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17 October 2008

The Manager
Finance and Strategy Unit
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via e-mail: tofa@treasury.gov.au

Dear Sir/Ms,

Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 ("the Bill")

In light of the Government's announced plan to proceed with Taxation of Financial Arrangements ("TOFA") Stages 3 and 4 through finalising the legislation contained within the Bill in consultation with interested parties, we offer the following submission for your consideration.

For the purposes of this Submission Pitcher Partners comprises 5 independent firms operating in Melbourne, Adelaide, Sydney, Brisbane and Perth. Collectively we would be regarded as one of the largest accounting associations outside the Big Four. Our specialisation is servicing and advising smaller public companies, large family businesses, small to medium enterprises ("SMEs") and high wealth individuals - which we refer to as "the middle market" or "our target client base" in this submission. Thus our particular focus in reviewing the Bill for the purpose of this submission is on its implications for the middle market.

Main submission points

<u>The proposed regime is inappropriate and unnecessary for the middle market</u>

In our experience, a complex set of taxation rules to deal with financial arrangements is unnecessary for our target client base. Typically, the middle market only uses ‘plain vanilla’ loan, option and swap arrangements - with the current law already producing similar outcomes for these arrangements to those intended by the Bill.

The proposed regime is also inappropriate for our target client base for at least two reasons.

First, most middle market taxpayers will be forced to use the Accruals/Realisation default methodologies but will not have the processes/resources to enable them to cope with the determination of a ‘sufficiently certain gain’, ‘re-assessments’, ‘re-estimations’, ‘running balance adjustments’ and the like.

Second, as the proposed TOFA rules will generally apply in preference to all other provisions in the Act they can potentially override existing concessions for the middle market in areas like Division 7A of the 1936 Tax Act - see the Appendices below for further details.

The compliance difficulties faced with trying to overlay the TOFA regime with existing regimes such as the consolidation regime will:

(a) only serve to exacerbate the problems that the middle market will encounter under TOFA; and

(b) cause us great concern as they highlight the unduly burdensome impact that TOFA will have on the middle market.

The draft Explanatory Memorandum identifies that the “revenue impact of this measure is unquantifiable” and that “Division 230 will lower ongoing compliance costs”.

As noted above, in our opinion the compliance costs are going to be significant for the middle market. To illustrate the compliance process we attach as Appendix 8 a 10 page analysis that we have had to undertake to work through a very simple case study. This highlights the fundamental complexity of the draft provisions.

In our opinion before these measures are introduced it behoves the Government to ensure that they understand, and disseminate, the revenue and compliance impact by sector in order to ensure that the measures are needed.

This issue is even more important in these very difficult economic times. It is critical at these times that the resources of businesses and their advisors are appropriately deployed on material issues.

The Bill should be modified to become an optional 'elect in' regime

In light of the compliance and technical problems that the Bill will pose for the middle market it is our strongly held view that taxpayers should be given the option of 'electing in' to a modified version of the Bill that merely contains those elective methods - if there are taxpayers who desire to use their audited accounts as the basis for the calculation of their taxable incomes they can then chose to do so by making the appropriate election(s).

Those taxpayers who do not 'elect in' to the regime can then have their taxable incomes calculated under the current law, which on the whole operates effectively for this market.

The turnover threshold needs to be increased to at least $250 million

If (contrary to our view as stated above) the Bill is not to be modified to become an optional 'elect in' regime, then in our opinion the currently proposed $100 million turnover threshold should be increased to at least $250 million.

We submit that an increase in the threshold to (at least) this amount is necessary to exclude all those enterprises that the ATO regards as SMEs under the market segments in its Compliance Program.

In addition, and regardless of what level the threshold is ultimately set at, the threshold should be indexed so as to ensure the policy upon which it was set is not eroded over time.

The legislation is not ready for introduction into Federal Parliament

We appreciate the consultation that has been undertaken in seeking to ready the legislation for introduction.

However, the more we review the legislation generally (and the more we seek to apply it to client circumstances) the more anomalies and/or unresolved issues we identify.

This experience is not unlike the anomalies and/or unresolved issues that mitigated against the effectiveness of other recent reforms such as Tax Consolidation and the Division 775 Forex measures. The consequent compliance costs borne by taxpayers and or their advisors have been significant.

We do not think that this should be repeated.

An additional reason why the introduction of the legislation should be deferred is to ensure that the outcomes under the Bill are consistent with the terms of reference of the Tax Reform review that is presently underway.

Debt forgiveness should be left to the existing commercial debt forgiveness rules

We endorse the intention of the Bill to ensure that gains arising under the commercial debt forgiveness provisions continue to be dealt with under those rules. However, we submit that certain modifications are required to the Bill to ensure that:

- this intent is reflected in the provisions; and

- a taxable gain does not arise from a debt forgiveness under the general rules in the Bill if no gain arises from that debt forgiveness under the specific (existing) commercial debt forgiveness rules (especially if, as under the existing law, no corresponding loss is allowed to the lender).

For example, the middle market often assigns loans between solvent entities as a way of 'tidying up' a group structure. In such a case there are no gains under the existing commercial debt forgiveness rules because the market values of the loans are deemed to be received as consideration - thereby reducing the net forgiven amounts to nil and resulting in no gains to the borrower and no losses to the lender (refer to more detail in the Appendices below).

If no taxable gain arises under the specific rules dealing with a debt forgiveness in these circumstances, then a taxable gain should not arise under a more general set of rules such as those in the Bill.

Discretionary trusts and unpaid present entitlements

We have serious concerns about the potential impact of the Bill on the large number of discretionary trusts that have unpaid present entitlements outstanding in favour of their beneficiaries. At the point that a present entitlement arises, the beneficiary's interest in the trust (or perhaps technically in the resulting sub-trust) becomes fixed to that extent. In our view, the rights of the beneficiary object once presently entitled are carried by their interest in the trust as a beneficiary. However, in order to spare middle market taxpayers and those who advise on and/or administer their tax affairs (including many small accounting firms) the uncertainty that new phrases such as 'carried by' introduce, we strongly recommend that the Explanatory Material at least provide an example of how this exception is intended to apply in respect of the ordinary operation of discretionary trusts.

Technical issues

We have noted several technical issues with the Bill that we encourage you to address to ensure the Bill operates as intended. Further details on the above issues are contained in the attached Appendices.

Please contact Fiona Dillon (on 03 8610 5394), Peter Gillies (on 03 8610 5361) or the writer if you would like additional information/require clarification on any of the matters we have raised.

Yours faithfully
PITCHER PARTNERS

PETER RILEY
Executive Director

cc: Roger Paul, Treasury; Peter Van de Maele, Treasury.

Appendix 1 - Summary of recommendations

RECOMMENDATION 1: General

All of the rules in the Bill, including any interaction with the current law, must be clear in their operation with minimal compliance problems.

RECOMMENDATION 2: Easing compliance burden

(*Please refer to Appendix 2 for more detail on these recommendations)

Option 'elect-in' regime

2.1. The Bill should be modified so that it becomes an optional 'elect-in' regime for those taxpayers who desire to use their audited accounts as the basis for the calculation of their taxable incomes.

De Minimis Threshold

2.2. We recommend that the de minimis threshold should be significantly increased above the $100m turnover threshold currently proposed. We suggest that an appropriate level would be $250m as per the definition of the middle market in the ATO Compliance Program.

2.3. Whether or not recommendation 2.2 is accepted, we further recommend that the relevant turnover threshold be indexed - to avoid either: (a) the need to continually monitor and update it; or (b) the threshold becoming out of date and no longer covering all intended taxpayers.

