Parliament of the Commonwealth of Australia

SENATE ECONOMICS LEGISLATION COMMITTEE

REPORT ON THE NEW BUSINESS TAX SYSTEM (CONSOLIDATION) BILL (No. 1) 2002

June 2002

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ISSN 1324-2830

Printed by the Senate Printing Unit, Parliament House, Canberra.

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CHAPTER ONE

INQUIRY INTO THE NEW BUSINESS TAX SYSTEM (CONSOLIDATION) BILL (NO. 1) 2002

Background

1.1 The New Business Tax System (Consolidation) Bill (No. 1) 2002 (the Bill) was presented to the House of Representatives on 16 May 2002 by Mr Peter Slipper MP, Parliamentary Secretary to the Minister for Finance and Administration. The Bill was passed in the House of Representatives on 29 May 2002 and introduced in the Senate on 19 June 2002.

Purpose of the Bill

1.2 The provisions of the Bill are designed to introduce a new consolidation regime that will allow certain groups of entities to be treated as single entities for income purposes. The proposed measures are intended to ensure greater consistency in the taxation of wholly owned groups in Australia.[1]

Reference of the Bill

1.3 In its report No. 4 of 2002, the Selection of Bills Committee recommended that the Bill be referred to the Senate Economics Legislation Committee to allow the Committee to examine the detail behind the costings of the measure, giving special regard to costs to the revenue and the costs to business. On 19 June 2002, the Senate referred the Bill to this Committee for report by 26 June 2002.[2]

Submissions

1.4 The Committee contacted a number of government agencies, organisations and individuals interested in the new business tax legislation, alerting them to the inquiry and inviting them to make a submission. In all the Committee received the following two submissions:

- Business Council of Australia which also contained the 1999 report prepared for the Business Coalition for Tax Reform by Access Economics entitled *Is the Government's Business Tax Reform Package Revenue-Neutral;* and
- Taxation Institute of Australia.

The submissions are public documents.

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1 See Mr Peter Slipper, MP, House of Representatives *Hansard*, 16 May 2002, p. 2315 and the *Explanatory Memorandum*. New Business Tax System (Consolidation) Bill (No. 1) 2002.

2 *Report No. 4 of 2002* of the Selection of Bills Committee, 19 June 2002.

Hearing and evidence

1.5 The Committee held one public hearing on this inquiry in Parliament House, Canberra on Monday, 24 June. It examined officers from the Treasury and the Australian Taxation Office. Witnesses who presented evidence before the Committee are listed in Appendix 1.

1.6 Copies of the Hansard transcript are tabled for the information of the Senate. They are also available through the internet at http://www.aph.gov.au/hansard. Additional information provided to the Committee by Senator the Hon Helen Coonan, Minister for Revenue and Assistant Treasurer, is also tabled with this report.

Acknowledgment

1.7 The Committee is grateful to, and wishes to thank the organisations and individuals who assisted with its inquiry.

CHAPTER TWO

THE PROVISIONS OF THE BILL

2.1 On 21 September 1999, following the release of the report on the Review of Business Taxation (the Ralph Review), the Treasurer announced the New Business Tax System. He stated that the New Business Tax System would make 'a significant contribution to reducing tax avoidance through the removal of complexities and anomalies and improved anti-avoidance measures'. He also stated that the Government would be introducing a number of integrity measures. He explained that the Government's response to the Review would be in two stages with phased implementation. The Bill before the Committee forms only one part of the Government's business tax reform package.[3]

2.2 This proposed legislation will introduce a consolidation regime that will allow certain groups of entities to be treated as a single entity for income tax purposes. The regime will apply to a wholly-owned group of Australian resident entities that chooses to form a consolidated group for income tax purposes. A consolidated group will consist of:

- a head company; and
- all of the subsidiary members of the group.

2.3 As noted above, a consolidated group is to be treated as a single taxpaying entity for income tax purposes. The subsidiary entities lose their individual income tax identities and are treated as parts of the head company of the consolidated group for the purposes of determining income tax liability.

2.4 An eligible wholly-owned group becomes a consolidated group after giving notice to the Commissioner of Taxation of its decision to consolidate.

2.5 The consolidation measure contained in the Bill represents a significant change to the taxation of corporate groups. Overall, the rules contained in this Bill will:

- allow wholly-owned groups of entities to make a choice to consolidate and therefore be treated as a single entity for the purposes of determining income tax liability;
- determine the membership of a consolidated group, including the membership of certain groups with a single non-resident head company;
- determine the cost (for income tax liability purposes) of assets, including membership interests, in relation to consolidated groups;
- allow, in certain circumstances, pre-consolidation losses to be transferred to the head company of a consolidated group, and prescribe how those losses may subsequently be used by the head company;
- allow the transfer of franking credits to a consolidated group;

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3 Press Release no. 058, The Commonwealth Treasurer, *The New Business Tax System,* 21 September 1999.

