEC group that is created from a consolidated group on or after 27 October 2006.

[Schedule 5, item 17]

5.106 However, the head company of a consolidated group or MEC group can make a choice to apply the amendments in Part 2 (other than the amendment in item 13) from 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 17]

5.107 The amendments, which were announced by the former government on 27 October 2006, were sought by affected taxpayers and are beneficial as they will significantly reduce compliance costs.

5.108 The option to apply the amendments from 1 July 2002 will allow consolidated groups and MEC groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

5.109 The amendment in item 13 to modify the circumstances in which a company is eligible to be appointed as the provisional head company of a MEC group applies from 1 July 2002. ***[Schedule 5, item 17]***

5.110 This amendment, which has been sought by taxpayers, is beneficial as it will allow greater access to certain transitional concessions that were available on the introduction of the consolidation regime.

Part 3 — Pre-CGT proportions

5.111 When an entity joins a consolidated group its membership interests cease to be recognised for income tax purposes. If those membership interests are pre-CGT assets (that is, interests acquired before 20 September 1985 that have not stopped being pre-CGT assets under the CGT provisions), the existing law preserves this status by attributing a pre-CGT factor to the underlying assets of the joining entity.

5.112 Due to the mechanics of the pre-CGT factor calculation, depending on the circumstances, only a proportion of the pre-CGT status of the group's membership interests in a joining entity is maintained when that entity later leaves the group. As a result, small and medium sized groups that have a significant proportion of pre-CGT membership interests may be disadvantaged by electing into the consolidation regime.

5.113 To overcome these concerns, the mechanism for preserving the pre-CGT status of membership interests in a joining entity will be modified. The new mechanism will involve working out the proportion (measured by market value) of membership interests in the joining entity that have pre-CGT status — that is, the pre-CGT proportion. The pre-CGT proportion is used when an entity leaves a consolidated group to work out the number of its membership interests that are pre-CGT assets. ***[Schedule 5, items 18, 19 and 34, subsection 705-125(1) and the definition of 'pre-CGT proportion' in subsection 995-1(1)]***

5.114 The pre-CGT proportion is the amount worked out using the formula:

$$\frac{\text{Market value of pre-CGT membership interests}}{\text{Market value of all membership interests}}$$

where:

- the market value of pre-CGT membership interests is the sum of the market value of each membership interest in the joining entity that:
  - is held by a member of the group at the joining time; and
  - is a pre-CGT asset; and

- the market value of all membership interests is the sum of the market value of each membership interest in the joining entity that is held by a member of the group at the joining time.

[Schedule 5, item 20, subsection 705-125(2)]

5.115 When the entity ceases to be a member of the consolidated group, subject to integrity rules, some or all of the membership interests in the leaving entity will be treated as pre-CGT assets. ***[Schedule 5, items 25 and 26, subsection 711-65(1)]***

5.116 This includes a leaving entity that ceases to be a member of a consolidated group because it is a wholly-owned subsidiary of another entity that ceases to be a member of the group. ***[Schedule 5, item 26, subsection 711-65(1A)]***

5.117 The membership interests in the leaving entity that are treated as pre-CGT assets is worked out using the formula:

$$\left(\begin{array}{l}\text{Number of membership interests}\\ \text{in the leaving entity held by}\\ \text{members of the old group}\end{array}\right) \times \left(\begin{array}{l}\text{Leaving entity's}\\ \text{pre-CGT proportion}\end{array}\right)$$

5.118 For the purposes of applying the formula, the leaving entity's pre-CGT proportion is the amount worked out under section 705-125. ***[Schedule 5, item 28, subsection 711-65(4)]***

Example 5.45: Pre-CGT proportion — single class of shares

Company J has 10,000 ordinary shares on issue. Head Co owns all 10,000 shares, 8,000 of which are pre-CGT assets. The remaining 2,000 shares are post-CGT assets.

On 1 July 2002 Head Co forms a consolidated group. Company J is a subsidiary member of the group. The net market value of Company J at the joining time is $450,000. Each share has a market value of $45.

The pre-CGT proportion of the membership interests in Company J is calculated as follows:

$$\frac{\text{Market value of pre-CGT shares}}{\text{Market value of all shares}}$$

$$= \frac{\$360{,}000}{\$450{,}000}$$

$$= 80 \text{ per cent.}$$

On 1 July 2004, Head Co sells 1,000 shares to a third party. As a result, Company J leaves Head Co's consolidated group.

The pre-CGT proportion of Head Co's membership interests in Company J is 80 per cent. Therefore, 8,000 shares are pre-CGT assets.

Head Co chooses to sell 1,000 shares that are pre-CGT assets. Therefore, of the 9,000 shares that Head Co continues to hold in Company J:

- 7,000 shares are pre-CGT assets; and
- 2,000 shares are post-CGT assets.

Example 5.46: Pre-CGT proportion — more than one class of shares

Company Z has 50 class A shares and 50 class B shares on issue.

Head Co owns:

- 25 of Company Z's class A shares — these shares are pre-CGT assets as they were acquired by Head Co prior to 20 September 1985 and have not stopped being pre-CGT assets under the CGT provisions; and
- 30 of Company Z's class B shares — these shares are post-CGT assets as they were acquired by Head Co after 19 September 1985.

Company Y, which is wholly-owned by Head Co, owns:

- 25 of Company Z's class A shares — these shares are pre-CGT assets as they were acquired by Company Y prior to 20 September 1985 and have not stopped being pre-CGT assets under the CGT provisions; and
- 20 of Company Z's class B shares — these shares are post-CGT assets as they were acquired by Company Y after 19 September 1985.

On 1 July 2003, Head Co forms a consolidated group. Company Y and Company Z are subsidiary members of the group.

The net market value of Company Z at the joining time is $5 million. The market value of each Class A share is $60,000 ($3 million in total) and the market value of each Class B share is $40,000 ($2 million in total).

The pre-CGT proportion of the membership interests in Company Z is 60 per cent, calculated as follows:

$$\frac{\text{Market value of pre-CGT shares}}{\text{Market value of all shares}}$$

$$= \frac{\$3{,}000{,}000}{\$5{,}000{,}000}$$

= 60 per cent.

After the consolidated group is formed the following intra-group transactions occur;

- Company Z buys back the 20 Class B shares held by Company Y (leaving Head Co with 30 Class B shares in Company Z); and

- Company Y sells the 25 Class A shares it holds in Company Z to another subsidiary member (Company W).

As these are intra-group transactions, they are ignored by Head Co for income tax purposes.

On 15 May 2008, Head Co sells 25 Class A shares and 30 Class B shares that it holds in Company Z to a third party. As a result, Company Z leaves Head Co's consolidated group.

As Company Z has two classes of shares, the pre-CGT proportion is applied separately to each class as if the shares in that class were all the shares held by the old group in the leaving entity. Therefore:

- 30 of the class A shares are pre-CGT assets (that is, 50 × 60 per cent); and

- 18 of the class B shares are pre-CGT assets (that is, 30 × 60 per cent).

In relation to the shares that are sold:

- Head Co chooses to treat all of the 25 Class A shares as pre-CGT assets; and
- 18 class B shares (out of the 30 shares that are sold) are pre-CGT assets.

Head Co continues to hold 25 Class A shares in Company Z, 5 of which are pre-CGT assets.

Application of Division 149 to the head company

5.119 Division 149 sets out when an asset acquired before 20 September 1985 will stop being a pre-CGT asset for CGT purposes.

5.120 Broadly, for an asset's pre-CGT status to be maintained, entities must be able to demonstrate that the same ultimate owners who held (directly or indirectly) more than 50 per cent of the beneficial interests in the asset, and in the ordinary income derived from the asset, just before 20 September 1985 have continued to hold more than 50 per cent of these interests at the relevant time.

5.121 An integrity rule will apply to ensure broadly consistent treatment for membership interests in a leaving entity that are taken to be pre-CGT assets under the pre-CGT proportion rules.

5.122 The integrity rule will apply if the leaving entity held assets when it became a subsidiary member of the old group (disregarding the single entity rule (subsection 701-1(1)), and:

- some or all of the assets stopped being pre-CGT assets under Division 149 at a time (the Division 149 time) when they were held by the head company of the group (because of the single entity rule), provided that the leaving entity was a subsidiary member of the group at that time; or
- some or all of the assets would have stopped being pre-CGT assets under Division 149 at a time (also the Division 149 time) when they were held by the head company of the group (because of the single entity rule) if they had been pre-CGT assets just before that time, provided that the leaving entity was a subsidiary member of the group at that time.

[Schedule 5, item 30, subsection 711-70(1)]

5.123 If the integrity rule applies, the pre-CGT proportion of a leaving entity at the leaving time is taken to be nil. ***[Schedule 5, item 30, subsection 711-70(2)]***

5.124 In addition, if the integrity rule applies, an adjustment may be made to the old group's allocable cost amount for the leaving entity.

5.125 The purpose of this adjustment is to provide, broadly, parity with the outcome that would arise if Division 149 applied to an entity that is not a member of a consolidated group. The integrity rule adjusts the tax costs of the membership interests in the leaving entity on the assumption that, because of Division 149, those membership interests lost their pre-CGT status at the time when the integrity rule applies.

5.126 The amount of the adjustment is worked out by comparing the amount worked under subsection 711-70(4) (the subsection 711-70(4) amount) with the amount worked out under subsection 711-70(6) (the subsection 711-70(6) amount).

- If the subsection 711-70(4) amount exceeds the subsection 711-70(6) amount, the old group's allocable cost amount for the leaving entity is increased by the amount of the excess.

- If the subsection 711-70(4) amount is less than the subsection 711-70(6) amount, the old group's allocable cost amount for the leaving entity is reduced by the amount of the shortfall.

[Schedule 5, item 30, subsection 711-70(3)]

5.127 The subsection 711-70(4) amount is:

- if the tax cost setting rules in Subdivision 705-A applied in relation to the leaving entity at the time it became a subsidiary member of the old group, the total of the amounts that were taken into account under subsection 711-65(1) for membership interests in the leaving entity at that time; or

- otherwise, the total of the amounts that would have been taken into account under subsection 711-65(1) for membership interests in the leaving entity at the time it became a subsidiary member of the old group assuming that the tax cost setting rules in Subdivision 705-A (rather than the rules in Subdivisions 705-B or 705-D) had applied in relation to the leaving entity at that time.

[Schedule 5, item 30, subsection 711-70(4)]

5.128 For these purposes, if a membership interest in the leaving entity was a pre-CGT interest when the entity joined the group, the amount that taken into account under subsection 711-65(1) for the membership interest is taken to be the market value of the interest just after the Division 149 time (rather than the amount actually taken into account under subsection 711-65(1) at the joining time). ***[Schedule 5, item 30, subsection 711-70(5)]***

5.129 The subsection 711-70(6) amount is the amount of the old group's allocable cost amount worked out on the assumption that the leaving entity ceased to be a subsidiary member of the old group just after the Division 149 time. ***[Schedule 5, item 30, subsection 711-70(6)]***

Example 5.47: Application of Division 149 to the head company

Head Co was incorporated on 1 July 1980 with share capital of $1,000 (1,000 ordinary shares). Suzanne and Wayne were each issued with 500 ordinary shares in Head Co.

Subco A was incorporated on 1 July 1983 with a share capital of $680 (680 ordinary shares). All of those ordinary shares were immediately issued to Head Co.

Subco B was incorporated on 1 August 1983 with share capital of $400 (400 ordinary shares). At that time, 280 ordinary shares were issued to Subco A. Subco A acquired the remaining 120 ordinary shares in 2000 for $1,583 (when the market value of Subco B was $5,275).

On 1 July 2002, Head Co formed a consolidated group, with Subco A and Subco B as subsidiary members of the group.

The market value and terminating value Subco A's assets and liabilities as at 1 July 2002 are as follows:

Subco A	***Market value ($)***	***Terminating value ($)***
Assets		
Cash	930	930
Land and buildings (pre-CGT)	3,000	400
Shares in Subco B	5,765	1,863
Total assets	9,695	3,193
Equity		
Share capital		680
Retained taxed profits		2,513
Total equity		3,193

The pre-CGT proportion of Subco A is 100 per cent.

Under the tax cost setting rules in Division 705, the assets brought into the group by Subco A receive the following tax cost setting amounts:

- Cash $930
- Land and buildings (pre-CGT) $775
- Shares in Subco B $1,488

The market value and terminating value Subco B's assets and liabilities as at 1 July 2002 are as follows:

Subco B	***Market value ($)***	***Terminating value ($)***
Assets		
Cash	405	405
Trading stock	2,300	2,300
Plant and equipment	1,360	1,360
Goodwill (pre-CGT)	4,000	0
Total assets	5,795	4,065
Liabilities		
Creditors	2,300	2,300
Net assets	5,765	1,765
Equity		
Share capital		400
Retained taxed profits		1,365
Total equity		1,765

The pre-CGT proportion of Subco B is 70 per cent (that is, 280 / 400).

Under the tax cost setting rules in Division 705, the assets brought into the group by Subco B receive the following tax cost setting amounts:

- Cash $405
- Trading stock $1,347
- Plant and equipment $796
- Goodwill (pre-CGT) $2,343

After formation of the consolidated group, Suzanne sells 30 of the ordinary shares she owns in Head Co to Melissa.

The share sale by Suzanne results in Division 149 applying to:

- the pre-CGT land and buildings asset brought into the group by Subco A; and
- the pre-CGT goodwill asset brought into the group by Subco B.

The market value of the land and buildings asset at the time that Division 149 applies is $3,000. Therefore, for CGT purposes, the asset is taken to have been acquired by Head Co for $3,000 at that time.

The market value of the goodwill asset at the time that Division 149 applies is $4,000. Therefore, for CGT purposes, the asset is taken to have been acquired by Head Co for $4,000 at that time.

Division 149 adjustment to the old group's allocable cost amount for Subco B

As Division 149 applies to the goodwill asset brought into the group by Subco B, the pre-CGT proportion allocated to Subco B's membership interests will be taken to be nil if it ceases to be a subsidiary member of the group (subsections 711-70(1) and (2)).

To compensate for the loss of the pre-CGT proportion, the old group's allocable cost amount for Subco B is adjusted when it leaves the group.

The Division 149 adjustment is worked out in three steps. For these purposes, it is assumed that the assets, liabilities and market value of Subco B just after the Division 149 time are the same as at 1 July 2002.

Step 1 is to work out the subsection 711-70(4) amount for the membership interests in Subco B, which is the sum of:

- the amount taken into account under section 705-65(1) for the 120 ordinary shares acquired after 20 September 1985, on the assumption that Subdivision 705-A applied to work out the tax cost setting amount for Subco B when it joined the group — that is, $1,583; and
- the amount that would have been included for the 280 ordinary shares acquired prior to 20 September 1985 if Subco B had joined the group just after the Division 149 time — that is, $4,036 (that is, $5,765 × 70 per cent).

Therefore, the subsection 711-70(4) amount is $5,619.

Step 2 is to work out the subsection 711-70(6) amount, which is the old group's allocable cost amount for Subco B on the assumption that if it left the group just after the Division 149 time, as follows:

- the terminating values of Subco B's assets just before the leaving time (step 1 of the old group's allocable cost amount) is $6,548 — that is, the sum of the following amounts:

  – Cash $405

  – Trading stock $1,347

  – Plant and equipment $796

  – Goodwill $4,000

- reduced by the amount of Subco B's liabilities just before the leaving time (step 4 of the old group's allocable cost amount) — that is, $2,300.

Therefore, the subsection 711-70(6) amount is $4,248.

Step 3 is to compare the subsection 711-70(4) amount with the subsection 711-70(6) amount. The subsection 711-70(4) amount ($5,619) exceeds the subsection 711-70(6) amount ($4,248) by $1,371.

Therefore, if Subco B leaves the group, the old group's allocable cost amount for Subco B will be increased by $1,371.

Division 149 adjustment to the old group's allocable cost amount for Subco A

As Division 149 applies to the land and buildings asset brought into the group by Subco A, the pre-CGT proportion allocated to Subco A's membership interests will be taken to be nil if it ceases to be a subsidiary member of the group (subsections 711-70(1) and (2)).

To compensate for the loss of the pre-CGT proportion, the old group's allocable cost amount for Subco A is adjusted when it leaves the group.

The Division 149 adjustment is worked out in three steps. For these purposes, it is assumed that the assets, liabilities and market value of Subco A just after the Division 149 time are the same as at 1 July 2002.

Step 1 is to work out the subsection 711-70(4) amount for the membership interests in Subco A. As all the membership interests in Subco A are pre-CGT assets, the subsection 711-70(4) amount is the amount that would have been included for the 680 ordinary shares

acquired prior to 20 September 1985 if Subco A had joined the group just after the Division 149 time — that is, $9,695.

Step 2 is to work out the subsection 711-70(6) amount, which is the old group's allocable cost amount for Subco A on the assumption that if it left the group just after the Division 149 time. As Subco A has no liabilities, the subsection 711-70(6) amount is the terminating values of Subco A's assets just before the leaving time (step 1 of the old group's allocable cost amount). Therefore, the subsection 711-70(6) amount is $9,549 — that is, the sum of the following amounts:

– Cash	$930
– Land and buildings	$3,000
– Shares in Subco B	$5,619

The terminating value for the shares in Subco B ($5,619) is the old group's allocable cost amount for those shares just after the Division 149 time ($4,248) increased by the adjustment made under paragraph 711-70(3)(a) ($1,371).

Step 3 is to compare the subsection 711-70(4) amount with the subsection 711-70(6) amount. The subsection 711-70(4) amount ($9,695) exceeds the subsection 711-70(6) amount ($9,549) by $146.

Therefore, if Subco B leaves the group, the old group's allocable cost amount for Subco B will be increased by $146.

Application of CGT event K6

5.130 CGT event K6 (section 104-230) happens if certain CGT events happen to pre-CGT shares in a company or pre-CGT interests in a trust and, just before the time of the event, the market value of the post-CGT property of the company or trust, or of other entities in which the company or trust has a direct or indirect interest, is 75 per cent or more of the net value of the company or trust.

5.131 An integrity rule will apply to ensure broadly consistent treatment for membership interests in a leaving entity that are taken to be pre-CGT assets under the pre-CGT proportion rules.

5.132 The integrity rule will apply if the leaving entity ceases to be a member of the old group and, as a result, one of the following CGT events happens to one or more of its membership interests:

- CGT event A1 (disposal of a CGT asset);
- CGT event C2 (cancellation, surrender and similar endings of an intangible CGT asset);
- CGT event E1 (creating a trust over a CGT asset);
- CGT event E2 (transferring a CGT asset to a trust); or
- CGT event E8 (disposal by a beneficiary of a capital interest in a trust).

[Schedule 5, item 30, subsection 711-75(1)]

5.133 In these circumstances, two modifications are made to the operation of CGT event K6 (section 104-230).

5.134 The first modification to the operation of CGT event K6 is that, for the purpose of applying subsections 104-230(2) and (8) in relation to those membership interests:

- the single entity rule (subsection 701-1(1)) is disregarded for the purpose of working out the net value of the leaving entity, which includes working out the market value of both the pre-CGT and post-CGT property; and
- subsection 104-230(2) is applied just before the leaving time (rather than just before the other event happened).

[Schedule 5, item 30, subsection 711-75(2)]

5.135 The single entity rule is still taken into account for the purpose of determining whether the property mentioned in subsection 104-230(2) for the leaving entity was acquired on or after the 20 September 1985. Consequently, if the property is pre-CGT property for the head company's tax purposes, then it will be pre-CGT property for the purposes of applying subsection 104-230(2), even if it was transferred to the leaving entity by another member of the group after joining time.

5.136 In the case where two or more entities leave the group at the same time (that is, a multiple exit (section 711-55)), the property referred to in subsection 104-230(2) may include membership interests in another entity which leaves the group at the leaving time. The pre-CGT proportion rules in section 711-65 apply to determine which of those

membership interests are post-CGT assets for the purposes of applying subsection 104-230(2).

5.137 As the single entity rule is disregarded for the purpose of working out the net value of the leaving entity, intra-group acquisitions of property by the leaving entity or the discharge or release of intra-group liabilities may still be taken into account for the purpose of applying subsection 104-230(8). The intra-group transaction would be taken into account if, for example, the acquisition, discharge or release was done for a purpose of ensuring that the requirement in subsection 104-230(2) would not be satisfied in a particular situation.

5.138 The second modification to the operation of CGT event K6 is that, for the purpose of determining the sum of the cost bases of the property mentioned in subsection 104-230(6), the cost base of an asset that is included in that property is taken to be:

- if the asset has its tax cost set at the leaving time under section 701-50 — the asset's tax cost setting amount;
- if the terminating value of the asset is taken into account in working out the step 1 amount under section 711-25 for the leaving entity — the asset's terminating value; or
- if the asset is taken into account in working out the step 3 amount under section 711-40 for the leaving entity — the value of the asset taken into account for that purpose.

[Schedule 5, item 30, subsection 711-75(3)]

Consequential amendments

5.139 Consequential amendments will:

- modify a cross reference in subsection 705-125(4);
- repeal the existing pre-CGT factor rules in sections 705-165, 705-205 and 705-245, the note to subsection 711-65(2), subsection 711-65(5), sections 713-245 and 713-270; and
- repeal the definition of 'pre-CGT factor' in subsection 995-1(1).

[Schedule 5, items 21 to 24, 27, 29 and 31 to 33, sections 705-125, 705-165,705-205, 705-245, 711-65, 713-245, 713-270 and the definition of 'pre-CGT factor' in subsection 995-1(1)]

Application of Part 3

5.140 The amendments in Part 3 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins a consolidated group on or after that date. ***[Schedule 5, item 35]***

5.141 However, the head company of a consolidated group can make a choice to apply the amendments in Part 3 to an entity that joins a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 35]

5.142 This option to apply the amendments from 1 July 2002 will allow consolidated groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

Modifications to the tax cost setting rules when an entity joins a consolidated group

5.143 Under the tax cost setting rules, the tax costs of a joining entity's assets are generally reset by allocating the joining entity's allocable cost amount to each of the joining entity's assets in proportion to their market value. This allocation process ensures that, broadly, the costs incurred by the head company to acquire the joining entity's membership interests are pushed down into the tax costs of the underlying assets of the joining entity.

5.144 The allocable cost amount is basically the sum of the cost bases of the head company's membership interests in the joining entity held by members of the joined group and the joining entity's liabilities. Several adjustments are made to this amount.

5.145 The amendments will clarify and improve the operation of the tax cost setting rules when an entity joins a consolidated group to:

- ensure adjustments to the allocable cost amount are not double counted;
- clarify the operation of the adjustment to the allocable cost amount in respect of certain pre-joining time CGT roll-overs that applied to a joining entity's assets; and
- phase out the over-depreciation adjustment to the allocable cost amount.

Part 4 — No double counting of amounts in the allocable cost amount

5.146 Under the tax cost setting rules, several adjustments are made to the allocable cost amount. In some circumstances the adjustments to the allocable cost amount can be duplicated. As a result, the tax costs allocated to the joining entity's assets can be distorted.

5.147 A duplication can arise, for example, because integrity measures in the income tax law prevent the duplication of losses by reducing the cost base of shares. This adjustment to the cost base of shares causes a potential double adjustment to the allocable cost amount because:

- it may be reflected in an adjustment to step 1;
- it may be reflected in reduced undistributed profits of the joining entity at step 3; and / or
- it may be reflected in the tax losses of the joining entity at step 5.

5.148 The object of section 705-62 is to prevent a particular amount from being taken into account more than once when calculating the allocable cost amount for the joining entity for the purpose of promoting the object of Subdivision 705-A. ***[Schedule 5, item 36, subsection 705-62(1)]***

5.149 The object of Subdivision 705-A, which is set out in subsections 705-10(2) and (3), is broadly:

- to recognise the head company's cost of becoming a holder of the joining entity's assets as an amount reflecting the group's cost of acquiring the entity; and

- to align the costs of the assets with the costs of membership interests, and to preserve this alignment until the entity ceases to be a subsidiary member, in order to:
  - prevent double taxation of gains and duplication of losses; and
  - remove the need to adjust costs of membership interests in response to transactions that shift value between them, as the required adjustments occur automatically.

5.150 Section 705-62 applies if two or more provisions of the income tax law operate with the result of:

- altering the allocable cost amount for the joining entity because of a particular economic attribute of the joining entity; or
- altering the allocable cost amount for another entity that becomes a subsidiary member of the group at the joining time because of a particular economic attribute of the joining entity.

[Schedule 5, item 36, subsection 705-62(2)]

5.151 The economic attributes of the joining entity include:

- the joining entity's retained profits;
- the joining entity's distributions of profits to other entities;
- the joining entity's realised and unrealised losses;
- the joining entity's deductions;
- the joining entity's accounting liabilities (within the meaning of subsection 705-70(1)); and
- consideration received by the joining entity for issuing membership interests in itself.

[Schedule 5, item 36, subsection 705-62(6)]

5.152 Where section 705-62 applies, the head company can choose which alteration is made. The choice must be made in writing by the day on which the head company lodges its income tax return for the income year in which the joining time occurs or within such further time as the Commissioner allows. ***[Schedule 5, item 36, paragraph 705-62(3)(a) and subsections 705-62(4) and (5)]***

5.153 If the head company does not make a choice, only the alteration that is most appropriate, in the light of the object of Subdivision 705-A, is to be made. ***[Schedule 5, item 36, paragraph 705-62(3)(b)]***

Example 5.48: No double counting of adjustments to the allocable cost amount

Holding Co incorporates Admin Co with $200,000. Admin Co uses the $200,000 to incorporate Beta Co. Beta Co realises a tax loss of $50, and has assets of $150,000 remaining.