Transactional accounts

2.4. We recommend that (for those taxpayers subject to the Bill) credit card accounts and accounts maintained for the purposes of facilitating transactions that are not subject to one of the elective methods under the Bill, be excluded for compliance cost reasons. This could be structured along the lines of the current definition of qualifying forex accounts in section 995-1 of the ITAA 1997.

These accounts are transactional financial arrangements (with no tax deferral) and the current rules for returning income when derived and outgoings when incurred work sufficiently well for them (and in a manner consistent with that intended under the Bill).

If there is a concern that such a carve out may (over time) go too far with financial ingenuity, there could be an add-back for any of these accounts that satisfy the definition of qualifying securities within the meaning of Division 16E of the ITAA 1936.

Uncertain gains and losses becoming certain only at the 'tail-end' of arrangements

2.5. We recommend that where a particular gain or loss can only be identified with sufficient certainty more than 12 months *after* the commencement of the arrangement, then:

- the realisation method should mandatorily apply to that arrangement; and
- any exception from this mandatory application of the realisation method should only apply where the period from the identification of a particular gain or loss till the time that the last of the financial benefits making up that gain or loss are to be received or provided is more than 12 months.

As a minimum, if this approach is not mandated it should be a choice of method available - that would then be required to be applied consistently pursuant to section 230-85 of the Bill.

2.6. The Bill speaks of gains and losses becoming sufficiently certain at a particular point in time after the commencement of the arrangement. We recommend that it should be clarified in the Bill (i.e. not just in the Explanatory Memorandum) that the identification of a new gain or loss that has become sufficiently certain is only required where there has been a material change in the circumstances, terms and/or conditions of an arrangement.

RECOMMENDATION 3: Commercial debt forgiveness ("CDF") interaction
(*Please refer to Appendix 3 for more detail on these recommendations).

No net forgiven amount or reduced gross forgiven amount

3.1. To deal with the situation where there is no net forgiven amount under the CDF rules due to consideration being deemed to have been paid, we recommend that a third paragraph be added to section 230-420 of the Bill to reduce the (TOFA) gain by:

(c) if subsections 245-65(2), 245-65(3) and/or 245-65(4) apply to a financial arrangement - an amount representing the consideration in respect of the forgiveness of the commercial debt as determined under section 245-65 of that Schedule (to the extent that it does not exceed the notional value of the debt within the meaning of Subdivision 245-C of that Schedule), disregarding any consideration already taken into account in determining the gain.

We further recommend that a note be included in section 230-420 to refer to section 230-442 and its interaction with subsection 245-65(2).

3.2. To deal with the situation where the gross forgiven amount of a debt is reduced as an amount has already been included in the debtor's assessable income, or any other reason contained in subsection 245-85(1) of the CDF rules, we recommend that another paragraph be added to section 230-420 of the Bill to reduce the (TOFA) gain by:

> *(d) if subsection 245-85(1) applies to a financial arrangement - the amount by which the gross forgiven amount is reduced under that subsection.*

We further recommend that another note be included in section 230-420 to refer to any provisions inserted in response to our Recommendation 4 (see below).

Debt parking and certain share subscriptions

3.3. To deal with the situation where there is a gain under the CDF rules from a debt parking or share subscription arrangement but no (TOFA) gain arises under the Bill as a result of this merely deemed forgiveness [a gain may later arise in normal course], we recommend that a new section be added to the Bill to treat the CDF gain as an amount paid under the arrangement. This may be done along the lines of the following:

If your financial arrangement is a debt which is in whole or in part taken to have been forgiven under subsection 245-35(4) or (5) of Schedule 2C to the Income Tax Assessment Act 1936, you are taken to have paid an amount under that arrangement equal to:

(a) if section 245-90 (about agreements to forgo capital losses or revenue reductions) of that Schedule does not apply - the debt's net forgiven amount as defined in paragraph 245-85(2)(a) of that Schedule; or

(b) if that section does apply - the debt's provisional net forgiven amount as defined in paragraph 245-85(2)(b) of that Schedule.

3.4. For completeness, consideration should also be given to:

(a) adding a note to section 230-25 of the Bill to ensure that the CDF rules still have application in situations where the forgiven amounts or deemed consideration have been taken into account in determining the amount of the relevant TOFA gain or loss; and

(b) reducing a TOFA loss made by a lender as a result of a commercial debt forgiveness of capital account debt in circumstances and to the extent that, had Division 230 not applied, a capital loss made as a result of the forgiveness would have been reduced as a result of the CGT market value substitution rules.

3.5. As a minor point, we also recommend changing the reference to "as defined in Subdivision 245-B" to "as described in" that Subdivision (or something similar) as the Subdivision does not actually contain a definition of a forgiven debt.

RECOMMENDATION 4: Interaction with Division 7A
(*Please refer to Appendix 4 for more detail on this recommendation)

To ensure that TOFA does not interfere with the operation of Division 7A of the 1936 Tax Act, an exception needs to be included in Subdivision 230-H to cover gains or losses arising from financial arrangements that are dealt with by Division 7A.

RECOMMENDATION 5: Discretionary trusts with unpaid present entitlements
(*Please refer to Appendix 5 for more detail on this recommendation)

We strongly recommend that an example be provided in the Explanatory Material to show that an object of a discretionary trust, with an unpaid present entitlement to a distribution from that trust, has a right that is carried by their interest in the trust as a beneficiary. That right should be an excluded financial arrangement as contemplated by paragraph 230-410(3)(b) of the Bill.

RECOMMENDATION 6: Section 230-440
(*Please refer to Appendix 6 for more detail on these recommendations)

6.1 We recommend that clear direction is required regarding how the value ascribed by section 230-440 for the rest of the Act is to be used within Division 230 itself. It is critical that whatever value is set by section 230-440 is then pegged as being the relevant value for both the other operative provisions of the Act and Division 230 itself so there are no gaps or overlaps.

6.2 We recommend that where the provision or acquisition of the thing (in fact) happens not more than 12 months after which the contract for that provision or acquisition was entered, the taxpayer may choose to have the market value of that thing as at the time of contract treated as its market value at the date when it was (in fact) provided or acquired.

6.3 We recommend a slight restructuring of subsection 230-440(2) along the lines of:

*(2) For the purpose of applying this Act to you, the *market value of the thing, at the time at which you (in fact) provide or acquire it, is to be treated as the amount that:*
(a) you acquire for providing the thing; or
(b) you provide for acquiring the thing.

6.4 In addition, as currently drafted we query the use of the word ‘obtain’ rather than ‘acquire’ in paragraph 230-440(2)(a), given acquire has already been defined for the section and used elsewhere. We recommended the wording be as consistent as possible to avoid any issue regarding whether different meanings were intended by the use of different words.

RECOMMENDATION 7: Other technical issues
(*Please refer to Appendix 7 for more detail on these issues)

We have identified (in Appendix 7) a number of other technical issues that require correction and recommend that these be amendments be made before the Bill is introduced into Parliament.

Appendix 2 – General compliance and technical concerns

1. This measure is badged as involving the introduction of a regime dealing with timing and hedging.

   Very significantly, however, this measure has the potential to bring onto revenue account many transactions that would ordinarily be governed by the Capital Gains Tax regime. This is important to the middle market for several reasons including the applicable tax rate, the ability to access tax concessions and the value of capital losses.

2. The Bill will allow many taxpayers to align their accounting and tax practices. However, this alignment will largely not apply to the middle market (numbering hundreds of thousands of taxpayers) as most businesses and individuals therein will either: (a) not qualify to make one of the 4 elections; or (b) will not wish to do so because they will not be prepared to suffer the cash flow costs of paying tax on unrealised gains.

