Worked example

Pre-formation changeover times – application of Subdivision 165-CC at formation (transitional period)

Description

This example illustrates what happens when the head company, a chosen transitional entity and a non-chosen subsidiary each had a pre-formation changeover time and when, at formation time, they still own '165-CC tagged assets' or have a '170-D deferred loss' (→ *Income Tax Assessment Act 1997* (ITAA 1997)) in relation to that changeover time.

The example relates to the formation of a consolidated group within the transitional period. It is assumed that none of the entities has a changeover time at formation time.

Commentary

At formation time, a head company retains the existing tax values of its assets. The head company applies the allocable cost amount (ACA) to determine the tax cost of assets of a non-chosen subsidiary (NCS). When a consolidated group is formed during the transitional period (1 July 2002–30 June 2004), the head company may choose, subject to certain requirements, that one or more of its entities be a chosen transitional entity (CTE). As with the head company, the tax costs of a CTE's assets are not reset under the ACA method, but existing tax values of its assets are retained. → ''Treatment of assets', C2-1

If a CTE has membership interests in a non-chosen subsidiary, the effect is that the CTE proceeds in the same manner as a head company, using the ACA method to determine the tax costs of the assets of the non-chosen subsidiary.

The ACA may need to be adjusted when the head company's most recent changeover time was before formation, and at formation time:

- the head company has membership interests (MI) or intragroup liabilities (IGL) in a subsidiary member, or has 165-CC tagged assets that it owned at the changeover time (170-D deferred losses are also relevant)
- the head company has a formation residual unrealised net loss (final RUNL) just before the joining time (→ paragraph 715-50(1)(c) and section 715-35), and
- a same business test is failed.

If some of the head company's membership interests or intragroup liabilities are in a non-chosen subsidiary, the amount of the ACA that the head company can allocate to the assets of the non-chosen subsidiary is adjusted (assuming the reduced cost bases of these interests and liabilities are relevant at step one for the MIs and step 2 for IGLs). The head company's formation RUNL is reduced by any MI and IGL adjustments.

If the head company has other 165-CC tagged assets or 170-D deferred losses, a loss denial pool (LDP) of the head company is created with a loss denial balance (LDB) equal to the formation RUNL (reduced by any MI and IGL adjustments).

→ ''Treatment of assets owned by head company at both formation time and pre-consolidation changeover time (no changeover time at formation)', C2-6-530

→ ''Effect of Subdivision 165-CC for steps 1 and 2 of the ACA calculation at formation and joining times ', C2-6-110

A chosen transitional entity retains the tax values of its assets even when the head company has some membership interests or intragroup liabilities in it. The ACA method is not used to reset the tax cost of the CTE's assets. As no MI or IGL adjustments are made, the head company's formation RUNL is not reduced.

If a chosen transitional entity has a pre-formation changeover time, the consequences for the CTE at formation can be the same as those for the head company (discussed above). A separate LDP of the head company (not of the CTE) can be created .

A further LDP of the head company can be created if a non-chosen subsidiary has a pre-formation changeover time, and at formation time:

- it has one or more 170-D deferred losses (relevant to the changeover time)
- its formation RUNL is not nil, and
- a same business test is failed.

A LDP of the head company is created consisting of only the 170-D deferred losses (section 715-360). The loss denial balance of the LDP is equal to the formation RUNL. If a non-chosen subsidiary has 165-CC tagged assets (including membership interests and/or intragroup liabilities in other group members) relating to the changeover time, but no 170-D deferred losses, no LDP is created. There are no MI or IGL adjustments, and there are no further implications for the non-chosen subsidiary's 165-CC tagged assets.

Example

Facts

On 1 July 2002, HC, the head company of a wholly-owned group, chooses to form a consolidated group. Subsidiary members of the group are:

- chosen transitional entities, PCo and YCo, and
- non-chosen subsidiaries, CCo, DCo, TCo and XCo.

Formation time is not a changeover time and HC, CCo, DCo and PCo each had a changeover time before formation. At formation time, each company still owns 165-CC tagged assets that they owned at the pre-formation changeover time. 170-D deferred losses in relation to the changeover times also still exist for all companies (except DCo). Each company has a formation RUNL and failed the relevant same business test.

