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Mr William Potts
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Contact Edgar Baltins, 02 9335 8254

10 March 2006

Dear Sir

Taxation Laws Amendment (Taxation of Financial Arrangements) Bill 2006

On behalf of Walker Group Holdings Pty Limited (**Walker**), we make the following submissions in relation to the Exposure Draft (**Exposure Draft**) of the Taxation Laws Amendment (Taxation of Financial Arrangements) Bill 2006 (**TOFA Bill**).

Recommendation

It is submitted that long term construction contracts covered under IT 2450 – *Income Tax: Recognition of income from long term constructions contracts* should be specifically excluded from the TOFA regime.

Background

Under one interpretation of the Exposure Draft as currently drafted, it appears that the tax timing rules to be introduced by the TOFA Bill may apply to long term construction contracts. If correct, this appears to be an unintended consequence of the wide definition of 'financial arrangement' for the purposes of the proposed rules.

It is submitted that the proposed TOFA tax timing rules should not apply to disturb the long-settled income tax treatment of long term construction contracts. Walker looks to Treasury to ensure that this will not be the case.

The Explanatory Material provides that the main objectives underpinning the TOFA framework include:

- “facilitating the appropriate allocation over time of the gains and losses from financial arrangements for tax purposes”; and
- “reducing taxpayer uncertainty and compliance costs.”

Appropriateness of current methods

The existing ATO ruling, IT 2450, already ensures that gains and losses arising from a long term construction contract are appropriately allocated over the life of the arrangement. The two acceptable methods of bringing income and deductions under long term construction contracts to account under IT 2450 already result in relevant taxpayers recognising the taxable income arising from their contracts over the term of those contracts. The acceptability of these methods has been confirmed by the courts e.g. *Grollo Nominees Pty Ltd v FCT* 97 ATC 4585. It is also equally clear (from both IT 2450 and Taxation Determination TD94/39) that the completed contracts method is generally unacceptable.

Moreover, Section 170(9) of the *Income Tax Assessment Act 1936* has existed for many years as a mechanism to permit the Commissioner to amend assessments where allocation of profits and losses over the term of a construction contract is considered inappropriate. Based on our understanding that this section is rarely used by the Commissioner, it would seem that the existing method of profit recognition is generally acceptable from a practical perspective.

Accordingly, from a policy perspective, it is submitted that the introduction of new tax timing rules that would also result in the taxable income being recognised over the term of construction contracts is unnecessary.

Uncertainty and increased compliance costs

Taxpayers in the long term construction industry have enjoyed a settled and widely understood income tax treatment of long term construction contracts for almost twenty years since IT 2450 was issued in October 1987.

The industry does not welcome and does not wish to be impacted by a fundamental change in a settled income tax treatment that already accords with the commercial position and is well understood. If long term construction contracts are within the TOFA regime, taxpayers could potentially be faced with the burden of additional compliance costs (from having to determine, for example, whether it is reasonably likely to make a gain or loss made under a long term construction contract and therefore accrue the gain or loss under the compounding accruals methodology).

The unnecessary creation of such additional compliance costs is clearly contrary to the objectives of the TOFA regime.

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*The Treasury
Taxation Laws Amendment (Taxation of Financial
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We look forward to your favourable consideration of these submissions and to receiving your responses.

Please contact us if you have any questions. We would be happy to arrange a meeting to discuss the matters raised in these submissions further should you consider it appropriate.

Yours faithfully

A handwritten signature in black ink that reads 'Edgar Baltins'. The signature is written in a cursive style with a large, looping 'E' and a long, sweeping underline.

Edgar Baltins
Partner