There is an alteration in underlying majority ownership of Holding Co so that Subdivision 165-CD applies to reduce the reduced cost base of Admin Co's membership interests in Beta Co, and Holding Co's membership interests in Admin Co, by $50,000 to $150,000. For the purposes of this example, any tax effects arising as a result of the alteration have been ignored.

Holding Co then forms a consolidated group.

Under the current law, the tax cost setting rules apply to Admin Co as follows.

- Step 1 of the allocable cost amount is the reduced cost base of Holding Co's membership interests in Admin Co (that is, $150,000) — the reduced cost base of the membership interests is used because the market value of those membership interests is less than or equal to their reduced cost base.
- No other steps apply, so Holding Co's allocable cost amount for Admin Co is $150,000.
- This allocable cost amount will be allocated to the membership interests in Beta Co (the only asset of Admin Co).

Under the current law, the tax cost setting rules apply to Beta Co as follows.

- Step 1 of the allocable cost amount is the reduced cost base of Admin Co's membership interests in Beta Co (that is, $150,000).
- The step 1 amount is reduced by the amount of losses accruing to joined group before the joining time (that is, $50,000) under step 5 of the allocable cost amount.
- Holding Co's allocable cost amount for Beta Co is $100,000.
- This allocable cost amount will be allocated to the assets of Beta Co.

This is an inappropriate outcome. Holding Co invested $200,000 in Admin Co which, in turn, invested $200,000 in Beta Co. Beta Co had a tax loss of $50,000. Therefore, the correct tax cost setting amount for both companies should be $150,000.

Applying section 705-62, the allocable cost amount for Admin Co will be unchanged — that is, it will continue to be $150,000.

However, to prevent double counting, Holding Co chooses to ignore the step 5 adjustment. This is because the loss has already been taken into account in calculating the step 1 amount for Beta Co. As a result, the allocable cost amount for Beta Co will be increased to $150,000.

Application of Part 4

5.154 The amendments in Part 4 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins a consolidated group on or after that date. ***[Schedule 5, item 37]***

5.155 However, the head company of a consolidated group can make a choice to apply the amendments in Part 4 to an entity that joins a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 37]

5.156 This option to apply the amendments from 1 July 2002 will allow consolidated groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

5.157 Where a choice is made to apply the amendments retrospectively (so that the joining time occurs before the day on which this Bill obtains Royal Assent), a transitional rule allows the choice to determine the alteration to the allocable cost amount which is most appropriate (that is, the choice in subsection 705-62(4)) to be made on or before 30 June 2011, or within such further time as the Commissioner allows. ***[Schedule 5, item 38]***

Part 5 — Pre-joining time roll-overs

5.158 Step 3A (section 705-93) adjusts the allocable cost amount for a joining entity where the joining entity has a deferred capital gain or loss

that arose because of a CGT roll-over from a foreign resident company before the joining time.

5.159 The step 3A amount is also adjusted where there has been a pre-formation time CGT roll-over of an asset from the head company to a member of the wholly-owned group (section 705-150).

5.160 The adjustment at step 3A of the allocable cost amount is intended to prevent the deferred gain or loss arising from the pre-joining time CGT roll-over of an asset between members of the same wholly-owned group from being included in the tax costs of a joining entity's assets as a result of the tax cost setting process. This adjustment removes the amount of the deferred gain or loss from the allocable cost amount and prevents it from being indefinitely deferred for tax purposes.

5.161 Currently the step 3A adjustment is deficient because, for example:

- the adjustment does not apply if a subsequent CGT event (such as CGT event G1) happened to the roll-over asset where that CGT event does not cause the deferred gain or loss to be brought to account for tax purposes;
- the adjustment may apply inappropriately when an entity becomes a member of a consolidated group after the tax costs of its membership interests has been set under Division 711 because it left another consolidated group; and
- the amount of the adjustment under section 705-150 may be incorrect.

5.162 To overcome these concerns, section 705-93 will be modified so that a step 3A amount arises where:

- before the joining time, there was a Subdivision 126-B roll-over or a former section 160ZZO roll-over in relation to an asset (existing paragraph 705-93(1)(a));
- at the joining time, as a result of the Subdivision 126-B roll-over or the former section 160ZZO roll-over, the roll-over asset has a deferred roll-over gain or a deferred roll-over loss;

- the originating company in relation to the Subdivision 126-B roll-over, or the transferor in relation to the former section 160ZZO roll-over:
  - was a foreign resident; or
  - is the head company in relation to the joined group;
- the recipient company in relation to the Subdivision 126-B roll-over, or the transferee in relation to the former section 160ZZO roll-over:
  - was an Australian resident; and
  - is a spread entity in relation to the joined group;
- if the recipient company was previously a subsidiary member of another consolidated group, the conditions in section 104-182 (which prevents CGT event J1 from happening if the recipient company ceases to be a subsidiary member of a consolidated group at the time the group breaks up) were not satisfied at any time in relation to the other group between:
  - the time of the Subdivision 126-B roll-over and the joining time; or
  - the time of the former section 160ZZO roll-over and the joining time;
- the roll-over asset is not a pre-CGT asset at the joining time (existing paragraph 705-93(1)(e)); and
- the roll-over asset becomes that of the head company of the joined group because the single entity rule (subsection 701-1(1)) applies when the joining entity becomes a subsidiary member of the group (existing paragraph 705-93(1)(f)).

[Schedule 5, items 41 to 45, paragraphs 705-93(1)(a) to (d)]

5.163 The step 3A amount is the amount of the deferred roll-over gain or the deferred roll-over loss. ***[Schedule 5, item 46, subsection 705-93(2)]***

5.164 If the step 3A amount is a deferred roll-over gain, the allocable cost amount is reduced by the amount of the deferred roll-over gain. If the step 3A amount is a deferred roll-over loss, the allocable cost amount is increased by the amount of the deferred roll-over loss. ***[Schedule 5, item 40, item 3A in the table in section 705-60]***

5.165 An asset has a ***deferred roll-over gain*** at a particular time if:

- before that time there was a CGT roll-over in relation to a disposal or a CGT event that happened in relation to the asset; and
- as a result of the roll-over, all or part of a capital gain from the CGT event was disregarded.

[Schedule 5, item 50, paragraphs (a) and (b) of the definition of 'deferred roll-over gain' in subsection 995-1(1)]

5.166 The amount of the deferred roll-over gain is the amount of the capital gain that was disregarded, reduced by the amount (if any) by which the gain has been taken into account in working out a net capital gain or net capital loss in relation to the asset between the roll-over time and the particular time. ***[Schedule 5, item 50, the definition of 'deferred roll-over gain' in subsection 995-1(1)]***

5.167 An asset has a ***deferred roll-over loss*** at a particular time if:

- before that time there was a CGT roll-over in relation to a disposal or a CGT event that happened in relation to the asset; and
- as a result of the roll-over, all or part of a capital loss from the CGT event was disregarded.

[Schedule 5, item 51, paragraphs (a) and (b) of the definition of 'deferred roll-over loss' in subsection 995-1(1)]

5.168 The amount of the deferred roll-over loss is the amount of the capital loss that was disregarded, reduced by the amount (if any) by which the loss has been taken into account in working out a net capital gain or net capital loss in relation to the asset between the roll-over time and the particular time. ***[Schedule 5, item 51, the definition of 'deferred roll-over loss' in subsection 995-1(1)]***

5.169 A ***stick entity***, in relation to a consolidated group, means a member of the group that is:

- the head company of the group;
- a chosen transitional entity; or
- a transitional foreign-held subsidiary.

[Schedule 5, item 53, paragraph (a) of the definition of 'stick entity' in subsection 995-1(1)]

5.170 A ***stick entity***, in relation to a MEC group, means a member of the group that is:

- the head company of the group;
- a chosen transitional entity;
- a transitional foreign-held subsidiary; or
- an eligible tier-1 company.

[Schedule 5, item 51, paragraph (b) of the definition of 'stick entity' in subsection 995-1(1)]

5.171 A ***spread entity***, in relation to a consolidated group or a MEC group, means a member of the group that is not a stick entity in relation to the group. ***[Schedule 5, item 52, the definition of 'spread entity' in subsection 995-1(1)]***

5.172 Section 705-147 modifies the operation of step 3A of the allocable cost amount (section 705-93) in the case of a group formation to:

- apportion the step 3A amount among the first level interposed entities; and
- take account of a roll-over asset that is a membership interest in an entity that becomes a subsidiary member at the formation time.

5.173 As a result of the amendments to section 705-93, consequential amendments to section 705-147 clarify the scope of its operation and remove redundant elements of the section. ***[Schedule 5, item 47, subsection 705-147(3)]***

5.174 Section 705-150 adjusts the step 3A amount for pre-formation time CGT roll-overs by the head company to a subsidiary member. The

amendments broaden the scope of section 705-93. As a result, section 705-150 is no longer necessary and is therefore being repealed. ***[Schedule 5, item 48]***

5.175 As a result of the modifications to section 705-93 and the repeal of section 705-150, consequential amendments will:

- remove the reference to section 705-150 in paragraph 104-505(1)(b); and
- replace the reference to section 705-150 with a reference to section 705-93 in section 126-165 of the *Income Tax (Transitional Provisions) Act 1997*.

[Schedule 5, items 39 and 54, paragraph 104-505(1)(b) of the ITAA 1997 and section 126-165 of the Income Tax (Transitional Provisions) Act 1997]

5.176 Section 705-227 modifies the operation of step 3A of the allocable cost amount (section 705-93) for linked entities that join a consolidated group to:

- apportion the step 3A amount among the first level interposed entities; and
- take account of a roll-over asset that is a membership interest in a linked entity that is held by another linked entity.

5.177 As a result of the amendments to section 705-93, consequential amendments to section 705-227 clarify the scope of its operation and remove redundant elements of the section. ***[Schedule 5, item 49, subsection 705-227(3)]***

Application of Part 5

5.178 The amendments in Part 5 apply from 1 July 2002. ***[Schedule 5, item 55]***

5.179 These amendments, which ensure that the income tax law operates as originally intended, prevent the duplication of capital gains in some circumstances and therefore are beneficial to taxpayers.

Part 6 — Phasing out over-depreciation adjustments

5.180 In some cases the amount of the reset tax cost setting amount that would otherwise apply to an over-depreciated asset of a joining entity is reduced (section 701-50).

5.181 The over-depreciation adjustment prevents the indefinite deferral of tax on the profits sheltered due to the over-depreciation of the asset. This can arise where the accelerated depreciation of assets has brought forward the joining entity's depreciation deductions, thus deferring the payment of tax on its profits. The profits remain untaxed when the entity joins the group where:

- the asset is over-depreciated at that time;
- the profits have been distributed to another entity that was entitled to the former inter-corporate dividend rebate; and
- the profits have not been distributed to another entity that did not have access to the former inter-corporate dividend rebate.

5.182 Currently, to work out whether the reset tax cost setting amount of an over-depreciated asset of a joining entity needs to be reduced by an over-depreciation adjustment, the joining entity needs to determine whether it paid unfranked or partly franked dividends to shareholders that were entitled to the former inter-corporate dividend rebate prior to the joining time. The inter-corporate dividend rebate for unfranked dividends was removed from 1 July 2004 following the introduction of the simplified imputation system.

5.183 To reduce compliance costs, a joining entity will have to look only at the five years of dividend history prior to the joining time to determine whether an over-depreciation adjustment is required. ***[Schedule 5, item 56, paragraph 705-50(2)(b)]***

5.184 As a consequence, the over-depreciation adjustment ceases to have any effect after 1 July 2009. Therefore, the over-depreciation adjustment is being repealed with effect from that date. ***[Schedule 5, items 58 to 77, sections 705-50, 705-55, 705-57, 705-59, 705-190, 713-225, 713-230, 715-900, 716-330, 716-340 and the definitions of 'over-depreciated' and 'over-depreciation' in subsection 995-1(1) of the ITAA 1997 and sections 126-165, 701-40 and 705-305 of the Income Tax (Transitional Provisions) Act 1997]***

Application of Part 6

5.185 The amendments in Part 6 that modify the operation of the over-depreciation adjustment apply in relation to entities that become members of a consolidated group between 9 May 2007 and 30 June 2009. ***[Schedule 5, item 57]***

5.186 In this regard, these amendments, which were sought by an industry representative body, are beneficial to taxpayers as they will significantly reduce compliance costs.

5.187 The amendments to repeal the over-depreciation adjustment apply in relation to entities that become members of a consolidated group on or after 1 July 2009. ***[Schedule 5, item 78]***

Modifications to the tax cost setting rules when an entity leaves a consolidated group

5.188 When an entity leaves a consolidated group, the tax costs of the membership interests in the leaving entity are reconstructed. That is, the tax cost setting amount for each membership interest held in the leaving entity by members of the old group is worked out by, broadly, allocating a proportion of the old group's allocable cost amount to each membership interest (section 711-15).

5.189 The amendments will clarify and improve the operation of the tax cost setting rules when an entity leaves a consolidated group to:

- clarify that the liabilities taken into account in working out step 4 of the old group's allocable cost amount are the liabilities held just before the leaving time; and
- ensure that an appropriate adjustment is made to the amount included at step 4 of the old group's allocable cost amount in respect of a liability when that liability was taken into account in working out the allocable cost amount for an entity that joined the group.

Division 1 of Part 7 — Leaving time liabilities: Timing

5.190 When an entity leaves a consolidated group, the group's cost of the membership interests in the leaving entity is set so that it reflects the cost to the group of the net assets of the leaving entity. The cost of the membership interests in the leaving entity is determined by working out the old group's allocable cost amount. The old group's allocable cost amount broadly consists of the terminating values of the leaving entity's assets less the value of the liabilities and certain equity interests of the leaving entity.

5.191 For these purposes, the liabilities that are included in step 4 of the old group's allocable cost amount are the liabilities of the leaving entity at the leaving time (section 711-45).

5.192 In *Handbury Holdings Pty Ltd v Commissioner of Taxation* [2009] FCAFC 141, a subsidiary member left a consolidated group when a debt held by a non-group member was converted to equity. The taxpayer argued that the debt was not included in step 4 of the old group's

allocable cost amount because it was not a liability that the leaving entity takes with it when it ceases to be a subsidiary member of the group.

5.193 The Full Federal Court concluded that subsection 711-45(1) includes liabilities held by the leaving entity just before the leaving time. As a result, the debt is included in step 4 of the old group's allocable cost amount.

5.194 However, to remove any doubt, the amendments will clarify that step 4 of the old group's allocable cost amount applies to liabilities of the leaving entity that exist just before the leaving entity ceases to be a subsidiary member of the group — that is, just before the leaving time. ***[Schedule 5, items 79 to 86, sections 711-20, 711-25, 711-45 and 713-265]***

Application of Division 1 of Part 7

5.195 The amendments in Division 1 of Part 7 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that leaves a consolidated group on or after that date. ***[Schedule 5, item 87]***

5.196 However, the amendments in Division 1 of Part 7 are disregarded for the purposes of interpreting:

- sections 711-20, 711-25, 711-45 and 713-265, as they applied before the date of introduction of this Bill into the House of Representatives; and
- any other provision of the ITAA 1997 or the *Income Tax (Transitional Provisions) Act 1997*, as that provision applied before the date of introduction of this Bill into the House of Representatives, to the extent that it relates to section 711-20, 711-25, 711-45 or 713-265.

[Schedule 5, item 87]

5.197 In this regard, the purpose of the amendments in Division 1 of Part 7 is to clarify the operation of sections 711-20, 711-25, 711-45 and 713-265. However, the amendments are not intended to alter the practical operation of the relevant provisions as reflected by the decision of the Full Federal Court in the *Handbury Holdings* case.

Division 2 of Part 7 — Leaving time liabilities: Adjustment of the step 4 amount

5.198 Currently, subsection 711-45(8) adjusts the amount of the liability that is subtracted from the old group's allocable cost amount for a joining entity under step 4 if:

- the liability was taken into account in working out the allocable cost amount for a subsidiary member when it joined a consolidated group (under Division 705);
- the entry amount of the liability taken into account at that time is different to the step 4 exit amount of the liability; and
- the entry allocable cost amount was different from what it would have been if the exit amount instead of the entry amount, had been taken into account in working it out.

5.199 In these circumstances, for the purpose of applying step 4, the liability is taken to be equal to the entry amount.

5.200 Subsection 711-45(8) is being modified to clarify its operation and reduce compliance costs by limiting the circumstances in which it applies.

5.201 As a result, the amount of liability included at step 4 of the old group's allocable cost amount under section 711-45 will be adjusted under subsection 711-45(10) if the four conditions in subsection 711-45(8) are satisfied.

5.202 The first condition is that subsection 711-45(5) applies to the liability. That is, if:

- an amount (the exit liability amount) was added for the liability under subsection 711-45(5); or
- the liability is covered by subsection 711-45(5), but no amount was added for it under that subsection — that is, the exit liability amount is zero.

[Schedule 5, item 88, paragraph 711-45(8)(a)]

5.203 Subsection 711-45(5) adjusts the amount of an accounting liability that is subtracted from the old group's allocable cost amount if the liability is an accounting liability that is taken into account at a later time for income tax purposes than for accounting purposes (such as a

liability that is an employee provision or a movement in a foreign currency liability).

5.204 The second condition in subsection 711-45(8) is that the liability was taken into account in working out the allocable cost amount (the original entry allocable cost amount) for a subsidiary member (whether or not the leaving entity) of the old group in accordance with Division 705. ***[Schedule 5, item 88, paragraph 711-45(8)(b)]***

5.205 The third condition in subsection 711-45(8) is that the exit liability amount is not the same as the entry liability amount. The entry liability amount is the amount of the liability that was taken into account in working out the original entry allocable cost amount after any adjustments made under:

- section 705-70, 705-75 or 705-80; and
- subsection 711-45(9).

[Schedule 5, item 88, paragraph 711-45(8)(c)]

5.206 The entry liability amount is generally the amount of the liability that was actually included at step 2 of the joined group's allocable cost amount for a joining entity.

5.207 However, the entry liability amount is adjusted if, at a time when the leaving entity was a subsidiary member of the old group, the head company paid an amount which reduced the liability. In this event, the entry liability amount is reduced by the amount of the reduction. ***[Schedule 5, item 88, subsection 711-45(9)]***

5.208 In addition, if the payment gave rise to an amount being included in the assessable income of the head company, the entry liability amount is further reduced by the following amount:

$$\text{assessable amount} \times \text{corporate tax rate}.$$

[Schedule 5, item 88, subsection 711-45(9)]

5.209 Alternatively, if the payment gave rise to a deduction for the head company, the entry liability amount is increased by the following amount:

$$\text{amount deducted} \times \text{corporate tax rate}.$$

[Schedule 5, item 88, subsection 711-45(9)]

5.210 Where the entry liability amount is reduced to nil after the application of subsection 711-45(9), then the liability taken into account at step 4 on exit will no longer be the same as the liability taken into account on entry. Therefore, the step 4 amount for the liability will not be adjusted under subsection 711-45(10).

5.211 The fourth condition in subsection 711-45(8) applies only if the liability is:

- a provision for annual leave or long service leave; or
- a provision for a liability contingent on a future event (such as a warranty provision).

[Schedule 5, item 88, paragraph 711-45(8)(d)]

5.212 In these circumstances, the step 4 amount for the liability will be adjusted under subsection 711-45(10) only if:

- in the case of a liability that was (in accordance with the accounting principles that the leaving entity would have used if it had prepared its financial statements just before the time it joined the consolidated group) a current liability at the joining time, the leaving time occurs less than one year after the joining time; or
- in any other case, the leaving time occurs less than four years after the joining time.

[Schedule 5, item 88, paragraph 711-45(8)(d)]

5.213 The purpose of the fourth condition is to reduce compliance costs because of the difficulty in tracking these types of liabilities. In addition:

- in the case of a current liability, the liability would generally have been fully paid out in the year after the joining time; and
- in the case of a non-current liability relating to a provision, the liability would generally have been fully paid out within four years after the joining time.

5.214 Where the four conditions in subsection 711-45(8) are satisfied, subsection 711-45(10) applies to adjust the step 4 amount:

- if the entry liability amount exceeds the exit liability amount, the step 4 amount is increased by the amount of the excess; or
- if the entry liability amount falls short of the exit liability amount, the step 4 amount is reduced by the amount of the shortfall.

[Schedule 5, item 88, subsection 711-45(10)]

Example 5.49: Provision for employee leave entitlements

Head Co acquires all of the membership interests in Company J on 1 July 2010. As a result, Company J joins Head Co's consolidated group.

Company J's financial reports at the joining time includes a total liability of $275,000 that is a provision for employee leave. Part of the liability ($55,000) is classified as a current liability. The remainder ($220,000) is classified as a non-current liability.

In working out the allocable cost amount for Company J at the joining time (the original entry allocable cost amount), the amount included at step 2 (the entry liability amount) for the employee provision is $192,500 — that is:

- $38,500 for the current liability — in this regard, subsection 705-75(1) applies to reduce the amount of the accounting liability ($55,000) by the amount of the future income tax deduction in respect of the liability ($55,000 × 30 per cent = $16,500); and
- $154,000 for the non-current liability — in this regard, subsection 705-75(1) applies to reduce the amount of the accounting liability ($220,000) by the amount of the future income tax deduction in respect of the liability ($220,000 × 30 per cent = $66,000).

After the joining time, Head Co makes leave payments of $60,000 to employees of Company J.

On 1 August 2012, Company J leaves Head Co's consolidated group as all of its membership interests are acquired by a third party entity.

Company J's financial reports at the leaving time includes a total liability of $285,000 that is a provision for employee leave. Part of the

liability ($50,000) is classified as a current liability. The remainder ($235,000) is classified as a non-current liability.

The amount included under subsection 711-45(1) as a liability for the provision for employee leave is $285,000. As Company J will be entitled to a future income tax deduction in respect of the liability, subsection 711-45(3) applies to reduce this amount to $199,500 — that is, by the amount of the future income tax deduction ($285,000 × 30 per cent = $85,500).

As the liability is taken into account for income tax purposes only when it is incurred (that is, at a later time than the time it is recognised for accounting purposes), subsection 711-45(5) applies to reduce the amount for the liability at step 4 to nil — that is to the amount of the payment that would be necessary to discharge the liability just before the leaving time without an amount being included in assessable income of, or allowable as a deduction to, the head company. This overrides the amount included at subsection 711-45(1) and the reduction at subsection 711-45(3).

However, to the extent that the employee leave provision is a non-current liability, the step 4 amount will be adjusted under subsection 711-45(10) because the four conditions in subsection 711-45(8) are satisfied.

- The first condition is satisfied because the non-current liability is covered by subsection 711-45(5) and the exit liability amount is nil.
- The second condition is satisfied because the non-current liability was taken into account in working out the original allocable cost amount for a joining entity.
- The third condition is satisfied because the exit liability amount (nil) is not the same as the entry liability amount ($150,500) — the entry liability amount is the sum of:
  - the amount taken into account at step 2 of the original allocable cost amount — $154,000;
  - reduced by the amount paid by Head Co to reduce the non-current liability — $5,000 (that is, the amount paid by Head Co after the joining time ($60,000) less the amount of the current liability at that time ($55,000);
  - increased by the product of the amount deducted by Head Co ($5,000) multiplied by the corporate tax rate (30 per cent) — $1,500.
- The fourth condition is satisfied because, even though the liability is a provision for employee leave, the liability was a non-current

liability at the joining time and the leaving time is within four years of the joining time.

Therefore, subsection 711-45(10) applies to alter the step 4 amount for the employee leave provision. As the entry liability amount ($150,500) exceeds the exit liability amount (nil), the step 4 amount is increased by the amount of the excess ($150,500).

To the extent that the employee provision is a current liability, the step 4 amount will not be adjusted under subsection 711-45(10). This is because the fourth condition in subsection 711-45(8) is not satisfied in respect of the liability — that is, the provision for employee leave was a current liability at the joining time and the leaving time is more than one year after the joining time.

Example 5.50: Foreign exchange liability — partial repayment after the joining time

Head Co acquires all of the membership interests in Company J on 1 July 2009. As a result, Company J joins Head Co's consolidated group.

Prior to joining time Company J borrowed US$100. At that time, A$1 was equivalent to US$0.80. Company J therefore received A$125 cash on issue of the foreign exchange (forex) liability.

At the joining time, A$1 is equivalent to US$0.75. Therefore, Company J's financial reports at the joining time include a forex liability of A$133.33 and a forex loss of A$8.33. As the loss is not deductible for income tax purposes, Company J has a deferred tax asset of A$2.50.

In working out the allocable cost amount for Company J at the joining time (the original entry allocable cost amount), the amount for the forex liability included at step 2 (the entry liability amount) is A$130.83. In this regard, under subsection 705-75(1), the step 2 amount is the amount of the accounting liability (A$133.33) reduced by the amount of the future income tax deduction in respect of the liability ($2.50).

Head Co repays US$50 of the US$100 forex liability after the joining time. At the time of the repayment, A$1 is equivalent to US$0.85. Therefore, Head Co makes a repayment of A$58.82 and realises a foreign exchange gain of A$3.68 for tax purposes. After taking into account the tax cost to Head Co of the gain, the repayment has an after-tax cost of A$59.92 (A$3.68 × 30 per cent = A$1.10).

On 30 June 2013, Company J leaves Head Co's consolidated group as all of its membership interests are acquired by a non-group member.

When Company J leaves the consolidated group, A$1 is equivalent to US$0.85. Therefore, Company J's financial reports at the leaving time include a forex liability of A$58.82.