3. Based on the above, we believe that it is critical for the middle market that the Bill be clear in its operation and give rise to minimal compliance issues.

RECOMMENDATION 1: General

All of the rules in the Bill, including any interaction with the current law, must be clear in their operation with minimal compliance problems.

<u>Compliance concerns for the middle market</u>

4. In our opinion, it will be the exception rather than the rule that middle market taxpayers who are otherwise within this regime will adopt any of the elective methodologies[1]. The reason for this is that they will not ordinarily take the risk of paying tax on volatile gains and losses.

5. Thus most of our target client base that are otherwise within the Division will be required to adopt the Accruals/Realisation default methodologies. To summarise the compliance outcomes for taxpayers in this position they must:

   i) Initially review an arrangement and identify all financial benefits.

   ii) Determine which (if any) of those financial benefits are sufficiently certain.

   iii) Value those financial benefits (if any) that are sufficiently certain.

[1] Other than perhaps Retranslation (as a means of avoiding many of the anomalies and complexities created by the current forex provisions in Division 775) and Hedging (to achieve better after-tax risk management practices).

iv) Where there is a sufficiently certain gain or loss - commence to apply the accruals process and:

- Continually monitor all financial benefits within the financial arrangement for material changes of terms, conditions or circumstances and consider whether there is a need to re-estimate the sufficiently certain gain or loss and/or reassess whether the accruals methodology should continue to apply.

- Compare each amount that is received or paid to the amount taken into account in the sufficiently certain gain or loss and undertake either a running balance adjustment or realisation calculation, and on our reading a further recalculation of the accruals amount under section 230-135(3B).

v) Where there is no sufficiently certain gain or loss –

- Continually monitor all financial benefits that were not sufficiently certain at the commencement of the arrangement to identify if they later become sufficiently certain so as to result in the identification of a *particular* gain or loss. This seems to be a requirement over and above the need to reassess at times of material change (under section 230-155 of the Bill) as subparagraph 230-105(3)(b)(ii) of the Bill sets out that such a gain or loss may, at a point in time, become sufficiently certain so as to be accrued. This seems unduly onerous.

- Continually monitor all financial benefits within the financial arrangement for material changes of terms, conditions or circumstances and reassess whether the accruals methodology should be applied.

- Apply the realisation methodology at the time a financial benefit is received or paid.

vi) Finally, and regardless of whether the accruals methodology has applied, undertake a balancing adjustment calculation.

6. The above steps highlight the complexity of the accruals/realisation methodologies and the compliance obligations imposed upon business.

7. The extent of the compliance burden imposed can be seen by contemplating having to take the above steps in the context of a financial arrangement comprising a high volume transaction account maintained with a financial institution. (In this regard, perhaps consideration could be given to excluding credit card and transaction accounts maintained with an ADI).

8. In light of the above, we strongly recommend the following changes to help ease the compliance burden associated with the default provisions:

RECOMMENDATION 2: Easing compliance burden

Optional 'elect-in" regime

2.1 *The Bill should be modified so that it becomes an optional 'elect-in' regime for those taxpayers who desire to use their audited accounts as the basis for the calculation of their taxable incomes.*

De Minimis Threshold

2.2 *We recommend that the de minimis threshold should be significantly increased above the $100m turnover threshold currently proposed. We suggest that an appropriate level would be $250m as per the definition of the middle market in the ATO Compliance Program.*

2.3 *Whether or not recommendation 2.2 is accepted, we further recommend that the relevant turnover threshold be indexed - to avoid either: (a) the need to continually monitor and update it; or (b) the threshold becoming out of date and no longer covering all intended taxpayers.*

Transactional accounts

2.4 *We recommend that (for those taxpayers subject to the Bill) credit card accounts and accounts maintained for the purposes of facilitating transactions that are not subject to one of the elective methods under the Bill, be excluded for compliance cost reasons. This could be structured along the lines of the current definition of qualifying forex accounts in section 995-1 of the ITAA 1997.*

These accounts are transactional financial arrangements (with no tax deferral) and the current rules for returning income when derived and outgoings when incurred work sufficiently well for them (and in a manner consistent with that intended under the Bill).

If there is a concern that such a carve out may (over time) go too far with financial ingenuity, there could be an add-back for any of these accounts that are qualifying securities within the meaning of Division 16E of the ITAA 1936.

Uncertain gains and losses becoming certain only at the 'tail-end' of arrangements

2.5 *We recommend that where a particular gain or loss can only be identified with certainty more than 12 months after the commencement of the arrangement, then:*

- *the realisation method should mandatorily apply to that arrangement; and*

- *any exception from this mandatory application of the realisation method should only apply where the period from the identification of a particular gain or loss till the time that the last of the financial benefits making up that gain or loss are to be received or provided is more than 12 months.*

As a minimum, if this approach is not mandated it should be a choice of method available - that would then be required to be applied consistently pursuant to section 230-85 of the Bill.

2.6 *The Bill [at subparagraph 230-105(3)(b)(ii)] speaks of gains and losses becoming sufficiently certain at a particular point in time after the commencement of the arrangement. We recommend that it should be clarified in the Bill (i.e. not just in the Explanatory Memorandum - see paragraph 4.178) that the identification of a new gain or loss that has become sufficiently certain is only required where there has been a material change in the circumstances, terms and/or conditions of an arrangement.*

Appendix 3 - Forgiveness of commercial debts

Where a debt is forgiven, the borrower will generally make a gain for Division 230 purposes equal to the amount forgiven (as the amount received under the loan will exceed the amount repaid to the extent of the forgiveness). In many cases, Division 245 of Schedule 2C of the ITAA 1936 will also treat this amount as a gain as there are detailed rules for taking this into account in that Division - the commercial debt forgiveness ("CDF") regime.

The Explanatory Memorandum to the Bill acknowledges the intention that relevant gains made from the release, waiver or extinguishment of a debt should continue to be dealt with under the CDF provisions - which is an approach and policy we endorse.

Specifically, section 230-420 of the Bill states that:

> *If a gain that you make from a *financial arrangement arises from the forgiveness of a debt (as defined in Subdivision 245-B of Schedule 2C to the Income Tax Assessment Act 1936), the gain is reduced by:*
>
> *(a) if section 245-90 (about agreements to forgo capital losses or revenue reductions) of that Schedule does not apply - the debt's net forgiven amount as defined in paragraph 245-85(2)(a) of that Schedule; or*
>
> *(b) if that section does apply - the debt's provisional net forgiven amount as defined in paragraph 245-85(2)(b) of that Schedule.*

It seems to us however, that in a number of instances the intention to exclude CDF gains from the TOFA provisions has not been achieved by section 230-420:

No net forgiven amount due to deemed consideration under the CDF rules

As pointed out in our previous submissions, the "net forgiven amount" of a debt is derived from the "gross forgiven amount" of the debt, which broadly is the debt's value (assuming an ability to pay) reduced by any consideration that is paid or taken to be paid in respect of the forgiveness. Where parties are not acting at arms length, the market value of the debt is typically deemed to be received as consideration under the CDF rules - which can reduce the gross forgiven amount, and therefore the net forgiven amount, to $nil.

