SECOND READING

SPEECH

Thursday, 16 May 2002

BY AUTHORITY OF THE HOUSE OF REPRESENTATIVES
Mr SLIPPER (Fisher—Parliamentary Secretary to the Minister for Finance and Administration) (10.16 am)—
I move:

That this bill be now read a second time.

As part of the government's reform of business taxation, this bill introduces an innovative and comprehensive consolidation regime for resident entities that comprise a wholly owned corporate group. The consolidation regime represents a significant change to the taxation of corporate groups. Because of its magnitude, the measure will be enacted progressively via a series of bills.

The consolidation regime is optional, although a choice to consolidate is irrevocable. Where a group makes such a choice, all its eligible resident wholly owned companies, trusts and partnerships, including wholly owned entities acquired in the future, must be included in the consolidated group.

The proposed regime will promote business efficiency, improve the integrity of the Australian tax system and reduce ongoing income tax compliance costs for groups that choose to consolidate. The proposed amendments will address the efficiency and integrity problems in the current taxation of wholly owned groups. These include:

- high compliance costs;
- the double taxation of gains which are taxed when realised and taxed again on disposal of the underlying equity;
- tax avoidance through intragroup dealings; and
- value shifting to create artificial losses where there is no actual economic loss.

After extensive consultation, the Ralph Review of Business Taxation recommended, in A tax system redesigned, that a consolidated regime for wholly owned groups be introduced for income tax purposes.

In December 2000 an exposure draft was released which contained the general principles for consolidation. In February of this year a further streamlined exposure draft was released taking into account submissions on the earlier exposure draft. The accompanying explanatory memorandum to the 2002 exposure draft provided a comprehensive overview of the regime as a whole. It discussed proposed legislative amendments not included in the exposure draft at that time. Throughout this period significant private sector contribution was made to the consolidation regime's development by both submissions and ongoing consultative groups.

The consolidation regime will treat wholly owned corporate groups as a single entity, rather than on an entity by entity basis, for income tax purposes. This `single entity rule' means that, when subsidiary entities join a consolidated group, they lose their separate income tax identities. Instead, each such entity is treated as a part of the head company of the consolidated group for the purposes of determining income tax liability.

As a result of the single entity rule, the group lodges a single income tax return and the assets and liabilities of the subsidiary members are treated as those of the head company. For income tax purposes, during the period an entity is treated as part of the head company of the group, the actions of that entity are taken to be the actions of the head company and all intragroup transactions are ignored.

This bill contains the core rules necessary to treat a subsidiary entity as a part of the head company of a consolidated group. It also contains the rules dealing with the formation and membership of a consolidated group, including provision for eligible companies, trusts and partnerships to access the benefits of consolidation. It also explains the notification requirements that will apply when an entity becomes, or ceases to be, a member of a consolidated group.
The bill sets out rules to determine the cost, for income tax purposes, of assets, including membership interests, when one or more entities join or leave a consolidated group. Broadly, the head company's cost for the assets of a joining entity reflects the cost to the head company of acquiring that entity. This alignment between the cost for the membership interests in an entity and the entity's assets is preserved where a subsidiary member leaves the group. Special transitional rules that will allow groups to retain the subsidiary members' existing costs for assets will be included in a later bill.

This bill also deals with the transfer of a joining entity's losses to the head company of a consolidated group, and how these losses may be subsequently used by the head company. A head company's use of transferred losses is subject to an annual limit which is intended to approximate the amount of losses that could have been used by the transferor entity outside the group. Concessional rules apply to increase the rate at which the head company can use certain transferred company losses where a group consolidates during the transitional period 1 July 2002 to 30 June 2004.

Another component of the bill allows the transfer of a joining entity's franking account to the head company of a consolidated group. During the period of consolidation, the head company will maintain a single franking account for the group while the franking accounts of subsidiary members become inoperative.

The head company of the consolidated group retains any losses and franking credits transferred to it by a subsidiary member if that subsidiary should later leave the group.

Foreign owned groups of Australian resident entities currently access existing grouping provisions despite not having a single resident head company. To prevent these groups having to restructure, the bill allows the Australian resident entities to form a multiple entry consolidated group. The bill also determines the membership of the group in those circumstances.

In general, the head company will be liable for the income tax-related liabilities of the consolidated group. However, where a head company fails to satisfy a group income tax-related liability on time, the bill provides rules for the recovery of this group liability directly from other members of the group unless certain exceptions apply.

The bill also contains consequential amendments that ensure that the members of a consolidated group are treated as a single entity for the purposes of PAYG instalments once the head company of a consolidated group is given an instalment rate worked out from its first head company assessment. There are also transitional rules setting how instalments are payable by a consolidated group's members until that time.

Amendments in this bill generally remove certain existing grouping provisions, including those allowing the transfer of losses between wholly owned groups, from 1 July 2003, subject to special rules applying to consolidated groups that have a substituted accounting period. Consequently, wholly owned groups that do not choose to consolidate will, in general, no longer have access to grouping rules outside of consolidation. However, loss transfer will continue to be available where the transfer involves an Australian branch of a foreign bank.

The proposed amendments to implement the consolidation regime are necessary to ensure greater consistency in the taxation of wholly owned groups in Australia. The existing grouping provisions of the Income Tax Assessment Act 1936 and 1997 allow groups of companies to currently obtain benefits of single entity treatment for some purposes. However, for other income tax purposes, the existing income tax law continues to require each entity to account separately for intragroup transactions and intragroup debt and equity interests. The proposed regime will remove such inconsistencies for consolidated groups by permitting intragroup transactions to be ignored for income tax purposes.

Further, the proposed consolidation regime will provide a basis for more robust investment decisions in Australia by improving the consistency and transparency of the taxation of wholly owned groups, reducing ongoing costs of compliance and providing fairer, more equitable outcomes. For this reason the consolidation measure has widespread support among Australian corporate groups.

The consolidation regime will apply from 1 July 2002.

Full details of the measures in this bill are contained in the explanatory memorandum. I commend the bill to the House and present the explanatory memorandum.

Debate (on motion by Mr Snowdon) adjourned.