HC's 165-CC tagged assets include membership interests in CCo, and membership interests and intragroup liabilities in DCo. PCo's 165-CC tagged assets include membership interests in XCo and YCo. Similarly, DCo's 165-CC tagged assets include membership interests in PCo and TCo.

Calculation

Figure 1 shows the consequences for a head company, its chosen transitional entities and non-chosen subsidiaries when they own assets at formation time that were owned at a pre-formation changeover time. It also illustrates when MI and IGL adjustments under the ACA method may need to be made, when a LDP of the head company may be created and when a 170-D deferred loss can be attached to a LDP.

Head company

HC's membership interests and intragroup liabilities in CCo and DCo are loss interests at formation (i.e. their market value is less than their reduced cost base). As CCo and DCo are non-chosen subsidiaries, HC applies the ACA method to reset the tax costs of their assets.

When HC is calculating the ACA to be allocated to the assets of CCo, a step 1 adjustment is made to reduce the reduced cost base of HC's membership interests in CCo.

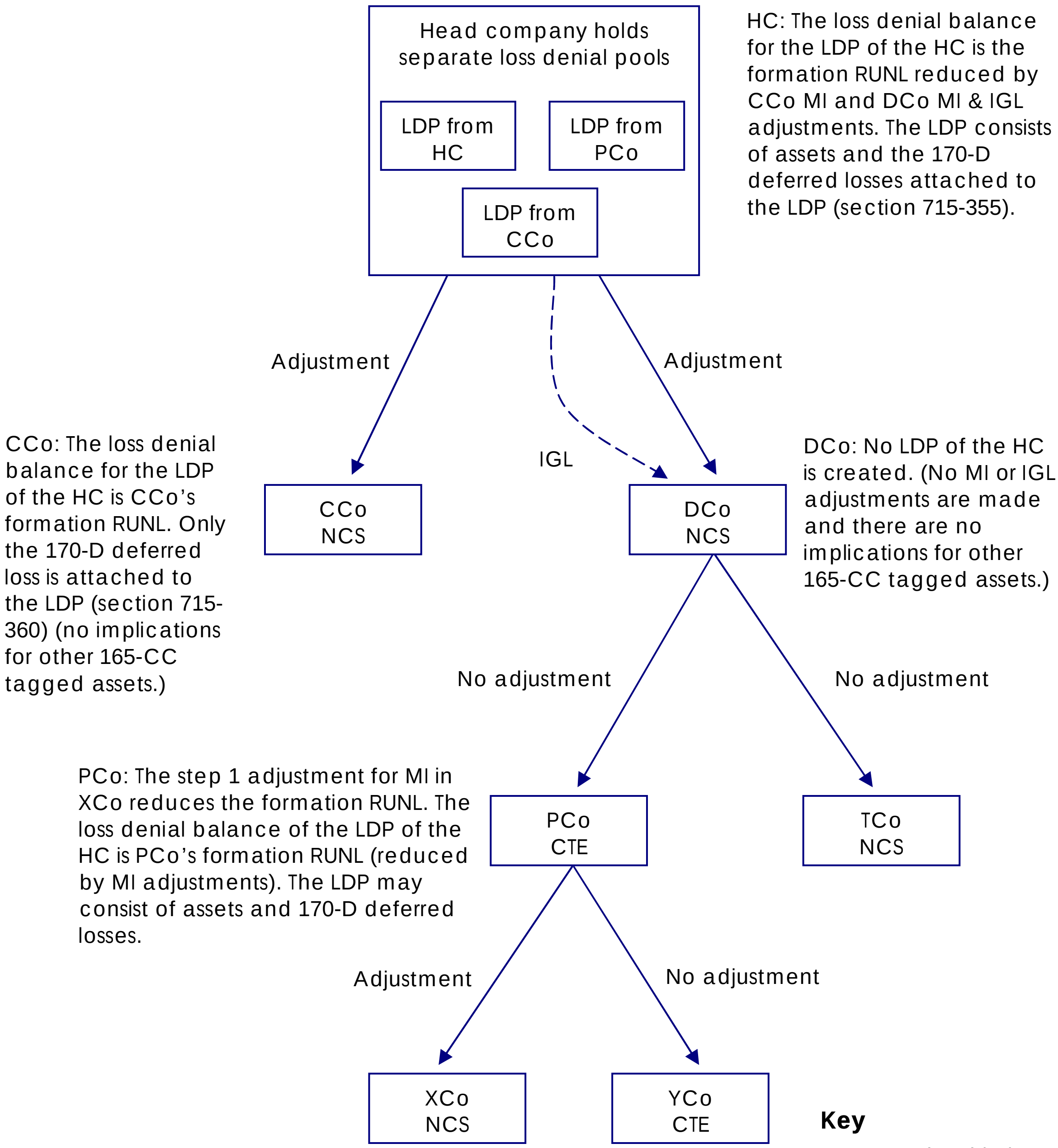
When HC is calculating the ACA to be allocated to the assets of DCo, a step 1 adjustment is made to reduce the reduced cost base of the membership interests HC holds in DCo. The intragroup liabilities to be added at step 2 may also be reduced.