For example, subsection 245-65(2)[2] in Schedule 2C of the 1936 Tax Act states that:

> *Subject to subsection (2A), if a debt (other than a money-lending debt) to which subsection (1) applies is forgiven and:*

[2] Which is referred to in section 230-442 in a way that suggests, on one reading anyway, that any TOFA gain will be reduced if subsection 245-65(2) applies - there being no note however, to section 230-420 indicating that a TOFA gain arising from the forgiveness of debt can also be reduced under section 230-442 we are not certain if this interpretation is the correct one.

> *(a) there is no consideration in respect of the forgiveness; or*
>
> *(b) the whole or a part of the consideration in respect of the forgiveness cannot be valued; or*
>
> *(c) the amount that, apart from this paragraph, would be taken to be the amount or value of the consideration in respect of the forgiveness is greater or less than the market value of the debt at the time of the forgiveness and the debtor and creditor were not dealing with each other at arm's length in connection with the forgiveness;*
>
> *the debtor is taken to have paid as "**consideration**" in respect of the forgiveness of the debt an amount equal to the market value of the debt at the time of the forgiveness.*

Where a debtor is solvent (i.e. able to pay its debts in full as and when they are due for repayment) the market value of a debt at the time of its forgiveness will equal the face (or, to use the language of the CDF rules, notional) value of that debt. A solvent debtor will not therefore, have any adverse consequences under the CDF rules because there will be no gross forgiven amount - the notional value of the debt will be equal to the consideration taken to be paid and "Subdivisions 245-D to 245-G do not apply in respect of the debt": paragraph 245-75(2)(b) of Schedule 2C to the 1936 Tax Act.

[We also note for completeness that no capital loss will arise for the creditor under CGT Event C2 as a result of the forgiveness due to the market value substitution rule in section 112-20 of the ITAA 1997 substituting the market value of the loan for the nil proceeds otherwise received. That is, the creditor is treated for CGT purposes as receiving an amount equal to the market value of the debt as capital proceeds for the debt forgiveness].

As there can only be a net forgiven amount under subsection 245-85(2)(a) if there is a gross forgiven amount (which there will not be for the above reasons), section 230-420 will not apply to reduce any TOFA gain made by a solvent borrower by having a debt forgiven by a related party. This is notwithstanding that no adjustment arises under the CDF rules themselves (and the related party is denied the corresponding capital loss). This is clearly an inappropriate outcome that should be corrected and we submit that section 230-420 should be amended to avoid this outcome.

This may be achieved by reducing any TOFA gain that arises as a result of a commercial debt forgiveness by the amount of consideration paid or taken to have been paid as a result of the forgiveness under the CDF rules (to the extent that such consideration was not already taken into account in determining that TOFA gain).

Moreover, and for the same reasons as expressed above, where the gross forgiven amount is reduced because an amount has already been included in the assessable of the debtor, or for any other reason listed in subsection 245-

85(1) of Schedule 2C to the ITAA 1936, any TOFA gain should also be reduced by those amounts.

Gain upon the assignment of a debt under the CDF rules (“debt parking”)

A CDF gain may also arise where a debt is assigned to a related party of the borrower (see subsection 245-35(4) of Schedule 2C to the ITAA 1936). The act of such a non-arms length assignment itself is unlikely to trigger a TOFA gain for the borrower (as the borrower’s financial arrangement, consisting of its obligation to repay the loan, will continue - see also TD2006/12).

However, if the policy that the CDF rules are meant to remain operational applies equally here, some adjustments to the Bill will be required. If the borrower has had to include a deemed gain under the CDF rules as a result of such an assignment, it is essential that this gain not be later double counted under the TOFA provisions. To ensure this double counting does not result, any amount included as a gain upon such an assignment under the CDF rules should be treated as an amount the borrower has paid under their financial arrangement for TOFA purposes (so that any TOFA gain or loss excludes that amount already brought to tax under the CDF provisions). The current section 230-420 of the Bill does not achieve this result as the relevant TOFA gain (the gain on the borrowing) is *not* made as a result of this assignment (which is deemed under the CDF rules to be a forgiveness).

For completeness we also mention that you might consider:

- whether a consequential note or amendment is required to section 230-25 of the Bill so that the value of the CDF gain (which is taken to be an amount paid under the financial arrangement) is not excluded from being dealt with under the CDF provisions by this anti-overlap rule; and
- including provisions to ensure that where capital losses made by a lender upon forgiving a debt that would be reduced under the market value substitution rules, any corresponding TOFA loss is to that extent also reduced.

Gain under the CDF rules when a share subscription is used to repay a debt due to that shareholder

A CDF gain may also arise where share subscription monies are used to repay a debt owed to that subscriber (see subsection 245-35(5) of Schedule 2C to the ITAA 1936). As shares, and in particular shares of which the taxpayer is the issuer, are excluded from taxation under the Bill such a subscription would not trigger a TOFA gain or loss for the borrower. As in the case of the “debt parking” situation mentioned above, we submit that it is essential that this CDF gain is not later double counted under the TOFA provisions. The current section 230-420 of the Bill does not avoid this double counting as the relevant TOFA gain (the gain on the borrowing) is *not* made as a result of this subscription (which is deemed under the CDF rules to be a forgiveness).

To ensure this double counting does not arise, any amount included as a gain upon such a subscription under the CDF rules should be treated as an amount the borrower has paid under their financial arrangement for TOFA purposes (so that any TOFA gain or loss excludes that amount which is already brought to tax under the CDF provisions). Again, a note or adjustment to section 230-25 of the Bill may also be required consequent this change.

RECOMMENDATION 3: Commercial debt forgiveness ("CDF") interaction

No net forgiven amount or reduced gross forgiven amount

3.1 *To deal with the situation where there is no net forgiven amount under the CDF rules due to consideration being deemed to have been paid, we recommend that a third paragraph be added to section 230-420 of the Bill to reduce the (TOFA) gain by:*

> *(c)* if subsections 245-65(2), 245-65(3) and/or 245-65(4) apply to the financial arrangement - an amount representing the consideration in respect of the forgiveness of the commercial debt as determined under section 245-65 of that Schedule (to the extent that it does not exceed the notional value of the debt within the meaning of Subdivision 245-C of that Schedule), disregarding any consideration already taken into account in determining the gain.

3.2 *To deal with the situation where the gross forgiven amount of a debt is reduced as an amount has already been included in the debtor's assessable income, or any other reason contained in subsection 245-85(1) of the CDF rules, we recommend that another paragraph be added to section 230-420 of the Bill to reduce the (TOFA) gain by:*

> (d) if subsection 245-85(1) applies to a financial arrangement – the amount by which the gross forgiven amount is reduced under that subsection.

We further recommend that another note be included in section 230-420 to refer to any provisions inserted in response to our Recommendation 4 (see below).

Debt parking and certain share subscriptions

3.2 *To deal with the situation where there is a gain under the CDF rules from a debt parking or share subscription arrangement but no (TOFA) gain arises under the Bill, as a result of this merely deemed forgiveness [a gain may later arise in normal course], we recommend that a new section be added to the Bill to treat the CDF gain as an amount paid under the arrangement. This may be done along the lines of the following:*

If your financial arrangement is a debt which is in whole or in part taken to have been forgiven under subsection 245-35(4) or (5) of Schedule 2C to the Income Tax Assessment Act 1936, you are taken to have paid an amount under that arrangement equal to:

(a) if section 245-90 (about agreements to forgo capital losses or revenue reductions) of that Schedule does not apply - the debt's net forgiven amount as defined in paragraph 245-85(2)(a) of that Schedule; or

(b) if that section does apply - the debt's provisional net forgiven amount as defined in paragraph 245-85(2)(b) of that Schedule.