- determine pay as you go (PAYG) instalments for consolidated groups;
- determine tax liability for income tax payments within a consolidated group where a head company fails to pay on time; and
- remove certain existing grouping provisions, including those allowing transfer of losses and capital gains tax (CGT) roll-over relief for the transfer of assets between wholly-owned company groups.[4]

2.6 The Committee recognises that the losses addressed by this Bill are already in existence and would be expected to wash through the corporate accounting system over time. What this Bill does is rationalise and simplify this process.

2.7 Under this scheme, wholly-owned entity groups will be allowed to choose to consolidate from 1 July 2002. There will be a transitional period that allows the existing grouping provisions to continue to operate in parallel with the new regime until July 2003.

2.8 In essence the measures in the Bill are designed to address efficiency and integrity problems under the existing taxation regime of wholly-owned groups, including:

- compliance and general tax costs;
- double taxation;
- tax avoidance through intra-group dealings, loss cascading and value shifting.

The objects of the proposed legislation as outlined in the Bill are:

a) to prevent double taxation of the same economic gain realised by a consolidated group; and

b) to prevent a double tax benefit being obtained from an economic loss realised by a consolidated group; and

c) to provide a systematic solution to the prevention of such double taxation and double tax benefits that will:

i) reduce the cost of complying with this Act; and

ii) improve business efficiency by removing complexities and promoting simplicity in the taxation of wholly-owned groups.

2.9 Overall the new system is intended to 'assist in the simplification of the tax system, resulting in both reduced taxpayer compliance costs and ATO administration costs, improve the efficiency of business restructuring and strengthen the integrity of the income tax system'.[5]

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4 *Explanatory Memorandum,* New Business Tax System (Consolidation) Bill (No. 1) 2002, p. 3.

5 *Explanatory Memorandum,* New Business Tax System (Consolidation) Bill (No. 1) 2002, pp. 4–5.

CHAPTER THREE

THE COST OF IMPLEMENTING THE BUSINESS TAX REFORM PACKAGE

The integrity of the package

3.1 The principles of the Bill have bipartisan support in the House of Representatives and cross-party support in the Senate.[6] During debate on the Bill, Mr Bob McMullan MP stated that the Opposition had long supported genuine business tax reform in Australia and commended the principle underpinning the proposed legislation. He told the House of Representatives that the Labor Party have consistently supported the principle of consolidations. Furthermore, he understood that the concept of consolidation was designed to:

- minimise compliance costs; and
- strengthen the integrity of the tax system.

He was not confident, however, that the measures in the Bill would met these objectives. He was also concerned about the Government's commitment to revenue neutrality and sought information on the following:

- the updated costs to the revenue per year over the forward estimates period;
- the split between the transition costs and the ongoing costs to the revenue;
- the costs to the revenue of all the changes to the original Ralph recommendations, in particular the full cost of the decision to alter the rate at which transferred losses can be used by the newly consolidated group; and
- the transition costs to business of this measure.

3.2 In answer to the issues raised by Mr McMullan, Mr Peter Slipper MP informed the House that:

> Overall, the consolidation measure is expected to reduce ongoing compliance costs for wholly-owned corporate groups. Consolidation groups will lodge a single tax income tax return, maintain a single franking account and will no longer have to account for intragroup dealings for income tax purposes. The measure will also remove income tax impediments to the restructuring of corporate groups. The consolidation regime will provide Australian corporate groups with economic savings by removing the double taxation of the same economic gain. The revenue will also benefit because the regime will improve the integrity of the tax system. [7]

3.3 He acknowledged that the figures available were based on costings provided in 1999 and that more information would be provided as soon as possible.

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6 Mr Bob McMullan, MP, House of Representatives *Hansard,* 29 May 2002, p. 2601.

7 Mr Peter Slipper, MP, House of Representatives *Hansard,* 29 May 2002, p. 2650.

3.4 In the following section, the Committee looks at the four cost aspects of the Bill that were of concern to the Opposition—costs to the revenue; transition and ongoing costs; costs to the revenue brought about by changes made to the original Ralph recommendations; and the transition costs to business.