The amount included under subsection 711-45(1) for the forex liability is A$58.82.

However, as the movement in the forex liability is taken into account for income tax purposes only when it is incurred (that is, at a later time than the time it is recognised for accounting purposes), subsection 711-45(5) applies to increase the amount for the forex liability at step 4 to A$62.50 — that is to the amount of the payment that would be necessary to discharge the forex liability just before the leaving time without an amount being included in assessable income of, or allowable as a deduction to, the head company. This overrides the amount included at subsection 711-45(1).

The step 4 amount for the forex liability will be adjusted under subsection 711-45(10) because the four conditions in subsection 711-45(8) are satisfied.

- The first condition is satisfied because an amount was added for the liability under subsection 711-45(5) — that is, the exit liability amount is A$62.50.

- The second condition is satisfied because the liability was taken into account in working out the original allocable cost amount for a joining entity.

- The third condition is satisfied because the exit liability amount (A$62.50) is not the same as the entry liability amount (A$70.91) — the entry liability amount is the sum of:

  – the amount taken into account at step 2 of the original allocable cost amount — A$130.83;

  – reduced by the amount paid by Head Co to reduce the liability — A$58.82; and

  – further reduced by the product of the amount included in Head Co's assessable income (A$3.68) multiplied by the corporate tax rate (30 per cent) — A$1.10.

- The fourth condition is satisfied because it does not apply to a forex liability.

Therefore, subsection 711-45(10) applies to alter the step 4 amount for the forex liability. As the entry liability amount (A$70.91) exceeds the exit liability amount (A$62.50), the step 4 amount is increased by the amount of the excess (A$8.41).

Application of Division 2 of Part 7

5.215 The amendments in Division 2 of Part 7 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that leaves a consolidated group on or after that date. ***[Schedule 5, item 89]***

Modifications to the tax cost setting rules when an entity joins or leaves a consolidated group

5.216 Some elements of the tax cost setting rules apply both:

- when an entity joins a consolidated group; and
- when an entity leaves a consolidated group.

5.217 The amendments will clarify and improve the operation of the tax cost setting rules when an entity joins or leaves a consolidated group to:

- clarify the accounting principles that apply to determine the accounting liabilities which are recognised under the tax cost setting rules;
- clarify the scope and amount of the adjustment to the allocable cost amount in respect of inherited deductions; and
- if the joining or leaving entity is a general insurance company, ensure that the tax cost setting rules apply appropriately to its deferred acquisition costs, deferred reinsurance expenses and recoveries receivable.

Part 8 — Accounting principles

5.218 The amendments in Part 8 clarify the accounting principles that apply to determine the accounting liabilities which are recognised under the tax cost setting rules when an entity joins or leaves a consolidated group.

Modifications when an entity joins a consolidated group

5.219 When an entity joins a consolidated group, the allocable cost amount for the joining entity is increased by the value of its liabilities at the joining time (step 2 in the table in section 705-60).

5.220 Generally, as a starting point, the step 2 amount includes the value of a joining entity’s liabilities that are recognised under the

accounting standards or under statements of accounting concepts made by the Australian Accounting Standards Board.

5.221 Where the joining entity does not apply the accounting standards or statements of accounting concepts to prepare a statement of its financial position, the liabilities of the joining entity that can or must be recognised under those standards as at the joining time must be taken into account for the purposes of working out the step 2 amount.

5.222 In *Envestra Ltd v Federal Commissioner of Taxation* [2008] FCA 249; 2008 ATC 20-012, the Federal Court confirmed that a joining entity cannot adopt an accounting standard to measure a liability for consolidation purposes if it did not adopt that accounting standard for the recognition and measurement of the liability for financial reporting purposes.

5.223 For the avoidance of doubt, the amendments will modify the tax cost setting rules to confirm this position.

5.224 That is, the amendments clarify that a matter is in accordance with the ***accounting principles*** if it is in accordance with:

- accounting standards; or
- if there are no accounting standards applicable to the matter, authoritative pronouncements of the Australian Accounting Standards Board that apply to the preparation of financial statements.

[Schedule 5, item 111, the definition of 'accounting principles' in subsection 995-1(1)]

5.225 In this regard, authoritative pronouncements of the Australian Accounting Standards Board can be relevant in the preparation of financial statements and would be considered when recognising and measuring accounting liabilities (and other elements on the balance sheet). These include:

- the Urgent Issue Group Interpretations;
- the Framework for the Preparation and Presentation of Financial Statements;
- statements of accounting concepts issued by the Australian Accounting Standards Board; and
- other authoritative pronouncements of the Australian Accounting Standards Board.

5.226 Broadly, when an entity joins a consolidated group, the joining entity's ***accounting principles for tax cost setting*** must be applied for the purposes of working out the allocable cost amount for the joining entity. These are the accounting principles that the joining entity would use if it were to prepare its financial statements just before the joining time. ***[Schedule 5, items 97 and 112, subsection 705-70(3) and the definition of 'accounting principles for tax cost setting' in subsection 995-1(1)]***

5.227 In practical terms, the joining entity's accounting principles for tax cost setting are:

- the accounting principles that the joining entity actually used to prepare its financial reports just before the joining time; or
- if the joining entity did not prepare financial reports just before the joining time, the accounting principles that it would use if it were to prepare its financial reports just before the joining time.

5.228 In this regard, if the joining entity used audited accounts as the basis for preparing its financial reports just before the joining time, the accounting principles applied in the preparation of those audited accounts are the joining entity's accounting principles for tax cost setting.

5.229 Therefore, for the purpose of working out step 2 of the allocable cost amount for a joining entity, the amendments clarify that the liabilities that are taken into account are those liabilities that, in accordance with the joining entity's accounting principles for tax cost setting, are liabilities of the entity. That is

- for the purpose of applying section 705-70 (other than subsection 705-70(1A)), the liabilities of the joining entity that are taken into account are those liabilities that, in accordance with the joining entity's accounting principles for tax cost setting, are liabilities of the entity;
- the adjustment to step 2 under section 705-80, if any, applies to an accounting liability that is taken into account at a later time than is the case in accordance with the joining entity's accounting principles for tax cost setting; and
- if an adjustment is made to step 2 of the allocable cost amount under section 705-85, the step 2 amount is increased by, if relevant, the market value of each thing that, in accordance with the joining entity's accounting principles for tax cost setting, is equity in the entity at the joining time, where the thing is also a debt interest.

[Schedule 5, items 94, 95, 98 and 99, subsections 705-70(1), 705-80(1) and 705-85(3)]

5.230 Subsection 705-70(1A) applies if the amount of an accounting liability of a joining entity would be different when it becomes an accounting liability of the joined group. In these circumstances, the different amount is treated as the amount of the liability. A consequential amendment ensures that the effect of subsection 705-70(1A) is unchanged. ***[Schedule 5, item 96, subsection 705-70(1A)]***

5.231 Finally, consequential amendments clarify that, when an entity joins a consolidated group:

- the tax cost setting rules in relation to finance leases under section 705-56 applies to a lease held by the joining entity that, in accordance with its accounting principles for tax cost setting, is classified as a finance lease;

- the consolidation provisions apply separately to each asset and liability even if, in accordance with accounting principles, they are required to be set off against each other (section 701-58);

- the exception for the treatment of linked assets and liabilities in section 701-59 refers to the assets and liabilities of the joining entity that, in accordance with the entity's accounting principles for tax cost setting, are linked; and

- the undistributed profits taken into account under step 3 of the allocable cost amount (section 705-90) are the amounts that, in accordance with the joining entity's accounting principles for tax cost setting, are retained profits of the entity.

[Schedule 5, items 91 to 93, 100 and 101, subsections 705-56(1), 705-58(1), 705-59(2), and 705-90(2)]

Modifications when an entity leaves a consolidated group

5.232 When an entity leaves a consolidated group, the old group's allocable cost amount is reduced by the value of the liabilities that the leaving entity takes with it when it ceases to be a member of the old group (step 4 in the table in section 711-20).

5.233 Broadly, when an entity leaves a consolidated group, the leaving entity's ***accounting principles for tax cost setting*** must be applied for the purposes of working out the old group's allocable cost amount for the leaving entity. These are the accounting principles that the group would use if it were to prepare its financial statements just before the joining time. ***[Schedule 5, items 104 and 112, subsection 711-45(1A) and the definition of 'accounting principles for tax cost setting' in subsection 995-1(1)]***

5.234 In practical terms, the leaving entity's accounting principles for tax cost setting are:

- the accounting principles that the group actually used to prepare its financial reports just before the leaving time; or

- if the group did not prepare financial reports just before the leaving time, the accounting principles that it would use if it were to prepare its financial reports just before the leaving time.

5.235 In this regard, if the group used audited accounts as the basis for preparing its financial reports just before the leaving time, the accounting principles applied in the preparation of those audited accounts are the leaving entity's accounting principles for tax cost setting.

5.236 Therefore, for the purpose of working out step 4 of the old group's allocable cost amount for a leaving entity, the amendments clarify that the liabilities that are taken into account are those liabilities that, in accordance with the leaving entity's accounting principles for tax cost setting, are liabilities of the leaving entity just before the leaving time. Therefore:

- the liabilities that are recognised under step 4 of the old group's allocable cost amount (section 711-45) are those things that, in accordance with the leaving entity's accounting principles for tax cost setting, are liabilities of the leaving entity just before the leaving time;

- the adjustment to step 4 of the old group's allocable cost amount under subsection 711-45(5) applies to an accounting liability that is taken into account at a later time for tax purposes than for accounting purposes in accordance with the leaving entity's accounting principles for tax cost setting; and

- if subsection 711-45(7) applies, step 4 of the old group's allocable cost amount is increased by the market value of each thing that, in accordance with the leaving entity's accounting principles for tax cost setting, is equity in the leaving entity just before the leaving time, where the thing is also a debt interest.

[Schedule 5, items 102 to 106, subsections 711-45(1), 711-45(5) and 711-45(7)]

5.237 In addition, when an entity leaves a consolidated group, the amendments clarify that the exit history rule (section 701-40) applies, so

far as is relevant, to any liability or other thing that, in accordance with the accounting principles, is a liability. ***[Schedule 5, item 90, subsection 701-40(2)]***

Modifications when a partnership joins or leaves a consolidated group

5.238 Under Subdivision 713-E, special modifications are made to the tax cost setting rules when:

- an entity that is a partner in a partnership becomes a subsidiary member of a consolidated group; or
- a partnership becomes, or ceases to be, a member of a consolidated group.

5.239 The amendments modify these special rules so that:

- when a partner in a partnership becomes a subsidiary member of a consolidated group, the modification to the treatment of partnership liabilities under the tax cost setting rules applies to things that, in accordance with the accounting principles that the partnership would use if it were to prepare financial statements just before the joining time, are liabilities of the partnership at the joining time; and
- when a partner in a partnership leaves a consolidated group, the modification to the treatment of partnership liabilities under the tax cost setting rules applies to things that, in accordance with the accounting principles that the partnership would use if it were to prepare financial statements just before the leaving time, are liabilities of the partnership at the leaving time.

[Schedule 5, items 107 to 110, subsections 713-225(6) and 713-265(4)]

Application of Part 8

5.240 The amendments in Part 8 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins or leaves a consolidated group on or after that date. ***[Schedule 5, item 113]***

5.241 In this regard, the amendments are intended to remove doubt but are consistent with the operation of the current law, as confirmed by the Federal Court's decision in the *Envestra* case.

Part 9 — Inherited deductions

5.242 When an entity joins a consolidated group, the allocable cost amount of a joining entity is reduced by certain deductions that are inherited by the head company under step 7 of the allocable cost amount (section 705-115). The purpose of this adjustment is to ensure that inherited deductions do not give rise to both a higher allocable cost amount and a future income tax deduction — that is, the adjustment prevents the head company from getting a double benefit.

5.243 Expenditure on certain assets acquired on or before 13 May 1997 (such as capital works expenditure on buildings) is specifically excluded from being an inherited deduction. This preserves the benefit of transitional provisions that grandfather the CGT cost base treatment of these assets.

5.244 To ensure that this exclusion operates as intended, inherited deductions that are covered by step 7 will not include deductions under section 43-15 for undeducted construction expenditure in relation to an asset if the asset was acquired by the joining entity before 7.30 pm, by legal time in the Australian Capital Territory, on 13 May 1997. ***[Schedule 5, item 114, subsection 705-115(3)]***

5.245 When an entity leaves a consolidated group, the old group's allocable cost amount is increased by the amount of deductions of the head company inherited by the leaving entity under step 2 (section 711-35).

5.246 A technical amendment will clarify that the step 2 amount is worked out by multiplying all the deductions of the head company inherited by the leaving entity by the corporate tax rate (currently 30 per cent). This will ensure that there is no duplication of the tax benefit associated with inherited deductions when an entity leaves a consolidated group. ***[Schedule 5, item 115, subsection 711-35(1)]***

5.247 In addition, inherited deductions that are covered by step 2 will not include deductions under section 43-15 for undeducted construction expenditure in relation to an asset that, because of the exit history rule (section 701-40), the leaving entity is taken to have acquired before 7.30 pm, by legal time in the Australian Capital Territory, on 13 May 1997. ***[Schedule 5, item 116, subsection 711-35(3)]***

Application of Part 9

5.248 The amendments in items 114 and 116 of Part 9, which modify the tax cost setting rules that apply when an entity joins or leaves a consolidated group to clarify that inherited deductions do not include

certain deductions for undeducted construction expenditure, apply from 1 July 2002. ***[Schedule 5, item 117]***

5.249 These amendments, which ensure that the income tax law operates as originally intended, reduce the adjustment for inherited deductions under the tax cost setting rules and therefore are beneficial to taxpayers.

5.250 The amendment in item 115 of Part 9, which modifies the amount of the adjustment for inherited deductions under the tax cost setting rules that apply when an entity leaves a consolidated group, applies from the date of introduction of this Bill into the House of Representatives. That is, the amendment will apply to an entity that leaves a consolidated group on or after that date. ***[Schedule 5, item 117]***

Part 10 — General insurance companies

5.251 General insurance companies are taxed on movements in the value of the unearned premium reserve and movements in the value of the outstanding claims liabilities.

- The unearned premium reserve broadly represents the amount of premium income received by a general insurance company in an income year that relates to risk coverage in a subsequent income year.

- The outstanding claims liabilities broadly represent the present value of the amount that a general insurance company determines to be necessary to set aside to pay outstanding claims.

5.252 A general insurance company can deduct the amount of any increase in the value of these amounts over an income year. The amount of any decrease in the value of these amounts over an income year is included in assessable income.

5.253 The basis for working out the value of the unearned premium reserve and the value of the outstanding claims liabilities under the income tax law is different to the basis for working out those amounts under the accounting standards. In particular, there are differences between the income tax treatment and the accounting treatment of:

- deferred acquisition costs — that is, certain costs incurred by a general insurance company in an income year in connection with issuing insurance policies that relate to benefits that are received by the company in a later income year;

- deferred reinsurance expenses — that is, certain reinsurance expenses incurred by a general insurance company in an income year in connection with reinsurance policies that relate to benefits that are received by the company in a later income year; and

- recoveries receivable — that is, amounts expected to be received under reinsurance policies and from other sources in relation to claims that have been incurred.

5.254 The differences between the income tax treatment and the accounting treatment of deferred acquisition costs, deferred reinsurance expenses and recoveries receivable cause distortions to arise under the tax cost setting rules.

5.255 To remove these distortions, the tax cost setting rules will be modified where a general insurance company joins or leaves a consolidated group and brings or takes with it:

- deferred acquisition costs in relation to the company's unearned premium reserve;

- deferred reinsurance expenses in relation to the company's unearned premium reserve; and

- recoveries receivable in relation to the company's outstanding claims.

[Schedule 5, item 118, subsections 713-725(1) and (4)]

5.256 If a general insurance company joins a consolidated group:

- the step 2 amount of the allocable cost amount for the joining entity is reduced by the amount of the deferred acquisition costs, deferred reinsurance expenses and recoveries receivable; and

- the deferred acquisition costs, deferred reinsurance expenses and recoveries receivable are taken to have a market value of zero for the purposes of working out their tax cost setting amount under section 705-35 — as a result, they will have a tax cost setting amount of nil.

[Schedule 5, item 118, subsection 713-725(2)]

5.257 If a general insurance company leaves a consolidated group:

- the step 4 amount of the old group's allocable cost amount for the leaving entity is reduced by the amount of the deferred acquisition costs, deferred reinsurance expenses and recoveries receivable; and
- the deferred acquisition costs, deferred reinsurance expenses and recoveries receivable are taken to have a terminating value of zero for the purposes of working out step 1 of the old group's allocable cost amount under section 711-25.

[Schedule 5, item 118, subsection 713-725(3)]

Application of Part 10

5.258 The amendments in Part 10 apply in relation to a general insurance company that joins or leaves a consolidated group on or after 1 July 2002. ***[Schedule 5, item 119]***

5.259 In this regard, the amendments, which were sought by representatives of the general insurance industry, are beneficial as they will reduce compliance costs by confirming existing industry practice.

Part 11 — Retained cost base assets

5.260 Under the tax cost setting rules, the cost of some assets is set at an amount that is equal to the joining entity's cost of those assets. These assets are known as retained cost base assets (as distinct from reset cost base assets) and include, among other things:

- Australian currency; and
- a right to receive a specified amount of Australian currency (such as a bank deposit).

5.261 The amendments will ensure that retained cost base assets include:

- units in cash management trusts; and
- certain rights to future income assets.

Division 1 of Part 11 — Cash management trusts

5.262 Currently units held by a joining entity in a cash management trust are reset cost base assets. This causes undue compliance costs to

arise where the cash management trust is effectively used like a bank account to meet day-to-day business needs. For example, a capital gain or capital loss will arise whenever an amount is withdrawn from the cash management trust.

5.263 Therefore, to reduce compliance costs, a unit in a cash management trust will be a retained cost base asset if:

- the redemption value of the unit is expressed in Australian dollars; and
- the redemption value of the unit cannot increase.

[Schedule 5, item 121, paragraph 705-25(5)(ba)]

5.264 The tax cost setting amount for a unit in a cash management trust that is a retained cost base asset is generally equal to the amount of Australian currency concerned — that is, the face value of the unit. ***[Schedule 5, item 120, subsection 705-25(2)]***

5.265 A ***cash management trust*** is a trust of a kind that is commonly known as a cash management trust where all the units in the trust carry the same rights. ***[Schedule 5, item 122, the definition of 'cash management trust' in subsection 995-1(1)]***

Application of Division 1 of Part 11

5.266 The amendments in Division 1 of Part 11 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins a consolidated group on or after that date. ***[Schedule 5, item 126]***

5.267 However, the head company of a consolidated group can make a choice to apply the amendments in Division 1 of Part 11 to an entity that joins a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 126]

5.268 This option to apply the amendments from 1 July 2002 will allow consolidated groups that effectively treated units in cash management trusts as retained cost base assets to retain that treatment. Other consolidated groups will also be able to choose to apply the

amendments from 1 July 2002 if they wish, having regard to the compliance cost implications of applying the changes retrospectively.

Division 2 of Part 11 — Rights to future income assets

5.269 Rights to future income assets (such as work in progress) held by a joining entity are reset cost base assets. This is appropriate if the joining entity was acquired by the head company prior to the joining time and held the rights to future income assets at the time of acquisition. In these circumstances, the amount paid by the head company to acquire the joining entity would reflect the value of the rights to future income assets at that time.

5.270 However, distortions can arise under the tax cost setting rules if rights to future income assets are owned by the group before the joining time and accrue to the head company.

5.271 To overcome these distortions, rights to future income assets held by a joining entity that accrue to the head company will be treated as retained cost base assets.

5.272 That is, a right that is an asset covered by section 716-410 will be a retained cost base asset if, at the time the right was created:

- the head company was the head company of a consolidatable group; and
- the joining entity was a subsidiary member of the consolidatable group.

[Schedule 5, items 124 and 125, paragraph 705-25(5)(d)]

5.273 An asset is covered by section 716-410 if

- the asset is a right (including a contingent right) to receive an amount for the doing of a thing;
- the asset is held by an entity just before the time it becomes a subsidiary member of a consolidated group; and
- it is reasonable to expect that an amount will be included in the assessable income of the head company of the group after the joining time in relation to the right.

[Schedule 5, item 4, section 716-410]

5.274 An asset covered by section 716-410 may be solely comprised of a right to future income. Alternatively, the asset may be right that is

embedded in a contract or agreement that includes a range of rights and associated obligations.

5.275 If a right to future income asset covered by section 716-410 is a retained cost base asset, the asset's tax cost setting amount will be equal to the joining entity's terminating value for the asset. ***[Schedule 5, item 123, subsection 705-25(4B)]***

5.276 The asset's terminating value is generally the amount that would be the asset's cost base just before the joining time if the asset were a CGT asset (subsection 705-30(5)). In most cases, the terminating value of a right to future income asset held by a joining entity that accrues to the head company will be nil.

Example 5.51: Long-term construction contract

Head Co acquired all the membership interests in Company J on 1 July 1999.

On 15 March 2003, Company J entered into a long-term construction contract with a third party.

Head Co formed a consolidated group on 1 July 2003 and Company J became a subsidiary member of the group.

At that time, Company J has partially performed work under the construction contract that has not yet been completed to a stage where a recoverable debt has arisen. For accounting purposes, Company J has estimated the amount of partly earned unbilled income as $15,000.

Substantial gross revenues are expected to be generated under the contract with an estimated profit over the period of the contract of $500,000. The market value of the asset at the joining time is determined to be $215,000.

The contract is an asset that is covered by section 716-410 because:

- the asset is solely a right to receive an amount for the doing of a thing (being the unbilled work already done and the work yet to be done);
- the asset is held by Company J just before the time it became a subsidiary member of Head Co; and
- it is reasonable to expect that an amount will be included in the assessable income of Head Co after the joining time in relation to the right.

The asset will be a retained cost base asset because it is a right to future income asset covered by section 716-410 and, at the time the right was created:

- Head Co was the head company of a consolidatable group; and
- Company J was a subsidiary member of the consolidatable group.

The tax cost setting amount for the bundle of rights that make up the contract is equal to Company J's terminating value for the asset, being its cost base just before the joining time. As the asset has a nil cost base at this time, the tax cost setting amount of the contract is nil.

Example 5.52: Unbilled income for the supply of gas

Company J has been wholly-owned by Head Co since it was incorporated on 1 July 1990.

Head Co formed a consolidated group on 1 July 2002. Therefore, Company J became a subsidiary member of the group.

Company J carries on the business of supplying gas to its customers (being both domestic and commercial gas consumers) in circumstances similar to those considered in *FC of T v Australasian Gas Light Co* 83 ATC 4800; (1983) 15 ATR 105.

In its profit and loss statement for the income year ended 30 June 2002, Company J had recorded unbilled gas income of $25,000. Its balance sheet contains an unbilled gas asset of the same amount. The unbilled gas income is recognised as income for accounting purposes but has not yet been recognised as assessable income for income tax purposes in accordance with Taxation Ruling No. IT 2095.

The unbilled gas is an asset that is covered by section 716-410 because:

- the asset is a right to receive an amount for the doing of a thing (being the supply of gas);
- the asset is held by Company J just before the time it became a subsidiary member of Head Co; and
- it is reasonable to expect that an amount will be included in the assessable income of Head Co after the joining time in relation to the right.

The asset will be a retained cost base asset because it is a right to future income asset covered by section 716-410 and, at the time the right was created:

- Head Co was the head company of a consolidatable group; and
- Company J was a subsidiary member of the consolidatable group.

The tax cost setting amount for the unbilled gas asset is equal to Company J's terminating value for the asset, being its cost base just before the joining time. As the asset has a nil cost base at this time, the tax cost setting amount of the asset is nil.

Application of Division 2 of Part 11

5.277 The amendments in Division 2 of Part 11 apply in relation to a consolidated group on or after 1 July 2002. ***[Schedule 5, item 126]***

5.278 In this regard, the amendments were sought by affected consolidated groups. The amendments are beneficial as they remove distortions that arise under the tax cost setting process.

Part 12 — Removal of CGT event L7

5.279 CGT event L7 (section 104-30) happens when:

- a liability that was taken into account in working out the allocable cost amount for a subsidiary member at the joining time is discharged for a different amount; and
- the allocable cost amount would have been different if the discharged amount was used at the joining time.

5.280 A capital gain arises under CGT event L7 if the amount of the liability ultimately discharged (the realised amount) is less than the amount taken into account at the joining time. A capital loss arises if the realised amount is greater than the amount taken into account at the joining time.

5.281 The value of liabilities that is used for tax cost setting purposes is generally the accounting value of those liabilities at the joining time (section 705-70).

5.282 The circumstances in which liabilities are discharged for an amount that is different to the accounting value at the joining time are generally limited to long standing provisions for liabilities that are contingent on future events (such as general insurance policy liabilities,

life insurance policy liabilities, warranties and provisions for long service or annual leave).

5.283 In many cases movements in the value of liabilities are taxed under other provisions of the income tax law, such as the provisions for the taxation of financial arrangements (Division 230) and the general insurance provisions (Division 321 in Schedule 2J to the ITAA 1936).

5.284 In an arm's length acquisition case, the accounting value of the liabilities at the joining time genuinely reflects the value of those liabilities at that time — that is, it is the best estimate of those liabilities at the joining time and is not open to manipulation.

