*Worked example*

# Transfer of attribution surpluses

## Description

This example shows how attribution account surpluses relating to interests in controlled foreign companies (CFCs), foreign investment funds (FIFs) and foreign life assurance policies (FLPs) are transferred from a joining company to a head company at the joining time and from a head company to a leaving company at the leaving time.

## Commentary

### CFC income (and FIF income up to 2009-10)

The FIF rules were repealed with effect from the 2010-11 income year. Companies with interests in a FIF or foreign life policy (FLP) are no longer subject to the attribution rules. Consequently, insofar as the examples here refer to FIFs and FLPs, they only apply in relation to income years before 2010-11. For later years, see → 'FIF income (2010-11 onwards)' below.

The transfer of attribution account surpluses from a joining company to a head company ensures that distributions from CFCs, FIFs and FLPs are not taxed to the head company where the joining company has already been taxed on the attributed income. The same rationale applies when a company leaves a group.

Where a company that holds interests in a CFC, FIF or FLP becomes a subsidiary member of a consolidated group, any surplus in the relevant attribution account at the joining time is transferred to the head company. This applies with respect to surpluses in attribution accounts, attributed tax accounts, FIF attribution accounts and FIF attributed tax accounts.

If the company leaves the consolidated group and takes interests in a CFC, FIF or FLP with it, the head company transfers to the leaving company at the leaving time a proportion of the surplus in the relevant attribution account kept by the head company.

### FIF income (2010-11 onwards

From the 2010-11 income year onwards, any FIF attribution surpluses that previously arose for the head company of a consolidated group, including those transferred to it and those of its own, will become part of its post-FIF abolition surplus.

When a company becomes a subsidiary member of a consolidated group and it has a post-FIF abolition surplus, the surplus is transferred to the head company of that group. → section 717-220, ITAA 1997

When a company leaves a consolidated group and takes with it interests in a FIF or FLP, the head company transfers to the leaving company a proportion of the post-FIF abolition surplus that it has in relation to those interests. The proportion is based on the percentage of the group's interest in the FIF or FLP held by the leaving company. → section 717-255, ITAA 1997

Under section 23AK of the ITAA 1936, when the head company or the leaving company receives a distribution paid out of previously attributed FIF income, it will continue to be exempt from tax.

Under section 23B of the ITAA 1936 (which was introduced to preserve the effect of former section 613 of the ITAA 1936), when the head company or the leaving company disposes of an interest in a FIF or FLP where the FIF income has been attributed but not distributed before disposal, the head company or the leaving company may reduce its capital proceeds. The capital proceeds may be reduced by so much of the post-FIF abolition surplus that it has in relation to those interests not exceeding the capital proceeds.

Therefore, on disposal of an interest in a FIF or FLP, the head company or the leaving company can continue to take advantage of the section 23AK exemption or the former section 613 reduction of capital proceeds.

→ 'Treatment of foreign income tax offsets, attribution surpluses and conduit foreign income', C6-1

From the 2010-11 income year onwards, taxpayers with interests in FIFs or FLPs are no longer subject to the attribution rules and are not required to make any elections in relation to calculating FIF income. Consequently, section 715-660 of the ITAA 1997 (about certain resettable elections) was amended to remove these elections from the list of elections that a head company can reset.

## Example: joining company

### Facts

HCo is the head company of a consolidated group. On 1 January 2006 HCo acquires all the shares in another company, ACo. Both companies have an income year of 1 July to 30 June.

At the joining time HCo has FIF interests in FIF1, which has a notional accounting period of 1 July to 30 June. At that time the FIF attribution account for FIF1 has a surplus of $50.

Table 1: ACo's FIF interests at the joining time

| | Notional accounting period | Attribution account balance as at 30.06.05 |
|---|---|---|
| FIF1 | 1 July to 30 June | $75 surplus |
| FIF2 | 1 January to 31 December* | $100 surplus |
| FIF3 | 1 January to 31 December* | $150 surplus |

* ACo made an election under subsection 486(3) of the *Income Tax Assessment Act 1936* (ITAA 1936) that the notional accounting period for FIF2 and FIF3 is the period for which the FIFs' accounts are prepared.

ACo has held these interests for the two years prior to the joining time, neither acquiring nor disposing of any interests during that period. ACo used the market value method to calculate the FIF income accruing to the FIF interests.

Section 529 in Part XI of the ITAA 1936 requires a taxpayer that holds an interest in a FIF at the end of the taxpayer's income year to include in their assessable income any FIF income that accrues to that FIF interest for the notional accounting period of the FIF that ends in the taxpayer's income year.

A non-membership period is treated as if it were an income year → former section 701-30, *Income Tax (Transitional Provisions) Act 1997*. This means ACo must determine the FIF income or loss that accrued in relation to its FIF interests for the non-membership period 1 July 2005 to 31 December 2005.