Note that both the step 1 and step 2 adjustments reduce the reduced cost bases to market value at formation time, but the total adjustments cannot be greater than the formation RUNL.

The head company's formation RUNL is reduced by the same amount as any adjustments to the membership interests in CCo and the membership interests and intragroup liabilities in DCo.

A LDP of the head company is created if the formation RUNL (reduced by any MI and IGL adjustments) is greater than nil. The LDP consists of the 165-C tagged assets of HC (other than membership interests and intragroup liabilities in CCo and DCo) and the loss denial balance is the adjusted formation RUNL. 170-D deferred losses relating to HC's pre-formation changeover time would also be attached to the LDP by section 715-360.

Figure 1: Assets owned at a pre-formation changeover time



MI and IGL adjustments

CTE	→	NCS	Yes
NCS	→	CTE	No
NCS	→	NCS	No
CTE	→	CTE	No
HC	→	CTE	No
HC	→	NCS	Yes

Key

MI = membership interests
IGL = intragroup liability
CTE = chosen transitional entity
LDP = loss denial pool
NCS = non-chosen subsidiary
RUNL = residual unrealised net loss

Note: Higher level push-down of ACA is assumed to have addressed any integrity issues at the lower level, in most cases.

PCo: chosen transitional entity

Because PCo is a chosen transitional entity, it follows a similar process to that of the head company. PCo's membership interests in XCo and YCo are loss interests at formation.

PCo must apply the ACA to its non-chosen subsidiary XCo. A step 1 adjustment will reduce the reduced cost base of the membership interests. This reduces the amount that PCo can allocate to the assets of XCo. PCo's formation RUNL will be reduced to take into account this adjustment.

PCo does not apply the ACA to the assets of its other subsidiary, YCo. As YCo is a chosen transitional entity, the existing tax values of its assets are retained. As there are no MI adjustments in relation to PCo's interests in YCo, there will be no adjustment to PCo's formation RUNL.

A further LDP of the head company is created if PCo's formation RUNL (reduced by any MI adjustments) is greater than nil. The LDP consists of the 165-CC tagged assets of PCo (other than membership interests in XCo and YCo) and the loss denial balance is the adjusted formation RUNL. 170-D deferred losses relating to PCo's pre-formation changeover time would also be attached to the LDP by section 715-360.

CCo: non-chosen subsidiary

Another LDP of the head company is created with the 170-D deferred losses attached (section 715-360). The loss denial balance for the LDP is CCo's formation RUNL. There are no implications for CCo's 165-CC tagged assets.

DCo: non-chosen subsidiary

As DCo has no 170-D deferred losses no LDP is created. There are no further implications for DCo's 165-CC tagged assets.

Separate loss denial pools created in the head company

At formation, the head company of the consolidated group will have three separate LDPs, one from HC, one from CCo and one from PCo.

References

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

Income Tax Assessment Act 1997, Division 715; as amended by *New Business Tax System (Consolidated and Other Measures) Act 2003* (No. 16 of 2003), Schedule 7

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