5.285 In addition, the value of long standing liability provisions tends to be calculated on a pooled basis, rather than on an individual basis. Tracking individual liabilities to determine whether the amount included at step 2 of the allocable cost amount for an individual liability exceeded the amount for which the liability was discharged places an unreasonable compliance cost burden on affected groups.

5.286 Therefore, as movements in the value of liabilities are usually taxed under other provisions of the income tax law and to reduce compliance costs, CGT event L7 (section 104-530) will be repealed. ***[Schedule 5, item 128]***

5.287 Consequential amendments will be made to:

- remove references to CGT event L7 in the table of CGT events in section 104-5;
- remove references to CGT event L7 in the table that sets out rules about the cost base and reduced cost base of a CGT asset in section 110-10; and
- repeal section 701-34 of the *Income Tax (Transitional Provisions) Act 1997* (which provides that CGT event L7 does not happen in respect of certain liabilities).

[Schedule 5, items 127, 129 and 130, sections 104-5 and 110-10 of the ITAA 1997 and section 701-34 of the Income Tax (Transitional Provisions) Act 1997]

Application of Part 12

5.288 The amendments in Part 12 apply on or after 1 July 2002. ***[Schedule 5, item 131]***

5.289 In this regard, the amendments are beneficial to taxpayers and will remove an unreasonable compliance cost burden on affected groups.

5.290 Anecdotal evidence suggests that no capital gains or losses have arisen under CGT event L7. However, as a transitional rule, if a taxpayer has made a capital loss under CGT event L7 prior to the introduction of this Bill into the House of Representatives, that capital loss will be preserved. ***[Schedule 5, item 131]***

Part 13 — Reduction in the tax cost setting amount that exceeds the market value of certain retained cost base assets

5.291 A capital gain arises under CGT event L3 if the total tax cost setting amounts for all retained cost base assets exceed the joining entity's allocable cost amount (section 104-510). A capital loss cannot arise under CGT event L3.

5.292 Impaired debts qualify as retained cost base assets because they are a right to receive a specified amount of Australian currency. The tax cost setting amount of impaired debts is the face value of those debts at the joining time.

5.293 However, the face value of the debt is likely to be higher than the amount that could be recovered under the debt (that is, the market value of the debt). Therefore, the amount taken into account in working out the capital gain under CGT event L3 does not reflect the amount of the debt that is likely to be recovered. Consequently, the capital gain arising under CGT event L3 is overstated.

5.294 To overcome this concern, the tax cost setting amount of an asset of a joining entity will be reduced if:

- the asset is a retained cost base that is a right to receive a specified amount of Australian currency covered by paragraph 705-25(5)(b);
- the market value of the asset is less than the tax cost setting amount of the asset — the tax cost setting amount is the amount of Australian currency concerned; and
- the head company makes a capital gain under CGT event L3 (disregarding this modification) as a result of the joining entity becoming a subsidiary member of the group.

[Schedule 5, item 132, subsection 705-27(1)]

5.295 Where an asset satisfies these conditions, the tax cost setting amount of the asset will be reduced by the amount of the capital gain arising under CGT event L3, but not below zero. ***[Schedule 5, item 132, subsection 705-27(1)]***

5.296 As the tax cost setting amount of the asset is reduced, the capital gain arising under CGT event L3 will also be reduced by an equivalent amount (paragraph 104-510(1)(b)). The amount of the capital gain might be reduced to nil.

5.297 However, the amount of the reduction under subsection 705-27(1) is reduced if:

- the asset is an intra-group asset of the consolidated group;
- the joining entity has been entitled to a deduction for an income year ending on or before the joining time because the market value of the asset is less than the specified amount of Australian currency; and
- the accounting liability that corresponds to the asset has not been reduced under subsection 705-75(2) because it is an intra-group liability.

[Schedule 5, item 132, subsection 705-27(2)]

5.298 In these circumstances, the amount of the reduction under subsection 705-27(1) is reduced by the amount of the deduction (but not below zero). ***[Schedule 5, item 132, subsection 705-27(2)]***

5.299 An asset is an intra-group asset if the requirements in subsection 701-58(1) are satisfied in relation to the asset. Those requirements are, broadly:

- the tax cost of the asset was set at the joining time because an entity became a subsidiary member of the group;
- ignoring the operation of the single entity rule (subsection 701-1(1)), the entity held the asset at the joining time; and
- taking into account the operation of the single entity rule, the head company of the group did not hold the asset at the joining time.

5.300 If the tax cost setting amount of two or more of a joining entity's assets could be reduced under subsections 705-27(1) and (2), a reduction is made sequentially to the tax cost setting amounts of each of those assets. ***[Schedule 5, item 132, paragraph 705-27(3)(a)]***

5.301 The head company can choose the sequence of assets to which the reduction applies. However, if the head company does not make such

a choice, the reduction applies sequentially to each of the assets according to the time at which they were created, from the earliest to the latest. ***[Schedule 5, item 132, paragraphs 705-27(3)(b) and (c)]***

5.302 The head company's choice must be made by the day on which the head company lodges its income tax return for the income year in which the CGT event happened or within a further time allowed by the Commissioner. The way that the head company prepares its income tax return is sufficient evidence of the making of the choice. ***[Schedule 5, item 132, subsections 705-27(4) and (5)]***

5.303 Once the amount of the capital gain arising under CGT event L3 is reduced to nil, no further reductions of the tax cost setting amount can be made under section 705-27.

5.304 As a consequence of these changes, paragraph 705-35(1)(b) is modified to remove a reference to section 705-25. ***[Schedule 5, item 133, paragraph 705-35(1)(b)]***

Application of Part 13

5.305 The amendments in Part 13 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins a consolidated group on or after that date. ***[Schedule 5, item 134]***

5.306 However, the head company of a consolidated group can make a choice to apply the amendments in Part 13 to an entity that joins a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 134]

5.307 This option to apply the amendments from 1 July 2002 will allow consolidated groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

Part 14 — Blackhole expenditure for MEC groups

5.308 In this Part, references to a consolidated group do not include a MEC group.

5.309 A capital gain arises if, broadly, the capital proceeds received by a taxpayer when a CGT event happens to a CGT asset exceed the cost base of that asset.

5.310 The cost base of a CGT asset consists of five elements. One of those elements is incidental costs incurred by the taxpayer (section 110-35). The ninth category of incidental costs is expenditure that:

- is incurred by the head company of a consolidated group to an entity that is not a member of the group;
- reasonably relates to a CGT asset held by the head company; and
- is incurred because of a transaction between members of the group.

5.311 The ninth category of incidental costs was inserted into the income tax law with effect from 1 July 2005 as part of the business related costs amendments (section 40-880) to ensure the head company of a consolidated group gets appropriate tax recognition for costs paid to third parties in respect of intra-group transactions affecting CGT assets held by the group.

5.312 A technical amendment will ensure that consistent treatment applies to the head company of a MEC group that pays costs to third parties in respect of intra-group transactions affecting CGT assets held by the group. ***[Schedule 5, item 135, paragraph 110-35(10)(a)]***

Application of Part 14

5.313 The amendments in Part 14 apply to CGT events happening on or after 1 July 2005 (that is, from the commencement of the business related costs amendments). ***[Schedule 5, item 136]***

5.314 In this regard, the amendments are beneficial as they ensure that MEC groups get appropriate tax recognition for costs paid to third parties in respect of intra-group transactions affecting CGT assets they hold by the group (in the same way as consolidated groups).

Part 15 — Transitional concessions for groups with substituted accounting periods

5.315 Under a transitional concession that applied when the consolidation regime commenced, the allocable cost amount of a joining entity could be increased by the undistributed, untaxed profits accrued to

the group before 1 July 2003 (former section 701-30 of the *Income Tax (Transitional Provisions) Act 1997*). This concession provided groups with an outcome that could be achieved through the payment of an unfranked dividend to the head company prior to the removal of the inter-corporate dividend rebate.

5.316 This transitional concession applied to:

- a consolidated group that came into existence before 1 July 2003; or
- a consolidated group that came into existence between 1 July 2003 and 30 June 2004, but only if it came into existence on the first day of the income year of the head company starting after 30 June 2003.

5.317 The transitional concession will be modified so that, where a consolidated group came into existence between 1 July 2003 and 30 June 2004, the concession applies only if the group came into existence on or before the first day of the income year of the head company starting after 30 June 2003. ***[Schedule 5, items 137 and 138, subsection 701-30(1) of the Income Tax (Transitional Provisions) Act 1997]***

5.318 Therefore, if the head company of a consolidated group had a substituted accounting period that ended, for example, on 31 March 2004, a joining entity can access the transitional concession provided the group came into existence on or before 31 March 2004.

Application of Part 15

5.319 The amendments in Part 15 apply to a consolidated group only if the head company of the group makes a choice to apply the amendments. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 139]

Revocation of choice for transitional entities

5.320 Under section 701-1 of the *Income Tax (Transitional Provisions) Act 1997* a consolidated group could access the transitional concessions that applied at the commencement of the consolidation regime if:

- the group qualified as a transitional group; and
- an entity which joined the group qualified as a transitional entity.

5.321 The transitional concessions applied to a transitional entity only if the head company of the group made a choice for the entity to be a chosen transitional entity (section 701-5 of the *Income Tax (Transitional Provisions) Act 1997*). The choice for the entity to be a chosen transitional entity was irrevocable, unless the revocation took place before 1 January 2006 (subsection 701-5(4) of the *Income Tax (Transitional Provisions) Act 1997*).

5.322 A transitional rule will extend the period for revoking an irrevocable choice that was made before 1 January 2006 where:

- the head company of a consolidated group makes a choice to apply the modification made by Part 15; and
- the group came into existence:
  - on or after 1 July 2003; and
  - on a day other than the first day of the income year of the head company starting after 1 July 2003.

[Schedule 5, item 140]

5.323 In these circumstances, the head company will be able to revoke a choice that was made before 1 January 2006 for a transitional entity to be, or not to be, a chosen transitional entity. The head company will be able to revoke its earlier choice within six months of this Bill receiving Royal Assent. ***[Schedule 5, item 140]***

5.324 The purpose of this transitional amendment is to ensure that affected consolidated groups can effectively access the relevant transitional concessions.

Part 16 — Loss multiplication rules for widely held companies

5.325 If one or more entities are interposed between individual shareholders and a company with realised or unrealised losses (a loss company), the company's losses could be reflected in the value of shares and loans held between such entities (inter-entity interests) when they are sold or otherwise realised.

5.326 The inter-entity loss multiplication rules in Subdivision 165-CD ensure that the economic losses of companies do not get inappropriate multiple tax recognition when inter-entity interests are sold or otherwise realised. Section 165-115K provides that the inter-entity loss multiplication rules apply where, broadly:

- an alteration time happens in respect of a loss company; and
- an entity has relevant equity interests or relevant debt interests in the loss company immediately before the alteration time.

5.327 Section 165-115X provides that an entity (other than an individual) has a relevant equity interest in a loss company at a particular time if, broadly:

- the entity has a controlling stake in the loss company; and
- the entity directly or indirectly has interests in the loss company that give it control of, or the ability to control, (either directly or indirectly through interposed entities) 10 per cent or more of the voting power, dividend rights, or capital distribution rights of the loss company.

5.328 However, a company will not have a relevant equity interest if it satisfies the exception in subsection 165-115X(3).

5.329 Similarly, section 165-115Y provides that an entity (other than an individual) has a relevant debt interest in a loss company at a particular time if, broadly, the entity has a controlling stake in the loss company and:

- the entity is owed a debt by the loss company of not less than $10,000; or
- the entity is owed a debt by an entity (the debtor entity) other than the loss company of not less than $10,000 where the debtor entity has a relevant equity interest or relevant debt interest in the loss company.

5.330 However, a company will not have a relevant debt interest if it satisfies the exception in subsection 165-115Y(4).

5.331 Widely held companies have difficulty in satisfying the exceptions in subsections 165-115X(3) and 165-115Y(4). As a result, in some circumstances the losses of a loss company receive no tax recognition at all.

5.332 To address these concerns, the inter-entity loss multiplication rules will be modified to make it easier for widely held companies to claim capital losses or deductions on the disposal of direct and indirect interests in loss companies. These modifications will significantly reduce compliance costs for widely held companies.

5.333 A 'widely held company' is defined in subsection 995-1(1) to mean, broadly:

- a company whose shares are listed for quotation in the official list of an approved stock exchange; or
- a company that has more than 50 members, unless no more than 20 persons had rights to at least 75 per cent of the value of the shares in the company or at least 75 per cent of the voting power or dividend rights of the company.

Circumstances in which a widely held company will have a relevant equity interest

5.334 For the purpose of applying the inter-entity loss multiplication rules, a widely held company will not have a relevant equity interest in a loss company at a particular time unless an entity has a controlling stake in the loss company and that entity has a direct or indirect interest in, or is owed a debt by, the widely held company in respect of which:

- the entity could, if a CGT event happened in respect of the interest or debt, make a capital loss (other than a capital loss that would be disregarded) that reflects any part of the loss company's overall loss; or
- the entity has deducted or can deduct, or could deduct at a later time, an amount in respect of the cost of the acquisition, or a net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the loss company's overall loss.

[Schedule 5, item 141, subsections 165-115X(2A) and (2B)]

5.335 However, subsection 165-115X(2A) will not apply to a widely held company in respect of a particular time if an entity that had a direct or indirect interest in, or was owed a debt by, the widely held company at an earlier time, and had a controlling stake in the loss company at that earlier time:

- made a capital loss (other than a capital loss that was disregarded) because a CGT event happened in respect of the interest or debt, where the capital loss reflected any part of the loss company's overall loss; or
- has deducted or could have deducted at an earlier time, or could deduct at a later time, an amount in respect of the cost of the acquisition, or a net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the loss company's overall loss.

[Schedule 5, item 141, subsection 165-115X(2C)]

5.336 Consequential amendments will clarify that subsections 165-115X(3) and (4), which exclude certain interests from being relevant equity interests, do not apply to widely held companies. ***[Schedule 5, items 142 and 143, subsections 165-115X(3A) and (4)]***

Circumstances in which a widely held company will have a relevant debt interest

5.337 For the purpose of applying the inter-entity loss multiplication rules, a widely held company will not have a relevant debt interest in a loss company at a particular time unless an entity has a controlling stake in the loss company and that entity has a direct or indirect interest in, or is owed a debt by, the widely held company in respect of which:

- the entity could, if a CGT event happened in respect of the interest or debt, make a capital loss (other than a capital loss that would be disregarded) that reflects any part of the loss company's overall loss; or
- the entity has deducted or can deduct, or could deduct at a later time, an amount in respect of the cost of the acquisition, or a net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the loss company's overall loss.

[Schedule 5, item 144, subsections 165-115Y(3A) and (3B)]

5.338 However, subsection 165-115Y(3A) will not apply to a widely held company in respect of a particular time if an entity that had a direct or indirect interest in, or was owed a debt by, the widely held company at an earlier time, and had a controlling stake in the loss company at that earlier time:

- made a capital loss (other than a capital loss that was disregarded) because a CGT event happened in respect of the interest or debt, where the capital loss reflected any part of the loss company's overall loss; or

- has deducted or could have deducted at an earlier time, or could deduct at a later time, an amount in respect of the cost of the acquisition, or a net loss on the disposal, of the interest or debt, where the deduction reflected or would have reflected, or would reflect, any part of the loss company's overall loss.

[Schedule 5, item 144, subsection 165-115Y(3C)]

5.339 Consequential amendments will clarify that subsections 165-115Y(4) and (5), which exclude certain interests from being relevant debt interests, do not apply to widely held companies. ***[Schedule 5, items 145 and 146, subsections 165-115Y(4A) and (5)]***

Application of the inter-entity loss multiplication rules to consolidated groups

5.340 Subdivision 715-B clarifies how the inter-entity loss multiplication rules in Subdivision 165-CD apply when a company or trust leaves a consolidated group.

5.341 Consequential amendments will ensure that:

- the consequences which arise under section 715-255 when a loss company leaves a consolidated group apply only if the head company has a relevant equity interest under section 165-115X in the leaving entity at the leaving time;

- the consequences which arise under section 715-270 when a trust that is taken to be a loss company leaves a consolidated group apply only if the head company has a relevant equity interest under section 165-115X in the leaving entity at the leaving time; and

- for the purposes of determining whether the head company has a relevant equity interest in a loss company or trust that

leaves a consolidated group, the operation of the single entity rule (subsection 701-1(1)) is disregarded in applying subsections 165-115X(2C) and (4).

[Schedule 5, items 147 to 150, paragraph 715-255(1)(ba), subsections 715-255(1A), 715-270(5) and (5A)]

Application of the inter-entity loss multiplication rules to MEC groups

5.342 Subdivision 719-T clarifies how the inter-entity loss multiplication rules in Subdivision 165-CD apply to MEC groups.

5.343 A MEC group is wholly-owned by a foreign resident top company. The amendments modify the operation of the inter-entity loss multiplication rules for MEC groups where the foreign resident top company is a widely held company.

5.344 The amendments apply for the purpose of determining whether the head company of a MEC group has a relevant equity interest or relevant debt interest in a loss company at a particular time — that is:

- at the time that section 715-255 or 715-270 applies; or
- at the time the head company disposes of an equity interest or a debt interest in a loss company that is not a member of the MEC group.

5.345 That is, for the purpose of applying the inter-entity loss multiplication rules in Subdivision 165-CD, the head company of a MEC group is treated as not having a relevant equity interest or relevant debt interest in a loss company at a particular time if the top company of the group is a widely held company at that time, and

- if the interest is an equity interest — because of subsections 165-115X(2A), (2B) and (2C), the top company does not have a relevant equity interest under section 165-115X in the loss company at that time; or
- if the interest is a debt interest — because of subsections 165-115Y(3A), (3B) and (3C), the top company does not have a relevant debt interest under section 165-115Y in the loss company at that time.

[Schedule 5, item 151, subsections 719-740(1) and (3)]

5.346 In addition, if the interest is an equity interest, for the purposes of paragraph 719-740(1)(b), the operation of the single entity rule (subsection 701-1(1)) is disregarded in determining whether

subsection 165-115X(2C) has the effect that the top company has a relevant equity interest under section 165-115X in the loss company at a particular time. ***[Schedule 5, item 151, subsection 719-740(2)]***

Application of Part 16

5.347 The amendments in Part 16 apply on or after 1 July 2002. ***[Schedule 5, item 152]***

5.348 In this regard, the amendments are beneficial to, and have been sought by, taxpayers as they will make it easier make it easier for widely held companies to claim capital losses or deductions on the disposal of direct and indirect interests in loss companies. These modifications will significantly reduce compliance costs for widely held companies.

Part 17 — CGT straddles

5.349 Under the CGT rules, a capital gain or loss arises when a CGT event happens to a CGT asset. For a number of CGT events, the CGT event is taken to happen at a time which is different to the time when the capital proceeds are received.

5.350 For example CGT event A1 happens when there is a change in beneficial ownership of a CGT asset (subsections 104-10(1) and (2)). In most cases the change in beneficial ownership of the CGT asset will occur at the time of settlement of a contract or when the capital proceeds are received. However, if the CGT event happened because the taxpayer entered into a contract, CGT event A1 is taken to happen at the time when the contract was entered into (subsection 104-10(3)).

5.351 Difficulties arise where the period between the time that the contract is entered into and the time of settlement straddles the time that an entity joins or leaves a consolidated group. That is, for example:

- if an entity enters into a contract to dispose of a CGT asset, and, prior to settlement, the entity joins a consolidated group — the entry-sell case; or
- if a member of a consolidated group enters into a contract to dispose of a CGT asset, and prior to settlement, the member leaves the group — the exit-sell case.

5.352 In these circumstances, the entity that entered into the contract (and makes a capital gain or loss) is different to the entity that holds the asset at the time of settlement (and receives the capital proceeds).

5.353 To overcome these difficulties, the CGT timing rules will be modified when an entity joins or leaves a consolidated group and the CGT event straddles the joining or leaving time.

5.354 In the entry-sell case, the CGT event in relation to a CGT asset will be taken to happen at the time when the circumstances that gave rise to the CGT event first existed if:

- an entity becomes a subsidiary member of a consolidated group;
- disregarding the operation of the single entity rule (subsection 701-1(1)), the joining entity held the CGT asset at the joining time;
- taking into account the operation of the single entity rule, the head company of the group held the CGT asset at the joining time; and
- a CGT event happened in relation to the asset at a time before the joining time, but the circumstances that gave rise to the CGT event first existed at a time on or after the joining time.

[Schedule 5, item 153, subsections 716-860(1) and (3)]

5.355 In the exit-sell case, the CGT event in relation to a CGT asset will be taken to happen at the time when the circumstances that gave rise to the CGT event first existed if:

- an entity ceases to be a subsidiary member of a consolidated group;
- taking into account the operation of the single entity rule, the head company of the group held the asset just before the leaving time;
- disregarding the operation of the single entity rule, the leaving entity held the asset just after the leaving time; and
- a CGT event happened in relation to the asset at a time before the leaving time, but the circumstances that gave rise to the CGT event first existed at a time on or after the leaving time.

[Schedule 5, item 153, subsections 716-860(2) and (3)]

5.356 A CGT event will straddle the joining or leaving time generally if the CGT event arises where a contract or some other agreement has been entered before the joining or leaving time — that is, when CGT

event A1, C2, D3, E8, F1, F4 or F5 happens to a CGT asset. The modified timing rule for each of these events is outlined in Table 5.1.

Table 5.1: Modified CGT timing rules where a CGT event straddles the joining or leaving time

CGT event	*Time the CGT event ordinarily happens*	*Time the circumstances that gave rise to the CGT event first existed*
A1 — Disposal of a CGT asset	When the contract is entered into.	When the change of beneficial ownership occurs.
C2 — Cancellation, surrender and similar endings	When the contract is entered into.	When ownership of the intangible asset ends.
D3 — Granting a right to income from mining	When the contract is entered into.	When the right to receive ordinary income or statutory income is granted.
E8 — Disposal by beneficiary of a capital interest	When the contract is entered into.	When the change of beneficial ownership of the beneficiary's interest occurs.
F1 — Granting a lease	When the contract is entered into.	When the lease, or the renewal or extension of the lease, starts.
F4 — Lessee receives payment for changing a lease	When the term of a lease is varied or waived.	When the payment from the lessor is received.
F5 — Lessor receives payment for changing a lease	When the term of a lease is varied or waived.	When the payment from the lessee is received.

Example 5.53: CGT straddle — The entry-sell case

Sub Co enters into a contract to sell an asset on 1 May 2010. On 1 June 2010, Head Co acquires Sub Co. As a result, Sub Co becomes a subsidiary member of Head Co's consolidated group. The contract settles on 1 August 2010.

Head Co will make a capital gain or loss under CGT event A1 at the time when the circumstances that gave rise to the CGT event first existed — that is, when the change in beneficial ownership of the asset occurs. This would be the time of settlement of the contract.

Example 5.54: CGT straddle — The exit-sell case

Sub Co is a member of Head Co's consolidated group. Head Co enters into a contract to sell an asset on 1 May 2010. On 1 June 2010, Sub Co leaves the consolidated group and takes the CGT asset with it. The contract settles on 1 July 2010.

Sub Co will make a capital gain or loss under CGT event A1 at the time when the circumstances that gave rise to the CGT event first existed — that is, when the change in beneficial ownership of the asset occurs. This would be the time of settlement of the contract.

Application of Part 17

5.357 The amendments in Part 17 apply in relation to CGT events that happen after 8 May 2007 — that is, after the date of announcement. ***[Schedule 5, item 154]***

5.358 In this regard, the amendments are beneficial as they provide certainty to taxpayers and potentially prevent double taxation.

Part 18 — Choice to consolidate

5.359 A consolidated group is formed when the head company of a consolidatable group makes a choice to form a consolidated group (section 703-50). Currently, notice of the choice in the approved form must be given to the Commissioner. The group is taken to be consolidated from the day specified in the choice.

5.360 Similarly, a MEC group is formed when, broadly:

- a choice is made by two or more eligible tier-1 companies of a top company (that is, broadly, the foreign resident owner of the group), which is given to the Commissioner in the approved form, that the potential MEC group derived from the eligible tier-1 companies is to be consolidated (section 719-50); or
- a special conversion event happens to a potential MEC group derived from the eligible tier-1 company of a top company, which is notified to the Commissioner in the approved form (section 719-40).

5.361 Further, if a company becomes a new eligible tier-1 company of a top company after a MEC group comes into existence, the provisional head company must give the Commissioner a notice in the approved form in order for that new eligible tier-1 company to become a member of the MEC group (section 719-5).

5.362 Finally, if a cessation event happens to the provisional head company of a MEC group, the eligible tier-1 companies that are or were members of the group immediately after the cessation event may make a choice to appoint a new provisional head company. The choice must be given to the Commissioner in the approved form within 28 days of the cessation event (section 719-60).

5.363 The requirement that these choices must be given to the Commissioner in the approved form for the choice to have effect is causing administrative difficulties. Cases have arisen where wholly-owned corporate groups have operated for several years on the basis that they have formed a consolidated group or MEC group, without having made an effective choice to consolidate because of a technical deficiency in completing the approved form.

5.364 This problem was compounded by a recent court decision (*MW MacIntosh Pty Ltd v Commissioner of Taxation* [2009] FCAFC 88) which has caused some practical difficulties relating to the time that the choice must be made.

5.365 To overcome these concerns, the amendments will modify the mechanism for making the following choices:

- the choice to consolidate a consolidatable group;
- the choice to consolidate a potential MEC group;
- the choice to consolidate a potential MEC group following a special conversion event;
- the choice for a new eligible tier-1 company to become a member of a MEC group; and
- the choice for a new provisional head company to be appointed to a MEC group after the group has formed.

