Retirement Village Association

Retirement Village
Association Limited
Suite 4, Level 7
350 Collins Street
Melbourne VIC 3000
Freecall 1800 240 080
Telephone 03 9670 0255
Facsimile 03 9670 2255
Email info@rva.com.au
ABN 18 100 945 211

Review of Rights to Future Income and Residual Tax Cost Setting Rules
The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

By email transmission: taxboard@treasury.gov.au

27th April 2011

Dear Sir or Madam

Review into the Income Tax Consolidation Rights to Future Income (RFI) and Residual Tax Cost Setting (RTCS) Rules

We would like to thank the Board of Taxation for allowing the Retirement Village Association (RVA) to make a submission in respect of the review into the income tax consolidation RFI and RTCS rules.

The RVA is the peak industry body representing 600 retirement villages which are home for more than 80,000 Australians. Our 790 members are representative of the full spectrum of the industry and include church, charitable and not-for-profit operators, private developers/operators, unlisted public companies and mutuals, and publicly listed companies.

As highlighted in the Honourable Bill Shorten MP's media release No. 45 issued on 30 March 2011, we acknowledge that there may still be unanswered questions around the intended operation of the income tax consolidation RFI and RTCS rules and we therefore understand the need to review and further clarify the scope of these rules. This is very much welcomed by all our members as clarification of the intended outcomes and operation of these rules will add certainty for the industry.

Our submission is based on our current concern that this announcement has brought uncertainty to our industry as to how the rules should apply to rights to deferred management fees in a retirement village context. Specifically, we are concerned that the announcement made could unintentionally omit taxpayers in our industry from accessing these rules in what are typically rights to deferred management agreements as contained in an agreement between a resident of a retirement village and the operator of a retirement village. We understand that the RFI, of which we submit are rights to deferred management fees, has always been regarded as being the type of asset that was contemplated when these rules were introduced which we elaborate further below.

As intended by the legislator, subsection 701-55(6) of the *Income Tax Assessment Act 1997* (ITAA1997) was meant to be "*a residual or catch all provision that applies to treat the tax cost setting amount as the cost of the asset where any provision of the income tax law not specifically mentioned in section 701-55 is to apply to an asset*".[1] Furthermore, we understand that the purpose of the subsection was to recognise the interaction and operation of "*other provision of the income tax law applies for the purposes of determining the amount included in assessable income or determining the amount of the deduction as if the cost, outgoing, expenditure or other amount had been incurred or paid to acquire the asset at the particular time for an amount equal to the tax cost setting amount*"[2].

You may recall that in the Explanatory Memorandum (EM) to *Tax Laws Amendment (2010 Measures No.1) Act 2010* at Example 5.10[3] considered that the rights to deferred management fees were clearly thought of to qualify as an RFI and *"identified as a separate asset"*[4] for the tax cost setting rules (we have replicated Example 5.10 in Appendix 1). For reasons unbeknown and rather disappointingly, this Example 5.10 was not replicated in the final supplementary EM to TLA (2010 Measures No.1). Instead, paragraph 2.22 of the supplementary EM to TLA (2010 Measures No.1) stated that whether a right to deferred management fees is an asset covered by subsection 701-90 of the *Income Tax Assessment Act 1997* (ITAA1997) will depend on the facts in each case. In our view, the legislator would have offered greater certainty to the retirement village industry if Example 5.10 was retained in the supplementary EM.

---

[1] Paragraph 5.9 of the Explanatory Memorandum (EM) to *Tax Laws Amendment (2010 Measures No.1) Act 2010*
[2] Paragraph 5.12 of the EM to TLA (2010 Measures No.1)
[3] Refer Appendix 1
[4] Example 5.10 Right to deferred management fees of the EM to TLA (2010 Measures No.1)

We understand that Assistant Treasurer Bill Shorten and Treasury are principally concerned that "*tax deductibility may be argued for types of assets that were not contemplated when the rules were introduced. This could result in the rules having a substantially greater revenue impact than anticipated*". We submit that in as far as the rights to deferred management fees in a retirement village are concerned; these were **clearly contemplated** by Treasury to fall within the RFI and the RTCS rules, albeit a specific example on rights to deferred management fees was omitted in the final supplementary EM.

