Investment & Financial Services Association Ltd
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Mr Roger Paul
Taxation of Financial Arrangements
The Treasury
Langton Crescent
PARKES ACT 2600

By Email: tofa@treasury.gov.au

Dear Mr Paul Roger

Re: Taxation of Financial Arrangements Stages 3 & 4

Thank you for the opportunity to comment on the exposure draft legislation and explanatory material.

IFSA agrees the TOFA Stages 3 & 4 legislation will provide clarity on the tax treatment of financial arrangements and is likely to assist in reducing compliance costs.

IFSA welcomes the unprecedented certainty TOFA will provide. Many years of consultation and consideration by government and industry, have produced a TOFA regime which is an example of positive communication and consultation, with an aim to achieve the beneficial outcome of greater neutrality for the tax-treatment of gains and losses made on financial arrangements. It is therefore appropriate to bring TOFA to a conclusion.

IFSA supports regimes and legislation which ensure a level-playing-field and alignment of tax treatment between financial arrangements. IFSA recommends in order for TOFA to provide the maximum utility to the financial services industry, two areas need to be addressed; the elective tax hedging rules and transitional election. These two elements are discussed below.

Elective Tax Hedging Rules

The definition of "hedging financial arrangement" in paragraph 230-290 (c) of the exposure draft requires that a "hedging financial arrangement" must constitute a "hedging instrument" for the purposes of AASB 139 in order for the "hedging financial arrangement" to qualify for the elective tax hedging rules in the exposure draft.

Unfortunately most if not all hedges entered into by funds management investment

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vehicles (unit trusts and superannuation funds) do not qualify as "hedging instruments" according to the strict tests of AASB 139 and therefore the benefit of the elective tax hedging rules will not be available to most, if not all of the Australian fund management industry. In many cases the reason for this failure is simply that funds hold fungible assets such as shares and bonds which are hedged on an overall portfolio basis and not on an asset by asset basis. The failure does not relate to the effectiveness of the hedges or to the genuine nature of the hedges, it is best described as a technical failure to satisfy the accounting hedge rules. The other integrity requirements of paragraphs 230-275 to 230-320 should be able to be satisfied by these funds and therefore IFSA can see no policy reason nor does there appear to be a specific intention to deny elective tax hedging treatment to such taxpayers.

This issue was raised in IFSA's previous submission of 24 August 2007 and has not been adequately dealt with, despite the inclusion of paragraphs 230-300 and 230-335 of the exposure draft, which seek to allow a broader application of the hedging rules in the case of mistake or non-compliance with recording requirements.

IFSA recommends this may be resolved by either;

- allowing for regulation making power to be included in the bill to allow other taxpayers such as these funds to access the elective tax regime or

- broadening the circumstances in which the Commissioner can exercise his discretion in paragraph 230-335, to allow taxpayers into the elective hedging tax regime, notwithstanding non-compliance with paragraph 230-290(c)

Transitional Election

IFSA recommends the provisions in the exposure draft law enabling taxpayers to elect to apply Division 230 to income years commencing on or after 1 July 2009, require one small amendment in regard to life companies that form part of tax consolidated groups. (Schedule 1, Part 3, sub-item 120(2) - refer EM paragraph 13.15)

Currently, sub-item 120(2) allows the head-entity of a tax consolidated group to make this election on behalf of all members of that group. This results in a life company, which forms part of a tax consolidated group, to be required to enter the TOFA regime early if the head of its tax consolidated group decides to make this election on behalf of the group. As the life company is a very different business and has unique systems and procedures to other companies, such as banks (which are typically in the same consolidated group), the life company may not be able to make the required changes to comply with an early election into TOFA.

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Accordingly, consistent with the policy behind carving-out life companies from the four elective TOFA regimes (refer for example paragraph 230-190(3) and paragraph 5.34 of the EM) IFSA recommends a carve-out from such election be made for life companies consistent with the provisions of paragraph 230-190(3) of the exposure draft.

Please feel welcome to contact me or Daniel Caruso on 02 9299 3022 if you would like to discuss this matter further.

Yours sincerely

Richard Gilbert
Chief Executive Officer

Cc The Hon. Chris Bowen MP
Assistant Treasurer and Minister for Competition Policy and Consumer Affairs

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