Introduction to consolidation

The Commonwealth Government introduced consolidated income taxation of corporate groups – that is, taxing wholly-owned groups as single entities – on 1 July 2002 as part of the Business Tax Reform package.

Before the introduction of consolidation, the income tax system treated each company in a wholly-owned group as a separate entity (subject to certain grouping provisions). Taxing member entities separately means that each entity must separately account for intragroup transactions and debt and equity interests. For business, this imposes extra compliance costs and sometimes stands in the way of the most efficient business structures. From the community's perspective, the grouping provisions for wholly-owned groups have provided opportunities for tax avoidance through artificial arrangements.

Consolidation improves efficiency and reduces ongoing compliance costs by facilitating group restructuring and providing a business environment in which some highly complex business structures are no longer seen as necessary.

Does this affect my business?

Any eligible business group can consolidate regardless of size. If a business consists of two or more eligible entities (for example, one company wholly owns another company), it can choose to consolidate. The head of a consolidatable group must be a company – it cannot be a trust or partnership.

Most small businesses involve single entities and are not affected by the consolidation measure. Consolidation is only relevant where a company wholly owns one or more other entities. Consolidation is not relevant to the business activities of individuals (such as people operating as sole traders).

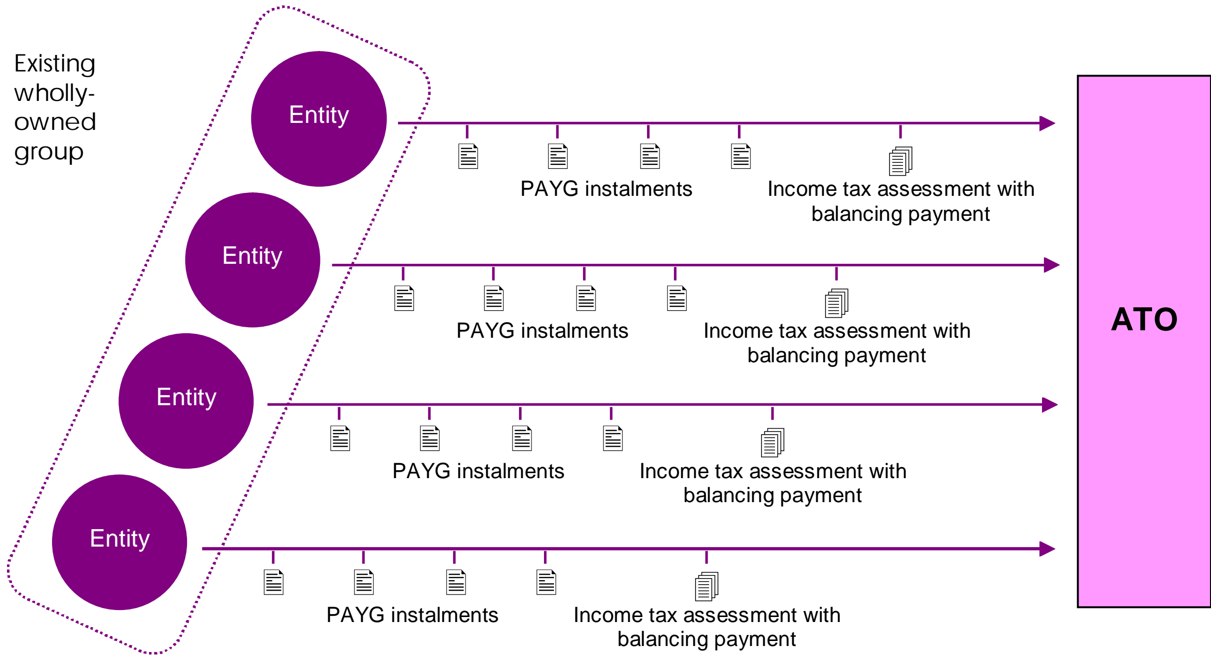
If a business group has been using the grouping provisions for wholly-owned groups, which end for most taxpayers on 30 June 2003, they will need to consider their structure and income tax arrangements.