5.366 These choices will no longer need to be given to the Commissioner in the approved form to be effective. Instead, the choice will need to be made in writing but will not need to be given to the Commissioner. However, the head company of the group must give the Commissioner relevant information relating to the choice.

5.367 Therefore, the amendments will alleviate the administrative difficulties that arise when, for example:

- a head company of a consolidatable group or potential MEC group has inadvertently failed to notify the

Commissioner of a choice to consolidate by a specified day but nevertheless has lodged an income tax return on the basis that the group was consolidated from that day;

- a consolidatable group or potential MEC group has chosen to consolidate but has inadvertently notified the Commissioner of the choice using the wrong approved form; or

- the approved form notifying the Commissioner that a consolidatable group or potential MEC group has chosen to consolidate contains a clerical error that has the effect of making the choice to consolidate ineffective.

5.368 In these circumstances, the amendments will ensure that a choice to consolidate a consolidatable group or potential MEC group remains effective despite the administrative defects relating to the written notice notifying the Commissioner of that choice.

Choice to consolidate a consolidatable group

5.369 The head company of a consolidatable group can make a choice to form a consolidated group from the day specified in the choice. The choice must be in writing. ***[Schedule 5, item 155, subsection 703-50(1)]***

5.370 The choice must be made no later than:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 157, subsection 703-50(3)]

5.371 A choice that is made in writing under section 703-50 to consolidate a consolidatable group does not need to be given to the Commissioner.

5.372 However, if a consolidated group comes into existence from a day specified in a choice that is made under section 703-50 to consolidate a consolidatable group, the head company of the group must give the Commissioner a notice in the approved form containing the following information:

- the identity of the head company;
- the day specified in the choice on which the consolidatable group is taken to consolidate;
- the identity of each subsidiary member of the group on that day;
- the identity of each entity that was a subsidiary member of the group on that day but has left the group when the notice is given;
- the identity of each entity that was not a subsidiary member of the group on that day but joined the group after that day and is a subsidiary member of the group when the notice is given; and
- the identity of each entity that joined the group after that day but is no longer a subsidiary member of the group when the notice is given.

[Schedule 5, items 156 and 159, subsections 703-50(1) and 703-58(1)]

5.373 The notice must be given to the Commissioner:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — by the day on which the company gives its income tax return to the Commissioner for that income year; or
- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — by the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 159, subsection 703-58(2)]

5.374 If the notice under section 703-58 contains a technical defect, that defect does not affect the choice to consolidate a consolidatable group.

5.375 Consequential amendments will:

- remove redundant provisions that have the effect of making the choice ineffective if it contains incorrect information and allow the Commissioner to give effect to the choice despite the wrong information;
- ensure that the operation of paragraphs 701-5(2)(a) and 701D-15(3)(a) of the *Income Tax (Transitional Provisions) Act 1997* are unaffected by the amendments; and
- ensure that the operation of paragraph 45-885(1)(e) of the *Taxation Administration Act 1953* (TAA 1953) is unaffected by the amendments.

[Schedule 5, items 158, 189 to 191, subsections 703-50(5) and (6) of the ITAA 1997, paragraphs 701-5(2)(a) and 701D-15(3)(a) of the Income Tax (Transitional Provisions) Act 1997 and paragraph 45-885(1)(e) of the TAA 1953]

5.376 When an entity joins or leaves a consolidated group, or when a consolidated group ceases to exist, notification in the approved form of the event must generally be given to the Commissioner within 28 days of the event (subsection 703-60(1)). The time for giving the notification to the Commissioner is modified where certain events happen before the Commissioner is notified that the group has come into existence (subsections 703-60(2) and (3)).

5.377 Consequential amendments will ensure that the effect of subsections 703-60(2) and (3) is maintained.

5.378 That is, subsection 703-60(2) modifies the time for giving notice to the Commissioner that an entity joins or leaves a consolidated group, or that a consolidated group ceases to exist, where:

- the consolidated group comes into existence on a day specified in a choice under section 703-50; and
- the notifiable event happens before the relevant notice is given to the Commissioner under section 703-58.

[Schedule 5, item 160, subsection 703-60(2)]

5.379 In these circumstances, the head company of the group must give the Commissioner notice in the approved form of the event no later than:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or
- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 161 and 162, subsections 703-60(2) and (2A)]

5.380 Similarly, subsection 703-60(3) modifies the time for giving notice to the Commissioner that an entity joins or leaves a consolidated group, or that a consolidated group ceases to exist, where:

- the consolidated group comes into existence at a time under subsection 703-55(1) because a MEC group ceased to exist at that time;
- the MEC group came into existence under paragraph 719-5(1)(a) because a choice under section 719-50 is made after that time; and
- the event happens before the relevant notice is given to the Commissioner under section 719-76.

[Schedule 5, items 163 and 164, subsection 703-60(3)]

5.381 In these circumstances, the head company of the group must give the Commissioner notice in the approved form of the event no later than:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 165 and 166, subsections 703-60(3) and (4)]

Choice to consolidate a potential MEC group

5.382 The eligible tier-1 companies of a potential MEC group can jointly make a choice to form a MEC group on and after the day specified in the choice. The choice must be in writing. ***[Schedule 5, item 172, subsection 719-50(1)]***

5.383 The choice must be made no later than:

- if the head company of the MEC group is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company of the MEC is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 178, subsections 719-50(3) and (3A)]

5.384 A choice to consolidate a potential MEC group under section 719-50 is taken to have effect from the day specified in the choice. ***[Schedule 5, item 180, section 719-55]***

5.385 However, only the eligible tier-1 companies that exist on a particular day can choose to consolidate a potential MEC group from the day the choice takes effect. The MEC group that results from the choice to consolidate a potential MEC group cannot include an eligible tier-1 company of a top company that did not exist at the time the choice takes effect. In this regard, an eligible tier-1 company of a top company that comes into existence after the MEC group has formed can join the MEC group from the time that it comes into existence (subsection 719-5(4)).

5.386 The choice that is made in writing under section 719-50 to consolidate a potential MEC group does not need to be given to the Commissioner.

5.387 However, if a MEC group comes into existence on a day specified in a choice that is made under section 719-50 to consolidate a potential MEC group, the head company of the group must give the Commissioner a notice in the approved form containing the following information:

- the identity of the head company;
- the day specified in the choice on which the MEC group comes into existence;
- the identity of each eligible tier-1 company of the top company in relation to the MEC group on that day;
- the identity of each subsidiary member of the group on that day;
- the identity of each entity that was a subsidiary member of the group on that day but has left the group when the notice is given;
- the identity of each entity that was not a subsidiary member of the group on that day but joined the group after that day and is a subsidiary member of the group when the notice is given; and
- the identity of each entity that joined the group after that day but is no longer a subsidiary member of the group when the notice is given.

[Schedule 5, items 177 and 183, subsections 719-50(1), 719-76(1) and (2)]

5.388 The notice must be given to the Commissioner:

- if the head company of the MEC group is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — by the day on which that the company gives its income tax return to the Commissioner for that income year; or
- if the head company of the MEC group is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — by the

last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 183, subsection 719-76(3)]

5.389 If the notice under section 719-76 contains a technical defect, that defect does not affect the choice to consolidate a potential MEC group.

5.390 Consequential amendments will:

- ensure that subsection 719-50(4) continues to apply when a company ceases to be an eligible tier-1 company before a notice under section 719-76 is given to the Commissioner;
- remove redundant provisions that have the effect of making the choice ineffective if it contains incorrect information and allow the Commissioner to give effect to the choice despite the wrong information; and
- ensure that the operation of section 45-935 of the TAA 1953 is unaffected by the amendments.

[Schedule 5, items 179, 180 and 192, paragraph 719-50(4)(b) and section 719-55 of the ITAA 1997 and section 45-935 of the TAA 1953]

5.391 When an entity joins or leaves a MEC group, or when a cessation event happens to the provisional head company of a MEC group, notification in the approved form of the event must generally be given to the Commissioner within 28 days of the event (section 719-80). The time for giving the notification to the Commissioner is modified where certain events happen before the Commissioner is notified that the group has come into existence.

5.392 Consequential amendments will ensure that the effect of section 719-80 is maintained.

5.393 That is, subsection 719-80(2) modifies the time for giving notice to the Commissioner that an entity joins or leaves a consolidated group, or when a cessation event happens to the provisional head company of a MEC group, where:

- the MEC group comes into existence because of a choice under section 719-50; and
- the event happens before the relevant notice is given to the Commissioner under section 719-76.

[Schedule 5, item 184, paragraph 719-80(2)(a)]

5.394 In these circumstances, the head company of the group must give the Commissioner notice in the approved form of the event no later than:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 185 and 188, paragraph 719-80(2)(a) and subsection 719-80(3)]

5.395 Subsection 719-80(2) also modifies the time for giving notice to the Commissioner that an entity joins or leaves a consolidated group, or when a cessation event happens to the provisional head company of a MEC group, where:

- the consolidated group comes into existence because of a special conversion event — that is, because a consolidated group converted to a MEC group;

- the consolidated group came into existence because a choice under section 703-50 in relation to the group; and

- the notifiable event happens before the relevant notice is given to the Commissioner under section 703-58.

[Schedule 5, item 186, paragraph 719-80(2)(b)]

5.396 In these circumstances, the head company of the group must give the Commissioner notice in the approved form of the event no later than:

- if the head company is required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company is not required to give the Commissioner an income tax return for the income year during which the day specified in the choice occurs — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 187 and 188, paragraph 719-80(2)(b) and subsection 719-80(3)]

Special conversion event happens to a potential MEC group

5.397 A special conversion event happens if, broadly, a consolidated group becomes a potential MEC group and makes a choice to form a MEC group — that is, if a consolidated group converts to a MEC group on a particular day (section 719-40).

5.398 If a special conversion event happens, the company that is an eligible tier-1 company and the head company of the consolidated group can make a choice in writing:

- specifying the companies that are eligible tier-1 companies of the top company; and

- stating that a MEC group is to come into existence at that time as a result of the specified companies becoming eligible tier-1 companies of the top company.

[Schedule 5, items 172 and 173, paragraph 719-40(1)(e)]

5.399 In addition, if an eligible tier-1 company that is specified in the choice was a member of another MEC group immediately before the time the choice was made and all the eligible tier-1 companies in that other MEC group became eligible tier-1 companies of the top company at that time, then each eligible tier-1 company in that other MEC group must be specified in the choice. ***[Schedule 5, item 174, paragraph 719-40(1)(f)]***

5.400 The choice must be made no later than:

- if the head company of the MEC group is required to give the Commissioner an income tax return for the income year during which the special conversion event happens — the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company of the MEC group is not required to give the Commissioner an income tax return for the income year during which the special conversion event happens — the

last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 172 and 176, paragraph 719-40(1)(e) and subsection 719-40(2)]

5.401 The choice that is made in writing under section 719-40 to consolidate a potential MEC group following a special conversion event does not need to be given to the Commissioner.

5.402 However, if a MEC group comes into existence because of a choice under section 719-40 to consolidate a potential MEC group following a special conversion event, the head company of the group must give the Commissioner a notice in the approved form containing the following information:

- the identity of the head company;
- the time that the special conversion event happens — that is, the day on which the MEC group comes into existence;
- the identity of each eligible tier-1 company of the top company in relation to the MEC group on that day;
- the identity of each subsidiary member of the group on that day;
- the identity of each entity that was a subsidiary member of the group on that day but has left the group when the notice is given;
- the identity of each entity that was not a subsidiary member of the group on that day but joined the group after that day and is a subsidiary member of the group when the notice is given; and
- the identity of each entity that joined the group after that day but is no longer a subsidiary member of the group when the notice is given.

[Schedule 5, items 175 and 183, subsections 719-40(1), 719-78(1) and (2)]

5.403 The notice must be given to the Commissioner:

- if the head company of the MEC group is required to give the Commissioner an income tax return for the income year during which the special conversion event happens — by the day on which the company gives its income tax return to the Commissioner for that income year; or
- if the head company of the MEC group is not required to give the Commissioner an income tax return for the income year during which the special conversion event happens — by the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 183, subsection 719-78(3)]

5.404 If the notice under section 719-78 contains a technical defect, that defect does not affect the choice to consolidate a potential MEC group following a special conversion event.

New eligible tier-1 companies of a MEC group

5.405 If a company becomes a new eligible tier-1 company of a top company at a time after a MEC group comes into existence, the provisional head company can make a choice in writing:

- specifying the company; and
- stating that the company is to become a member of the MEC group with effect from that time.

[Schedule 5, item 167, paragraph 719-5(4)(c)]

5.406 In addition, if the eligible tier-1 company that is specified in the choice was a member of another MEC group immediately before the time the choice was made and all the eligible tier-1 companies in that other MEC group became eligible tier-1 companies of the top company at that time, then each eligible tier-1 company in that other MEC group must be specified in the choice. ***[Schedule 5, item 168, paragraph 719-5(4)(d)]***

5.407 The choice must be made no later than:

- if the head company of the MEC group is required to give the Commissioner an income tax return for the income year during which the company becomes an eligible tier-1 company of the top company — the day on which the

company gives its income tax return to the Commissioner for that income year; or

- if the head company of the MEC group is not required to give the Commissioner an income tax return for the income year during which the company becomes an eligible tier-1 company of the top company — the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, items 167 and 171, paragraph 719-5(4)(c) and subsections 719-5(6) and (6A)]

5.408 If a choice under section 719-5 is made, a new eligible tier-1 company covered by the choice will become a member of the MEC group with effect from the day that it became an eligible tier-1 company of the top company. ***[Schedule 5, item 169, paragraph 719-5(4)(f)]***

5.409 However, a choice for a new eligible tier-1 company to become a member of a MEC group will not be valid if, for example, that eligible tier-1 company did not exist at the time the choice takes effect.

5.410 The choice that is made in writing under section 719-5 for a new eligible tier-1 company to become a member of a MEC group does not need to be given to the Commissioner.

5.411 However, if a new eligible tier-1 company becomes a member of a MEC group because of a choice under section 719-5, the head company of the group must give the Commissioner a notice in the approved form containing the following information:

- the identity of the head company;
- the day on which the new eligible tier-1 company became a member of the MEC group — that is, the day the company became an eligible tier-1 company of the top company;
- the identity of each eligible tier-1 company of the top company in relation to the MEC group at that time because of the choice;
- the identity of each entity that becomes a subsidiary member of the group at that time because of the choice; and

- the identity of each entity that was a subsidiary member of the group at that time because of the choice but has left the group when the notice is given.

[Schedule 5, items 170 and 183, section 719-40 and subsections 719-77(1) and (2)]

5.412 The notice must be given to the Commissioner:

- if the head company is required to give the Commissioner an income tax return for the income year during which the company becomes an eligible tier-1 company of the top company — by the day on which the company gives its income tax return to the Commissioner for that income year; or

- if the head company is not required to give the Commissioner an income tax return for the income year during which the company becomes an eligible tier-1 company of the top company — by the last day in the period within which the company would be required to give the Commissioner such a return if it were required to give the Commissioner such a return.

[Schedule 5, item 183, subsection 719-77(3)]

5.413 If the notice under section 719-77 contains a technical defect, that defect does not affect the choice for the new eligible tier-1 company to become a member of the MEC group.

5.414 Only a provisional head company that exists on the relevant day can choose to include a new eligible tier-1 company in its existing MEC group.

5.415 If an eligible tier-1 company comes into existence after a MEC group has been formed, it is not included in the MEC group under the written choice to consolidate, as it was not a member of the potential MEC group that was consolidated. A further choice must be made in writing to include that eligible tier-1 company in the group.

5.416 Under the current law, both the choice to consolidate and the choice to include a new eligible tier-1 company in a MEC group must be made in the approved form in order to be effective. In the majority of cases, the approved forms given to the Commissioner will contain sufficient information to be considered both a written choice, and a notice of that written choice under the new provisions.

5.417 However, where a defect in an original approved form is such that it is unclear that a written choice was made to include a new eligible tier-1 company in a MEC group, the choice may not be effective.

Appointment of a provisional head company after formation

5.418 If a cessation event happens to the provisional head company of a MEC group, the eligible tier-1 companies that are or were members of the group immediately after the cessation event may make a choice in writing jointly appointing a new provisional head company of the group. The appointment is taken to have come into force immediately after the cessation event. ***[Schedule 5, items 181 and 182, subsections 719-60(1) and (3)]***

5.419 The choice must generally be made within 28 days of the cessation event (subsection 719-60(3)).

5.420 The choice that is made in writing under subsection 719-60(3) for the appointment of a new provisional head company following a cessation event does not need to be given to the Commissioner.

5.421 However, if a choice is made under subsection 719-60(3) to appoint a new provisional head company following a cessation event, the provisional head company must give the Commissioner a notice in the approved form containing the following information:

- the identity of the provisional head company;
- the day on which the choice is made; and
- the day on which the cessation event occurs.

[Schedule 5, item 183, subsections 719-79(1) and (2)]

5.422 The notice must be given to the Commissioner no later than:

- if the group came into existence because a choice has been made under section 719-50 to form a MEC group and the event happens more than 28 days before a notice of a choice under section 719-76 is given — the day on which the notice of a choice under section 719-76 is given; or
- otherwise — 28 days after the cessation event.

[Schedule 5, item 183, subsection 719-79(3)]

5.423 If the notice under section 719-79 contains a technical defect, that defect does not affect the choice to appoint a new provisional head company following a cessation event.

Application of the amendments in Part 18

5.424 The amendments in Part 18 apply from 1 July 2002. ***[Schedule 5, item 193]***

5.425 In this regard, the amendments are beneficial to taxpayers and, in the vast majority of cases, will have no retrospective impact. That is, where an effective choice has been made before the introduction of the amendments, that choice is not affected by the amendments and no further information needs to be given to the Commissioner.

5.426 However, where a choice made prior to the introduction of these amendments is ineffective because of a defect in the approved form, the amendments may allow that defect to be corrected.

5.427 Consequently, the amendments will overcome difficulties that have arisen, for example, where some wholly-owned corporate groups have operated for a number of years on the basis that they have formed a consolidated group or MEC group, without having made an effective choice to consolidate because notice has not been given to the Commissioner in the approved form.

Part 19 — Life insurance companies

5.428 Division 320 contains special rules for life insurance companies.

5.429 Life insurance companies essentially carry on three different types of business:

- ordinary business — taxable income in respect of this business is taxed at the corporate tax rate of 30 per cent;
- complying superannuation/FHSA business — taxable income in respect of this business is taxed at the complying superannuation fund and first home saver account (FHSA) rate of 15 per cent; and
- immediate annuity business — income relating to this business is non-assessable non-exempt income.

5.430 To ensure that income belonging to each class of business is clearly identified, assets belonging to each class must be segregated.

- Assets relating to the complying superannuation/FHSA business are called complying superannuation/FHSA assets (section 320-170).

- Assets relating to immediate annuity business are called segregated exempt assets (section 320-225).

5.431 The value of assets and liabilities in each segregated pool must be valued annually (sections 320-175 and 320-230). Excess assets held in a segregated pool must be transferred out of that pool at the end of each income year (sections 320-180 and 320-235). Certain transactions between the different classes of business are specifically recognised for tax purposes (sections 320-200 and 320-255).

5.432 If a life insurance company joins a consolidated group, the head company is taken to be a life insurance company (section 713-505). The purpose of section 713-505 is to ensure that Division 320 applies to the head company of the group.

5.433 When Division 320 was introduced in 2000, many life insurance companies invested the assets belonging to each class of business by acquiring membership interests in wholly-owned subsidiaries. The segregated asset income of each class could be clearly identified by the income flowing from the relevant membership interests.

5.434 Under the consolidation regime, the life insurance company and all of its wholly-owned subsidiaries (other than those subsidiaries covered by section 713-510) are members of the same consolidated group. Therefore, as a consequence of the single entity rule (subsection 701-1(1)), the membership interests that a life insurance company holds in a wholly-owned subsidiary entity are no longer recognised. This has caused practical difficulties for the head company in identifying the segregated asset income of each class.

5.435 Further difficulties arise because the segregated assets of a life insurance company may include other types of intra-group assets (in addition to membership interests) that need to be recognised to identify the segregated asset income of each class, such as:

- a bank account held by the life insurance company with another member of the group;

- a leasing arrangement between the life insurance company and another member of the group; or

- an immediate annuity policy issued by the life insurance company to another member of the group.

5.436 To overcome these difficulties, if a life insurance company is a member of a consolidated group, the single entity rule (subsection 701-1(1)) will be disregarded for the purposes of working out:

- amounts of the head company's ordinary income and statutory income derived from segregated exempt assets that are non-assessable non-exempt income (see paragraph 320-37(1)(a));
- the head company's taxable income of the complying superannuation class (see section 320-137);
- the head company's tax loss of the complying superannuation/FHSA class (see section 320-141);
- the total transfer value of the head company's complying superannuation/FHSA assets (see paragraph 320-175(1)(a));
- the amount of the head company's complying superannuation/FHSA liabilities (see paragraph 320-175(1)(b));
- the total transfer value of the head company's segregated exempt assets (see paragraph 320-230(1)(a)); and
- the amount of the head company's exempt life insurance policy liabilities (see paragraph 320-230(1)(b)).

[Schedule 5, items 194 and 198 to 201, subsections 713-510A(1) and (3)]

5.437 However, if the life insurance company is a subsidiary member of the group, these modifications do not apply:

- for the purposes of working out the tax cost setting amount of an asset of the life insurance company when it becomes a subsidiary member of the group; and
- for the purposes of working out the tax cost setting amount of a membership interest in the life insurance company if it ceases to be a subsidiary member of the group.

[Schedule 5, item 194, subsection 713-510A(2)]

5.438 Prior to the introduction of first home saver accounts in 2007:

- the complying superannuation/FHSA class was called the virtual pooled superannuation trust (PST) class;
- complying superannuation/FHSA assets were called virtual PST assets, and
- complying superannuation/FHSA liabilities were called the virtual PST liabilities.

5.439 Consequential amendments reflect this change of terminology. ***[Schedule 5, items 198 to 201, subsection 713-510A(3)]***

5.440 In addition, a consequential amendment will repeal sections 713-553 to 713-560. Those provisions were inserted to ensure that the income tax law operated appropriately when, prior to joining the group, a life insurance company had issued an immediate annuity policy to another company that has joined the same consolidated group as the life insurance company. As this is an intra-group transaction that will be appropriately recognised under the proposed amendments, these specific rules will no longer be necessary. ***[Schedule 5, items 195 and 196]***

Application of the amendments in Part 19

5.441 The amendments in Part 19 apply from 1 July 2002. ***[Schedule 5, item 197]***

5.442 In this regard, the amendments are beneficial to taxpayers as they confirm existing practice and will ensure that life insurance companies can calculate their taxable income correctly.

5.443 The technical amendments to update terminology apply on or after the commencement of the *First Home Savers Accounts (Consequential Amendments) Act 2008*. ***[Schedule 5, item 202]***

Part 20 — Non-membership equity interests

5.444 A gap exists in the tax cost setting rules when an entity that joins or leaves a consolidated group has issued non-membership equity interests — that is, interests that are neither membership interests nor liabilities. An example of non-membership equity interests is convertible notes.

5.445 As a result, when an entity that has issued non-membership equity interests joins a consolidated group, the tax costs of the entity's assets are understated because of the exclusion of these interests from the tax cost setting calculation.

5.446 When an entity that has issued non-membership equity interests leaves a consolidated group:

- if the leaving entity has issued non-membership equity interests to entities that are members of the old group, no tax cost arises for those membership interests; and

- if the leaving entity has issued non-membership equity interests to entities that are not members of the old group, the old group's allocable cost amount for the leaving entity is overstated.

5.447 The tax cost setting rules will be modified where an entity that has issued non-membership equity interests joins or leaves a consolidated group.

5.448 As a result, the allocable cost amount for a joining entity will be increased to reflect the amount received by the joining entity from the issue of non-membership equity interests.

5.449 In addition, when an entity leaves a consolidated group:

- if the leaving entity has issued non-membership equity interests to entities that are members of the old group, a tax cost will arise for those membership interests; and

- if the leaving entity has issued non-membership equity interests to entities that are not members of the old group, the old group's allocable cost amount for the leaving entity will be reduced to reflect the amount received by the old group from the issue of the non-membership equity interests.

What is a non-membership equity interest?

5.450 A ***non-membership equity interest*** in an entity is defined to mean an interest in the entity at a time, to the extent that it is not an accounting liability (within the meaning of subsection 705-70(1)) in the entity at that time, if:

- the interest is not a membership interest (as defined in section 960-135) in the entity at that time; and

- the interest is not a debt interest (as defined in Subdivision 974-B) in the entity at that time.

[Schedule 5, item 219, definition of 'non-membership equity interest' in subsection 995-1(1)]

5.451 In this regard, for the purpose of determining the extent to which an interest is not an accounting liability within the meaning of subsection 705-70(1):

- each reference in subsection 705-70(1) to the joining entity is treated as being a reference to the entity; and
- the reference in subsection 705-70(1) to the joining time is treated as being a reference to the time that the definition of non-membership equity interest is being applied.

[Schedule 5, item 219, definition of 'non-membership equity interest' in subsection 995-1(1)]

5.452 Examples of the types of interests in an entity that will typically qualify as non-membership equity interests include:

- a right or option (including a contingent right or option) created or issued by the entity to acquire a membership interest in the entity; and
- a convertible note created or issued by the entity.

