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Steele Broderick
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The Treasury
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Dear Mr Broderick

Consultation on consolidation integrity measures

The Property Council of Australia welcomes the opportunity to comment on the exposure draft for Treasury Laws Amendment (2017 Measures No.9) Bill 2017: Consolidation ("the ED").

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment industry. We represent owners, fund managers, superannuation trusts, developers and investors across all four quadrants of property investments: debt, equity, public and private.

The matters outlined below are of particular interest to retirement village taxpayers, though the second item dealing with deferred tax liabilities will also be relevant to the wider property sector.

1. Carve out for retirement village residence and service contracts

We note that retirement village residence contracts and retirement village service contracts are excluded from the proposed provisions dealing with deductible liabilities.

We support this provision and thank you for taking into account the unique situation of retirement villages.

2. Deferred tax liabilities ("DTL") measure – Application provision

2.1 DTLs not previously included in entry ACA calculation

The DTL measure included in the ED generally provides for the exclusion of DTLs from entry ACA and exit ACA calculations for arrangements that commenced on or after the start of the day on which the relevant Bill is introduced into the House of Representatives.

As set out in the explanatory memorandum ("the EM") to the ED, it is intended that the exclusion of DTLs from the exit ACA would not, however, apply to DTLs that were "taken into account for the purposes of working out the entry tax cost setting amount for a joining entity [paragraph 1.82 of the EM]."

The application provisions in the ED do not, however, reflect this intention. Specifically, the relevant application provision (item 9(3) of the ED) provides:

> *"the amendment made by item 8* [the exclusion of DTLs from the exit ACA] *does not apply in relation to an accounting liability of an entity that ceases to be a subsidiary member of a consolidated group or MEC group if the amendment made by item 7* [the exclusion of DTLs from the entry ACA] *did not previously apply in relation to the liability as a result of subitem (1)."*

The difference in expression may seem subtle but can result in fundamentally different outcomes.

Item 9(3) requires that the DTL was excluded in an entry ACA calculation, whereas the intention (as set out in the EM) is that the DTL is excluded in the exit ACA unless it was previously included in the entry ACA.

There are a number of common situations where a DTL would not be included in the determination of the cost base of acquired assets that do not involve the exclusion of the DTL from an entry ACA calculation, for example:

- Where an asset is acquired directly, rather than through an entity acquisition involving an ACA calculation
- Where the asset was held on the date of formation of a tax consolidated group and the group's head company chose the transitional method, such that the tax cost base of assets were not reset based on an ACA calculation.

In either case, as no DTL was included in an entry ACA calculation, any DTL should be excluded from the exit ACA calculation, however Item 9(3) requires a DTL to be included in the exit ACA on the basis that the DTL was not previously excluded from an entry ACA calculation. This outcome appears to be an unintended consequence and should be addressed in the final form of the Bill by only including DTLs in the exit ACA calculation where an amount was included in an entry ACA calculation.

Refer to the suggested drafting comments below.

2.2 DTL increases

Item 9(3) provides that item 8, regarding the exclusion of DTLs from the exit ACA, does not apply in respect of "an accounting liability" if item 7, regarding the exclusion of DTLs from the entry ACA, "did not previously apply in relation to the liability".

The relevant liability would be the DTL in respect of a particular asset held by the leaving entity.

The accounting value of the particular asset may have increased substantially since the date of acquisition, which would mean that the DTL in relation to the asset at the time of the exit ACA is much higher than the DTL that was included in the entry ACA calculation. In this case it would not be appropriate to require the entire DTL to be included in the exit ACA calculation. Excluding the entire DTL from the exit ACA calculations goes beyond reversing any benefit that the head company may have obtained as a result of the DTL being included in the entry ACA calculation, and therefore the DTL included in the exit ACA should be based on the DTL actually included in the entry ACA calculations.

It is noted that, due to the use of Investment Property accounting within corporate taxpaying entities, large increases in DTLs are particularly prevalent in the retirement village industry (where the accounting carrying value of a retirement village is required to be revalued regularly, but the tax base of the asset remains constant). Accordingly, if the provision as drafted were to be legislated, this would heavily impact that industry.

Refer to the suggested drafting comments below.

2.3 Compliance costs associated with identifying DTLs excluded from entry ACA calculation

Following the start of the day on which the relevant Bill is introduced into the House of Representatives, based on the ED, it will become necessary to separately track DTLs that were excluded from an entry ACA and DTLs that were not excluded from an entry ACA in order to determine the DTLs that must be included in any future exit ACA calculation.

This gives rise to substantial compliance costs on the basis that the DTL balance shown in the financial statements of a leaving entity would be comprised of separate DTLs for each relevant asset.

A leaving entity would often hold a significant number of assets (for example depreciating assets captured in the entities fixed asset register) and the costs associated with tracking assets and DTLs would be significant.

To address these compliance cost concerns, no amount should be included for a DTL in an exit ACA where the relevant asset was acquired four years or more before the leaving time.

A four year period is consistent with the application of subsection 711-45(8) in relation to long service leave liabilities previously included in an entry ACA calculation. The EM for *Tax Laws Amendment (2010 Measures No. 1) Bill 2010* which introduced this subsection provided that "the purpose [of limiting the application to four years was] to reduce compliance costs because of the difficulty in tracking these types of liabilities [paragraph 5.213]."

As similar issues arise in relation to tracking DTLs for particular assets as those that arise in tracking liabilities for particular employees, it is considered that four years is an appropriate balance between maintaining integrity while reducing compliance costs.

2.4 Suggested drafting

To deal with the issues identified above in relation to the DTL measure, it is submitted that the following changes to item 9(3) would be required:

> (3) Despite subitem (2), the amendment made by item 8 does not apply in relation to an accounting liability of an entity that ceases to be a subsidiary member of a consolidated group or MEC group to the extent that an amount was included by the head company in relation to the liability under section 705-70. ~~if the amendment made by item 7 did not previously apply as a result of subitem (1).~~

(4) Subitem (3) does not apply in relation to an accounting liability of an entity that ceases to be a subsidiary member of a consolidated group or MEC group where an amount was included by the head company in relation to the liability under section 705-70 more than four years prior to the leaving time.

We would be pleased to meet with you to discuss any of the above issues further.

Please contact Leida Pirts, Senior Policy Manager – Retirement Living, on (07) 3225 3007 or LPirts@propertycouncil.com.au if you have any queries.

Yours sincerely

Ben Myers
Executive Director – Retirement Living