Costs to the revenue

3.5 During debate on the proposed legislation, Mr McMullan sought to establish why there was an ongoing cost to revenue from what 'is supposed to be an integrity measure'. He stated:

> I want to know how we can be implementing an agreement that was supposed to be, for the package as a whole, revenue neutral—and implementing an enhanced integrity measure, which is the basic reason for our support—if this is costing us $1 billion.[8]

3.6 The Explanatory Memorandum makes clear that the cost to revenue is estimated to be around $1 billion. It states:

> The consolidation measure is expected to cost approximately a billion dollars over the forward estimate period. This cost largely relates to the transitional concessions and the expectation that groups will be able to use their losses faster than is allowed under the current law.[9]

3.7 Evidence presented to the Committee during its public hearing confirmed this figure. Mr David Martine, General Manager, Business Entities and International Tax Division, Department of the Treasury, told the Committee that Treasury's best estimate of the impact on revenue is the figure currently given in the estimates, that is $1.1 billion as stated in the Explanatory Memorandum.[10] Treasury also provided to the Committee the following table which shows the estimated cost to revenue of the New Business Tax System (Consolidation) Bill (No. 1) 2002 as outlined in the Treasurer's press release of 11 November 1999 and the current estimates.

Reconciliation of revenue estimates

Revenue impact of consolidation included in the forward estimates ($m)

	2001-02	**2002-03**	**2003-04**	**2004-05**	**2005-06**
Consolidation of losses	0	-200	-400	-420	-370
Value shifting and loss duplication in groups	0	0	80	85	90
Deferred repeal of the grouping rules	0	20	-50	0	0

8 Mr Bob McMullan, MP, House of Representatives *Hansard,* 29 May 2002, p. 2601.

9 *Explanatory Memorandum,* New Business Tax System (Consolidation) Bill (No. 1) 2002, p. 4.

10 Proof Committee *Hansard*, 24 June 2002, p. E4. See also p. E7.

	2001-02	2002-03	2003-04	2004-05	2005-06
Total consolidation	**0**	**-180**	**-370**	**-335**	**-280**

Revenue estimates published in the Treasurer's Press Release 11 November 1999

	2001-02 $m	2003-03 $m	2003-04 $m	2004-05 $m
Consolidation of losses in acquired companies	-190	-380	-390	-300
Value shifting and loss duplication in groups	0	75	80	85

Treasury makes the point that the cost of the measure is similar over the 4 year forward estimates period (apart from the 1 year lagged start date) as per the tables above.

Transition and ongoing costs to the revenue

3.8 Treasury also provided the following details on the effects on revenue beyond the forward estimate years:

> Long-term projections of the revenue impact of consolidation have not been produced. However, the revenue cost from the consolidation of losses is expected to decline over time as the existing pool of carry-forward losses is exhausted. In contrast, the revenue gains from consolidation and related integrity measures (which address the creation of artificial and duplicate losses through inter-group dealings) are expected to increase over time, in line with growth in the economy.
>
> The major component of the cost included in the forward estimates is transitional in that it relates to the increased usage of carry-forward losses currently held in member entities which are not currently transferable to other group members. This pool of losses is not expected to be exhausted until well beyond the forward estimate years, although the pool (and the associated cost) is expected to diminish after 2004-05, due largely to the impact of the concessional option that allows certain Continuity of Ownership Test losses to be used over three years.
>
> There is expected to be an ongoing cost from the modified Same Business Test (SBT) that will apply to losses held in entities taken over by a consolidated group. Because it is not practical to compare the business of an individual group member with that of the consolidated group, the SBT will apply (in a modified form) at the time a loss company joins the group but, having passed that test, SBT losses are then 'refreshed' – treated as having been incurred by the head company at the joining time. This is expected to reduce the current level of 'wastage' that occurs when a loss company is taken over.
>
> This ongoing cost is mitigated by a number of design features of the consolidation regime, including:
>
> - The rate at which transferred losses can be used by the head company will be limited by a loss factor, which serves as a proxy for the rate at which the losses would have been able to be recouped by the loss company itself.

- Once part of a consolidated group, losses remain with the head company and can not be bought and sold with individual member entities.

- The modified SBT applying on entry to consolidation is more rigorous for losses made by a joining entity in an income year starting after 30 June 1999 and for previously transferred losses. Over time, an increasing proportion of SBT losses 'acquired' by a consolidated group would be subject to these more rigorous testing requirements.[11]

3.9 The Business Council of Australia submitted that in its opinion the implications of business tax reforms to date have been positive to the revenue. It also noted that removing the scope for value shifting and for the duplication of losses together with the removal of double taxation of income and gains, the easing (in some instances) of restrictions against the use of losses and removing (in some instances) obstacles preventing the use of franking credits will improve the integrity of the system.[12]

Implications for the costs to revenue stemming from changes to the Ralph recommendations