The benefits of consolidation for a particular group will depend on factors such as the extent and current utilisation of group losses and franking credits, as well as compliance cost savings related to accounting for intragroup transactions and meeting multiple PAYG instalment obligations.

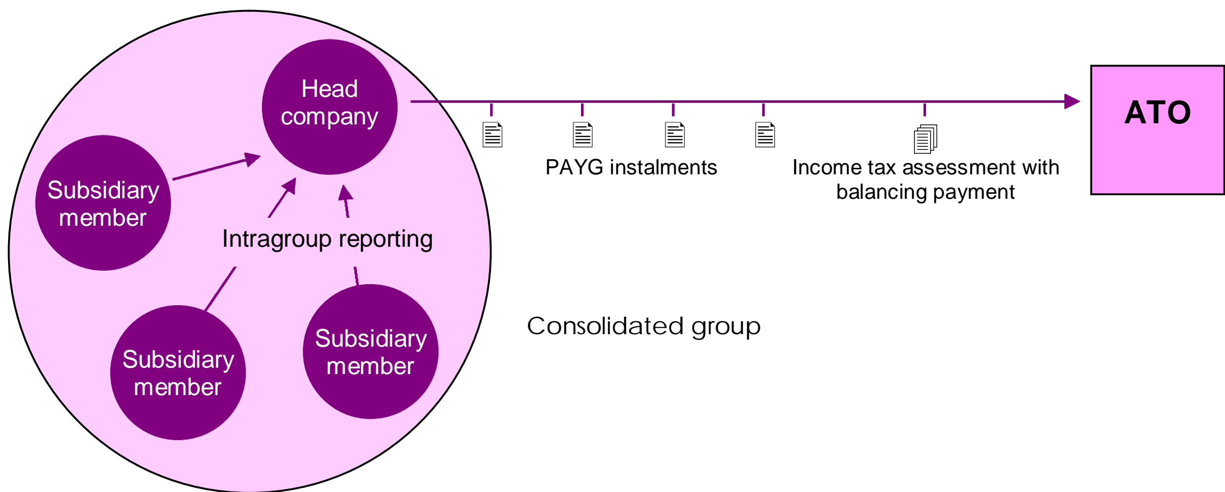
The cost of consolidation will include the cost of advice, collecting information about the group (including asset valuations) and setting up new accounting systems if necessary.

Figure 1: Reporting and payment of income tax

before consolidation . . .



. . . and after consolidation . . .



Impacts and consequences

Taxing the group as a single entity

Consolidation involves treating the wholly-owned group as a single tax entity, with the subsidiary members treated as parts of the head company. Intragroup transactions are disregarded for income tax purposes. This:

- allows pooling of losses and credits – simplifying obligations and delivering cost savings for consolidated groups
- eliminates many complex provisions applying to intragroup transactions, such as:
  - deemed dividend rules
  - rules for determining capital gains and losses
  - franking rules in relation to intragroup dividends
  - formal requirements for intragroup transfers
  - related anti-avoidance rules
- reduces impediments to group restructuring and allows:
  - movement of assets between group entities to be disregarded for income tax purposes with no formal rollover requirements
  - buying back shares without triggering a capital gain or loss
  - liquidating a member entity without triggering a deemed dividend or a capital gain or loss.

Treatment of assets

On consolidation, the assets of subsidiary members are treated as if they were assets of the head company, and may be transferred between members of the group without any income tax consequences. Intragroup debt and shareholding are also ignored for income tax purposes.

When a consolidated group forms or an entity joins a consolidated group, new tax costs (or tax values) for the assets of each subsidiary member are calculated, based on the tax costs of the membership interests (or equity) in that subsidiary member. The cost base of the membership interests in the joining entity is effectively transferred to the assets of the entity, aligning the tax costs of the entity's assets with the costs of its membership interests.