3.3 For completeness, consideration should also be given to:

(a) *adding a note to section 230-25 of the Bill to ensure that the CDF rules still have application in situations where the forgiven amounts or deemed consideration have been taken into account in determining the amount of the relevant TOFA gain or loss; and*

(b) *reducing a TOFA loss made by a lender as a result of a commercial debt forgiveness of capital account debt in circumstances and to the extent that, had Division 230 not applied, a capital loss made as a result of the forgiveness would have been reduced as a result of the CGT market value substitution rules.*

3.4 *As a minor point, we also recommend changing the reference to "as defined in Subdivision 245-B" to "as described in" that Subdivision (or something similar) as the Subdivision does not actually contain a definition of a forgiven debt.*

Appendix 4 - Interaction with Division 7A

If TOFA is not an optional ‘elect in’ regime then it is crucial that the Bill clearly sets out how TOFA will interact with Division 7A of the 1936 Tax Act.

The potential interaction issues that we have identified (there may well be more) can best be seen by considering the following scenario:

Non-complying loan to Kevin

Kevin is the spouse of a major shareholder in a private company (“X Co”) and thus, an associate of that shareholder for the purposes of Division 7A.

Because Kevin is an associate of one of its main shareholders X Co makes a loan to him on terms that are more favourable than those it would impose if it was dealing with a 3rd party (such an employee), namely, a 5 year interest free loan of $100,000. Kevin uses this loan to buy some ASX listed shares in various companies.

As the loan is used to buy income producing assets X Co and Kevin believe (based on the so-called ‘otherwise deductible’ rule which they know exists for FBT purposes) that there will be no adverse tax consequences for him from this loan.

Because Kevin is an associate of a shareholder in X Co however, the loan he receives is subject to Division 7A. In this regard, as the loan is interest free it will:

- not comply with the requirements in section 109N of the 1936 Tax Act; and
- be treated as a dividend under section 109D of that Act - the loan not having been repaid in full by the lodgement date of X Co’s tax return for the relevant year and X Co having a distributable surplus well in excess of the amount of the loan.

Interaction issue 1

Because the whole amount of the loan will be deemed to be a dividend in Kevin’s hands under a specific set of rules outside TOFA, we submit that there should be no need to consider the implications of the loan under TOFA. That is, we believe that the rule of statutory interpretation that the specific overrides the general should apply.

Our problem is that we have been unable to find any provision in the Bill that allows the above result to be achieved. That is, there is no exception in Subdivision 230-H for financial arrangements that are covered by Division 7A of the 1936 Tax Act and, whilst Kevin is an individual, a 5 year interest free loan in circumstances like those above may well be regarded by the ATO as a qualifying security (see subsection 159GP(2) of the 1936 Tax Act).

Assuming that it is intended that a taxpayer like Kevin will be required to consider both Division 7A and TOFA, then as we understand the operation of the TOFA arm's length rules they will not apply to the loan to alter the consideration flowing between the parties - i.e. the ordinary operation of Division 230 will be such that no gain or loss will arise. However, as the $100,000 Kevin receives under the loan is still a financial benefit that is taken into account in determining that no gain or loss arises under Division 230 on this financial arrangement, it would seem to be excluded from being an assessable dividend under section 109D of the ITAA 1936 by virtue of paragraph 230-25(2)(a) of the Bill.

We appreciate this result would (clearly) be an unintended outcome but it does illustrate the difficulties faced when middle market arrangements for which there are already specific regimes are interfaced with TOFA. (It also highlights the inappropriateness of the proposed Division 230 for taxpayers outside of the finance industry for whom the existing provisions are operating relatively effectively).

Interaction issue 2

In the course of a tax audit of X Co the ATO discovers the loan to Kevin, sees that it is caught by Division 7A but decides to exercise the discretion granted to the ATO in section 109RB of the 1936 Tax Act to allow the (deemed) dividend to be fully franked.

To bring the accounts of X Co more into line with the above tax position (i.e. that a fully franked dividend has been paid), the ATO also exercises its discretion under section 109RB to allow the accountant of X Co to amends its accounts to show that the loan to Kevin was really a dividend. The loan to Kevin is thus effectively forgiven as it has been extinguished or waived by being removed from the accounts and no longer treated as an outstanding debt.

Because the amount of the loan has been included in Kevin's assessable income as a dividend, the ATO agrees that there are no adverse implications from the above process for Kevin under either Division 7A or the commercial debt forgiveness rules in Schedule 2C of the 1936 Tax Act. (That is, the ATO is happy to accept that section 109G applies to prevent the debt forgiveness from being a deemed dividend under Division 7A and that section 245-85 in Schedule 2C will apply to reduce the gross forgiven amount to nil).

Despite the fact that there are no adverse implications from the above process under the specific rules in Division 7A and Schedule 2C of the 1936 Tax Act we have been unable to find any part of the Bill that will prevent a TOFA gain from arising in such a case.

We once again submit therefore, that the specific should override the general and that the Bill needs to be amended to reflect this principle - TOFA must not be allowed to effectively overturn concessions that are granted to taxpayers by specific provisions elsewhere in the Act.

RECOMMENDATION 4: Interaction with Division 7A

To ensure that TOFA does not interfere with the operation of Division 7A of the 1936 Tax Act, an exception needs to be included in subdivision 230-H to cover gains or losses arising from financial arrangements that are dealt with by Division 7A.

Appendix 5 – Discretionary trusts and unpaid present entitlements

We have serious concerns about the potential impact of the Bill on the large number of discretionary trusts that have unpaid present entitlements outstanding in favour of their beneficiaries. At the point that a present entitlement arises, the beneficiary's interest in the trust (or perhaps technically in the resulting sub-trust) becomes fixed to that extent. In our view, the rights of the beneficiary object once presently entitled are carried by their interest in the trust as a beneficiary. However, in order to spare middle market taxpayers and those who advise on and/or administer their tax affairs (including many small accounting firms) the uncertainty that new phrases such as 'carried by' introduce, we strongly recommend that the Explanatory Material at least provide an example of how this exception is intended to apply in respect of the ordinary operation of discretionary trusts.

We strongly recommend that an example be provided in the Explanatory Material to show that an object of a discretionary trust, with an unpaid present entitlement to a distribution from that trust, has a right that is carried by their interest in the trust as beneficiary. That right should be an excluded financial arrangement as contemplated by paragraph 230-410(3)(b) of the Bill.

RECOMMENDATION 5: Discretionary trusts with unpaid present entitlements

We strongly recommend that an example be provided in the Explanatory Material to show that an object of a discretionary trust, with an unpaid present entitlement to a distribution from that trust, has a right that is carried by their interest in the trust as a beneficiary. That right should be an excluded financial arrangement as contemplated by paragraph 230-410(3)(b) of the Bill.

Appendix 6 - Section 230-440

Whilst the redrafted section 230-440 is an improvement on the former draft, there are still a number of issues with this provision.

Scope

We are deeply concerned that this provision is crafted far too generically, given that it is intended to be the gateway to the interaction between the financial arrangement and all other areas of the Act.

In particular, we are concerned that whilst the section may in many instances appropriately deem the value to be taken to have been provided or received for other provisions of the Act (though see our interpretative concerns below), it does not seem to then use that value so deemed as the starting point for the financial arrangement acquired, or disposal value for a financial arrangement that ceases (in consideration for the provision or acquisition of the thing).