3.10 The Opposition were also seeking detailed costings on the progress of the implementation of the business tax reform package agreed between the Treasurer and the then shadow Treasurer based on the Ralph Review. They were seeking the costings not only on the measure contained in the Bill.[13]

3.11 Treasury informed the Committee that the most significant changes made to the proposed legislation since the Ralph Review relate to the treatment of losses being brought into consolidation. Mr Michael Buckley, Manager, Business Entities Unit, Treasury, told the Committee that these changes, however, 'are broadly revenue neutral in the effect'. He went on to explain:

> The measure does prevent the loss to the revenue through lost duplication and value shifting, because it improves the integrity of the tax system. In relation to losses, there is a cost to the revenue because, as you noted, the rules will allow some of those losses which are brought in to be used faster than they possibly would have been able to be used in the group situation, and some losses which may have failed the loss test may actually be passed once the group is in consolidation. But those costs are known and they are included in the forward estimates for the measure.[14]

3.12 Treasury also informed the Committee that the revenue impact of other changes made to the Ralph recommendations was unquantifiable, with the exception of deferring repeal of the grouping rules until 1 July 2003. On this particular matter, Treasury provided the following information:

> The costing for deferring repeal of the grouping rules assumes that some groups will elect to remain outside consolidation where they potentially have more to gain

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11 Taken from documents tabled by Treasury during hearing. See appendix 2.

12 Submission no. 1.

13 Mr Bob McMullan, MP, House of Representatives *Hansard,* 29 May 2002, p. 2601.

14 Proof Committee *Hansard*, 24 June 2002, p. E4.

from value shifting and loss duplication than from faster use of losses inside consolidation. (The scope for wholly-owned groups to benefit from value shifting, however, will be restricted by the general value shifting regime which will commence from 1 July 2002). The costing is made up of two components:

- A reduction in the first year cost of consolidation due to some groups deferring entry into consolidation. That is, consolidation involves a cost to revenue. To the extent that some groups elect to remain outside consolidation for an additional year, some of this cost will be deferred.

- A cost from groups that remain outside consolidation with a capacity to create some artificial and duplicate losses. Specific loss integrity and value shifting rules will apply outside of consolidated groups. However, consolidation provides a more complete solution to these integrity concerns. The forward estimates include a gain of $80m in 2003-04 attributed to the impact of consolidation in preventing value shifting and loss duplication in groups - the costing for extending the grouping concessions assumes that the revenue loses a proportion of that.[15]

3.13 Further information about the costings relating not only to this Bill but including statements on the financial impacts of the package introduced so far are included at Appendix 3. A table is also included at Appendix 4 that outlines the significant changes to the proposed legislation since the February 2002 exposure draft.

Transition costs to business

3.14 In turning specifically to compliance costs, the Bill itself outlines the measures that are expected to reduce ongoing compliance costs by ensuring that:

- intra-group transactions are ignored for taxation purposes, so that taxation and accounting treatment are more closely aligned;
- administrative requirements, such as multiple tax returns and multiple franking account, losses, foreign tax credit, and PAYG obligations, are reduced; and
- integrity measures aimed at preventing loss duplication, value shifting or the avoidance or deferral of capital gains within groups do not apply within a consolidated group.

3.15 The Explanatory Memorandum, however, recognises that while the consolidation regime is expected to reduce ongoing compliance costs there will be some initial up-front costs. It offers the following explanation:

> The consolidation regime will necessitate some initial up-front costs for groups as they familiarise themselves with the new law, update software and notify the ATO of a choice to consolidate. Large corporate groups may incur greater start-up costs in determining the market values of group assets. These costs will be alleviated by a transitional measure under which the group can elect (prior to 1 July 2003) to bring assets into the group at their existing cost bases. Groups that form after the

15 Taken from documents provided by Treasury and tabled with the report. See Appendix 2.

transitional period may use the market value guidelines developed by the ATO to minimise compliance costs.[16]

3.16 Treasury also provided the following information to the Committee:

> Initially taxpayers will need to set up new processes or systems to consolidate the taxation information for the consolidated group. They will need to consolidate their tax balance sheet and income statement items to report as one single consolidated entity. Most taxpayers will minimise their compliance costs by aggregating their data on a bottom-up consolidation basis. Furthermore, on-going minimisation of these costs can happen by purchasing software to assist in this on-going process of tax consolidation. The ATO reports that most taxpayers at a recent Consolidation Walkthrough indicated that these new costs will not be substantial. The extent of any additional upfront compliance costs will be driven by the size of the group.
>
> …
>
> - The need to establish market valuations of assets on entry to consolidation is potentially a more significant compliance cost, although transitional concessions will limit the need for market valuations. The costs of compliance associated with the market valuation requirement will depend on:
> - the extent of groups choosing to consolidate;
> - the extent of groups which choose to not take up the cost effective administrative options outlined in the draft Consolidation Market Valuation Guidelines dated 19 April 2002;
> - the extent of groups which choose to not take advantage of the transitional option for resetting cost bases;
> - the extent of groups which choose to not take advantage of the concessional method for utilising losses.[17]