The new tax costs provide a cost base for depreciation and for calculating capital gains and losses on assets that are later disposed of outside the group, either directly or as a consequence of the disposal of equity in a member (which leads to that member's exit from the consolidated group).

The use of special cost setting rules is the normal method of determining the value of assets of joining subsidiary entities. However, groups consolidating during the transitional period may have the option of retaining the existing value of assets for tax purposes on a subsidiary-by-subsidiary basis → 'Timeframe', p. 5. The head company itself always enters consolidation with existing asset values.

Group inherits subsidiary member's history

For most purposes, a consolidated group inherits the tax history of its joining subsidiaries. Specifically, the entry history rule ensures that everything that happened in relation to a subsidiary member before joining a consolidated group is taken to have happened in relation to the head company for the purposes of calculating the head company's future income tax liability or tax losses.

For example, where an entity incurs borrowing expenses in a particular income year and then joins a consolidated group at the start of the next income year, the group's head company may be entitled to a deduction for any undeducted borrowing costs as if it had actually incurred the expenditure itself.

Note that the entry history rule:

- applies only for the purposes of working out the head company's income tax liability or tax loss
- relates only to the subsidiary member's history that affects or could affect the head company's tax liability. (Note that a franking surplus arising in the franking account of the subsidiary member immediately before the joining time is able to be transferred to the franking account of the head company under consolidation. However the transfer is not made under the entry history rule because the treatment of franking credits is not taken into account in determining the head company's tax liability. → B2-4)
- can be modified by the operation of other provisions – for example, special rules may affect an asset's cost base history or the amount of losses transferred to the head company when an entity joins a consolidated group
- does not mean that the head company is liable to pay income tax in relation to a subsidiary member for a period before it joined the group – each member entity remains liable for any income tax liability resulting from a period before it became part of the consolidated group.

Consolidation replaces the grouping provisions

As the grouping provisions for wholly-owned groups are withdrawn for most taxpayers from 1 July 2003, a business group that uses these provisions should carefully analyse the consequences of not consolidating. If a wholly-owned group chooses not to consolidate, the group will no longer be able to:

- transfer losses between entities in a group
- transfer assets between entities without triggering a capital gain or loss
- pay unfranked dividends within the group without tax being payable, or
- transfer excess foreign tax credits within the group.

In some cases relating to foreign bank branches, loss transfers continue to be available.

Where the head company has a substituted accounting period (SAP), the grouping provisions will continue to be available until the next balance date of the group after 30 June 2003, provided the group consolidates on the first day of the next SAP income year.

Prospective buyers

From 1 July 2002, the prospective buyer of a company needs to consider the company's consolidation status. At the time of acquisition, the buyer needs to be aware that a retrospective election to consolidate by the vendor could have implications for:

- who gets the company's tax attributes, such as losses and franking credits
- the cost base of the company's assets, and
- the company's tax liabilities.

These issues need to be considered as part of the normal due diligence process when buying and selling a business. → ATO fact sheet: Consolidation – implications when buying a wholly-owned business entity (Nat 8209)

Pre-membership and formation period tax liabilities

A member of a consolidated group is liable for the income tax liabilities incurred by it before becoming a member of the group. If the entity leaves the consolidated group it will still be liable for any debt incurred before it joined the group. A member is also liable for any outstanding PAYG instalment payments that are its responsibility during the formation period – that is, before the head company receives the group's consolidated PAYG instalment rate.

Group tax liabilities

A member of a consolidated group is jointly and severally liable for the group's tax liabilities incurred while it is a member to the extent that its liability is not limited to the amount determined by a valid tax sharing agreement (TSA) between group members.

After it leaves a consolidated group, an entity remains jointly and severally liable for the group's tax liabilities incurred while it was a member unless it meets certain 'clear exit' conditions, which include paying an amount allocated under a valid TSA (or a reasonable estimate of the amount) to the head company.