We formally request for Treasury to clarify the rules as to when a right to deferred management fees in a retirement village will constitute an asset covered by subsection 701-90(1) of the ITAA1997. We are deeply concerned that short of doing this, uncertainty in our industry may be exacerbated further by the ATO's own interpretation of how these subsections will apply to rights to deferred management fees in its proposed administrative practice to be released shortly[5].

Furthermore, given that at this stage no law change has been proposed, this uncertainty in practice will subject certain taxpayers in our industry to costly and unnecessary delays in private binding ruling applications and/or related amendment /objection requests to the ATO from being processed. Additionally, we also submit that unless the intended operation and outcomes of these rules as they relate to the retirement industry is clarified by Treasury expediently, this could significantly affect the purchase price and timing of commercial negotiations between vendors and potential purchasers of entities who own the property interest in retirement villages.

At a time when Australia faces a rapidly ageing population and growing demand for affordable quality retirement living options, the outcome of this review and finalisation of the technical position on these rules are crucial to the existing and future developments in the retirement village industry.

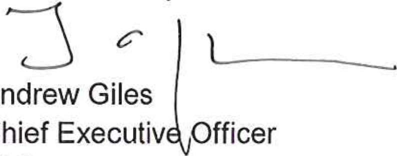
[5] National Tax Liaison Group Consolidation Subcommittee Meeting: 13 April 2011 – Unofficial notes as prepared by PricewaterhouseCoopers in their Tax News Network Australia issued on 15 April 2011

In our view, improvements in the application of the RFI and RTCS rules with regards to rights to deferred management fees in a retirement village could be achieved by referencing the definitions to leasing arrangements between a resident and operator as contained in the various state based Retirement Villages Acts and/or as described in TR 2002/14[6] as "an asset" for the purposes of subsections 701-55(6) and 701-90(1). In the absence of any further clarification and guidance from Treasury, what was intended and contemplated to qualify as RFI for our industry may in practice be very difficult for to establish with any great deal of certainty and confidence.

In closing, given that we are the peak body representing the retirement village industry, we would be pleased to further consult and discuss this matter with you.

Should you have any questions in relation to any of the above, please do not hesitate to contact me or Mark Bird who is the chair of our National Tax and Finance Advisory Sub Committee on 03 8682 6004.

Yours sincerely



Andrew Giles
Chief Executive Officer
RVA

---

[6] TR 2002/14 Income tax: taxation of retirement village operators

APPENDIX 1

Example 5.10: Right to deferred management fees of the EM to TLA (2010 Measures No.1) Act 2010

Company J operates a retirement village business and has a right to deferred management fees in respect of each resident's unit - that is, a right to fees that accrue over a resident's tenure in a retirement village unit but are not payable until the time the resident ceases to reside at the retirement village.

Head Co acquires all of Company J's membership interests on 1 July 2010. Consequently, Company J joins Head Co's consolidated group.

Taxation Ruling TR 2004/13 addresses the question of what is an asset for the purposes of the tax cost setting rules. If, applying the principles in that ruling, the right to deferred management fees is identified as a separate asset, the market value of the asset must be determined using a recognised market valuation methodology. The market value of the asset is determined to be $80,000.

The asset is a reset cost base asset to which section 705-40 applies. The tax cost setting amount allocated to the asset under the tax cost setting rules is $80,000.

Head Co can deduct the tax cost setting amount for the asset ($80,000) under section 716-405 because:

- the asset is solely a contingent right to receive an amount for the doing of a thing (being the management of the retirement village); and
- it is reasonable to expect that the Head Co will include an amount in assessable income after the joining time in relation to the asset.

Head Co derives management fees of $70,000, and includes this amount in its assessable income, when the resident ceases to reside in the retirement village in the 2015-16 income year. Therefore, Head Co can deduct part of the tax cost setting amount for the right to deferred management fees ($70,000) in the 2015-16 income year.

The tax cost setting amount allocated to the right to deferred management fees ($80,000) exceeds the total management fees included in Head Co's assessable income ($70,000). However, as the right to deferred management fees comes to an end in the 2015-16 income year, Head Co can deduct the balance of the unexpended tax cost setting amount for the right ($10,000) in that income year.