

## Tax Brief

17 November 2009

# **TOFA – first election deadline looming!**

The new taxation of financial arrangements (**TOFA**) regime cannot be left in the too-hard/not relevant basket for much longer. Affected taxpayers need to decide whether they should make any or all of the available elections that deal with the transition to TOFA. This decision has to be made relatively soon (by 15 January 2010 for taxpayers with a 30 June year end) and will require some careful consideration. This Tax Brief is a guide to these transition-to-TOFA elections.

The default position is that the TOFA rules will apply only to new financial arrangements issued or held in the first tax year starting on or after 1 July 2010. However, there are two elections which can vary this position:

### **1 Early start election**

This is an election to invoke the TOFA regime for the first tax year starting on or after 1 July 2009. For taxpayers with a 30 June balance date, this means the tax year starting on 1 July 2009. For a taxpayer with a 31 December year end, this would be the tax year starting on 1 January 2010.

### **2 Pre-existing transactions election**

This is an election to have the TOFA regime apply to financial arrangements already held or on issue as at the start of the TOFA regime (whether that is the mandatory start date or an early start date).

The two elections can be made independently.

The table below sets out the relevant requirements for each election.

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Effect	Time for making election	Manner of making the election	Notification to ATO
<b>1 Early start election</b>			
TOFA applies to financial arrangements that the taxpayer 'starts to have' in the next income year starting on or after 1 July 2009 (rather than 1 July 2010).	The election must be made by the due date for lodging the first income tax return due after the start of the 2009-10 income year (ie, 15 January 2010 for a taxpayer with a 30 June year end.)	No requirements stipulated*	Not stipulated
<b>2 Pre-existing transactions election</b>			
TOFA applies to all financial arrangements that the taxpayer 'has' when TOFA first applies.**  Making this election triggers a requirement to make balancing adjustments (amounts are brought to account in the year of making the election and the next 3 years).	The election must be made by the due date for lodging the first income tax return due after the TOFA regime commences to apply (ie, 15 January 2010 for a taxpayer with a 30 June year end who elects for TOFA to apply from 1 July 2009).	The ATO has released a form for this purpose. See ATO website: <a href="http://www.ato.gov.au/corporate/content.asp?doc=/content/00206473.htm">http://www.ato.gov.au/corporate/content.asp?doc=/content/00206473.htm</a>	Must be notified to the Commissioner by the time the next income tax return is due to be lodged.
<p>* The Australian Taxation Office may accept that an election has been made if the taxpayer prepares and files its return in a particular manner, but taxpayers who wish to avoid any doubt may prefer to prepare a written statement making each relevant election which is signed by the Public Officer, dated and retained with the taxpayer's tax records.</p> <p>For a consolidated group, the election would need to be made by the head entity of the group.</p> <p>** The election does not bring into TOFA existing financial arrangements that arose out of a sale of property – ie, deferred settlements.</p> <p>Also, a head entity can specify that financial arrangements of life insurance companies that are members of the group are not included in the election.</p>			

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It should be noted that making the second election – to bring existing financial arrangements into TOFA – only automatically enlivens the accruals or realisation rules, and the balancing adjustment rules, in respect of pre-existing financial arrangements. If the taxpayer also wishes to employ any of the elective timing methods – the fair value method, foreign exchange retranslation method, hedging financial arrangements method or financial reports method – the taxpayer must also separately make any or all of those elections.

If the taxpayer wishes to make the hedging election, additional requirements about the status and documentation of the hedge at the time it was put in place must be met to bring an existing hedge into TOFA. Further, the hedging election does not extend the benefit of tax character matching to the gains and losses arising on a pre-existing hedge. That is, a pre-existing hedge will only enjoy the benefit of tax timing matching.

Making TOFA timing elections also requires compliance with further conditions, typically that:

- the taxpayer prepares financial statements in accordance with the relevant Australian accounting standard or comparable foreign accounting standard;
- the taxpayer has its accounts audited in accordance with the relevant Australian auditing standards or comparable foreign standards; and
- the relevant financial arrangement(s) are subject to a particular kind of treatment in accordance with the accounting standard. (In the case of the hedging election, there are further and separate requirements about preparing specified tax-only records.)

## **Why go early and ‘ungrandfather’?**

There are a number of reasons why a taxpayer may wish to make a ‘go early’ election and possibly also an ‘ungrandfathering’ election. These reasons include:

- earlier access to the hedging election. For example, this would be beneficial in the circumstance where an entity is planning to hedge the FX risk on a major onshore or offshore capital acquisition in the 2009-10 year;
- to take the transitional balancing adjustment. For some taxpayers, it may be favourable to recognise the transitional balancing adjustment over 4 years (eg if it represents an earlier recognition of potential deductions); and
- accessing the financial reports election earlier. There may be compliance cost savings from adopting the financial reports election, particularly for those entities with a significant number of financial arrangements subject to Division 230. Notwithstanding, we do not expect that this reason alone would generally be sufficient to warrant making a ‘go early’ election.

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## Not going early?

Even though you may choose not to make a 'go early' election, it does not mean that your TOFA project should be put on hold until 1 July 2010. The first half of 2010 represents an ideal time to be examining the impact of the TOFA legislation on your organisation prior to it going 'live'. Undertaking preparatory work also means that the TOFA elections can be made with greater confidence when the time arrives.

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