Modifications when a joining entity has non-membership equity interests on issue

5.453 When an entity joins a consolidated group, the tax costs of the joining entity's assets are generally reset by allocating the joining entity's allocable cost amount to each of the joining entity's assets in proportion to their market value. This allocation process ensures that, broadly, the costs incurred by the head company to acquire the joining entity's membership interests are pushed down into the tax costs of the underlying assets of the joining entity.

5.454 Step 1 of the allocable cost amount is, broadly, the costs of the membership interests in the joining entity (section 705-65). For these purposes, certain rights and options to acquire membership interests in the joining entity which are held by the members of the joined group are treated as if they were membership interests in the joining entity (subsection 705-65(6)).

5.455 The scope of subsection 705-65(6) will be broadened so that, if at the joining time a member of the joined group holds a non-membership equity interest in the joining entity, then the non-membership equity interest is treated as a membership interest for the purposes of step 1 of the allocable cost amount. ***[Schedule 5, item 203, subsection 705-65(6)]***

5.456 As a result, in most cases the cost bases of non-membership equity interests that members of the joined group hold in the joining entity will be included in step 1 of the allocable cost amount.

5.457 Step 2 of the allocable cost amount is, broadly, the value of the joining entity's accounting liabilities (section 705-70). However, the step 2 amount is increased by, among other things, the market value of certain rights and options to acquire membership interests in the joining entity which are held by a person who is not a member of the joined group (paragraph 705-85(3)(a)).

5.458 Paragraph 705-85(3)(a) will be modified so that the step 2 amount is increased by the amount that would be the balance of the joining entity's non-share capital account, assuming that:

- if it is not a company, the joining entity were a company;
- each non-membership equity interest (if any) in the joining entity held at the joining time by a person other than a member of the joined group were a non-share equity interest in the joining entity; and
- those non-share equity interests (if any) were the only non-share equity interests in the joining entity.

[Schedule 5, item 205, paragraph 705-85(3)(a)]

5.459 As a result, the step 2 amount will effectively be increased by the amount received by the joining entity from the issue of non-membership equity interests to a person who is not a member of the joined group.

5.460 Consequential amendments will modify various provisions so that they appropriately refer to non-membership equity interests (rather than to rights or options to acquire membership interests). ***[Schedule 5, items 204 and 206 to 212, subsections 705-85(3), 705-145(5), 705-195(1) and (2), 705-200(1) and (3) and 705-225(5)]***

Modifications when a leaving entity has non-membership equity interests on issue

5.461 When an entity leaves a consolidated group, the tax costs of the membership interests in the leaving entity are reconstructed. That is, the tax cost setting amount for each membership interest held in the leaving entity by members of the old group is worked out by, broadly, allocating a proportion of the old group's allocable cost amount to each membership interest (section 711-15).

5.462 For these purposes, certain rights and options to acquire membership interests in the leaving entity which are held by the members of the old group are treated as if they were a separate class of membership interests in the leaving entity (subsection 711-15(2)).

5.463 The scope of subsection 711-15(2) will be broadened so that, if at the leaving time a member of the old group holds a non-membership equity interest in the leaving entity, then the non-membership equity interest is treated as if:

- it were a membership interest in the leaving entity; and
- it were of a different class than any other membership interest in the leaving entity.

[Schedule 5, item 213, subsection 711-15(2)]

5.464 As a result, the tax costs of any non-membership equity interests in the leaving entity held by members of the old group will be worked out by allocating part of the old group's allocable cost amount to those non-membership equity interests.

5.465 The old group's allocable cost amount for a leaving entity is, broadly, the sum of the terminating value of the leaving entity's assets (step 1 of the old group's allocable cost amount (section 711-25)) less the value of its accounting liabilities and the value of membership interests held in the leaving entity that are not held by members of the old group (step 4 of the old group's allocable cost amount (section 711-45)).

5.466 Section 711-45 will be modified so that the step 4 amount is increased by the amount that would be the balance of the leaving entity's non-share capital account, assuming that:

- if it is not a company, the leaving entity were a company;
- each non-membership equity interest (if any) in the leaving entity held just before the leaving time by a person other than

a member of the old group were a non-share equity interest in the leaving entity; and

- those non-share equity interests (if any) were the only non-share equity interests in the leaving entity.

[Schedule 5, item 215, subsection 711-45(6B)]

5.467 As a result, the step 4 amount will effectively be increased by the amount received by the old group from the issue of non-membership equity interests in the leaving entity to a person who is not a member of the old group.

5.468 Consequential amendments will modify various provisions so that they appropriately refer to non-membership equity interests (rather than to rights or options to acquire membership interests). ***[Schedule 5, items 216 to 218, subsections 715-50(6), 715-255(6) and 715-270(6)]***

Application of Part 20

5.469 The amendments in Part 20 apply from the date of introduction of this Bill into the House of Representatives. That is, the amendments will apply to an entity that joins or leaves a consolidated group on or after that date. ***[Schedule 5, item 220]***

5.470 However, the head company of a consolidated group can make a choice to apply the amendments in Part 20 to an entity that joins or leaves a consolidated group on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and

- must be made in writing.

[Schedule 5, item 220]

5.471 This option to apply the amendments from 1 July 2002 will allow consolidated groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

Application and transitional provisions

Measures that apply from 1 July 2002

5.472 The following measures apply from 1 July 2002 (that is, from the commencement of the consolidation regime):

- the amendments in Division 1 of Part 1 which ensure the tax cost setting amount allocated to a joining entity's assets is used for the purposes of applying other provisions of the income tax law;
- the amendment in item 13 of Part 2, which modifies the circumstances in which a company is eligible to be appointed as the provisional head company of a MEC group;
- the amendments in Part 5, which modify the treatment of pre-joining time roll-overs under the tax cost setting rules that apply when an entity joins a consolidated group;
- the amendments in items 114 and 116 of Part 9, which modify the tax cost setting rules that apply when an entity joins or leaves a consolidated group to clarify that the adjustment for inherited deductions does not apply to certain deductions for undeducted construction expenditure;
- the amendments in Part 10, which modify the operation of the tax cost setting rules that apply when an entity joins or leaves a consolidated group for general insurance companies;
- the amendments in Division 2 of Part 11, which ensure that certain rights to future income assets are treated as retained cost base assets;
- the amendments in Part 12, which repeal CGT event L7;
- the amendments in Part 15, which ensure certain consolidation transitional rules apply to the head company of a group which has a substituted accounting period where the group consolidated on or after 1 July 2003 on a day prior to the first day of its income year;
- the amendments in Part 16, which modify the operation of the loss multiplication rules for widely held companies;
- the amendments in Part 18, which modify the way that a choice to consolidate is made; and

- the amendments in Part 19, which modify the mechanism for working out the taxable income of consolidated groups that have life insurance company members in respect of intra-group transactions.

[Schedule 5, items 7, 17, 55, 117, 119, 126, 131, 139, 152, 193 and 202]

5.473 These amendments, which were sought by taxpayers, are beneficial because, broadly, they ensure that the consolidation provisions operate as intended and confirm established practice.

5.474 Business and professional groups representing taxpayers involved in the consultation process support the application of these measures from 1 July 2002.

Measures that apply from 1 July 2005

5.475 The amendments in Part 14, which ensure that the blackhole expenditure provisions that apply to consolidated groups also apply to MEC groups, apply from 1 July 2005 (that is, from the commencement of the blackhole expenditure provisions). ***[Schedule 5, item 136]***

5.476 These amendments are beneficial as they ensure that MEC groups get appropriate tax recognition for costs paid to third parties in respect of intra-group transactions affecting CGT assets they hold by the group (in the same way as consolidated groups).

Measures that apply from 27 October 2006, but with an option to apply the measure from 1 July 2002

5.477 The amendments in Part 2, which allow consolidated groups to convert to MEC groups, and vice versa, with minimal tax consequences (other than the modification to the circumstances in which a company is eligible to be appointed as the provisional head company of a MEC group), apply to conversion events which happen on or after 27 October 2006 (that is, from the date of announcement). ***[Schedule 5, item 17]***

5.478 However, the head company of a consolidated group or MEC group can make a choice to apply the amendments in Part 2 from 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

[Schedule 5, item 17]

5.479 These amendments were sought by affected taxpayers and are beneficial as they will substantially reduce unnecessary compliance costs.

5.480 The option to apply the amendments from 1 July 2002 will allow consolidated groups and MEC groups that are adversely affected by the operation of the current law to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

5.481 Business and professional groups representing taxpayers involved in the consultation process support the optional application of these measures from 1 July 2002.

Measures that apply from 8 May 2007

5.482 The following measures apply after 8 May 2007 (that is, from the date of announcement):

- the amendments in Division 1 of Part 6, which phase out the over-depreciation adjustment to the allocable cost amount; and
- the amendments in Part 17, which modify the CGT timing rules where a CGT event that happens to a CGT asset straddles the time that an entity joins or leaves a consolidated group.

[Schedule 1, items 57 and 154]

5.483 These amendments were sought by affected taxpayers. Business and professional groups representing taxpayers involved in the consultation process support the application of these measures from 8 May 2007.

Measures that apply from 1 July 2009

5.484 The amendments in Division 2 of Part 6, which repeal the over-depreciation adjustment provisions, apply from 1 July 2009. ***[Schedule 5, item 78]***

Measures that apply from the date of introduction, but with an option to apply the measure from 1 July 2002

5.485 Some measures in this Bill apply from the date of introduction of this Bill into the House of Representatives. However, the head

company of a consolidated group can make a choice to apply the amendments on or after 1 July 2002. The choice:

- must be made on or before 30 June 2011, or within such further time as the Commissioner allows; and
- must be made in writing.

5.486 These measures are:

- the amendments in Division 2 of Part 1, which clarify interactions with the foreign currency gains and losses provisions (Division 775) when an entity joins a consolidated group;
- the amendments in Part 3, which improve the treatment of pre-CGT membership interests of a joining entity;
- the amendments in Part 4, which ensure that amounts are not double counted when working out the allocable cost amount of a joining entity;
- the amendments in Division 1 of Part 11, which ensure that units held in cash management trusts are treated as retained cost base assets;
- the amendments in Part 13, which reduce the tax cost setting amount of a joining entity where that amount exceeds the market value of certain retained cost base assets; and
- the amendments in Part 20, which modify the tax cost setting rules where an entity that has issued non-membership equity interests joins or leaves a consolidated group.

[Schedule 5, items 7, 35, 37, 126, 134 and 220]

5.487 These amendments, which were sought by taxpayers, are beneficial. However, taxpayers have taken different positions on the operation of the current law in relation to these issues.

5.488 Therefore, the option to apply the amendments from 1 July 2002 will ensure that taxpayers do not need to disturb past practices. However, it will allow consolidated groups to take advantage of the amendments, having regard to the compliance cost implications of applying the changes retrospectively.

5.489 Business and professional groups representing taxpayers involved in the consultation process support the optional application of these measures from 1 July 2002.

Measures that apply from the date of introduction

5.490 The following measures apply from the date of introduction of this Bill into the House of Representatives:

- the amendments in Part 7, which modify the treatment of liabilities under the tax cost setting rules that apply when an entity leaves a consolidated group;
- the amendments in Part 8, which clarify the accounting principles that are used under the tax cost setting rules that apply when an entity joins or leaves a consolidated group; and
- the amendment in item 113 of Part 9, which modifies the amount of the adjustment for inherited deductions under the tax cost setting rules that apply when an entity leaves a consolidated group.

[Schedule 5, items 87, 89, 113, and 117]

Amendment of assessments

5.491 Generally, the Commissioner can amend an assessment of a company, other than a small business entity, within four years from the date of the notice of assessment (section 170 of the ITAA 1936).

5.492 As a number of these amendments apply from 1 July 2002, the period for amending assessments will be extended. That is, the operation of section 170 will be modified so that it does not prevent the amendment of an assessment if:

- the assessment was made before the commencement of Schedule 5;
- the amendment is made within two years after that date; and
- the amendment is made for the purpose of giving effect to the amendments in Schedule 5.

[Section 4]

Chapter 6
Miscellaneous amendments

Outline of chapter

6.1 Schedule 6 to this Bill makes miscellaneous amendments to the taxation laws. Most of them are of a minor nature.

Context of amendments

6.2 The amendments seek to ensure the taxation law operates as intended, by correcting technical or drafting defects, removing anomalies and addressing unintended outcomes. These amendments are part of the Government's commitment to the care and maintenance of the taxation laws.

6.3 The package of amendments includes addressing issues raised through the Tax Issues Entry System (TIES). The TIES website (www.ties.gov.au), which the Australian Taxation Office (ATO) and the Treasury jointly operate, provides a vehicle for tax professionals and the general public to raise issues relating to the care and maintenance of the tax system. The relevant part of the explanatory memorandum identifies TIES issues.

Summary of new law

6.4 The issues these amendments deal with include:

- rectifying incorrect terminology;
- correcting grammatical and spelling errors;
- repealing inoperative material;
- clarifying ambiguities; and
- ensuring that provisions are consistent with their original policy intent.

6.5 Part 1 of this Schedule concerns the capital gains tax (CGT) main residence exemption for a replacement dwelling; Part 2 concerns the CGT small business retirement exemption; Part 3 concerns a waiver connected with proceeds of crime proceedings; Part 4 has amendments relating to higher education; Part 5 concerns pay as you go (PAYG) withholding from delayed payments for termination of employment; Part 6 concerns administrative penalties because of false or misleading statements; Part 7 concerns offsets against the superannuation charge; Part 8 concerns the status of certain superannuation funds; Part 9 makes technical corrections; Part 10 repeals redundant material; and Part 11 makes other minor amendments.

6.6 The more significant amendments are:

- ensuring that a replacement dwelling that is eligible for the compulsory acquisition roll-over is also treated as a continuation of the original dwelling for CGT main residence exemption purposes (this issue was identified through **TIES 0007-2009**) (see Part 1, items 1 to 6);
- correcting an unintended effect on the operation of the small business CGT retirement exemption made by the *Superannuation Legislation Amendment (Simplification) Act 2007* which inadvertently exposed payments a trust makes to a CGT concession stakeholder under the retirement exemption to CGT event E4 (this issue was identified through **TIES 0045-009**) (see Part 2, items 7 to 11);
- enabling the Commissioner of Taxation (Commissioner) to waive tax-related liabilities in appropriate cases to facilitate proceedings under the *Proceeds of Crime Act 2002* (see Part 3, items 12 to 14);
- extending the administrative penalty for making a false or misleading statement to cover statements that do not produce a shortfall amount (see Part 6, items 58 to 105); and
- clarifying the operation of an anti-avoidance provision that applies to certain capital benefits paid by a company (see Part 11, items 124 and 125).

6.7 All of the amendments in this Schedule commence from Royal Assent unless otherwise stated.

Detailed explanation of new law

Part 1 — Main residence exemption for replacement dwelling

Table 6.2: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	*What the amendment does*
118-145(3) 118-147 118-150(3)(a) 118-190(3A) 118-200(4)(b)	These amendments give effect to a suggestion made through **TIES 0007-2009**. A taxpayer's main residence is usually not subject to CGT. Section 118-145 allows a taxpayer to continue to treat a dwelling as their main residence (instead of any other dwelling) after it has actually ceased to be their main residence. If the dwelling was used to produce assessable income, that treatment can last for up to six years; otherwise it can last indefinitely. When a dwelling that was no longer a taxpayer's main residence, but is still being treated as one, is destroyed or compulsorily acquired, the taxpayer ceases to have a main residence for CGT purposes. They have to live in a new dwelling to establish a new main residence. The amendments, which extend the rule about absences from a main residence, allow a taxpayer to transfer the main residence status in such cases to a replacement dwelling, even if the taxpayer never lives in it. ***[Schedule 6, item 2, subsections 118-147(1) and (2)]*** The taxpayer can transfer the main residence status only if the replacement dwelling (or the land on which it is built) is acquired no later than one year after the income year in which the original dwelling was destroyed or compulsorily acquired. The Commissioner can allow more time if there are special circumstances. ***[Schedule 6, item 2, paragraph 118-147(1)(d)]*** The taxpayer can transfer the main residence status to a replacement dwelling they build only if it is built within four years after the original dwelling was destroyed or compulsorily acquired (or after the land for the replacement dwelling was acquired if that was later). ***[Schedule 6, item 2, subsection 118-147(2)]*** If the taxpayer transfers the main residence status to a replacement dwelling, it is treated as being the main residence from when the replacement dwelling was acquired (or from a year before the original dwelling was destroyed or compulsorily acquired if that is later). ***[Schedule 6, item 2, subsection 118-147(2)]*** It can continue to be treated as the taxpayer's main residence indefinitely if it is not used to produce assessable income. ***[Schedule 6, item 2, subsection 118-147(5)]***

Provision being amended	***What the amendment does***
	If it is used to produce assessable income, it can be treated as the taxpayer's main residence for up to six years after the original dwelling was destroyed or compulsorily acquired (or after the replacement dwelling was acquired if that was later). If the original dwelling was also used to produce assessable income, the six years is instead the balance of the six-year period that was running on the original dwelling. ***[Schedule 6, item 1, subsections 118-147(3) and (4)]*** If the original dwelling is accidentally destroyed but the taxpayer does not transfer the main residence status to a replacement dwelling, existing section 118-160 allows the taxpayer to choose to treat the original land as if it remained the main residence. If the taxpayer's replacement dwelling (or land) is subject to the extended absence rule, they cannot treat another dwelling as their main residence during this period. However, where the taxpayer acquires a replacement dwelling (or land) before the involuntary event, the taxpayer may treat both the old dwelling and the replacement dwelling (or land) as their main residence but only up to a maximum period of one year before the involuntary event happened. ***[Schedule 6, item 2, paragraph 118-147(6)(a) and subsections 118-147(2) and (7)]*** Sections 118-140 (about changing main residences), and 118-150 and 118-155 (about building, repairing or renovating a dwelling) do not apply if the taxpayer chooses to transfer their main residence status. ***[Schedule 6, item 2, paragraphs 118-147(6)(b) to (d)]*** There are a number of minor consequential amendments. ***[Schedule 6, items 1 and 3 to 5, paragraphs 118-150(3)(a) and 118-200(4)(b) and subsections 118-145(3) and 118-190(3A)]*** The amendments apply to CGT events happening in relation to replacement dwellings on or after the day this Bill receives Royal Assent. ***[Schedule 6, item 6]***

Part 2 — Small business retirement exemption

Table 6.3: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	*What the amendment does*
152-310(2)(a)	This amendment gives effect to a suggestion made through **TIES 0045-2009**. The amendment corrects an unintended effect on the operation of the small business CGT retirement exemption made by the *Superannuation Legislation Amendment (Simplification) Act 2007*. That Act inadvertently made any payment, or part of any payment, that a trust makes to a CGT concession stakeholder under the retirement exemption subject to CGT event E4 (contained in section 104-70 of the ITAA 1997). CGT event E4 has the effect of reducing the cost base and reduced cost base of the unit or interest in the trust by the amount of the non-assessable payment. If the cost base is reduced to zero, a capital gain arises to the beneficiary to the extent of the remainder of the payment. Prior to the superannuation amendments in 2007, any payment made under the retirement exemption to a CGT concession stakeholder was an eligible termination payment. Under the eligible termination payment rules, CGT exempt amounts were ignored in determining whether the CGT concession stakeholder made a capital gain. This amendment effectively restores that position by treating a payment representing an amount that was subject to the small business retirement exemption made by a company or trust to a CGT concession stakeholder as not assessable and not exempt income of the stakeholder. This means that the payments are disregarded for the purposes of CGT event E4 through the operation of paragraph 104-71(1)(a) of the ITAA 1997. ***[Schedule 6, item 7, paragraph 152-310(2)(a)]*** The amendment applies to payments made after 30 June 2007 to give it the same date of effect as the superannuation amendments mentioned above. The retrospective application of this amendment should benefit affected taxpayers or, at the very least, not have a negative effect on such taxpayers. ***[Schedule 6, item 8]*** A number of consequential amendments deal with the small business retirement exemption. ***[Schedule 6, items 9 to 11, item headed 'small business retirement exemption' in the table in section 11-15, section 11-55 and items headed 'capital gains tax' in the table in section 12-5]***

Part 3 — Waiver connected with proceeds of crime proceedings

Table 6.4: Amendments to the *Taxation Administration Act 1953*

Provision being amended	***What the amendment does***
340 in Schedule 1 (heading) 342-1 in Schedule 1 342-5 in Schedule 1 342-10 in Schedule 1	These amendments address the interaction between actions brought by the Commonwealth Director of Public Prosecutions under the Proceeds of Crime Act 2002 (POC Act) and the Commissioner's obligations to collect tax under the tax laws. The POC Act provides a comprehensive scheme to trace, restrain and confiscate the proceeds of crimes against Commonwealth law. Under current tax law, the Commissioner is required to follow an administrative process of assessing and collecting taxes without taking into consideration that action may also be taken under the POC Act. The Commissioner cannot waive, or refuse to collect, a tax liability, even where following the administrative process hinders the operation of the POC Act. The amendments enable the Commissioner to waive tax-related liabilities in appropriate cases to facilitate proceedings under the POC Act. ***[Schedule 6, item 13, Division 342 in Schedule 1]*** The Commissioner must be satisfied that the tax-related liability is connected with the circumstances associated with the proceedings under the POC Act and that waiving the liability facilitates proceedings under the POC Act. ***[Schedule 6, item 13, subsection 342-10(1) in Schedule 1]*** In deciding whether to waive the tax liability, the Commissioner must take into account the amount that the Commissioner believes the Commonwealth would forgo as a result of the waiver (taking into account things that might be saved, such as recovery costs that would not have been spent), the amount the Commonwealth is likely to collect from the proceedings and the times at which those amounts would be, or would have been, likely to be collected. The Commissioner may also consider other matters. ***[Schedule 6, item 13, subsections 342-10(2) and (3)]*** The Commissioner also has some existing powers that might be exercised for the purpose of facilitating proceedings under the POC Act. Those powers allow him to defer the time for payment of tax-related liabilities (under section 255-10 in Schedule 1) and to remit amounts of general interest charge (under section 8AAG). As a consequential amendment, Division 340 (which provides a power to release taxpayers from their liabilities in hardship cases) is renamed to reflect the fact that it is no

Provision being amended	What the amendment does
	longer the only power to wave tax-related liabilities. ***[Schedule 6, item 12, Division 340 (heading) in Schedule 1]***
	This amendment only applies to proceeds of crime proceedings that start or are proposed to start on or after the amendments commence and to proceedings that had started but not ended before commencement. The amendments do not affect proceeds of crime actions that were settled before commencement. The amendment facilitates the resolution of outstanding proceedings under the POC Act, and will not have an adverse impact on taxpayers. ***[Schedule 6, item 14]***
	Proceedings under the POC Act start when an application for a restraining order, or an application for a confiscation order, has been filed. They end when the time for applying for exclusion from forfeiture, recovery from forfeiture or compensation orders expires. They also end when any applications for exclusion, recovery, compensation or for enforcement of confiscation orders have been finally determined and all confiscation orders made in the proceedings have been satisfied.