3.17 The Taxation Institute of Australia was particularly concerned about the costs associated with valuations for small and medium sized enterprises entering into consolidation.[18]

3.18 The Business Council of Australia, however, noted that one of the major benefits of consolidation was the ongoing compliance cost saving partly offset by initial compliance costs associated with the introduction of the new system.[19]

Committee's view

3.19 After examination of the provisions of the Bill and the accompanying Explanatory Memorandum together with additional information provided by Treasury, the Committee is satisfied that the consolidation regime represents a substantial change to the taxation of

16 *Explanatory Memorandum,* New Business Tax System (Consolidation) Bill (No. 1) 2002, p. 4.

17 Taken from documents provided by Treasury. See Appendix 3.

18 Submission no. 2.

19 Submission no. 1.

corporate groups which will improve the overall efficiency of this system of taxation. It agrees with the Treasurer's assessment that the proposed consolidation regime will make 'a significant contribution to reducing tax avoidance through the removal of complexities and anomalies and improved anti-avoidance measures'.

Recommendation

The Committee reports to the Senate that it has considered the provisions of the New Business Tax System (Consolidation) Bill (No. 1) 2002 and recommends that the Bill proceed.

SENATOR GEORGE BRANDIS
Chairman

ADDITIONAL COMMENT BY LABOR SENATORS

The Labor Party has consistently supported the principle of consolidations to minimise compliance costs and strengthen the integrity of the tax system. In referring this Bill to the Committee, Labor Senators flagged a particular interest in exploring the costings provided in the Explanatory Memorandum to examine if it does indeed meet these goals.

Year by year breakdown of costings

In this regard, we note that further information on the costings has now been tabled in the Committee by the Treasury.

This further information provides for the first time a year by year breakdown of the costs of the measure, estimated to be $180m in 2002-03, $370m in 2003-04, $335m in 2004-05 and $280m in 2005-06. This gives a total cost to the revenue of $1165m over four years, which is $165m more than the cursory estimate previously given the Explanatory Memorandum.

Transfer of losses

The Treasury information shows that the main element of the costs arises from the faster utilisation of losses due to their transfer into the consolidated groups.

Labor Senators were concerned that the treatment of losses in this Bill, in departing from the Ralph review recommendations, may have further increased the cost to the revenue beyond what was originally envisioned in the Ralph review. In this regard, we welcome the assurance from the Treasury that the net impact of these departures is 'broadly' revenue neutral.

We would expect a continuing watch to be kept on this potential threat to the revenue.

Valuation of assets

Labor Senators were also concerned that the measure could potentially provide a considerable tax break to companies which obtained a higher 'reset' cost basis for the assets at the time of consolidation.

The evidence provided in the hearing by the Australian Tax Office and the Treasury indicates that for this part of the measure, 'the rules were intended to broadly replicate outcomes under the current law'. Nevertheless, we remain concerned that the arrangements allowing this to be done on a subsidiary by subsidiary basis leaves open the possibility of conducting asset transfers in such a way as to generate artificially favourable tax outcomes.

We would expect a continuing watch to be kept on this potential threat to the revenue.

Long term revenue effects

The Labor Party has consistently supported the business tax reform package brought forward from the Ralph review, on the condition that the overall package is revenue neutral.

We note that, for this particular measure, the Treasury's view is that,

> … the revenue cost from the consolidation of losses is expected to decline over time as the existing pool of carry-forward losses is exhausted. In contrast, the revenue gains from consolidation and related integrity measures (which address the creation of artificial and duplicate losses through inter-group dealings) are expected to increase over time, in line with growth in the economy.

The Government should provide detailed costings on the progress of the overall business tax reform package as soon as possible.

Accompanying legislation

Labor Senators note oral evidence presented to the Committee that important further rules on issues such as valuation of assets will be presented in accompanying legislation which is not yet before the Parliament. This is a matter of significant concern, given previous examples of dramatic changes between the Government's announcements on business tax reforms, and the presentation of them to Parliament.

While continuing to support the Bill in principle, and the proposed starting date of 1 July 2002, we consider that the Bill should remain available to the Senate for further scrutiny until the whole package is available.