## Calculation

For the purpose of calculating the FIF income assessable to ACo, FIF1's notional accounting period is taken to end earlier than it actually does. Ending the notional accounting period of FIF1 immediately before the joining time ensures that ACo is assessed on the FIF income that accrues to its FIF1 interest for the non-membership period before the joining time, and that HCo is assessed on any FIF income that accrues to its FIF1 interests (which include ACo's interests) during the period of consolidation. HCo determines the FIF income as if it has acquired the FIF interests at the joining time. If HCo chooses to use the market value method, the consideration taken to be given at the joining time is the market value of those interests immediately before the joining time.

The notional accounting periods of FIF2 and FIF3 both end at the joining time. Therefore, for the purpose of calculating its assessable income in the non-membership period, ACo must determine in relation to each FIF the FIF income or loss that accrued for the whole of the notional accounting period.

The FIF income/loss for each of ACo's FIF interests determined for the purposes of ACo's assessable income for the non-membership period before the joining time is shown in table 2.

Table 2: FIF income/loss of ACo FIF interests for non-membership period

| | Period in which FIF income accrued | FIF income |
|---|---|---|
| FIF1 | 1 July 2005 to 31 December 2005 | $200 |
| FIF2 | 1 January 2005 to 31 December 2005 | ($100) |
| FIF3 | 1 January 2005 to 31 December 2005 | $300 |

The FIF loss in relation to FIF2 can be claimed as a deduction against ACo's other assessable income → section 532, ITAA 1936. ACo can claim the deduction only to the extent of the surplus in the attribution account of FIF2. The deduction gives rise to an attribution account debit to the extent of the loss or the surplus, whichever is less. ACo includes the FIF income for FIF3 for the whole of the notional accounting period in its assessable income.

The FIF income included in ACo's assessable income gives rise to an attribution account credit immediately before the joining time.

The attribution account surplus transferred by ACo for each of the three FIFs is shown in table 3.

Table 3: Attribution account surplus transferred by ACo

| | FIF1 | | FIF2 | | FIF3 | |
|---|---|---|---|---|---|---|
| | Credit | Debit | Credit | Debit | Credit | Debit |
| Balance brought forward as at 1.7.05 | $75 | | $100 | | $150 | |
| Credit/debit as at 31.12.05 | $200 | | | $100 | $300 | |
| Balance as at 31.12.05 | $275 | | NIL | | $450 | |

Had the FIF loss in relation to ACo's interest in FIF2 exceeded the attribution account surplus, that excess would not have been allowable as a deduction. Instead the entry history rule would make the remaining FIF loss available to HCo to offset against FIF income accruing in later income years for interests in FIF2 held by the group.

The attribution account surpluses transferred by ACo are pooled with those of HCo as head company of the group. As HCo also held interests in FIF1 and had a surplus of $50 in the attribution account that it kept for its interest in FIF1, the attribution accounts kept by HCo immediately following the joining time are as shown in table 4.

Table 4: HCo's attribution accounts immediately following joining time

| | FIF1 | | FIF2 | | FIF3 | |
|---|---|---|---|---|---|---|
| | Credit | Debit | Credit | Debit | Credit | Debit |
| Balance at joining time | $50 | | N/A | N/A | N/A | N/A |
| Surplus from ACo | $275 | | NIL | | $450 | |
| Balance post joining time | $325 | | NIL | | $450 | |

## Example: leaving company

**Facts**

On 1 July 2006 HCo sells all its shares in ACo to a company outside the group. ACo takes 50% of the group's interests in FIF1 with it. FIF1's attribution account was in surplus to the extent of $350.

The proportion of the attribution account surplus to be transferred to ACo is determined using the following formula:

$$\frac{\text{Leaving company's attribution account percentage in relation to the attribution account entity at the leaving time}}{\text{Head company's attribution account percentage in relation to the attribution account entity just before the leaving time}} \times \text{Attribution surplus for the attribution account entity in relation to the head company just before the leaving time}$$

**Calculation**

ACo's attribution account percentage in FIF1 at the leaving time is 50% of HCo's attribution account percentage in FIF1 just before the leaving time. The proportion of the attribution account surplus transferred to ACo at the leaving time will therefore be $175, i.e. 50/100 x $350.

The attribution account surplus taken by ACo ensures that it will not be assessed on distributions it receives from FIF1 in relation to the interests it holds to the extent of the surplus.

## References

*Income Tax Assessment Act 1936*, sections 532 and 529 and subsection 486(3)

*Income Tax Assessment Act 1997,* Division 717, Subdivisions 717-D and 717-E; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 6

*Income Tax (Transitional Provisions) Act 1997*, former section 701-30; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7

Explanatory Memorandum to New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, Chapter 2

*Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006* (No. 101 of 2006), which repealed section 701-30 of the *Income Tax (Transitional Provisions) Act 1997*

### Revision history

Section C6-2-210 first published (excluding drafts) 2 December 2002.

Further revisions are described below.

| Date | Amendment | Reason |
|---|---|---|
| 15.11.06 | Updated references to inoperative provisions. | Legislative amendment. |
| 6.5.11 | Revised to take into account the repeal of Part XI of the ITAA 1936 in relation to the FIF and FLP rules. | Legislative amendments. |