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Federal Budget 2016-17
Tax insights
Tax consolidation changes bring clarity for taxpayers

Snapshot

Proposed changes to the treatment of deductible liabilities for tax consolidation cost setting purposes contained in the 2016-17 Federal Budget (**the Budget**) take a very different approach to the proposed reforms set out in the Exposure Draft legislation (**ED**) issued in April 2015.

The proposal set out in the ED has been scrapped. Instead, to address the perceived double benefits which may arise, such liabilities will now be excluded from the tax cost setting process entirely. The measures also propose a deferral for the commencement date for the proposed changes which will be a welcome outcome for many taxpayers.

A further measure announced in the Budget, consistent with the Board of Taxation's recommendations in its 2013 report proposes deferred tax liabilities be excluded from the cost setting process when an entity joins or leaves a tax consolidated or MEC group.

The Budget also contained an announcement extending to all taxpayers, proposed changes to tax cost setting in respect of securitised assets, which had previously been limited to financial institutions.

Implementation of the above measures will be impacted by the Federal election process. Taxpayers should continue to monitor developments on these measures.

Deductible liabilities measure

Current law

Under current law, the inclusion of 70 per cent of the amount of deductible liabilities in the Allocable Cost Amount (**ACA**) calculation may result in a double deduction arising to the Head Company of a consolidated group in the form of:

a) the deductible liability amount being taken into account in resetting the tax cost of the assets of the joining entity (resulting in, for example, higher capital allowance deductions and/or reduced capital gains); and

b) a deduction being allowed to the head company of the consolidated group when the deductible liability is later discharged and comes to an end.

There is debate amongst practitioners, Treasury and the ATO as to the cause of, and appropriate remedy for, this potential anomaly – in particular whether this issue results from specific provisions in the tax consolidation exit, rather than entry, provisions.

The approach set out in the Budget announcement seeks to resolve this issue via amendments to the entry tax cost setting rules.

Comparison of Budget proposal and ED

Budget proposal	2015 ED proposals
• Disregard all deductible liabilities at step 2 of the entry tax cost setting process	• 'Acquired liabilities' are included in step 2 of ACA calculation • The amount of the joining time liability would be assessable to the joined group over a period of time, depending on whether the deductible liability was a current or non-current liability
• Application date of 1 July 2016	• (Retrospective) application date of 14 May 2013

What was proposed in the ED?

The approach proposed in the ED was to include an amount of assessable income in respect of 'acquired liabilities' in the head company's assessable income over a period of time. The timing of the inclusion of such amounts in assessable income was to be progressive:

- over 12 months from the joining time in respect of a current deductible liability; or
- over four years in respect of non-current future deductible liabilities.

Importantly, the changes proposed in the ED had a retrospective application date, applying to arrangements that commenced after 14 May 2013 (when the measure was first announced, albeit in broad terms, in the 2013-14 Federal Budget).

As a result of the delayed progress of the proposed measures, during the period between 14 May 2013 and the date that the ED was released, taxpayers faced considerable uncertainty as to the approach to adopt, giving rise to concerns on deal pricing and potential financial statement impacts.

The Budget proposal

The Budget announcement proposes:

a) a prospective application date of 1 July 2016, and

b) that no deductible liabilities be included in step 2 of the ACA.

The announcement that the measures will have application from 1 July 2016 is welcome news for affected taxpayers. However, the proposed approach to deal with the 'double benefit' is quite different to that proposed in the ED.

We understand that Treasury intends that the reduction in step 2 of the ACA will be for all deductible liability amounts and that there will be no distinction between 'owned' and 'acquired' liabilities.

The Board of Taxation in its April 2013 Report on Certain Aspects of the Consolidation Tax Cost Setting Process clearly stated that:

"… the issues which have been identified generally arise to the extent that all of the interests in an entity are acquired by the tax consolidated group in a single transaction, as distinct from cases where the tax consolidation group has owned an interest in the joining entity prior to the entity joining the tax consolidated group acquiring all of the remaining interests in the entity (<u>that is, the issues generally relate to acquired deductible liabilities, as distinct from owned deductible liabilities</u>)." [Emphasis added]

The appropriate way to deal with owned liabilities should be further examined in the course of the consultation process.

Timing of reform

Given the recent announcement of a 2 July 2016 election, the Government is now in caretaker mode. Therefore, we will not see any further update on the deductible liabilities measure until after the election.

It seems we are still at least some months away from seeing any advancement of the proposed reforms in respect of the tax consolidation treatment of deductible liabilities. Affected taxpayers should continue to monitor the progression of these reform proposals.

Deloitte perspective:

- Taxpayers should reconsider the financial reporting and taxation positions that they have taken on a preliminary basis under the announced laws since May 2013.
- Taxpayers undertaking M&A transactions after 1 July 2016 in respect of targets with material deductible liabilities will need to consider the likely outcomes under the Budget announcement, and how the proposed exclusion from the ACA process may impact transaction pricing.

Deferred Tax Liabilities

The Government has also announced that deferred tax liabilities (**DTLs**) will be excluded from the tax consolidation entry and exit calculations. The current treatment, which includes DTLs in entry and exit calculations, may result in:

- a mismatch of commercial and tax outcomes for both the vendor and the purchaser. This mismatch arises on entry because the DTL relating to a reset cost base asset included in step 2 of the ACA calculation is allocated to reset cost base assets which, when sold, has the effect of reducing the future tax liability (on exit a similar mismatch occurs); and
- integrity risks and uncertainty.

The removal of DTLs from the entry and exit calculations is intended to address this potential mismatch and eliminate much of the current uncertainty caused by their inclusion in the cost setting process.

The proposed change to exclude DTLs from exit and entry calculations will apply to joining and leaving events that commence after the date amending legislation is introduced into Parliament.

Securitised assets

The Government will broaden the application of the securitised assets measure contained in the 2014-15 Federal Budget to non-financial institutions with securitised assets.

This measure will ensure that liabilities arising from securitisation arrangements will be disregarded for the purposes of the tax cost setting regime if that entity joins a consolidated group or exits an existing consolidated group, and certain related assets are not recognised for tax cost setting purposes.

This new measure will apply to arrangements that commence on or after 7.30 pm on 3 May 2016, with transitional rules applying to arrangements that commence before this time

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