

**TAXATION OF FINANCIAL ARRANGEMENTS  
(TOFA) STAGES 3 & 4  
REVISED EXPOSURE DRAFT LEGISLATION**

The Minister for Revenue & Assistant Treasurer has just released revised *Exposure Draft Legislation* and *Explanatory Material* that contain proposals for a new tax treatment of financial arrangements. They will introduce new tax timing rules (relating to fair value, retranslation and hedging) and are intended to modernise the accruals and realisation rules as they apply to financial arrangements.

The revised exposure draft incorporates a number of significant changes – to the initial exposure draft released on 16 December 2005. They include:

- A confirmed or clarified TOFA carve-out (from what is a ‘financial arrangement’) for
  - Arrangements which do not have significant deferral and that are held by individuals or entities with less than \$20 million turnover.
  - Short-term arrangements (not more than 12 months) where a non-monetary amount is involved.
  - Gains on the forgiveness of commercial debts.
  - Leasing or property arrangements other than certain finance leases.
  - Interests in partnerships or trusts.
  - Certain insurance policies.
  - Certain guarantees or indemnities, personal arrangements and personal injury.
  - Superannuation and pension income.
  - Interests in a controlled foreign company [CFC].
  - Interests in a foreign investment fund [FIF].
  - Retirement village resident and service contracts.
  - Proceeds from certain business sales.
  
- An amended approach to determining the scope of financial arrangements and additional hedging rules that will facilitate a high level of matching between the tax treatment of the gain or loss on a hedging arrangement and the tax treatment of the gain or loss on the underlying transaction.

The additional hedging rules should have substantial benefits for industry in terms of improved risk management and lower business costs.

- Details of the proposed commencement date and transitional issues.

It is proposed that the new TOFA rules (to be in a new proposed Division 230 of the *Income Tax Assessment Act 1997*) will apply **from 1 July 2007 where a taxpayer makes an appropriate election**. Otherwise, it will apply **on or after 1 July 2008**.

The TOFA Stages 3 and 4 reforms will also contain rules to address the tax treatment of synthetic financial arrangements.

**Friendly societies that conduct life insurance business** may wish to note that:

- A right or obligation under a *life insurance policy* within the meaning of the *Life Insurance Act 1995* is subject to an exception unless the policy provides for an annuity that is not contingent upon the termination or continuation of a person's life.

Also carved-out under “certain insurance policies” is

- A right or obligation under a *general insurance policy* where those policies are property or casualty contracts that result in payment of benefits as a result of an identifiable insurance event. Examples of such events include theft, fire, flooding, earthquake and car accidents.
- The general insurance policy exception does not extend to derivative financial arrangements — contracts that result in the payment of a benefit as a result of changes in a variable (eg, a price).

**Friendly societies that are retirement village operators** may wish to note that:

- Proposed Division 230 will not apply to a taxpayer's gains and losses from a financial arrangement for any income year to the extent that the taxpayer's rights and / or obligations are a right or obligation arising under a *retirement village residence contract* or a *retirement village services contract*.
- A ‘retirement village residence contract’ is a contract that gives rise to a right to occupy residential premises in a retirement village. The requirement of the existence of a residential premises and a retirement village is defined in section 195-1 of the *A New Tax System (Goods and Services) Act 1999*. That definition provides that a residential premises in a retirement village exists if:
  - the premises are occupied by one or more persons as a main residence;
  - accommodation in the premises is intended to be for persons who are at least 55 years old, or who are a certain age that is more than 55 years; and
  - the premises include communal facilities for use by the residents of the premises.

But excludes:

- premises used, or intended to be used, for the provision of residential care (within the meaning of the *Aged Care Act 1997*) by an approved provider (within the meaning of that Act); and
- commercial residential premises as defined in section 195-1 of the *A New Tax System (Goods and Services) Act 1999*.
- A ‘retirement village services contract’ is a contract under which a retirement village resident is provided with general or personal services.

It is emphasized that the *Exposure Draft Legislation* is not a Bill, and invites comments to be submitted by 28 February 2007 to

The Manager,  
Taxation of Financial Arrangements Unit,  
Business Tax Division,  
The Treasury,  
Langton Crescent,  
Parkes ACT 2600.

All comments that are not marked confidential will be treated as public and will be placed on the Treasury's website: <http://tofa.treasury.gov.au/content/default.asp>.

The *Exposure Draft Legislation* and *Explanatory Material* are also available on this website.

**Tony C Jacob**  
**Chairman**  
**AFSA Tax Committee**

**4 January 2007**

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