Whilst Note 2(a) to subsection 230-440(2) mentions that the value may be relevant for a balancing adjustment, is the note sufficient? Of greater concern is financial arrangements acquired for the provision or acquisition of a thing taken into account under 230-65. This provision is not referred to at all. If for example widgets are provided in exchange for a financial arrangement (a right to receive $100 in 18 months), how do we know that the 'cost' of the financial arrangement under section 230-65 (the obligation to provide widgets under the arrangement) is to be their value when provided, rather than their actual cost to the seller or otherwise?

We recommend that clear direction is required regarding how the value ascribed by section 230-440 for the rest of the Act, is to be used within Division 230 itself. It is critical that whatever value set by section 230-440 is then pegged as being the relevant value for both the other operative provisions of the Act, and Division 230 itself so there are no gaps or overlaps.

Market value at time of provision or receipt

We also raise the issue that in requiring the relevant 'thing' provided or acquired to be market valued at the time of provision or acquisition, there is the additional compliance burden that market values appropriately taken into account at the time of contract may not be relevant for tax purposes if the relevant thing is provided some time later.

For example, if a taxpayer enters into a contract to sell a factory based on its current market value, under which the possession and title of the factory is transferred in 6 months time, with payment occurring some 18 months later, the taxpayer will need to obtain a second valuation for tax purposes at the time the factory is provided. We submit that this is a considerable compliance burden that is not offset by any measurable integrity concerns where the difference between the contract date and the provision or recept of the thing is not more than 12 months. (In addition, as the current volatile economic times illustrate there can be marked movements in value that the parties to the arrangement could not realistically have anticipated).

Accordingly, we recommend that where the provision or acquisition of the thing (in fact) happens not more than 12 months after which the contract for that provision or acquisition was entered, the taxpayer may choose to have the market value of that thing as at the time of contract treated as its market value at the date when it was (in fact) provided or acquired.

This could then be subject to an integrity provision to ensure that if a taxpayer so chooses, they must use such a method consistently to ensure there were no issues of selectivity. We believe this is a genuine compliance cost issue and not a matter of tax-cost, as values may fluctuate either way (as has been evidenced in the current volatile market).

Interpretative issues

As currently drafted, there is a risk that the provision may be read in a manner capable of ascribing a particular value (namely, the amount received or paid as consideration), as being deemed to be the relevant market value of the 'thing' at the requisite time. We understand that the intended reading is in fact the other way around, so that the market value of the thing should instead be deemed to be the amount that is actually paid or received as consideration. To avoid this interpretative confusion, we recommend a slight restructuring of subsection 230-440(2) along the lines of:

> *(2) For the purpose of applying this Act to you, the *market value of the thing, at the time at which you (in fact) provide or acquire it, is to be treated as the amount that:*
> *(a) you acquire for providing the thing; or*
> *(b) you provide for acquiring the thing.*

In addition, as currently drafted we query the use of the word 'obtain' rather than 'acquire' in paragraph 230-440(2)(a), given acquire has already been defined for the section and used elsewhere. We recommended the wording be as consistent as possible to avoid any issue regarding whether different meanings were intended by the use of different words.

RECOMMENDATION 6: Section 230-440

6.1 We recommend that clear direction is required regarding how the value ascribed by section 230-440 for the rest of the Act is to be used within Division 230 itself. It is critical that whatever value is set by section 230-440 is then pegged as being the relevant value for both the other operative provisions of the Act and Division 230 itself so there are no gaps or overlaps.

6.2 We recommend that where the provision or acquisition of the thing (in fact) happens not more than 12 months after which the contract for that *provision or acquisition was entered, the taxpayer may choose to have the market value of that thing as at the time of contract treated as its market value at the date when it was (in fact) provided or acquired.*

6.3 We recommend a slight restructuring of subsection 230-440(2) along the lines of:

(2) For the purpose of applying this Act to you, the *market value of the thing, at the time at which you (in fact) provide or acquire it, is to be treated as the amount that:
(a) you acquire for providing the thing; or
(b) you provide for acquiring the thing.

6.4 In addition, as currently drafted we query the use of the word 'obtain' rather than 'acquire' in paragraph 230-440(2)(a), given acquire has already been defined for the section and used elsewhere. We recommended the wording be as consistent as possible to avoid any issue regarding whether different meanings were intended by the use of different words.

Appendix 7: Other technical issues

Anti-avoidance rule and net amounts

In a broad sense, section 230-25 excludes financial benefits that have factored into a TOFA gain or loss from being otherwise assessable or deductible. However, in our view this is insufficient to deal with financial benefits which may be included in the calculation of a capital loss, which is not of itself allowable as a deduction.

There are similar issues with other net sums in that an amount that contributes to the calculation of a net amount (in particular, in reducing an otherwise greater amount of a gain or loss) cannot itself be said to be otherwise included in assessable income or allowable as a deduction to any extent.

As such, we recommend that a new subsection (3) be inserted into section 230-25 to provide something along the lines as:

> *(3) A *financial benefit to which this section applies is not to be (to any extent) included in the calculation of a net amount that is*
> > *(a) included in your assessable income under any provision of this Act outside of this Division;*
> > *(b) allowable as a deduction to you under any provision of this Act outside of this Division; or*
> > *(c) taken into account under Parts 3-1 or 3-5 of this Act;*
>
> *for the same or any other income year.*

Farm Management Deposits

The current wording of 230-410(15) will exclude from the TOFA provisions *all* financial arrangements (and not just farm management deposits) of taxpayers who own a farm management deposit. This does not seem to have been intended.

No 'grandfathering' for arrangements subject to the forex amendments

The forex amendments contained in item 6 of the Bill will, pursuant to item 120 of the Bill, apply to income years commencing on or after 1 July 2009. The rules which quarantine the application of the amendments in the Bill to new financial arrangements unless an election is made (item 121 of the Bill) do not apply to other arrangements (non-financial arrangements) that are otherwise subject to the forex amendments (see for example proposed new section 775-295). Absent a specific 'grandfathering' rule therefore, there is the risk that the new forex provisions will automatically apply to all relevant non-financial arrangements (subject to the retranslation election being made) and none of these arrangements will factor in the balancing adjustment set out in item 121 of the Bill.

Election for portfolio treatment of fees

This election may be made if certain conditions are satisfied in respect of accounts 'you' prepare. We would recommend that these requirements be extended to allow those conditions to be satisfied by relevant consolidated accounts along the line of those in subsections 230-180(2A), 230-220(2A), 230-275(2A) and 230-350(2A) of the Bill.

Hedging documentation

As many records (that is broadly as defined anything in writing or on computer) are prepared in respect of the preparation of financial reports, most of which will not even relate to hedging, the requirement to record the hedging financial instruments in all documents is not practical and would severely limit the intended application of these provisions.

Even if the requirement is restricted to relevant hedge records, the requirement that it be so recorded in *all* documents would also not be practical when such documents may extend to original source documents including for example an invoice from the counter-party in respect of the hedging financial arrangement, to whom the taxpayer's accounting (and moreover tax) requirements would be irrelevant.

We recommend that Treasury reconsider the scope of this documentation requirement.

Exclusion for partnership and trust interests

As all other excluded rights and obligations under section 230-410 remain 'the subject of an exception', we are concerned that these words have been removed. We would recommend that this phrase be reinserted.

Typos

The heading to subsection 230-15(7) should be changed from 'Section' to 'Division' per the change in the body of the provision.

The reference to subsection 230-230(5) in subsection 775-295(3) in item 6 of the Bill (the forex amendments) should instead be to subsection 230-230(4).

There appears to be a typo in paragraph 2.141 of the Explanatory Material, as the reference to paragraph 2.99 should be to 2.100.

