Effect of Subdivision 165-CC where an entity leaves a consolidated group

When an entity ceases to be eligible to be a member of a consolidated group – referred to in this section as a leaving entity – Division 715 of the ITAA 1997 may require adjustments to the adjustable values of certain assets that leave the group or the creation of a loss denial pool in the leaving entity. In some cases the head company must fail an adjusted same business test (SBT) to trigger the adjustments.

Broadly, whether adjustments to adjustable values or creating a loss denial pool are necessary will depend on whether the:

- head company has a RUNL at the leaving time (leaving RUNL) from a Subdivision 165-CC changeover time that happened during the period of consolidation but before leaving time, and whether one or more of the assets at that changeover time are in the leaving entity
- head company has one or more loss denial pools and some or all of the assets in the pool leave with the leaving entity, and
- leaving time is a changeover time for the leaving company.

There are no continuing implications under Subdivision 165-CC for the head company in respect of assets that it held at its last changeover time during consolidation and that leave the group in the leaving entity.

RUNL from changeover time during consolidation period

If the head company has a RUNL from a changeover time that occurred during the period of consolidation, it will – in certain circumstances – have to choose a method of adjusting the adjustable values of the leaving assets or create a loss denial pool. The head company must make such a choice where the following occurs:

- the leaving time is not a changeover time for a leaving company, or the leaving entity is a trust
- the head company's last changeover time was at or after the group came into existence and before the leaving time
- just before the leaving time the head company owned at least one 165-CC tagged asset (as defined in section 715-30) that it owned at the latest changeover time
- one or more of the assets (leaving assets) in the above point become assets of the leaving entity at leaving time (because the single entity principle ceases to apply)
- the head company's leaving RUNL at the subsidiary's leaving time is greater than nil, and
- the head company fails the adjusted SBT → section 715-95(3).

Where the adjusted SBT is passed there are no consequences for the head company or the leaving entity. If the leaving entity is a company, a subsequent Subdivision 165-CC changeover time will be determined using the head company's reference time and assuming that all the membership interests in the leaving entity have been held by the head company from the reference time to immediately before the leaving time.

The head company makes the choice about the method used to adjust the adjustable values of the leaving assets or create a loss denial pool and must notify the leaving entity. Any adjustments to the adjustable values are done 'just before leaving time'. The tax cost setting process for membership interests in the leaving entity process may use the adjusted reduced cost bases of leaving entity assets in Division 711 → section 711-20(2).

The head company must choose which method is to be used within six months of the leaving time, or within a further period allowed by the Commissioner, and provide a notice to the leaving entity within a month of that choice being made. Where no choice is made, the head company will be treated as having made the first choice.

First choice: Adjustable values of leaving assets are reduced to nil

The head company may choose to reduce the adjustable value of each leaving asset to nil. This choice will take effect just before the leaving time. Where this choice is exercised the leaving RUNL (i.e. the final *RUNL* at leaving time) of the head company is not reduced.

The effects of the choice on assets with different characteristics are set out in the table in section 715-145. Very broadly, the adjustable value to be reduced just before leaving time will depend on the character of the asset. For example, if the asset is a revenue asset the adjustable values to be adjusted are its reduced cost base and the amount that would be subtracted in calculating a profit or loss.

Second choice: Head company's RUNL is applied to reduce the adjustable value of loss assets

Where this choice is made the head company's leaving RUNL is effectively applied to reduce the adjustable values of leaving assets that are loss assets. Broadly, to determine if the asset is a loss asset a notional gain or loss is calculated by comparing the market value of the asset just before the leaving time with its adjustable value. The adjustable value is then reduced to the asset's market value to reduce potential losses but the reduction cannot exceed the leaving RUNL.

Third choice: A loss denial pool is created in the leaving entity

The head company may choose that a loss denial pool be created in the leaving entity. Note that a loss denial pool can be created in a leaving entity that is a trust.

This choice can only be made if every asset that is a *165-CC tagged asset* that the head company owned just before the leaving time and that it owned at its most recent changeover time leaves in the leaving entity.

Where this choice is made the loss denial pool consists of the leaving assets and the loss denial balance for that pool is equal to the head company's leaving RUNL.

Leaving entity cancels loss denial pool

Provided a choice is made within six months after the loss denial pool is created in the leaving entity (or within a further period allowed by the Commissioner), the leaving entity may choose to be treated as if the head company had made the first or second choice above. If this choice is made the loss denial pool will cease to exist just after the leaving time and at the leaving time the adjustable value of each CGT asset in the pool is reduced to what it would have been at that time if the head company had instead made the choice now specified by the leaving entity.

Leaving assets are in head company loss denial pool

Where a subsidiary member (company or trust) of a consolidated group leaves the group with an asset that was in a loss denial pool of the head company, provided that the leaving time is not a changeover time for the leaving entity if it is a company, the head company must make one of three choices. The first two choices are broadly the same as the choices discussed above. That is:

- The adjustable values of leaving assets may be reduced to nil. The reduction has effect just before leaving time and the balance of the head company's loss denial balance is not reduced because of the choice made → 715-125.
- The head company's leaving RUNL is effectively applied to reduce the adjustable values of leaving assets that are loss assets. Broadly, to determine if the asset is a loss asset a notional gain or loss is calculated by comparing the market value of the asset just before the leaving time with its adjustable value. The adjustable value is then reduced to the asset's market value to reduce potential losses but the reduction cannot exceed the leaving RUNL.

The third choice is only available where every asset that was in the loss denial pool just before the leaving time is a leaving asset. A loss denial pool consisting of each of these leaving assets is created in the leaving entity at the leaving time. This loss denial pool is distinct from any other loss denial pool of the leaving entity. Further, when the loss denial pool is created, its loss denial balance must equal the loss denial balance of the head company's loss denial pool as reduced by any previous reductions → sections 715-130 and 715-160.

The head company's loss denial pool ceases to exist when the leaving entity's loss denial pool is created. The leaving entity can choose to cancel this pool under certain circumstances.

Leaving time is a changeover time for leaving company

If the leaving entity is a company, Subdivision 165-CC will apply to it after the leaving time. The leaving entity determines if the leaving time is a changeover time using the head company's reference time and assuming that all the leaving company's membership interests were held by the head company from its reference time to immediately before the leaving time.

If the leaving time is a changeover time for the loss company, Subdivision 165-CC applies normally to the company except that the continuity period relevant to the SBT in Subdivision 165-CC is taken to end just after the leaving time.

Example

In 2003 there is a changeover time for the head company of a consolidated group. At changeover there was an unrealised net loss of $5 million on assets X, Y and Z. A subsidiary member, ACo, subsequently leaves the group with assets X and Y (no changeover time on leaving). The adjusted SBT is failed and there is a leaving RUNL for the head company. Because ACo did not leave the consolidated group with all of the remaining changeover time assets the head company may do one of the following:

- Reduce the adjustable values of the assets to their market values just before the leaving time. The sum of the reductions cannot exceed the leaving RUNL. In these circumstances the head company's leaving RUNL is reduced by the amount of the reductions.
- Reduce the adjustable values of assets X and Y to nil.

References

Income Tax Assessment Act 1997, Subdivisions 165-CC, 170-D

New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003), Division 715, Schedule 7

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 11