SENATOR JACINTA COLLINS
Deputy Chair

APPENDIX 1

PUBLIC HEARING AND WITNESSES

Monday, 24 June 2002, Canberra

Department of the Treasury

Buckley, Mr Michael Thomas, Manager, Business Entities Unit

Martine, Mr David John, General Manager, Business Entities and International Tax Division

Australian Taxation Office

Jackson, Mr Mark John, First Assistant Commissioner, Consolidation

Sim, Ms Irene, Acting Assistant Commissioner, Tax Design Group

THE FOLLOWING DOCUMENTS HAVE BEEN PROVIDED TO THE COMMITTEE BY THE DEPARTMENT OF THE TREASURY

APPENDIX 2

NEW BUSINESS TAX SYSTEM (CONSOLIDATION) BILL (NO. 1) 2002

Reconciliation of revenue estimates

Revenue impact of consolidation included in the forward estimates ($m)

	2001-02	2002-03	2003-04	2004-05	2005-06
Consolidation of losses	0	-200	-400	-420	-370
Value shifting and loss duplication in groups	0	0	80	85	90
Deferred repeal of the grouping rules	0	20	-50	0	0
Total consolidation	**0**	**-180**	**-370**	**-335**	**-280**

Revenue estimates published in the Treasurer's Press Release 11 November 1999

	2001-02 $m	2003-03 $m	2003-04 $m	2004-05 $m
Consolidation of losses in acquired companies	-190	-380	-390	-300
Value shifting and loss duplication in groups	0	75	80	85

The cost of the measure is similar over the 4 year forward estimates period (apart from the 1 year lagged start date) as per the tables above:

The major departure from the Ralph report recommendations involve a relaxation of the entry rules for same business test losses. A counter balancing impact arises from the tightening of the entry rules for the continuity of ownership losses. The revenue impacts broadly cancel each other out.

Revenue impact of other changes to the Ralph consolidation recommendations

The revenue impact of other changes made to the Ralph consolidation recommendations is unquantifiable, with the exception of deferring repeal of the grouping rules until 1 July 2003.

The costing for deferring repeal of the grouping rules assumes that some groups will elect to remain outside consolidation where they potentially have more to gain from value shifting and loss duplication than from faster use of losses inside consolidation. (The scope for wholly-owned groups to benefit from value shifting, however, will be restricted by the general value shifting regime which will commence from 1 July 2002). The costing is made up of two components:

- A reduction in the first year cost of consolidation due to some groups deferring entry into consolidation. That is, consolidation involves a cost to revenue. To the extent

that some groups elect to remain outside consolidation for an additional year, some of this cost will be deferred.

- A cost from groups that remain outside consolidation with a capacity to create some artificial and duplicate losses. Specific loss integrity and value shifting rules will apply outside of consolidated groups. However, consolidation provides a more complete solution to these integrity concerns. The forward estimates include a gain of $80m in 2003-04 attributed to the impact of consolidation in preventing value shifting and loss duplication in groups - the costing for extending the grouping concessions assumes that the revenue loses a proportion of that.

Revenue effects beyond the forward estimate years

Long-term projections of the revenue impact of consolidation have not been produced. However, the revenue cost from the consolidation of losses is expected to decline over time as the existing pool of carry-forward losses is exhausted. In contrast, the revenue gains from consolidation and related integrity measures (which address the creation of artificial and duplicate losses through inter-group dealings) are expected to increase over time, in line with growth in the economy.

The major component of the cost included in the forward estimates is transitional in that it relates to the increased usage of carry-forward losses currently held in member entities which are not currently transferable to other group members. This pool of losses is not expected to be exhausted until well beyond the forward estimate years, although the pool (and the associated cost) is expected to diminish after 2004-05, due largely to the impact of the concessional option that allows certain Continuity of Ownership Test losses to be used over three years.

There is expected to be an ongoing cost from the modified Same Business Test (SBT) that will apply to losses held in entities taken over by a consolidated group. Because it is not practical to compare the business of an individual group member with that of the consolidated group, the SBT will apply (in a modified form) at the time a loss company joins the group but, having passed that test, SBT losses are then ‘refreshed’ – treated as having been incurred by the head company at the joining time. This is expected to reduce the current level of ‘wastage’ that occurs when a loss company is taken over.

This ongoing cost is mitigated by a number of design features of the consolidation regime, including:

- The rate at which transferred losses can be used by the head company will be limited by a loss factor, which serves as a proxy for the rate at which the losses would have been able to be recouped by the loss company itself;

- Once part of a consolidated group, losses remain with the head company and can not be bought and sold with individual member entities;

- The modified SBT applying on entry to consolidation is more rigorous for losses made by a joining entity in an income year starting after 30 June 1999 and for previously transferred losses. Over time, an increasing proportion of SBT losses ‘acquired’ by a consolidated group would be subject to these more rigorous testing requirements.

