

## New 'TOFA' tax rules now apply



Glenda Nixon, Partner, Accru Felsers Chartered Accountants and Business Advisors

TOFA is a recent Australian tax reform measure designed to minimise the way tax treatment of financial arrangements can distort trading, financing and investment decisions. As the new rules apply to companies with an aggregate turnover of \$100m from all related companies, many German subsidiaries in Australia may be affected.

"Totally Over the top Financial Accounting"? No, TOFA actually stands for "Taxation of Financial Arrangements" and those of us in the accounting profession have been watching its gestation since 1993. After a decade of consultations, reviews and drafting, the TOFA reforms are being implemented from 01 July 2010. December

year end taxpayers can also choose by early election to implement the rules from 01 January 2010.

TOFA covers the final two stages of a tax reform process covering financial instruments. It follows earlier stages reforming Australia's debt / equity rules and foreign exchange legislation in 2003.

Tax is a cost that can distort market responses, so TOFA attempts to remove this distortion by more closely aligning the tax and commercial recognition of gains and losses from financial arrangements. The definition of "financial arrangements" is quite complex, but basically means a cash settleable legal or equitable right to receive a financial benefit, or an obligation to provide a financial benefit (nothing to do with fringe benefits tax).

### Who the new rules apply to

TOFA applies to taxpayers meeting the following threshold rules:

Entity	Threshold (TOFA applies)
Individual	Qualifying security with remaining term of more than 12 months
Superannuation funds, managed investment schemes (or similar foreign entities)	Assets of more than \$100 million
Authorised Deposit-taking Institutions, securitisation vehicles, entities registered or required to be registered under the Financial Section (Collection of Data) Act 2001	Aggregated annual turnover is more than \$20 million
All other entities	Aggregated annual turnover is more than \$100 million or Financial assets are more than \$100 million or Assets are more than \$300 million

However, taxpayers not meeting the threshold rules may elect to adopt TOFA. Once an election is made, TOFA will apply to all of the financial arrangements you start to hold in the income year the election was made and afterwards. The election is irrevocable.

### Why an Australian foreign subsidiary may be caught

Aggregated annual turnover is defined in the legislation as the sum of the relevant annual turnovers. Relevant annual turnovers include annual turnovers for your company, connected entities and your affiliates.

A subsidiary of a foreign parent company may have an annual turnover of less than \$100 million, but as their foreign parent company is connected to them, the annual turnover from their parent company will also be considered. When all connected companies' turnovers are aggregated this may mean that your Australian company will meet the threshold rules and TOFA rules will apply.

### Consequences

When TOFA rules apply to an existing financial arrangement that you have at the time of TOFA's commencement (i.e. 1 July 2010 for most), a transitional balancing adjustment is required to adjust the financial arrangement to the new tax regime.

Applying the 'balancing adjustment' will result in gains and losses from financial arrangements being calculated as if the TOFA rules had always applied.

The adjustment is then included in tax assessable income (if it is a gain) or allowed as a tax deduction (if it is a loss) in equal installments over four income years commencing from the income year in which TOFA first applies.

### Methods determining amount and timing of gains and losses

The Australian Tax Office requires the gains from financial arrangements within the scope of TOFA to be determined by using one of the six methods outlined in the table on page 59.

If no election is made, then default options are enacted. This means you will have to use the accruals method or the realisation method, depending on the certainty of the gain/loss which will be derived from the financial arrangement.

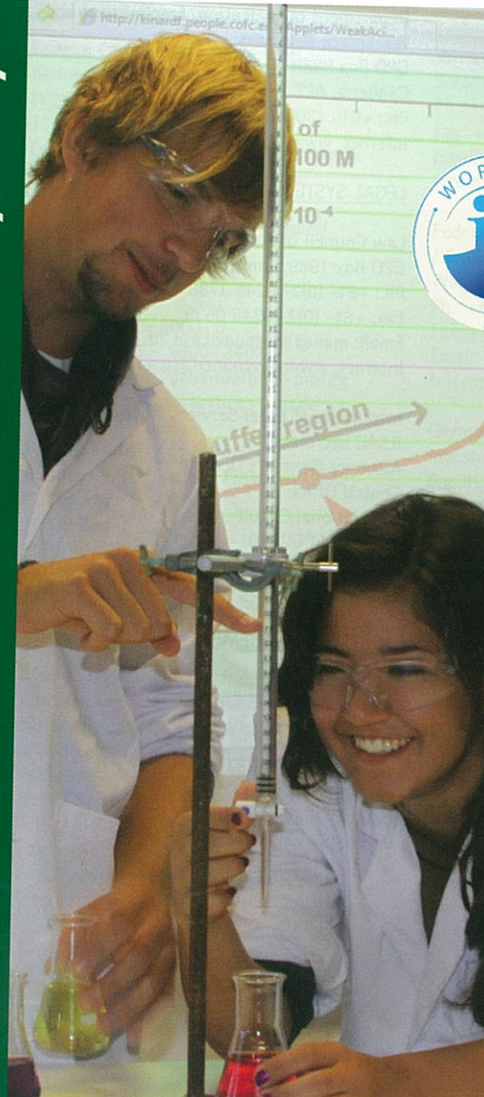
Method	How gains and losses are calculated
Accruals	Allocates gains and losses from a financial arrangement to income years according to an implicit (or internal) rate of return.
Realisation	Allocates gains and losses to income years when they occur.
Elective fair value	By reference to changes in their fair value as calculated under the relevant accounting standards.
Elective foreign exchange retranslation	Taxpayers with foreign currency dominated financial arrangements can recognise foreign exchange gains and losses for tax purposes on the same basis as they are recognised for accounting purposes.
Elective hedging method	Taxpayers with hedging financial arrangements can allocate gains and losses from the hedging transactions on the same basis as the hedged item.
Election to rely on financial reports	By reference to the accounting profit and loss as set out in their financial reports only if the financial reports are prepared and audited in accordance with Accounting and Auditing Standards.

Implementing new legislation always comes down to understanding and interpreting the detail, often with little guidance from Treasury or the Australian Tax Office.

German companies operating in Australia should examine the different choices they can make under the TOFA regime, the factors they need to take into account, and the potential impact of these changes on key business transactions. If you and your advisors have not delved into this regime yet then we would certainly encourage you to start.

If you would like assistance on this issue please contact Glenda Nixon from Accru Felsers on (02) 8226 1655 or email [gnixon@accrusyd.com.au](mailto:gnixon@accrusyd.com.au).

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