Gains or losses arising under a will or a codicil

The Bill should be amended so that:

- a gain or loss under a financial arrangement is the subject of an exception if the gain or loss arises from the release, waiver, extinguishment or forgiveness of the financial arrangement pursuant to a will, codicil or an order of a Court that varied or modified the provision of a will or a codicil;

- the pre-TOFA status of a financial arrangement is maintained (i.e. 'grandfathered') if it is transferred pursuant to a will, codicil or an order of a Court that varied or modified the provisions of a will or a codicil; and
- the transfer of a financial arrangement pursuant to a will, codicil or an order of a Court that varied or modified the provisions of a will or a codicil does not require a balancing adjustment to be made. That is, there needs to be some form of 'rollover' to deal with the transfer of financial arrangements in such cases.

RECOMMENDATION 7: Other technical issues

We have identified (in this Appendix) a number of other technical issues that require correction and recommend that these be amendments be made before the Bill is introduced into Parliament.

Appendix 8 - Worked example

Question	Relevant Provisions	Outcome
	Facts: 1. Contract entered into to deliver Widgets for $100 in 6 months time with payment due on the 1st July, 18 months thereafter; 2. At time of delivery Widgets have a market value of $80; (b) Purchaser defaults on payment and in due course only $5 is received. Assume that the financial difficulty that brought this about did not arise until just prior to the due date for settlement.	
Is there a financial arrangement?	**Financial arrangement** … Note 1 to Section 230-50: Whether your rights and/or obligations under an arrangement constitute a financial arrangement can change over time depending on changes either to the terms of the arrangement or external circumstances (such as particular rights or obligations under the arrangement being satisfied by the parties). For example, a contract may provide for the transfer of a boat in 6 months time and payment of the contract price at the end of 2 years. Until the boat is delivered, there is no financial arrangement because of the operation of paragraphs (d), (e) and (f) above. Once the boat is delivered, there is a financial arrangement because those paragraphs are no longer applicable. To start, you have an obligation to provide widgets and a right to receive $100. After 6 months you only have a cash settlable right to receive $100. That right … constitutes the financial arrangement, which comes into existence at the expiration of the 6 moths The short-term arrangements exemption where a non-money amount is involved (refer 230-400) is inapplicable as the period between the following is more than 12 months:	After 6 months you only have a remaining cash settlable right to receive $100. That right … constitutes the financial arrangement, which comes into existence at the expiration of the 6 months.

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Question	Relevant Provisions	Outcome
	(i) the time when you … receive the consideration (or a substantial proportion of it); and (ii)the time when you … provided the property, goods or services (or a substantial proportion of them).	
What amount is assessable on the sale transaction?	**230-440 Financial arrangement as consideration for provision or acquisition of a thing** (1) This section applies if you start or cease to have a *Division 230 financial arrangement as consideration for the provision or acquisition of a thing. (2) For the purposes of applying this Act to you, treat the amount that: (a) you obtain for providing the thing; or (b) you provide for acquiring the thing; as the *market value of the thing at the time at which you (in fact) provide or acquire it. Note 1: The amount may be relevant, for example, for the purposes of applying the provisions of this Act dealing with capital gains, capital allowances or trading stock to the thing. Note 2: This subsection does not affect the financial benefits received or provided under the financial arrangement from you starting or ceasing to have it (except in the circumstances described in Note 3). However: (a) the market value of the thing will be, or form part of, those financial benefits for the purposes of section 230-395; and (b) in the case of a non arm's length transaction, the amount of those financial benefits may be affected by section 230-441. Suggest read (2) as follows: (2) For the purposes of applying this Act to you, the *market value of the thing at the time at which you (in fact) provide or acquire it is to be treated as the amount that:	Whilst the words in the section are very generic, it appears that they intend that $80 (the market value of the Widgets at the time they are in fact provided) is the deemed amount given to the sale proceeds. It has been derived when the $100 would ordinarily have been regarded as derived.

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Question	Relevant Provisions	Outcome
	(a) you obtain for providing the thing; or (b) you provide for acquiring the thing;	
Do you have a 'cost' in acquiring the right to receive the $100?	**230-65 When financial benefit provided or received under financial arrangement** *Financial benefit provided under financial arrangement* (1) You are taken, for the purposes of this Division, to have (or to have had) an obligation to provide a *financial benefit under a *financial arrangement if: (a) you have (or had) an obligation to provide the financial benefit in relation to the arrangement; and (b) the financial benefit would not otherwise be treated as one that you have (or had) an obligation to provide under the arrangement; and I the financial benefit plays an integral role in determining: (i) whether you make a gain or loss from the arrangement; or (ii) the amount of such a gain or loss. Paragraph (a) applies even if the entity to which you provide the financial benefit is not a party to the arrangement. Note: This means that the financial benefits you provide to acquire the financial arrangement (whether to the issuer, a previous holder or a third party) are taken to be financial benefits you provide under the arrangement. The financial benefits you provide may include, for example, fees paid or the forgoing of rights to receive a financial benefit.	Broadly as the widgets were consideration for your right to receive $100, they are integral to calculating whether you make a gain or loss in respect of that right. The provision of the Widgets therefore causes you to be deemed to have an obligation to provide a financial benefit under the financial arrangement. In this respect you have a 'cost' in acquiring the right. There are now two elements to the financial arrangement being: 1. a *cash settlable legal or equitable right to

Question	Relevant Provisions	Outcome
		receive a *financial benefit; and 2. an obligation to provide a financial benefit. N.B the obligation is not deemed to be a cash settlable legal or equitable obligation to provide a financial benefit.
Which TOFA method applies?	230-105(2) The accruals method provided for in this Subdivision applies to a gain or loss you make from a *financial arrangement if: (a) the gain or loss is an overall gain or loss from the arrangement; and (b) the gain or loss is sufficiently certain at the time when you start to have the arrangement. Note: Subsection 230-110(1) tells you when you have a sufficiently certain overall gain or loss. **230-110 Sufficiently certain overall gain or loss** (1) You have a sufficiently certain overall gain or loss from a *financial arrangement at the time when you start to have the arrangement only if it is sufficiently certain at that time that you will make an overall gain or loss from the arrangement of: (a) a particular amount; or (b) at least a particular amount. The amount of the gain or loss is the amount referred to in paragraph (a) or (b). Note: Sections 230-75 and 230-80 (about apportionment of financial benefits) only apply in working out whether you make, or will make, a gain or loss (and the amount of the gain or loss) when particular events happen. They do not apply in working out, at the time when you start to have a financial	There appears to be a sufficiently certain overall gain of $20. In reaching that conclusion regard is had to the prima facie nominal value of the right of $100 and the prima facie nominal value of the obligation of $80. N.B. It could be said that the value of your obligation is not the deemed amount received but your cost of sales – however this would cause double tax. Query the effectiveness of 230-440.

Question	Relevant Provisions	Outcome
	arrangement, whether it is sufficiently certain that you will make an overall gain or loss from the arrangement. (2) In applying subsection (1), you must: (a) assume that you will continue to have the *financial arrangement for the rest of its life; and (b) have regard to the extent of the risk that a *financial benefit that you are not sufficiently certain to provide or receive under the arrangement may reduce the amount of the gain or loss.	There are no cost base equivalent rules or capital proceeds equivalent rules in the Division.
Application of the method	**230-135 How gain or loss is spread** *How to spread gain or loss* (1) This section tells you how to spread a gain or loss to which the accruals method applies. *Compounding accruals or approximation* (2) The gain or loss is to be spread using: (a) compounding accruals; or (b) a method whose results approximate those obtained using the method referred to in paragraph (a) (having regard to the length of the period over which the gain or loss is to be spread). (2A) The following subsections of this section clarify the way in which the gain or loss is to be spread in accordance with subsection (2). *Intervals to which parts of gain or loss allocated*	Approximately $20 is brought to account on an accrual basis up to the 30 June immediately prior to the 1 July due date.