Compliance costs to large and small business

The integrated tax design process for consolidation has had and will continue to have a strong focus on ensuring that all segments of the market, large, medium and small business are represented in the design of this measure. The objective has been to develop legal and administrative systems that work for the whole community whilst minimising the compliance burdens on the community.

The Tax Office has developed a range of guide material to assist business in the transition to consolidation. This material will assist business to understand the advice it will require and the steps that need to be completed for consolidation of group income tax. The cost of this advice will depend on the size, structure and tax attributes of the group. Smaller groups will need to make a cost-benefit decision as to whether they need to or will enter the regime.

Initially taxpayers will need to set up new processes or systems to consolidate the taxation information for the consolidated group. They will need to consolidate their tax balance sheet and income statement items to report as one single consolidated entity. Most taxpayers will minimise their compliance costs by aggregating their data on a bottom-up consolidation basis. Furthermore, on-going minimisation of these costs can happen by purchasing software to assist in this on-going process of tax consolidation. The ATO reports that most taxpayers at a recent Consolidation Walkthrough indicated that these new costs will not be substantial. The extent of any additional upfront compliance costs will be driven by the size of the group.

The ATO is meeting with software developers to develop software solutions that are cost-effective, easy to understand and use whilst ensuring the integrity of tax processes and outcomes. These solutions should be applicable to both large and small consolidated groups.

The need to establish market valuations of assets on entry to consolidation is potentially a more significant compliance cost, although transitional concessions will limit the need for market valuations. The costs of compliance associated with the market valuation requirement will depend on:

- the extent of groups choosing to consolidate;
- the extent of groups which choose to not take up the cost effective administrative options outlined in the draft Consolidation Market Valuation Guidelines dated 19 April 2002;
- the extent of groups which choose to not take advantage of the transitional option for resetting cost bases;
- the extent of groups which choose to not take advantage of the concessional method for utilising losses.

Small Business

The percentage of small businesses impacted by this measure is around 1% of the small business population.

Each potential consolidated group will need to undertake an analysis to decide if they are to enter into the regime which is not compulsory. The extension of the grouping provisions and the transitional arrangements will allow business additional time to undertake this analysis.

The ATO's education strategy for small business will focus very strongly on creating strong awareness around ways to achieve minimal-cost implementation of the measure whilst still ensuring tax system integrity. In particular, the ATO will emphasise the availability of the option to bring existing tax asset values into consolidated groups, especially smaller groups. ATO research has shown that it is best to approach those businesses which could be impacted by this measure through their tax advisers and this is the approach the ATO intends to adopt.

APPENDIX 3

SIGNIFICANT CHANGES TO CONSOLIDATION SINCE THE FEBRUARY 2002 EXPOSURE DRAFT
The clean slate rule The clean slate entry rule has been replaced with a 'retained history rule' to ensure that the consolidation regime will not change the tax character of a subsidiary's accounts. A more limited retained history rule will apply on exit.
Extending the range of entities able to access the transitional cost setting rules Groups consolidating prior to 1 July 2004 will generally be allowed to apply the transitional cost base rules in relation to subsidiary entities that join the group on or before 30 June 2003. This change addresses concerns that small business and groups with substituted accounting periods may neglect to acquire minority shareholdings prior to 1 July 2002.
Multiple Entry Consolidated Groups The 'one in all in rule' has been modified to the effect that each eligible tier-1 member of a foreign owned group will be able to make an irrevocable election to join with other tier-1 companies as part of an MEC group, or to form a separate consolidated group (where it has eligible subsidiaries) or remain unconsolidated. This change recognises that the subsidiaries of certain non-resident owned groups currently operate on an autonomous basis.
Eligibility to be the head company of an MEC group The requirement that the head company of a MEC group be directly owned by a non-resident company has been relaxed to also allow the head company to be indirectly owned by the non-resident company through one or more interposed entities.
Non-profit companies Non-profit companies will be eligible to be head companies.
Companies subject to the mutuality principle Companies that are subject to the mutuality principle will be eligible for head company or subsidiary status.
Co-operatives *Companies that can be taxed as Division 9 co-operatives will be eligible for head company or subsidiary status.*

Foreign tax credits

A head company will be allowed to utilise transferred excess foreign tax credits after a period of time, notwithstanding that the transferor may have left the group.

The current requirement for the transferor of foreign tax credits to remain a member of the group for the full year in which the transfer takes place is not practical under a consolidation regime in which a joining entity ceases to be a separate taxpayer and has no option to take excess foreign tax credits with it upon exiting the group.

