Tel: +61 7 3237 5999
Fax: +61 7 3221 9227
www.bdo.com.au

Level 10, 12 Creek St
Brisbane QLD 4000
GPO Box 457 Brisbane QLD 4001
Australia

Via email: Email: consolidation@treasury.gov.au

Attention: Consolidation@treasury.gov.au

6 October 2017

Treasury Laws Amendment (2017 Measures No. 9) Bill 2017: Consolidation

Dear Sir/Madam,

BDO welcomes the opportunity to provide feedback in response to Treasury Laws Amendment (2017 Measures No. 9) Bill 2017: Consolidation ('Exposure Draft'), released by Treasury on 11 September 2017, which proposes the introduction of various changes to the tax consolidation measures in Part 3-90 of the Income Tax Assessment Act 1997 ('ITAA 1997').

This BDO submission identifies the following issues as outlined in the Appendix:

- The churning measure applies to retain the tax cost of a joining entity's assets even where part of the participation interests in the joining entity are acquired from outside the consolidated group, which could result in double taxation for the consolidated group;
- The churning measure does not take account of capital gains of CFC's that are included in the attributed income of the Australian parent companies, which could result in double taxation for the consolidated group.

Should you wish to discuss any of our comments, please feel free to contact me on +61 2 9240 9736, or via email: Lance.Cunningham@bdo.com.au.

Kind regards,

Lance Cunningham
BDO National Tax Director

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Appendix

Churning Measure

Issue - The churning measure applies to retain the tax cost of a joining entity's assets even where part of the participation interests in the joining entity are acquired from outside the consolidated group. This results in double taxation for the consolidated group.

We can see the rationale of the proposed churning measure in Part 5 of the Exposure Draft applying where Australian Group ('consolidated group') members hold 100% of participation interests in the joining entity before the joining time. However, it appears the churning measure can result in double taxation where consolidated group members' participation interests in the joining entity before the joining time were less than 100% (and not less than 50%).

If an arrangement qualifies for the churning measure, all the tax costs of assets of the joining entity are retained at historic tax costs. However, where only part of the participation interests in the joining entity were previously owned by group members, this could result in the real cost of acquiring the remaining participation interests being ignored for the entry ACA process. This could result in double taxation for the consolidated group to the extent of these interests in the joining entity are acquired from outside the consolidated group.

The cost of acquiring remaining membership interests is a real cost for the consolidated group and should not be ignored for the entry ACA process.

BDO recommends the proposed section 716-440 be modified to allow a partial ACA process be applicable to the proportion of the step 1, step 3, step 6, and step 7, entry ACA calculation that relates to the proportion of the participation interests in a joining entity that were not previously held by group members. The application of the proposed 716-440 would then be limited to the proportion of the retained cost of the joining entity's assets that relate to the proportion of the membership interests of the joining entity that were previously held by consolidated group members.

Issue: The Churning measure does not take account of capital gains of CFC's that are included in the attributed income of the Australian parent companies - this could result in double taxation for the consolidated group.

The churning measure in the Part 5 of the Exposure Draft does not take account of situations where an Australian attributable taxpayer is attributed with and assessed on the capital gain made by the foreign entity as a result of the modification in section 408 of the controlled foreign companies (CFC) rules in the Income Tax Assessment Act 1936 ('ITAA 1936'). This can result in double taxation for the consolidated group

This is highlighted by Example 1.4 in the Explanatory Memorandum of the Exposure Draft where there is a consolidated group consisting of 2 Australian resident companies, Head Co and Acquirer Co. Acquirer Co beneficially owns all of the membership interests in Foreign Co which in turn owns an Australian subsidiary, Target Co. Target Co is not eligible to be a member of Head Co's consolidated group because its immediate holding company is a non-resident (Foreign Co). Foreign Co transfers its membership interests in Target Co to Acquirer Co and Target Co becomes a member of Head Co's consolidated group. As the membership interests in Target Co are not taxable Australian property, the capital gain for Foreign Co is exempt under Div 855 ITAA 1997.

In this example, Foreign Co would be a CFC in relation to Acquirer Co and Acquirer Co would be an attributable taxpayer in relation to Foreign Co. There would be the potential for the capital gain that is exempt to Foreign Co under Div 855 being included in the attributable income of Acquirer Co, thus, in effect, reversing the Div 855 exemption.

However, as Foreign Co is 100% owned by Acquirer Co it is likely that the transfer of the Target Co shares could be entitled to the Subdivision 126B ITAA 1997 rollover, as modified by section 419 ITAA 1936. If this rollover is available and chosen, the capital gain would not be included in Foreign Co's attributable income and therefore not assessed to Acquirer Co. If the rollover was available and chosen, the proposed churning measure would provide an appropriate result.

However, if the modified Subdivision 126B rollover has not been chosen or does not apply e.g. where Acquirer Co did not hold 100% of the shares in Foreign Co, the capital gain could be included Foreign Co's attributable income and Acquirer Co's attributable percentage of that attributable income could be included in Acquirer Co's assessable income.

In this case, the application of proposed section 716-440 in the Exposure Draft would result in double taxation as the cost of acquirer's Co's assets will not be set, thus retaining the historic tax costs of Acquirer Co's assets. This will, in effect, result in the attributed capital gain being taxed again on the consolidated group's subsequent disposal of or CGT event for Target Co's assets.

BDO recommends that the proposed section 716-440 be modified so that it does not apply where the Division 855 exempt gain is included in the CFC attributable income and assessed to one of the members of the consolidated group.