Part 4 — Amendments relating to higher education

Table 6.5: Amendments related to the *Higher Education Support Act 2003*

Provision being amended	What the amendment does
Provisions in various acts	The *Higher Education Support Act 2003* (HESA) has superseded the *Higher Education Funding Act 1988* (HEFA).
	Various tax laws refer to concepts in the HEFA, such as: ‘higher education institution’, ‘self education’ and ‘higher education provider’.
	The amendments remove references to HEFA equivalent concepts and, where appropriate, replace them with references to equivalent concepts in the HESA. ***[Schedule 6, items 15 to 43, section 195-1 of the A New Tax System (Goods and Services Tax) Act 1999, section 135M of the Fringe Benefits Tax Assessment Act 1986, subsection 82A(2) (paragraphs (a), (ab), and (b) of the definition of ‘expenses of self-education’) of the Income Tax Assessment Act 1936 (ITAA 1936), paragraphs 26-20(1)(a) to (c), subsection 30-25(1) (cell at table item 2.1.3, column headed ‘Fund, authority or institution’), subsection 30-25(1) (cell at table item 2.1.6, column headed ‘Fund, authority or institution’), subparagraphs 52-132(a)(x) and 52-140(3)(a)(x) of the ITAA 1997, section 8AAZA, paragraph 8AAZLD(aa), paragraphs 11-1(c), 15-50(1)(b) and 45-5(1)(c) in Schedule 1, section 45-340 in Schedule 1 (method statement, step 3) and section 45-375 in Schedule 1***

Provision being amended	What the amendment does
	(method statement, step 3) of the Taxation Administration Act 1953 (TAA 1953), subsection 3(1) (definition of 'HEC assessment debt'), item 40 in the table in section 3C, subparagraph 8A(1)(a)(ii), paragraph 8A(2)(b), subparagraphs 8E(1)(d)(iii) and (2)(d)(iii) and sub-subparagraph 12A(1)(a)(iv)(B) and paragraph 12A(2)(b) of the Taxation (Interest on Overpayments and Early Payments) Act 1983] The amendments apply in relation to gifts made, or payments received, on or after the day this Bill receives Royal Assent. ***[Schedule 6, items 23 and 26]***

Part 5 — PAYG withholding from delayed payments for termination of employment

Table 6.6: Amendments relating to PAYG withholding from delayed payments because of termination of employment

Provision being amended	What the amendment does
TAA 1953 10-5(1) in Schedule 1 (table item 8) 12-5(2) in Schedule 1 (table item 2) 12-C in Schedule 1 (heading) 12-85 in Schedule 1 (heading) 12-85(b) in Schedule 1 16-165 in Schedule 1 (heading) 16-165(2)(b) in Schedule 1 18-65(3)(d)(ii) in Schedule 1 90-1 in Schedule 1 (note) ***Child Support (Registration and Collection) Act 1988*** 4(1) (note at the end of the definition of 'work and income support related withholding payments') **ITAA 1936** 6(1) (note at the end of the definition of 'work and income support related withholding payments and benefits')	These amendments give effect to a suggestion made through **TIES 0009-2008**. Under section 12-85 of Schedule 1 to the TAA 1953, an entity must withhold an amount from an employment termination payment it makes to an individual. Broadly, employment termination payments are payments received in consequence of the termination of a person's employment. Before 1 July 2007, these payments were eligible termination payments and were subject to PAYG withholding under section 12-85. Payments for termination of employment received more than 12 months after termination will only be employment termination payments where the Commissioner has determined that they are employment termination payments. This 12-month restriction exists to prevent abuse of the tax concession provided to employment termination payments by structuring a series of payments over a number of income years. This restriction did not apply to eligible termination payments and its introduction has created an unintended gap in the coverage of the PAYG withholding provisions. These amendments extend the application of the PAYG withholding provisions to amounts that would be employment termination payments except that they are received more than 12 months after termination of employment. ***[Schedule 6, items 44 to 52, item 8 in the table in subsection 10-5(1) in Schedule 1, item 2 in the table in subsection 12-5(2) in Schedule 1, section 12-C (heading) in***

Provision being amended	*What the amendment does*
	Schedule 1, section 12-85 (heading) in Schedule 1, subsection 12-85(b) in Schedule 1, section 16-165 (heading) in Schedule 1, paragraph 16-165(2)(b) in Schedule 1, subparagraph 18-65(3)(d)(ii) in Schedule 1, section 90-1 (note) in Schedule 1 to the TAA 1953] These amendments apply in relation to payments made on or after the later of, the day this Bill receives Royal Assent or 1 July 2010. ***[Schedule 6, item 53]*** Consequential amendments are made to ensure that the notes refer correctly to the types of payments covered by relevant definitions. ***[Schedule 6, items 54 and 55, subsection 4(1) (note at the end of the definition of 'work and income support related withholding payments') in the Child Support (Registration and Collection) Act 1988, and subsection 6(1) (note at the end of the definition of 'work and income support related withholding payments and benefits') of the ITAA 1936]*** Consequential amendments are made to ensure the provisions refer correctly to payments included in Subdivision 12-C of Schedule 1 to the TAA 1953. ***[Schedule 6, items 56 and 57, subsection 28-185(3) (cell at table item 5, column headed 'Subject matter') and subsection 900-12(3) (cell at table item 5, column headed 'Subject matter') of the ITAA 1997]***

Part 6 — Administrative penalties for false or misleading statements

6.8 Subdivision 284-B in Schedule 1 to the TAA 1953 provides an administrative penalty for making a false or misleading statement to the Commissioner (or to another entity exercising a power or performing a function under a taxation law). That administrative penalty regime provides a simpler and more cost effective approach to penalties than prosecuting all offences.

6.9 The penalty is set to take account of the extent of the taxpayer's culpability and any behaviour that helps or frustrates the Commissioner's investigation after the statement is made.

6.10 The penalty is also based on the shortfall amount caused by the statement being false or misleading. That ensures that the penalty increases as the consequences become more serious. However, it also means that a statement that does not produce any shortfall amount is not penalised, even though it is false or misleading. For such a statement, prosecuting an offence is generally the only remedy currently available.

6.11 The amendments extend the existing administrative penalty regime to cover false or misleading statements that do not directly produce a shortfall amount.

6.12 They also extend the regime to cover some false or misleading statements made to entities other than the Commissioner.

6.13 All references in this part are to provisions in Schedule 1 to the TAA 1953 unless otherwise indicated.

Liability for the penalty (Division 284)

6.14 Section 284-75 creates a liability for a penalty for making a false or misleading statement. It is amended to remove the need for the statement to lead to a shortfall amount. It is also amended to extend it to cover some statements that are made neither to the Commissioner nor to another entity exercising a power or performing a function under a taxation law. Those statements must be statements that the tax law either requires be made or permits to be made. So, for instance, they would include the statements the tax law requires the trustee of a super fund to provide to the fund's members and they would also include declarations that employees may opt to give to their employers to reduce the amount of tax withheld from their wages. ***[Schedule 6, items 60, 61, 66, 67, 70 and 72, paragraphs 274-75(1)(b) and (c) and (2)(c), subsection 284-75(4) and items 1 to 4 in the table in subsection 284-90(1)]***

6.15 The penalty applies if a taxpayer makes a false or misleading statement or if the taxpayer's agent makes the statement for the taxpayer. The amendments make it clear that outcome applies even if a statement an agent makes is not made in an approved form. ***[Schedule 6, items 58, 59 and 62 to 65, paragraphs 284-75(2)(a) and (b), subsection 284-75(1) and section 284-25]***

The amount of the penalty

6.16 Currently, the penalty starts with the 'base penalty amount', which is calculated by reference to the shortfall amount and the taxpayer's culpability — it is 25 per cent of the shortfall if the taxpayer merely fails to take reasonable care, 50 per cent if the shortfall is caused by recklessness, and 75 per cent if the shortfall is caused by an intentional disregard of the law. The amendments provide a base penalty amount for false or misleading statements that do not cause any shortfall amount. The amount is 20, 40 or 60 penalty units depending on whether the taxpayer did not take reasonable care, was reckless, or intentionally disregarded the law. Under section 4AA of the *Crimes Act 1914*, a penalty unit is currently $110. ***[Schedule 6, item 71, items 3A to 3C in the table in subsection 284-90(1)]***

6.17 The amendments also ensure that there can be only one base penalty amount for each false or misleading statement. ***[Schedule 6, item 74, subsection 284-90(2)]***

6.18 Those base penalty amounts are set to provide a sufficient incentive for taxpayers to take care in the taxation statements they make. Where the statement merely involves a failure to take reasonable care, the amount reflects the existing penalty imposed by section 288-85 on trustees of self-managed super funds. The increase in the amount for more serious cases follows the proportions that apply under the existing base penalty amount rules.

6.19 Section 284-220 provides for a base penalty amount to be increased by 20 per cent if the taxpayer takes steps to prevent the Commissioner learning that a statement was false or misleading or if the taxpayer has been subject to a previous penalty for making a false or misleading statement.

6.20 Section 284-225 provides for the penalty to be reduced by 20 per cent if the taxpayer informs the Commissioner about a false or misleading statement after the Commissioner announces an audit. If the taxpayer informs the Commissioner before an audit is announced, and before any public request from the Commissioner to disclose a relevant scheme or transaction, the reduction is 80 percent (or 100 per cent if the shortfall amount is $1,000 or less).

6.21 The amendments ensure those provisions also apply to statements that do not produce a shortfall amount.

6.22 Under the amendments, the increase in a base penalty amount under section 284-220 applies if the taxpayer has a previous penalty of the same sort. This is a minor change from the current law (which increases the base penalty amount if there was a similar penalty for a *previous accounting period*). The change is necessary because false or misleading statements that do not lead to a shortfall amount will not always be related to an accounting period. ***[Schedule 6, items 83 to 87, paragraphs 284-220(1)(c) to (e)]***

6.23 If there is no shortfall amount, the 100 per cent reduction for a shortfall amount under $1,000 could not apply. Therefore, the amendments reduce the penalty in those cases to nil if the taxpayer informs the Commissioner before an audit is announced. ***[Schedule 6, item 91, subsection 284-225(4A)]***

6.24 The Commissioner can also exercise his existing power under section 298-20 to remit some or all of the penalty.

6.25 Directors of a corporate trustee of a self-managed super fund that becomes liable for the penalty are themselves jointly and severally liable to pay that penalty. That preserves the existing outcome provided for by section 288-85, which is repealed by the amendments. ***[Schedule 6, item 75, section 284-95]***

Exclusion from liability

6.26 Section 284-215 does two things. First, it reduces the penalty to the extent that the shortfall amount is caused by the taxpayer treating the law as applying in a way that was consistent with the Commissioner's advice or general practice. Second, it reduces the penalty to nil if the taxpayer takes reasonable care in making a false or misleading statement.

6.27 The amendments split section 284-215 into two parts so that each can be located in its proper place in Division 284. They also ensure that the reduction in penalty for relying on the Commissioner's advice or general practice also applies in cases where there is no shortfall amount. For example, if a taxpayer makes a statement that is false or misleading but is consistent with the Commissioner's published view, the penalty is reduced accordingly. ***[Schedule 6, items 67, 79 and 88, subsection 284-225(5) and sections 284-215 and 284-224]***

6.28 The provision that reproduces the effect of the existing subsection 284-215(2) is slightly changed to ensure that it extends to all false or misleading statements rather than just to those that produce a shortfall amount. It excludes taxpayers from liability for any penalty if they take reasonable care in making the statement. If their agent makes the statement, both the taxpayer and the agent need to take reasonable care before the exclusion from liability applies. ***[Schedule 6, item 67, subsection 284-75(5)]***

Consequential amendments

6.29 A number of consequential amendments deal with section 284-215's change in location. ***[Schedule 6, items 68, 69, 73, 76 to 78 and 95 to 97, subsections 284-80(1) (note), 284-90(1), 284-150(2) (note) and 361-5(1) (notes) and (3) and section 284-160]***

6.30 A number of other minor amendments are also made as a consequence of the main amendments. ***[Schedule 6, items 80 to 87, 89 to 93 and 98, subsections 284-220(1) and 284-225(1), (2), (4A) and (5) and section 284-225 (heading) in Schedule 1 to the TAA 1953 and paragraph 35(1)(b) of the Product Grants and Benefits Administration Act 2000]***

6.31 The amendments repeal section 288-85, which penalises trustees for statements that do not directly produce a shortfall amount. This is because the general extension of the penalty regime now covers that case. ***[Schedule 6, item 94, section 288-85, Division 288]***

6.32 Consequential amendments reflect the fact that section 288-85 is replaced by the general penalty regime. ***[Schedule 6, items 99 and 100, subsection 39(1B) and section 38A (subparagraph (ab)(i) of the definition of 'regulatory provision') of the Superannuation Industry (Supervision) Act 1993]***

6.33 The *Tax Agent Services (Transitional Provisions and Consequential Amendments) Act 2009* introduced a safe harbour for taxpayers who use the services of a tax agent. As long as the taxpayer provides the agent with all relevant information and the agent takes reasonable care, the taxpayer will not incur a penalty for making a false or misleading statement that produces a shortfall amount.

6.34 After the safe harbour commences on 1 March 2010, the amendments in this Act extend the safe harbour to also cover cases where the statement does not produce a shortfall amount. ***[Schedule 6, items 102 to 105, subsections 284-75(1A), (1B), (5) (heading), (6) and (7), and item 3 in the table in clause 2]***

Application

6.35 The amendments apply in relation to things done (such as statements being made) after the amendments commence (which is the start of the day following Royal Assent). ***[Schedule 6, item 101 and item 2 in the table in clause 2]***

Part 7 — Offset against superannuation guarantee charge

Table 6.7: Amendments to the *Tax Laws Amendment (2008 Measures No. 2) Act 2008*

Provision being amended	***What the amendment does***
Schedule 2 to the *Tax Laws Amendment (2008 Measures No. 2) Act 2008*	The amendments correct an anomaly in the application of the superannuation guarantee late payment offset which arose from amendments made to the offset by the *Tax Laws Amendment (2008 Measures No. 2) Act 2008*. The superannuation guarantee late payment offset is intended to allow employers to elect to offset late contributions against superannuation guarantee charge liabilities. However, this only applies to contributions made on or after 1 January 2006. The amendments ensure that late contributions made before 1 January 2006 are eligible for the offset. ***[Schedule 6, items 106, 107 and section 7A and paragraphs 8(1)(a) and 9(a) of Schedule 2]***

Provision being amended	*What the amendment does*
	The amendments commence immediately after the commencement of the *Tax Laws Amendment (2008 Measures No. 2) Act 2008,* on 24 June 2008. ***[Item 4 in the table in clause 2]*** Retrospective commencement delivers the policy intent of the original amendments and will validate any late payment offset elections that have already been processed by the ATO on the assumption that the offset applied to all late contributions. Except for no longer being confined to late contributions made on or after 1 January 2006, the late payment offset continues to operate without change.

Part 8 — Status of certain superannuation funds

Table 6.8: Amendments to the *Income Tax Assessment Act 1936*

Provision being amended	*What the amendment does*
267(1)	The amendment ensures that two South Australian public sector superannuation schemes are 'taxed superannuation entities' at all times, as was always intended. ***[Schedule 6, item 108, subsection 267(1)]*** For periods in the 2006-07 income year, these schemes became constitutionally protected funds as the unintended consequence of changes to South Australian legislation and therefore exempt from income tax for those periods. The amendment commences on 1 July 2006. ***[Item 5 in the table in clause 2]***

Part 9 — Technical corrections

Table 6.9: Amendments to the *A New Tax System (Luxury Car Tax) Act 1999*

Provision being amended	*What the amendment does*
9-20	Corrects a spelling error that was made in the original enactment, referring to 'the *approved from' instead of 'the *approved form'. ***[Schedule 6, item 109, section 9-20]***

Table 6.10: Amendments to the *Taxation Administration Act 1953*

Provision being amended	*What the amendment does*
363-35 in Schedule 1 426-165(1)(b)(a) and (b) in Schedule 1	Corrects numbering errors. ***[Schedule 6, items 110 and 111, section 363-35 in Schedule 1 and subparagraphs 426-165(1)(b)(a) and (b) in Schedule 1]***

Table 6.11: Amendments to the *Tax Laws Amendment (2009 Measures No. 4) Act 2009*

Provision being amended	*What the amendment does*
Items 132 and 133 of Schedule 5	Corrects a misdescribed amendment. ***[Schedule 6, items 112 and 113, items 132 and 133 of Schedule 5]***

Part 10 — Repeal of redundant material

Table 6.12: Amendments to the *Income Tax Assessment Act 1936*

Provision being amended	*What the amendment does*
6(1) (definition of ‘accrued leave transfer payment’)	Repeals the definition of ‘accrued leave transfer payment’ as it is no longer used in the Act. ***[Schedule 6, item 114, subsection 6(1)]***

Table 6.13: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	*What the amendment does*
116-30(1) (note)	Repeals a note that merely refers to provisions that have been repealed. ***[Schedule 6, item 115, subsection 116-30(1)]***

Table 6.14: Amendments to the *Taxation Administration Act 1953*

Provision being amended	*What the amendment does*
16-150(1) in Schedule 1	Omits a subsection number from a section that is no longer divided into subsections. ***[Schedule 6, item 116, subsection 16-150(1) in Schedule 1]***

Part 11 — Other minor changes

Table 6.15: Amendments to *A New Tax System (Goods and Services Tax) Act 1999*

Provision being amended	*What the amendment does*
195-1 (definition of 'luxury car')	The amendment gives effect to the suggestion made through **TIES 0001-2008.** The amendment inserts a definition of the term 'luxury car' that adopts the meaning provided by the *A New Tax System (Goods and Services Tax) Act 1999.* This confirms the meaning the term was always intended to have. ***[Schedule 6, item 117, section 195-1]***

Table 6.16: Amendments to the *Income Tax Assessment Act 1936*

Provision being amended	*What the amendment does*
6(1) 45B(10)	The amendments adopt the ITAA 1997 meanings of the terms 'agent', 'allowable deduction', 'friendly society dispensary', 'paid-up share capital', 'person' and 'scheme' for reasons of simplicity. The meanings in the two Acts are the same in all material respects. ***[Schedule 6, items 118 and 120, subsection 6(1), item 126, subsection 45B(10)]*** A transitional provision preserves the effect of any determinations that the Commissioner may have made about who is an agent for the purposes of the ITAA 1936. ***[Schedule 6, item 119]***
45B(9)	The amendment changes the reference at the end of subsection 45B(9) from 'dividend' to 'assessable dividend', as in some cases the amount of tax payable on a dividend is nil. This clarifies that the hypothetical dividend a capital benefit is compared to, in working out whether there is a tax benefit, is an *assessable* dividend. ***[Schedule 6, item 124, subsection 45B(9)]*** This amendment applies to the provision of capital benefits on or after 30 November 2009 (the date the exposure draft of the amendment was released for public comment). This approach is consistent with the application provision for section 45B when it was originally introduced. It does not affect the interpretation of the provision before that time. ***[Schedule 6, item 125, subsection 45B(9)]***

Table 6.17: Amendments to the *Income Tax Assessment Act 1997*

Provision being amended	*What the amendment does*
12-5 25-7	The amendments reflect the fact that Family Tax Benefit can no longer be claimed through the tax system after 1 July 2009. ***[Schedule 6, items 127 and 128, item headed 'family tax benefit' in the table in section 12-5 and section 25-7]***
67-23 67-25(7)	The amendments reinstate the result that the tax offset available under the National Rental Affordability Scheme is a *refundable* tax offset. The provision enacted in 2008 to make it a refundable tax offset was inadvertently omitted early in 2009. ***[Schedule 6, item 131, item 23 in the table in section 67-23]*** This amendment applies to assessments for the 2008-09 and later income years to ensure that taxpayers are entitled to the refundable tax offset from when Parliament intended. ***[Schedule 6, item 132]*** The amendments also relocate subsection 67-25(7) (which makes the tax offset for education expenses a refundable tax offset) to a more appropriate place. There is no change in operation. ***[Schedule 6, items 129 and 133, subsection 67-25(7) and item 12 in the table in section 67-23]*** These amendments apply to the 2009-10 and later income years. ***[Schedule 6, items 130 and 134]***
112-97	The amendment replaces references to general provisions with references to specific provisions. Item 21 in the table in section 112-97 should refer to subsection 320-200(2), rather than Division 320. Item 22 in the same table should refer to subsection 320-255(2), rather than Division 320. ***[Schedule 6, items 137 and 138, section 112-97]***
109-55(table item 8C) 109-55 115-32 115-34 115-45(4) 115-45(6)	These amendments give effect to a suggestion made through **TIES 0042-2009.** Section 115-30 provides for a different acquisition date for a CGT asset that its owner acquired because of a same asset, or replacement asset, roll-over. Sections 115-30 and 115-45 may operate in certain circumstances to deny taxpayers access to the CGT discount if they sell their replacement interests within 12 months of receiving a roll-over because the acquirer entity will not have owned the interests in the original entity for at least 12 months. The amendment allows a taxpayer who sells their interest in the acquirer entity to 'look through' to the assets of the original entity to establish whether the interests in the original entity, which are now owned by the acquirer entity, can be considered to have been owned for at least

Provision being amended	What the amendment does
	12 months. ***[Schedule 6, item 136, section 115-32]*** This means that the requirements in subsections 115-45(4) and (5) need to be applied to the shares or trust interests now owned by the acquirer entity to determine whether they have been owned for at least 12 months. These requirements will be satisfied if the cost bases and the net capital gain of assets of the original entity that have been owned for less than 12 months are not more than 50 per cent of the cost bases and net capital of all the original entity's assets. This result is then used to test whether the taxpayer is entitled to the discount under section 115-45 by applying subsections 115-45(4) and (5) to the acquirer entity's assets. The amendment does not apply to replacement assets acquired under the replacement asset roll-overs provided by Subdivisions 122-A, 122-B and 124-N. ***[Schedule 6, items 135, 136, 139 to 145, section 115-32, subsections 115-45(4) and (6)]*** Sections 115-30 and 115-45 may also deny taxpayers access to the CGT discount if they sell a company share received as a replacement asset under a Subdivision 122-A or 122-B replacement-asset roll-over (disposal of assets to a wholly-owned company) or a Subdivision 124-N replacement-asset roll-over (disposal of assets by a trust to a company) before they have owned the share for 12 months. Also, as the company acquires its assets at the time of the roll-over, selling a share in the company before owning it for at least 12 months will mean the conditions in subsections 115-45(4) and (5) may be met as the company has held its assets for less than 12 months. This results in denying the taxpayer the CGT discount. The amendment for these specific replacement-asset roll-overs treats the taxpayer's replacement asset (share) for the purpose of the CGT discount as being owned for a period of at least 12 months where the share is sold within 12 months of its actual acquisition. The taxpayer therefore does not need to establish an acquisition date for the replacement asset under item 2 in the table in subsection 115-30(1), which is turned off for the purpose of new section 115-34. ***[Schedule 6, item 142, section 115-34]*** Also, the amendment allows for the assets owned by the acquiring company to be taken to be owned from the time when the taxpayer originally acquired them for the purposes of subsections 115-45(4) and (6).

Provision being amended	*What the amendment does*
	The amendments result in the taxpayer being able to sell their share within 12 months of acquisition and still receive the discount where not more than 50 per cent (by cost base and net capital gain) of the company's assets have been owned for less than 12 months including the period they were owned by the taxpayer. ***[Schedule 6 items 142 to 145, section 115-34, subsections 115-45(4) and (6)]*** The amendments apply to assessments for the income year including 21 September 1999 and for later income years, in relation to CGT events happening after 11.45 am (by legal time in the Australian Capital Territory) on that day. This makes the application of the amendments consistent with the general approach taken to the application of the CGT discount. However, standard amendment periods still apply. The retrospective application of these amendments does not have a negative affect on taxpayers. ***[Schedule 6, item 146]***
152-320(1)	Adds a non-operative note to alert readers to the effect of a transitional provision in another Act. ***[Schedule 6, item 147, subsection 152-320(1) (note)]***
974-110(1)(b)	Section 974-110 provides a mechanism for reclassifying debt and equity interests if there is a material change to the scheme that gave rise to those interests. It is not clear whether that mechanism could apply in a case where part of an interest ceases to exist. The amendment makes it clear that the remaining part of the interest can be reclassified in such a case. ***[Schedule 6, item 148, paragraph 974-110(1)(b)]*** An example is the case where a redeemable preference share and an ordinary share are stapled together and together constitute a debt interest for the purposes of the debt/equity rules. On redemption of the redeemable preference share, there is no clear mechanism available under those rules to re-characterise the remaining ordinary share as an equity interest, so it continues to be a debt interest. The amendment enables the remaining interest to be properly characterised as an equity interest. ***[Schedule 6, item 148, paragraph 974-110(1)(b)]*** This amendment applies to changes to schemes giving rise to a debt interest occurring on or after Royal Assent. ***[Schedule 6, item 149]***
995-1(1)	The definitions of 'common stake', 'common stakeholder', 'significant stake' and 'significant stakeholder', which appear in section 124-783, are added to the Act's dictionary. ***[Schedule 6, items 150, 151, 154 and 155, subsection 995-1(1) (definitions of 'common stake',***

Provision being amended	*What the amendment does*
	'common stakeholder', 'significant stake' and 'significant stakeholder' in subsection 995-1(1))] Multiple relational definitions of the terms 'quote' and 'quoted' are merged into a single definition. ***[Schedule 6, items 152 and 153]***

Table 6.18: Amendments to the *Income Tax (Transitional Provisions) Act 1997*

Provision being amended	*What the amendment does*
1-10	Ensures that Division 950 of the ITAA 1997 applies to the *Income Tax (Transitional Provisions) Act 1997* to clarify the status of notes, examples and headings in that Act. ***[Schedule 6, item 156]***
770-230(5)	The new foreign income tax offset rules introduced in 2009 were intended to recognise certain amounts of foreign income tax paid before the new offset commenced. Those 'pre-commencement excess foreign income tax' amounts were to only apply once and then be extinguished upon application. However, the word 'limit' was mistakenly included in the subsection that achieved that and, as a result, the subsection makes no sense, either literally or otherwise. ***[Schedule 6, item 157, subsection 770-230(5)]*** This amendment removes the word 'limit' from the end of subsection 770-230(5), so that the subsection makes sense and gives effect to the original intent of the policy. ***[Schedule 6, item 157, subsection 770-230(5)]*** This amendment applies to income years, statutory accounting periods and notional accounting periods starting on or after 1 July 2008 — the start date for the new foreign income tax offset rules — to ensure those rules apply, as intended, from their first application. ***[Schedule 6, item 158]***

Table 6.19: Amendments to the *Taxation Administration Act 1953*

Provision being amended	*What the amendment does*
45-288(a) in Schedule 1	The provision refers to 'a resident trust within the meaning of section 102Q' but section 102Q actually defines a 'resident *unit* trust'. Therefore, the amendment replaces 'resident trust' with 'resident unit trust'. ***[Schedule 6, item 159, paragraph 45-288(a) in Schedule 1]***

Provision being amended	***What the amendment does***
Part 2-30 in Schedule 1	There is some doubt whether the ITAA 1997 and Schedule 1 to the TAA 1953 apply, as intended, to the Medicare levy and the Medicare levy surcharge in the same way as they apply to normal income tax. That could mean, for example, that taxpayers calculating the limit on their foreign income tax offset for an income year would only include the amount of ordinary Australian income tax they would have paid on the income rather than also including the amount of Medicare levy or Medicare levy surcharge they would have paid. The amendment to Schedule 1 to the TAA 1953 ensures that the Schedule and the ITAA 1997 do apply to the Medicare levy (as defined in section 251R of the ITAA 1936) and the Medicare levy surcharge in the same way as they apply to normal income tax. This part is taken to have always applied in the same way as it applies in relation to normal income tax. ***[Schedule 6, item 160]***