Rollover relief for non-residents

CGT rollover relief will be retained for asset transfers between a non-resident company and a single Australian resident company that is not part of a consolidatable group.

This change addresses concerns that only retaining CGT rollover relief for asset transfers between a non-resident and the head entity of a consolidated group discriminates against groups investing in Australia though a single resident entity and is inconsistent with the principle that a consolidated group and a single unconsolidated company should be treated consistently.

Joint and several liability

The liability rules will allow a group to put in place a tax sharing agreement to apportion the outstanding tax liability between group members in the event of default by the head company. Where a reasonable tax sharing agreement is not in place, joint and several liability will apply.

An exemption from joint and several liability will apply for entities that are prohibited under an Australian law (ie APRA regulations) from taking on a joint and several liability.

Grouping rules

Existing grouping concessions will be maintained for an additional 12 months following commencement of the consolidation regime. The grouping provisions will now be removed with effect from 1 July 2003, or from the start of a group's first income year commencing after 1 July 2003 where the group's head company has a Substituted Accounting Period (SAP) and elects to consolidate from that date.

CHANGES TO RELATED AREAS OF THE TAX LAW

Current year losses

The imputation system will be amended to ensure that companies are not required to 'waste' current year losses against franked dividends. This will ensure that corporate groups are not disadvantaged by the impact of consolidation in removing their ability to quarantine losses from franked dividends.

Accessing the Same Business Test

The Income Tax Assessment Act will be amended to remove an anomaly that prevents companies from accessing the Same Business Test where they are unable to identify a precise date on which they failed the Continuity of Ownership Test.

APPENDIX 4

1999/2000 INTEGRITY MEASURES – BILLS AND COSTINGS

Measure	Included in Bill:	Costing data included in EM
Interim value shifting and loss duplication (Value shifting through debt forgiveness)	*New Business Tax System (Integrity and Other Measures) Act 1999 (169 of 1999)*	EM (not revised in Senate): ***Financial impact:*** This measure is estimated to raise revenue of $25million in 2000-2001 and $22 million in 2001-2002. This measure is expected to cease on commencement of consolidation.
Prevent duplication of unrealised losses (Applying the same business test to unrealised losses)	*New Business Tax System (Integrity and Other Measures) Act 1999*	***Financial impact:*** The financial impact of this measure is set out in the following table:[20]
Defects in continuity of ownership test	*New Business Tax System (Integrity and Other Measures) Act 1999* *New Business Tax System (Miscellaneous) Bill (No. 2) 2000*	***Financial impact:*** The financial impact of this measure is set out in the following table: [21] ***Financial impact:*** The amendments clarify and refine the current provisions in the Bill and do not affect the costings for the measures.

[20] ***Prevent duplication of unrealised losses (Applying the same business test to unrealised losses)***
Financial impact: The financial impact of this measure is set out in the following table:

2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
$65m	$90m	$85m	$95m	$100m

[21] ***Continuity of ownership test***
Financial impact (Not amended in Senate): The financial impact of this measure is set out in the following table:

2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
$35m	$35m	$35m	$40m	$40m

Measure	**Included in Bill:**	**Costing data included in EM**
Disposal of loss assets (Preventing a deduction and a capital loss arising from a single economic loss)	*New Business Tax System (Integrity and Other Measures) Act 1999* *New Business Tax System (Miscellaneous) Bill (No. 2) 2000*	*New Business Tax System (Integrity and Other Measures) Act 1999 (169 of 1999)* ***EM: Financial impact:*** This is a revenue protection measure. *New Business Tax System (Miscellaneous) Bill (No. 2) 2000* (No amendment to financial impact in Senate) ***EM: Financial impact:*** The financial impact of this measure is included in the estimates reported under the following measures: • preventing a deduction and a capital loss arising from a single economic loss; and • transfer or creation of assets by companies that are members of linked groups; dealt with in the Integrity and Other Measures Act.
Prevent inter-entity loss duplication	*New Business Tax System (Miscellaneous) Act (No. 2) 2000*	***EM (Reps and Senate) Financial impact:*** The financial impact of this measure is included in the estimate for measures to prevent inter-entity loss multiplication. The financial impact of these measures is set out in the following table:[22]

[22] ***Inter- entity loss multiplication – EM Reps (this part of EM not revised in Senate)***
Financial impact: The financial impact of this measure is included in the estimate for measures to prevent inter-entity loss multiplication. The financial impact of these measures is set out in the following table:

2000-2001	2001-2002	2002-2003	2003-2004	2004-2005
$15m	$20m	$25m	$20m	$25m