

JOINT SUBMISSION BY

The Institute of Chartered Accountants in Australia, The Taxation Institute of Australia, the National Institute of Accountants, CPA Australia and Taxpayers Australia

TD 2010/D4 - Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in acquiring shares in an entity that becomes a subsidiary member of the group, before the entity joins the group?

TD 2010/D5 - Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in acquiring shares in an entity that becomes a subsidiary member of the group, after the entity joins the group?

TD 2010/D6 - Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, after the member leaves the group?

Date: 24 December 2010

The Professional Bodies welcome the opportunity to comment on Draft Taxation Determinations TD 2010/D4, TD 2010/D5 and TD 2010/D6 (“the Draft Determinations”).

SPECIFIC COMMENTS

Broadly, the Professional Bodies agree with the conclusions contained in the Draft Determinations. However, we raise the following comments for the ATO’s consideration.

1. Paragraph 2 of the Draft Determinations states “This draft Determination does not apply to the extent (if any) that the incidental costs mentioned in paragraph 1 of this draft Determination are remuneration to a member of the group.” We request the ATO to elaborate on this statement. That is, it appears that the statement is a simple extrapolation of section 701-1 (i.e. the intra-group payment would be ignored). Accordingly, the ATO should clarify if this is the case and whether the paragraph is intended to cover any other transaction that the ATO has in mind. The statement is currently misleading and not easy to understand.
2. The Draft Determinations are limited to incidental costs under subsection 110-35(2). There seems to be no apparent reason to limit the binding status of the ruling to only those costs that fall under the first element of incidental costs. We believe that this is an oversight and that the Draft Determinations should be changed so that all references are to section 110-35 throughout.
3. For example, we are unsure why transfer costs incurred prior to the joining time on the transfer of shares (where applicable) under subsection 110-35(3) would not be capable of forming part of the Draft Determination.
4. Should the ATO disagree with the previous two points, we still believe the ATO should refer to section 110-35 throughout the Draft Determination and specifically reference those provisions that the ATO does not believe have application. For example, subsection 110-35(10).

5. Paragraph 14 of TD 2010/D4 states that “Paragraph 40-880(5)(f) has no regard to whether the capital expenditure is actually taken into account in working out a capital gain or capital loss from a later CGT event.” We do not agree with this statement. The cost base is used under section 705-60 and then is not to be used further due to the operation of section 701-1 and (more specifically) section 701-58. Furthermore, the EM is not clear in its operation where a section of the Act subsequently prevents the use of the cost base of an asset (i.e. section 701-58, together with section 701-1, prevents such future use). More specifically, the EM states that an “amount is not taken into account in working out a capital gain or loss if the expenditure cannot be included in the cost base or reduced cost base of the asset”. It follows then that we consider the better view is that paragraph 40-880(5)(h) operates, being the more applicable paragraph in this circumstance. This is because the expenditure is expressly prevented from being used in calculating a future capital gain. As we believe that s40-880(5)(h) is the more appropriate paragraph to prevent the deduction, the ATO should consider either (1) redrafting the question addressed by TD 2010/D4 to ask whether s40-880 generally applies or (2) redrafting paragraph 1 of TD 2010/D4 to state (in answer to the question posed) “No, s40-880(5)(f) does not prevent the deduction , but s40-880(5)(h) will do so.”
6. Paragraph 13 of TD 2010/D5 states “A consequence of the SER is that when an entity becomes a subsidiary member of a consolidated group the membership interests in the entity held by the group are ignored for those purposes. This means that while the SER applies, the incidental costs cannot be included in the cost base or reduced cost base of the shares.” Furthermore, paragraph 15 states “Since there is no other way in which the incidental costs could be taken into account in working out a capital gain or capital loss from a CGT event, paragraph 40-880(5)(f) does not prevent an amount being deducted for the incidental costs under section 40-880.” We highlight that paragraph 13 could imply that the head company now “holds” the underlying assets. Furthermore, subsection 701-55(2), (5A) and (5B) specifically state that the head company is taken to acquire the relevant assets. We request the ATO to more formally state and conclude that the head company is not taken to incur such incidental costs in acquiring the underlying assets.
7. Paragraph 15 of TD 2010/D5 states “However, it does not follow that the incidental costs are deductible under section 40-880: that will depend on the facts of each case and whether the other requirements under that section are met.” In our view, this is an unsatisfactory conclusion for the Draft Determination as it leaves a taxpayer with uncertainty as to the application of section 40-880 in a vanilla case. That is, we understand that each case is fact specific and that an amount of the deduction may be denied by the operation of another provision (e.g. subsection 40-880(3)). However, this conclusion leaves one to question whether a deduction is at all available and whether a taxpayer is missing a fundamental issue the ATO has with any of the other provisions of section 40-880. We believe it is only appropriate to provide appropriate guidance to taxpayers with a vanilla example (as taxpayers will be uncertain whether the ATO has a concern with any other provisions of section 40-880). For example, we request the ATO to conclude the example contained in paragraphs 3 to 5 by stating”

For the purpose of the example, it is assumed that the business of Aco and Bco is operated solely for a taxable purpose. In this example, a deduction would be allowed for the \$10,000 under section 40-880 over five years.

8. In Draft Determination TD 2010/D6, the ATO should consider linking the operation of section 701-55(5) to section 112-15, which deems the tax cost setting amount to be an “amount paid” by the head company for the membership interests. The operation of this provision would support the ATO’s conclusion contained in paragraph 13.