



**CORPORATE TAX
ASSOCIATION**
of Australia Incorporated

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Mr Roger Paul,
Manager, Finance and Strategy Unit
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: tofa@treasury.gov.au

Dear Roger,

**TOFA 3&4
EXPOSURE DRAFT LEGISLATION AND EXPLANATORY MATERIAL**

Further to our meeting in Canberra last week, I understand you will by now have received certain additional information from Peter Filipovic from Foster's Group about the differences in the treatment of certain instruments as between the accounting standards and the compounding accruals method in proposed Subdiv 230-B. For the sake of completeness, I attach a copy of Peter's letter of today's date.

You will recall at our meeting we raised concerns about the additional compliance costs and uncertainty created by the compounding accruals method, particularly for non-banks.

As part of the discussion, we agreed it would be helpful to look at a commercial example in order to better understand the nature of the timing differences that are likely arise between the allocation of (for example) interest expenses under the accounting standards and the proposed compounding accruals method.

The main reason for the differences in the case of the floating rate bond in the example provided by Foster's Group is that under AASB 139 the starting interest rate is applied for each quarterly period, with resets every three months, as well as a mark-to-market adjustment at the end of each reporting period. The compounding accruals method, if strictly applied, would adjust for material changes in the floating rate whenever they occur.

This does create relatively minor timing differences between the two methods. However, the overall gain on the financial asset will be identical as between the two methods, since the timing differences wash out over the term of the bond. Importantly, any timing differences that do occur would not be systemic in the sense of mostly resulting in the deferral or acceleration of taxable income.

We acknowledge that proposed sec 230-135(2)(b) of the Exposure Draft (ED), which deals with how to spread the gain or loss on a financial arrangement under the accruals method, gives taxpayers the choice of using "... a method whose results approximate those obtained using the method referred to in paragraph (a) ...", para (a) being the compounding accruals method as set out in the ED.

Such a provision is useful up to a point, but at a practical compliance level para (b) raises the not altogether rhetorical question of how much work taxpayers have to do in order to demonstrate they don't have to do all the work involved in the compounding accruals method.

While the EM provides some limited guidance, we really don't know what sort of evidence the Tax Office might be looking for in future active compliance work to establish that the methods taxpayers have used in fact approximate the results that would have been obtained using the statutory method. This creates uncertainty and additional compliance costs.

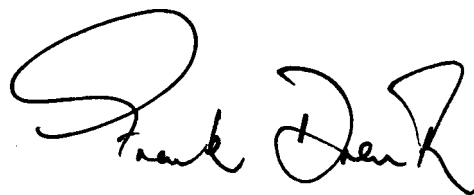
As we indicated at our meeting, we recognise it would not be practical or appropriate to let companies 'opt in' to the TOFA 3&4 regime, since that might negate the objective of preventing unwarranted deferrals.

Instead, we have suggested a statutory safe-harbour for reporting entities using the same rules set out in proposed sec 230-350 in relation to the election to rely on financial reports – i.e. audited in accordance with the auditing standards; no recent qualifications relating to the tax treatment of financial arrangements; reliable internal controls and governance processes etc. Such a provision would achieve the necessary level of certainty as well as reducing compliance costs.

This is the one major issue affecting mainly non-bank taxpayers that, absent the making of elections, will be subject to the two default methods of accounting for their financial assets and liabilities. We have not had other technical issues raised by members, although we understand that some organisations will have made industry specific submissions.

My apologies for the delay in providing these additional comments. Please feel free to contact me on 03 9600 4411 if you would like to discuss this issue in more detail.

Yours Faithfully,



(Frank Drenth)
Executive Director