Question	Relevant Provisions	Outcome
	(3) The intervals to which parts of the gain or loss are allocated must: (a) not exceed 12 months; and (b) all be of the same length. Paragraph (b) does not apply to the first and last intervals. These may be shorter than the other intervals. *Fixing of amount and rate for interval* (3A) For each interval: (a) determine a rate of return; and (b) determine an amount to which you apply the rate of return. (3B) For the purposes of paragraph (3A)(b), in determining the amount to which you apply the rate of return for an interval, have regard to: (a) the amount or value; and (b) the timing; of *financial benefits that are to be taken into account in working out the amount of the gain or loss, and were provided or received by you during the interval. *Assumption of continuing to hold arrangement for rest of its life* (4) The gain or loss is to be spread assuming that you will continue to have the *financial arrangement for the rest of its life. *Regard to be had to financial benefits provided or received in interval* (5) In allocating the gain or loss to intervals, have regard to the *financial benefits to be provided or received in each of those intervals.	

Question	Relevant Provisions	Outcome
What happens at the end of the 18 months deferred period when you accept $5 in full and final settlement?	**230-390 Exceptions [to Balancing Charges]** *Bad debts, margining and conversion into, or exchange for, ordinary shares* (3) A balancing adjustment is not made under this Subdivision in relation to the following events: (a) a *financial arrangement being written off in whole or part as a bad debt; (b) … … Note: Paragraph (a)—For the treatment of bad debts, see paragraph 230-160(2)(c).	N.B. A financial arrangement is not being written off as a bad debt. Rather a financial benefit is. Perhaps this is "a *financial arrangement being written off in … part" as a bad debt Thus it appears that there cannot be a balancing charge. S. 230-160(2)(c) is the Re-estimation provision.
	230-45 Methods for taking gain or loss into account *Methods available* (1) The methods that can be applied to take account of a gain or loss you make from a *financial arrangement are: (a) the accruals and realisation methods provided for in Subdivision 230-B; or (b) the fair value method provided for in Subdivision 230-C; or (c) the foreign exchange retranslation method provided for in Subdivision 230-D; or (d) the hedging financial arrangement method provided for in Subdivision 230-E; or (e) the method of relying on your financial reports provided for in Subdivision 230-F; or (f) a balancing adjustment provided for in Subdivision 230-G.	If a balancing adjustment is not permitted, then the accruals regime continues to apply to the financial arrangement.

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Question	Relevant Provisions	Outcome
	Note: The methods referred to in paragraphs (b) to (e) only apply if you make an election under the relevant Subdivision and you must meet certain requirements before you can make such an election. (1A) A gain or loss is not taken into account under any of the methods referred to in paragraphs (1)(a), (b), (c) and (e) to the extent to which it is taken into account under the method referred to in paragraph (1)(f) (balancing adjustment). **230-145 Running balancing adjustments** *Overestimate of financial benefit to be received* (1) You are taken for the purposes of this Division to make a loss from a *financial arrangement if: (a) a provision of this Subdivision has applied on the basis that you were sufficiently certain, at a particular time, to receive a *financial benefit of, or of at least, a particular amount under the arrangement; and (b) when you receive the benefit (or the time comes for you to receive the benefit), the amount you receive (or are to receive) is nil or is less than the amount estimated. The amount of the loss is equal to the difference between the amount estimated and the amount you receive (or are to receive). You are taken to have made the loss for the income year in which you receive the benefit (or in which the time comes for you to receive the benefit).	A provision of this Subdivision has applied on the basis that you were sufficiently certain, at a particular time, to receive a *financial benefit of, or of at least, $100 under the arrangement and you only receive $5. Thus you are taken to have made a loss of $95. Together with the gain you should have already accrued your total loss will appropriately be $75.
Operation of Anti-Overlap	**230-20 Gain or loss to be taken into account only once under this Act** *Application of section*	Because the accrual running balance loss made on receipt of the $5 of $95 is deductible under Div 230 no part of that loss (the loss made on receipt

Question	Relevant Provisions	Outcome
	(1) This section applies to the following: (a) a gain that is included in your assessable income for an income year under this Division; (b) a loss that is allowable as a deduction to you for an income year under this Division; (c) a gain or a loss that is dealt with in accordance with subsection 230-270(4) in relation to an income year. *Purpose of this section* (2) The purpose of this section is to ensure that your gains and losses, and *financial benefits, to which this section applies are taken into account only once under this Act in working out your taxable income. *Gain or loss to be taken into account only once* (3) A gain or loss to which this section applies is not to be (to any extent): (a) included in your assessable income; or (b) allowable as a deduction to you; or (c) dealt with in accordance with subsection 230-270(4); again under this Division for the same or any other income year. (4) A gain or loss to which this section applies is not to be (to any extent): (a) included in your assessable income; or (b) allowable as a deduction to you; under any provisions of this Act outside this Division for the same or any other income year. *Section does not give rise to exempt income*	of $5 instead of $100) may be deductible under any other provision. However, is this sufficient to prevent a $75 deduction under 25-35 on write-off of the debt? As the TOFA loss is a statutory calculation as part of an accruals calculation, does the write-off of a debt produce the <u>same loss</u> that is deductible "again" under 25-35? Arguably the better view is that 230-20 is designed to prevent double counting, so no 25-35 deduction can arise here. Certainly, 230-20 seems to be the only relevant provision as 230-25 expressly contemplates the allowance of a bad debt deduction in respect of financial benefits which have contributed to TOFA gains and losses.

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Question	Relevant Provisions	Outcome
	(5) A gain is not to be treated as *exempt income merely because it is not included in your assessable income under this section. **230-25 Associated financial benefits to be taken into account only once under this Act** *Application of section* (1) This section applies to a *financial benefit whose amount or value is taken into account in working out whether you make, or the amount of, a gain or loss to which paragraph 230-20(1)(a), (b) or (c) applies. *Associated financial benefit to be taken into account only once* (2) A *financial benefit to which this section applies is not to be (to any extent): (a) included in your assessable income; or (b) allowable as a deduction to you; under any provision of this Act outside this Division for the same or any other income year. *Exception for certain bad debts* (5) If: (a) a *financial benefit has been included in your assessable income under a provision of this Act outside this Division; and (b) a bad debt deduction would have been allowed under section 25-35 in relation to the financial benefit; subsection (2) does not prevent that bad debt deduction from being allowed under section 25-35 in relation to the financial benefit as if the debt were still outstanding.	Unless the $75 loss is otherwise deductible under Div 230 [as in this case 230-20(4) would deny a second deduction outside the Division], S. 230-25(5) appears to be intended to allow a $75 bad debt deduction in principle as $80 has been included in assessable income under a provision of this Act outside this Division. Whilst it appears that this section is intended to facilitate a bad debt deduction assuming the relevant tests are satisfied, in these facts a bad debt deduction is only allowed in relation to part of the financial benefit, consistent with S. 25-35 allowing a write off of part of a debt. Note that

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Question	Relevant Provisions	Outcome
		S. 230-390 set out herein refers to a write off in whole or in part, which may suggest that 230-25(5) only applies to the whole of the financial benefit being written off. Alternatively, the reference to a deduction under 25-35 “in relation” to the financial benefit may enable part write-offs to be covered. Query the use of different language however.

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