ATTACHMENT B

OPERATION OF THE TOFA RULES FOR CONSOLIDATED GROUPS

Ensuring TOFA/consolidation interaction provisions operate as intended

1. The TOFA Stages 3 & 4 provisions are a major legislative reform of the tax arrangements applying to a complex area of commerce. At the time of its introduction, it was expected by the Government and industry that monitoring of the implementation of this reform would lead to the need for further legislative refinements (see Media Release No. 103 of 2008 from the then Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, the Hon Chris Bowen MP). These provisions define what a Division 230 financial arrangement is and provide various tax timing methods to account for the gains and losses from financial arrangements for income tax purposes.

2. The TOFA/consolidation interaction provisions are intended to ensure appropriate interaction between the TOFA Stages 3 & 4 regime and the tax consolidation regime. Post enactment consultation with industry and the Australia Taxation Office (ATO) on the provisions have revealed several technical deficiencies with the current wording of the provisions. Changes are proposed to address these technical issues.

3. These changes clarify that the head company is deemed to have acquired financial arrangements that are assets and/or assumed financial arrangements that are liabilities from the joining entity at the joining time.

4. For financial arrangements that are liabilities to be subject to fair value, retranslation or financial reports tax timing methods, the changes clarify that the head company is deemed to have assumed the liability for its accounting value at the joining time.

Appropriate treatment of financial arrangements that are liabilities upon joining

5. For financial arrangements that are liabilities to be subject to a tax timing method other than fair value, retranslation or financial reports method, it is proposed that the head company is deemed to have assumed the liability for its accounting value at the joining time.

6. Currently, the TOFA starting value upon joining for financial arrangements that are liabilities subject to a tax timing method other than the elective fair value, retranslation or financial reports methods is generally the original value of the liability. This is inappropriate where the value of the liability at the joining time changes from its historical value due to reasons other than the repayment of principal.

Ensuring TOFA transitional balancing adjustment provisions operate as intended

7. Changes are proposed to ensure that the TOFA transitional balancing adjustment provisions operate as intended for existing financial arrangements of a joining entity where consolidation occurred prior to the head company entering the TOFA Stages 3 & 4 regime.

8. In particular, it is proposed to amend these provisions so that taxpayers can only use the primary method for working out TOFA transitional adjustments with respect to these financial arrangements. Additionally, it is also proposed to clarify that the primary method takes into account the operation of the TOFA/consolidation interaction provisions.

9. The primary method of transitioning into the TOFA Stages 3 & 4 regime requires the taxpayer to calculate, for their existing financial arrangements, the difference between the pre-TOFA and post-TOFA tax treatments and spread it, as a transitional balancing adjustment over four years.

10. To reduce compliance costs for taxpayers that elect to rely on their financial reports to account for gains and losses from their financial arrangements for tax purposes, an alternative method is to use balances in the taxpayer's financial statements to approximate the transitional balancing adjustment under the primary method.

11. For existing financial arrangements of a joining entity where joining occurred prior to the head company entering the TOFA Stages 3 & 4 regime, due to the accounting/tax differences in the treatment of consolidation events, the alternative method that uses balances in taxpayers' financial reports may produce the unintended outcome of a permanent difference between the taxpayer's financial accounting profit/loss and TOFA gain/loss from the relevant financial arrangement.