Grant Thornton

Do you have a right to additional tax deductions?

Rights to future income - Your tax group may be entitled to significant tax deductions under recent amendments to the tax consolidation provisions.

Recent law changes[1] have modified the tax cost-setting rules dealing with valuable rights to future income.

Importantly, **the amendments apply retrospectively from 1 July 2002.** So if your organisation has been acquisitive in recent years you may be eligible to lodge tax amendments and possibly access large retrospective tax deductions and associated refunds.

What is "Rights to Future Income"?

Examples of "Rights to Future Income" assets (or **RTFI assets**) may include:

- work in progress
- contracts to supply goods or services
- construction contracts
- right to trailing commission
- right to deferred management fee

Tax deduction eligibility

A tax deduction may be allowed where the following conditions are met:

- A company joins a tax consolidated group as part of an acquisition
- The acquired entity has a RTFI asset at the time of acquisition
- The RTFI asset is expected to generate taxable income
- The RTFI asset's value is greater than nil and can be set using a recognised market valuation methodology.

A deduction is allowed to be claimed over the lesser of:

- Ten years, or
- The specified period of the contract or agreement giving rise to the RTFI asset.

There are certain instances in which a tax deduction is not allowed, for example:

- If the target is part of the same consolidated group when the right is created
- For rights that result in the derivation of passive income (e.g. leasing contracts or interest income).

[1] The Tax Laws Amendment (2010 Measures No.1) Act 2010.

Grant Thornton Australia Limited is a member firm within Grant Thornton International Ltd. Grant Thornton International Ltd and the member firms are not a worldwide partnership. Grant Thornton Australia Limited, together with its subsidiaries and related entities, delivers its services independently in Australia.

Liability limited by a scheme approved under Professional Standards Legislation

What has changed?

Under the old system, the tax cost setting amount was usually considered non-deductible for the head entity of a tax consolidated group.

Even if the buyer was paying for the RTFI asset, it was uncertain under the old regime when and how the amount allocated to the RTFI asset should be treated for tax purposes.

Following the recent amendments, it is now clear that the tax cost allocated to the RTFI asset is a deductable cost. Provided all conditions are met, a deduction can be claimed.

A practical example

Assume a tax group acquires 100% of a company's shares on 1 July 2010 and consequently, the acquired company joins the tax group.

Suppose the newly-purchased company has a service contract in place for a residual term of 5 years, for which it is expected to receive $100,000 per year under the life of the contract. In this situation, the service contract is a RTFI asset.

The market value of this RTFI asset is then determined based on a **recognised market valuation methodology** at $250,000. This is also established as the tax cost base of the asset under the consolidation tax cost setting process (NB: this is a simplified assumption. In some cases the market value of the RTFI asset may not necessarily equal the tax cost as per the tax consolidation calculation).

Before the introduction of the recent amendment, the acquiring group would likely have treated the $250,000 tax cost of the asset as non-deductible for tax purposes. However now, under the new rules (assuming the acquirer now includes $100,000 a year as additional assessable income in its tax return), the additional deductions able to be claimed can be summarised as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5
Gross income	$100,000	$100,000	$100,000	$100,000	$100,000
Additional deduction under the new regime	**($50,000)**	**($50,000)**	**($50,000)**	**($50,000)**	**($50,000)**
Total additional deduction under the new regime					**($250,000)**

What do you need to do?

Before you can claim a deduction under the new RTFI regime, the following steps must be undertaken:

- Identify RTFI assets
- Ensure RTFI assets' eligibility for a tax deduction under the new regime
- Have RTFI assets valued using a recognised market valuation methodology
- Establish a tax cost base for RTFI assets
- Amend your past income tax returns (if applicable)
- Consider other tax implications (i.e. the impact to entity's franking account, etc).

We can help

Grant Thornton has a team of technical tax and valuations experts dedicated to guiding you through these new changes. If you would like more information on how to manage the impact of the recent tax consolidation amendments, or assistance assessing your eligibility for the deductions potentially available, please contact one of our national experts who will put you in touch with a local advisor:

Andrea De Cian
Director – Corporate Finance
P +61 2 8297 2554
E andrea.decian@au.gt.com
Or
Scott Treatt
Director – Tax
P + 61 2 8297 2542
E scott.treatt@au.gt.com

Alternatively, contact your local Grant Thornton Director.