Index

Schedule 1: Approved superannuation clearing house

Bill reference	***Paragraph number***
Items 1 and 6, subsection 183(2A) of the RSA Act 1997, subsection 64(2A) of the SIS Act 1993	1.18
Items 2 and 5, subsections 6(1) and 79A(3)	1.13
Item 3, section 23B	1.12
Item 4, subsection 32C(2B)	1.15
Item 5, section 79A	1.16
Items 7 and 8, paragraph 16(4)(hbb) of the *Income Tax Assessment Act 1936* (ITAA 1936), subsection 355-65(3) of the *Tax Administration Act 1953* (TAA 1953)	1.19
Item 9	1.20
Items 57 and 154	5.482

Schedule 2: Forestry managed investment schemes

Bill reference	***Paragraph number***
Clause 4	2.34
Items 1 and 2, subsections 82KZMG(1A) of the ITAA 1936 and 394-10(5A) of the ITAA 1997	2.22
Items 1 and 2, paragraphs 82KZMG(1A)(a) of the ITAA 1936 and 394-10(5A)(a) of the ITAA 1997	2.25
Items 1 and 2, paragraphs 82KZMG(1A)(b) of the ITAA 1936 and 394-10(5A)(b) of the ITAA 1997	2.27
Item 3, subsection 290-50(2A) of Schedule 1 to the TAA 1953	2.31
Item 4	2.33

Schedule 3: Managed investment trusts

Bill reference	*Paragraph number*
Item 4, subsections 275-5(1) to (5) of Division 275 of Part 3-25	3.16
Item 4, subparagraph 275-5(4)(a)(i) and paragraphs 275-5(4)(b) and (c) of Division 275 of Part 3-25	3.18
Item 4, subparagraph 275-5(4)(a)(ii) and paragraph 275-5(4)(d) of Division 275 of Part 3-25	3.19
Item 4, subsections 275-5(6), 275-10(2), 275-15(2) and section 275-20 of Division 275 of Part 3-25	3.22
Item 4, subsection 275-10(1) of Division 275 of Part 3-25	3.20
Item 4, subsection 275-15(1) of Division 275 of Part 3-25	3.15
Item 4, section 275-20 of Division 275 of Part 3-25	3.13
Item 4, section 275-25 of Division 275 of Part 3-25	3.23
Item 4, section 275-30 of Division 275 of Part 3-25	3.24
Item 4, section 275-35 of Division 275 of Part 3-25	3.25
Item 4, section 275-100 of Division 275 of Part 3-25	3.36
Item 4, subsections 275-100(1) and 275-115(1) of Division 275 of Part 3-25	3.26
Item 4, subsection 275-100(1) of Division 275 of Part 3-25	3.31
Item 4, subsections 275-100(3) and (4) of Division 275 of Part 3-25	3.37
Item 4, subsections 275-100(5) and (6) of Division 275 of Part 3-25	3.38
Item 4, subsection 275-105(1) of Division 275 of Part 3-25	3.27
Item 4, subsection 275-105(2) of Division 275 of Part 3-25	3.28
Item 4, subsections 275-110(1) and (2) of Division 275 of Part 3-25	3.30
Item 4, subsection 275-115(2) of Division 275 of Part 3-25	3.33
Item 4, subsection 275-115(3) of Division 275 of Part 3-25	3.32
Item 4, subsection 275-115(4) and section 275-5 of Division 275 of Part 3-25	3.41
Item 4, subsection 275-115(4) of Division 275 of Part 3-25	3.35
Item 4, subsection 275-115(5) of Division 275 of Part 3-25	3.34
Item 4, paragraphs 275-120(1)(a), (c) and (d) and subsection 275-120(2) of Division 275 of Part 3-25	3.39
Item 4, paragraph 275-120(1)(b) of Division 275 of Part 3-25	3.40
Item 4, section 275-200 of Division 275 of Part 3-25	3.43, 3.46
Item 4, paragraph 275-200(1)(c) of Division 275 of Part 3-25	3.47
Item 4, subsection 275-200(4) of Division 275 of Part 3-25	3.44
Item 4, subsection 275-200(7) of Division 275 of Part 3-25	3.48

Bill reference	*Paragraph number*
Items 5 and 6, subsection 840-805(7)	3.58
Item 7, definition of 'instalment income' in subsection 995-1(1)	3.57
Item 8, section 275-10 of Division 275 of Part 3-25 of the *Income Tax (Transitional Provisions) Act 1997*	3.49
Item 8, subsection 275-10(4) of Division 275 of Part 3-25 of the *Income Tax (Transitional Provisions) Act 1997*	3.50
Item 9, section 45-286 in Schedule 1 to the TAA 1953	3.55
Subitem 10(1)	3.51
Subitem 10(2)	3.52
Subitem 10(3)	3.53
Subitem 10(4)	3.54
Subitem 10(5)	3.56

Schedule 4: 25% entrepreneurs' tax offset

Bill reference	*Paragraph number*
Item 8, definition of 'threshold amount' in section 61-523	4.12
Item 8, definitions of 'non-ETO small business income' and 'threshold amount' in section 61-523	4.13
Item 8, definition of 'non-ETO small business income' in section 61-523	4.14, 4.17
Item 8, definition of 'non-ETO small business income' in section 61-523	4.15
Item 8, section 61-523	4.9, 4.18, 4.20

Schedule 5: Consolidation

Bill reference	*Paragraph number*
Item 1, section 12-5	5.45
Item 2, subsection 701-55(3)	5.49
Item 3, subsection 701-55(5C)	5.32
Item 3, subsection 701-55(6)	5.11, 5.12
Item 3, note to subsection 701-55(6)	5.13
Item 3, subsection 701-56(1)	5.16, 5.50
Item 3, subsection 701-56(2)	5.17
Item 3, subsection 701-56(3)	5.18

Bill reference	***Paragraph number***
Item 4, subsection 716-400(1)	5.23
Item 4, subsection 716-400(2)	5.24
Item 4, subsection 716-400(3)	5.25
Item 4, subsection 716-405(1)	5.34
Item 4, subsections 716-405(2) and (5)	5.37
Item 4, paragraph 716-405(2)(a)	5.38
Item 4, paragraph 716-405(2)(b)	5.39
Item 4, subsection 716-405(3)	5.40
Items 4 and 5, paragraph 716-405(4)(a) and the definition of 'unexpended tax cost setting amount' in subsection 995-1(1)	5.42
Items 4 and 5, paragraph 716-405(4)(b) and the definition of 'unexpended tax cost setting amount' in subsection 995-1(1)	5.43
Item 4, subsection 716-405(6)	5.44
Item 4, section 716-410	5.33, 5.273
Item 6, subsection 715-370(1)	5.52
Item 6, subsection 715-370(2)	5.53
Item 7	5.54, 5.56, 5.57
Items 7, 17, 55, 117, 119, 126, 131, 139, 152, 193 and 202	5.472
Items 7, 35, 37, 126, 134 and 220	5.486
Item 8	5.62, 5.63
Items 9 and 10, paragraph 703-75(2)(d)	5.97
Items 11, 12 and 16, subsection 719-25(3) and the definition of 'member' in subsection 995-1(1)	5.100
Item 13, subparagraph 719-65(3)(d)(i)	5.104
Item 14, paragraph 719-90(2)(ca)	5.99
Item 15, subsections 719-120(2) and 719-130(3) to (5)	5.81
Item 15, subsection 719-120(2) and section 719-135	5.88
Item 15, subsection 719-120(1)	5.69
Item 15, subsection 719-120(2)	5.78
Item 15, subsection 719-125(1)	5.70
Item 15, subsection 719-125(2)	5.71
Item 15, subsection 719-125(3)	5.73
Item 15, subsection 719-125(4)	5.75
Item 15, subsections 719-130(1), (2) and (5)	5.77
Item 15, section 719-140	5.92
Item 17	5.105, 5.106, 5.109, 5.477, 5.478

Bill reference	***Paragraph number***
Items 18, 19 and 34, subsection 705-125(1) and the definition of 'pre-CGT proportion' in subsection 995-1(1)	5.113
Item 20, subsection 705-125(2)	5.114
Items 21 to 24, 27, 29 and 31 to 33, sections 705-125, 705-165,705-205, 705-245, 711-65, 713-245, 713-270 and the definition of 'pre-CGT factor' in subsection 995-1(1)	5.139
Items 25 and 26, subsection 711-65(1)	5.115
Item 26, subsection 711-65(1A)	5.116
Item 28, subsection 711-65(4)	5.118
Item 30, subsection 711-70(1)	5.122
Item 30, subsection 711-70(2)	5.123
Item 30, subsection 711-70(3)	5.126
Item 30, subsection 711-70(4)	5.127
Item 30, subsection 711-70(5)	5.128
Item 30, subsection 711-70(6)	5.129
Item 30, subsection 711-75(1)	5.132
Item 30, subsection 711-75(2)	5.134
Item 30, subsection 711-75(3)	5.138
Item 35	5.140, 5.141
Item 36, subsection 705-62(1)	5.148
Item 36, subsection 705-62(2)	5.150
Item 36, paragraph 705-62(3)(a) and subsections 705-62(4) and (5)	5.152
Item 36, paragraph 705-62(3)(b)	5.153
Item 36, subsection 705-62(6)	5.151
Item 37	5.154, 5.155
Item 38	5.157
Items 39 and 54, paragraph 104-505(1)(b) of the ITAA 1997 and section 126-165 of the *Income Tax (Transitional Provisions) Act 1997*	5.175
Item 40, item 3A in the table in section 705-60	5.164
Items 41 to 45, paragraphs 705-93(1)(a) to (d)	5.162
Item 46, subsection 705-93(2)	5.163
Item 47, subsection 705-147(3)	5.173
Item 48	5.174
Item 49, subsection 705-227(3)	5.177
Item 50, the definition of 'deferred roll-over gain' in subsection 995-1(1)	5.166

Bill reference	***Paragraph number***
Item 50, paragraphs (a) and (b) of the definition of 'deferred roll-over gain' in subsection 995-1(1)	5.165
Item 51, the definition of 'deferred roll-over loss' in subsection 995-1(1)	5.168
Item 51, paragraph (b) of the definition of 'stick entity' in subsection 995-1(1)	5.170
Item 51, paragraphs (a) and (b) of the definition of 'deferred roll-over loss' in subsection 995-1(1)	5.167
Item 52, the definition of 'spread entity' in subsection 995-1(1)	5.171
Item 53, paragraph (a) of the definition of 'stick entity' in subsection 995-1(1)	5.169
Item 55	5.178
Item 56, paragraph 705-50(2)(b)	5.183
Item 57	5.185
Items 58 to 77, sections 705-50, 705-55, 705-57, 705-59, 705-190, 713-225, 713-230, 715-900, 716-330, 716-340 and the definitions of 'over-depreciated' and 'over-depreciation' in subsection 995-1(1) of the ITAA 1997 and sections 126-165, 701-40 and 705-305 of the *Income Tax (Transitional Provisions) Act 1997*	5.184
Item 78	5.187, 5.484
Items 79 to 86, sections 711-20, 711-25, 711-45 and 713-265	5.194
Item 87	5.195, 5.196
Items 87, 89, 113, and 117	5.490
Item 88, paragraph 711-45(8)(a)	5.202
Item 88, paragraph 711-45(8)(b)	5.204
Item 88, paragraph 711-45(8)(c)	5.205
Item 88, paragraph 711-45(8)(d)	5.211, 5.212
Item 88, subsection 711-45(9)	5.207
Item 88, subsection 711-45(10)	5.214
Item 89	5.215
Item 90, subsection 701-40(2)	5.237
Items 91 to 93, 100 and 101, subsections 705-56(1), 705-58(1), 705-59(2), and 705-90(2)	5.231
Items 94, 95, 98 and 99, subsections 705-70(1), 705-80(1) and 705-85(3)	5.229
Item 96, subsection 705-70(1A)	5.230
Items 97 and 112, subsection 705-70(3) and the definition of 'accounting principles for tax cost setting' in subsection 995-1(1)	5.226
Items 102 to 106, subsections 711-45(1), 711-45(5) and 711-45(7)	5.236

Bill reference	***Paragraph number***
Items 104 and 112, subsection 711-45(1A) and the definition of ‘accounting principles for tax cost setting’ in subsection 995-1(1)	5.233
Items 107 to 110, subsections 713-225(6) and 713-265(4)	5.239
Item 111, the definition of ‘accounting principles’ in subsection 995-1(1)	5.224
Item 113	5.240
Item 114, subsection 705-115(3)	5.244
Item 115, subsection 711-35(1)	5.246
Item 116, subsection 711-35(3)	5.247
Item 117	5.248, 5.250
Item 118, subsections 713-725(1) and (4)	5.255
Item 118, subsection 713-725(2)	5.256
Item 118, subsection 713-725(3)	5.257
Item 119	5.258
Item 120, subsection 705-25(2)	5.264
Item 121, paragraph 705-25(5)(ba)	5.263
Item 122, the definition of ‘cash management trust’ in subsection 995-1(1)	5.265
Item 123, subsection 705-25(4B)	5.275
Items 124 and 125, paragraph 705-25(5)(d)	5.272
Item 126	5.266, 5.267, 5.277
Items 127, 129 and 130, sections 104-5 and 110-10 of the ITAA 1997 and section 701-34 of the *Income Tax (Transitional Provisions) Act 1997*	5.287
Item 128	5.286
Item 131	5.288, 5.290
Item 132, subsection 705-27(1)	5.294, 5.295
Item 132, subsection 705-27(2)	5.297, 5.298
Item 132, paragraph 705-27(3)(a)	5.300
Item 132, paragraphs 705-27(3)(b) and (c)	5.301
Item 132, subsections 705-27(4) and (5)	5.302
Item 133, paragraph 705-35(1)(b)	5.304
Item 134	5.305, 5.306
Item 135, paragraph 110-35(10)(a)	5.312
Item 136	5.313, 5.475
Items 137 and 138, subsection 701-30(1) of the *Income Tax (Transitional Provisions) Act 1997*	5.317

Bill reference	***Paragraph number***
Item 139	5.319
Item 140	5.322, 5.323
Item 141, subsections 165-115X(2A) and (2B)	5.334
Item 141, subsection 165-115X(2C)	5.335
Items 142 and 143, subsections 165-115X(3A) and (4)	5.336
Item 144, subsections 165-115Y(3A) and (3B)	5.337
Item 144, subsection 165-115Y(3C)	5.338
Items 145 and 146, subsections 165-115Y(4A) and (5)	5.339
Items 147 to 150, paragraph 715-255(1)(ba), subsections 715-255(1A), 715-270(5) and (5A)	5.341
Item 151, subsections 719-740(1) and (3)	5.345
Item 151, subsection 719-740(2)	5.346
Item 152	5.347
Item 153, subsections 716-860(1) and (3)	5.354
Item 153, subsections 716-860(2) and (3)	5.355
Item 154	5.357
Item 155, subsection 703-50(1)	5.369
Items 156 and 159, subsections 703-50(1) and 703-58(1)	5.372
Item 157, subsection 703-50(3)	5.370
Items 158, 189 to 191, subsections 703-50(5) and (6) of the ITAA 1997 and paragraphs 701-5(2)(a) and 701D-15(3)(a) of the *Income Tax (Transitional Provisions) Act 1997*, paragraph 45-885(1)(e) of the TAA 1953	5.375
Item 159, subsection 703-58(2)	5.373
Item 160, subsection 703-60(2)	5.378
Items 161 and 162, subsections 703-60(2) and (2A)	5.379
Items 163 and 164, subsection 703-60(3)	5.380
Items 165 and 166, subsections 703-60(3) and (4)	5.381
Item 167, paragraph 719-5(4)(c)	5.405
Items 167 and 171, paragraph 719-5(4)(c) and subsections 719-5(6) and (6A)	5.407
Item 168, paragraph 719-5(4)(d)	5.406
Item 169, paragraph 719-5(4)(f)	5.408
Items 170 and 183, section 719-40 and subsections 719-77(1) and (2)	5.411
Item 172, subsection 719-50(1)	5.382
Items 172 and 173, paragraph 719-40(1)(e)	5.398

Bill reference	***Paragraph number***
Items 172 and 176, paragraph 719-40(1)(e) and subsection 719-40(2)	5.400
Item 174, paragraph 719-40(1)(f)	5.399
Items 175 and 183, subsections 719-40(1), 719-78(1) and (2)	5.402
Items 177 and 183, subsections 719-50(1), 719-76(1) and (2)	5.387
Item 178, subsections 719-50(3) and (3A)	5.383
Items 179, 180 and 192, paragraph 719-50(4)(b) and section 719-55 of the ITAA 1997, section 45-935 of the TAA 1953	5.390
Item 180, section 719-55	5.384
Items 181 and 182, subsections 719-60(1) and (3)	5.418
Item 183, subsection 719-76(3)	5.388
Item 183, subsection 719-77(3)	5.412
Item 183, subsection 719-78(3)	5.403
Item 183, subsections 719-79(1) and (2)	5.421
Item 183, subsection 719-79(3)	5.422
Item 184, paragraph 719-80(2)(a)	5.393
Items 185 and 188, paragraph 719-80(2)(a) and subsection 719-80(3)	5.394
Item 186, paragraph 719-80(2)(b)	5.395
Items 187 and 188, paragraph 719-80(2)(b) and subsection 719-80(3)	5.396
Item 193	5.424
Items 194 and 198 to 201, subsections 713-510A(1) and (3)	5.436
Item 194, subsection 713-510A(2)	5.437
Items 195 and 196	5.440
Item 197	5.441
Items 198 to 201, subsection 713-510A(3)	5.439
Item 202	5.443
Item 203, subsection 705-65(6)	5.455
Items 204 and 206 to 212, subsections 705-85(3), 705-145(5), 705-195(1) and (2), 705-200(1) and (3) and 705-225(5)	5.460
Item 205, paragraph 705-85(3)(a)	5.458
Item 213, subsection 711-15(2)	5.463
Item 215, subsection 711-45(6B)	5.466
Items 216 to 218, subsections 715-50(6), 715-255(6) and 715-270(6)	5.468
Item 219, definition of 'non-membership equity interest' in subsection 995-1(1)	5.450, 5.451
Item 220	5.469, 5.470
Section 4	5.492

Schedule 6: Miscellaneous amendments

Bill reference	***Paragraph number***
Item 1, subsections 118-147(3) and (4)	Table 6.1
Items 1 and 3 to 5, paragraphs 118-150(3)(a) and 118-200(4)(b) and subsections 118-145(3) and 118-190(3A)	Table 6.1
Item 2, subsections 118-147(1) and (2)	Table 6.1
Item 2, paragraph 118-147(1)(d)	Table 6.1
Item 2, subsection 118-147(2)	Table 6.1
Item 2, subsection 118-147(5)	Table 6.1
Item 2, paragraph 118-147(6)(a) and subsections 118-147(2) and (7)	Table 6.1
Item 2, paragraphs 118-147(6)(b) to (d)	Table 6.1
Item 6	Table 6.1
Item 7, paragraph 152-310(2)(a)	Table 6.2
Item 8	Table 6.2
Items 9 to 11, item headed 'small business retirement exemption' in the table in section 11-15, section 11-55 and items headed 'capital gains tax' in the table in section 12-5	Table 6.2
Item 12, Division 340 (heading) in Schedule 1	Table 6.3
Item 13, Division 342 in Schedule 1	Table 6.3
Item 13, subsection 342-10(1) in Schedule 1	Table 6.3
Item 13, subsections 342-10(2) and (3)	Table 6.3
Item 14	Table 6.3
Items 15 to 43, section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999*, section 135M of the *Fringe Benefits Tax Assessment Act 1986*, subsection 82A(2) (paragraphs (a), (ab), and (b) of the definition of 'expenses of self-education') of the ITAA 1936, paragraphs 26-20(1)(a) to (c), subsection 30-25(1) (cell at table item 2.1.3, column headed 'Fund, authority or institution'), subsection 30-25(1) (cell at table item 2.1.6, column headed 'Fund, authority or institution'), subparagraphs 52-132(a)(x) and 52-140(3)(a)(x) of the ITAA 1997, section 8AAZA, paragraph 8AAZLD(aa), paragraphs 11-1(c), 15-50(1)(b) and 45-5(1)(c) in Schedule 1, section 45-340 in Schedule 1 (method statement, step 3) and section 45-375 in Schedule 1 (method statement, step 3) of the TAA 1953, subsection 3(1) (definition of 'HEC assessment debt'), item 40 in the table in section 3C, subparagraph 8A(1)(a)(ii), paragraph 8A(2)(b), subparagraphs 8E(1)(d)(iii) and (2)(d)(iii) and sub-subparagraph 12A(1)(a)(iv)(B) and paragraph 12A(2)(b) of the *Taxation (Interest on Overpayments and Early Payments) Act 1983*	Table 6.4
Items 23 and 26	Table 6.4

Bill reference	***Paragraph number***
Items 44 to 52, item 8 in the table in subsection 10-5(1) in Schedule 1, item 2 in the table in subsection 12-5(2) in Schedule 1, section 12-C (heading) in Schedule 1, section 12-85 (heading) in Schedule 1, subsection 12-85(b) in Schedule 1, section 16-165 (heading) in Schedule 1, paragraph 16-165(2)(b) in Schedule 1, subparagraph 18-65(3)(d)(ii) in Schedule 1, section 90-1 (note) in Schedule 1 to the TAA 1953	Table 6.5
Item 53	Table 6.5
Items 54 and 55, subsection 4(1) (note at the end of the definition of 'work and income support related withholding payments') in the *Child Support (Registration and Collection) Act 1988*, and subsection 6(1) (note at the end of the definition of 'work and income support related withholding payments and benefits') of the ITAA 1936	Table 6.5
Items 56 and 57, subsection 28-185(3) (cell at table item 5, column headed 'Subject matter') and subsection 900-12(3) (cell at table item 5, column headed 'Subject matter') of the ITAA 1997	Table 6.5
Items 58, 59 and 62 to 65, paragraphs 284-75(2)(a) and (b), subsection 284-75(1) and section 284-25	6.15
Items 60, 61, 66, 67, 70 and 72, paragraphs 274-75(1)(b) and (c) and (2)(c), subsection 284-75(4) and items 1 to 4 in the table in subsection 284-90(1)	6.14
Item 67, subsection 284-75(5)	6.28
Items 67, 79 and 88, subsection 284-225(5) and sections 284-215 and 284-224	6.27
Items 68, 69, 73, 76 to 78 and 95 to 97, subsections 284-80(1) (note), 284-90(1), 284-150(2) (note) and 361-5(1) (notes) and (3) and section 284-160	6.29
Item 71, items 3A to 3C in the table in subsection 284-90(1)	6.16
Item 74, subsection 284-90(2)	6.17
Item 75, section 284-95	6.25
Items 80 to 87, 89 to 93 and 98, subsections 284-220(1) and 284-225(1), (2), (4A) and (5) and section 284-225 (heading) in Schedule 1 to the TAA 1953 and paragraph 35(1)(b) of the *Product Grants and Benefits Administration Act 2000*	6.30
Items 83 to 87, paragraphs 284-220(1)(c) to (e)	6.22
Item 91, subsection 284-225(4A)	6.23
Item 94, section 288-85, Division 288	6.31
Items 99 and 100, subsection 39(1B) and section 38A (subparagraph (ab)(i) of the definition of 'regulatory provision') of the *Superannuation Industry (Supervision) Act 1993*	6.32
Item 101 and item 2 in the table in clause 2	6.35

Bill reference	***Paragraph number***
Items 102 to 105, subsections 284-75(1A), (1B), (5) (heading), (6) and (7), and item 3 in the table in clause 2	6.34
Items 106, 107 and section 7A and paragraphs 8(1)(a) and 9(a) of Schedule 2	Table 6.6
Item 108, subsection 267(1)	Table 6.7
Item 109, section 9-20	Table 6.8
Items 110 and 111, section 363-35 in Schedule 1 and subparagraphs 426-165(1)(b)(a) and (b) in Schedule 1	Table 6.9
Items 112 and 113, items 132 and 133 of Schedule 5	Table 6.10
Item 114, subsection 6(1)	Table 6.11
Item 115, subsection 116-30(1)	Table 6.12
Item 116, subsection 16-150(1) in Schedule 1	Table 6.13
Item 117, section 195-1	Table 6.14
Items 118 and 120, subsection 6(1), item 126, subsection 45B(10)	Table 6.15
Item 119	Table 6.15
Item 124, subsection 45B(9)	Table 6.15
Item 125, subsection 45B(9)	Table 6.15
Items 127 and 128, item headed ‘family tax benefit’ in the table in section 12-5 and section 25-7	Table 6.16
Items 129 and 133, subsection 67-25(7) and item 12 in the table in section 67-23	Table 6.16
Items 130 and 134	Table 6.16
Item 131, item 23 in the table in section 67-23	Table 6.16
Item 132	Table 6.16
Items 135, 136, 139 to 145, section 115-32, subsections 115 45(4) and 115-45(6)	Table 6.16
Item 136, section 115-32	Table 6.16
Items 137 and 138, section 112-97	Table 6.16
Item 142, section 115-34	Table 6.16
Item 146	Table 6.16
Item 147, subsection 152-320(1) (note)	Table 6.16
Item 148, paragraph 974-110(1)(b)	Table 6.16
Item 149	Table 6.16
Items 150, 151, 154 and 155, subsection 995-1(1) (definitions of ‘common stake’, ‘common stakeholder’, ‘significant stake’ and ‘significant stakeholder’)	Table 6.16
Items 152 and 153	Table 6.16
Item 156	Table 6.17

Bill reference	***Paragraph number***
Item 157, subsection 770-230(5)	Table 6.17
Item 158	Table 6.17
Item 159, paragraph 45-288(a) in Schedule 1	Table 6.18
Item 160	Table 6.18
Section 115-34, subsections 115-45(4) and (6)	Table 6.16