→ 'Managing obligations', B3-4

Timeframe

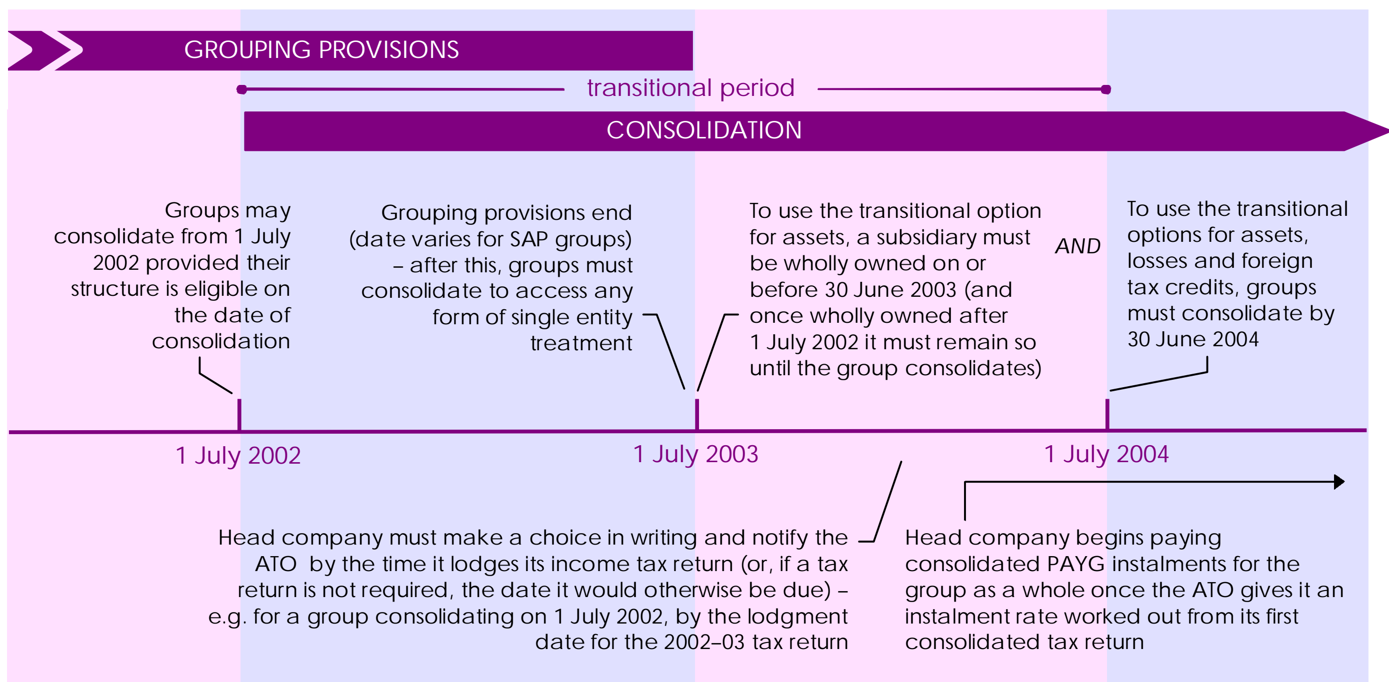
Consolidation takes effect from 1 July 2002 and eligible groups are able to consolidate from that date.

- The head company must make a choice in writing to form a consolidated group by the time it lodges its income tax return for the year in which the day specified in the choice occurs (or, if a return is not required, the date it would have otherwise been due). In addition, it must notify the ATO of its choice (using the appropriate notification form) within the same timeframe. → 'Making a choice to consolidate and notifying', B3-1
- Individual member entities continue to pay PAYG instalments until the head company lodges the group's first consolidated income tax return and receives its consolidated instalment rate. After this, the head company

pays consolidated PAYG instalments for the group as a whole. → 'Paying PAYG instalments', B3-2

- Transitional concessions for dealing with assets, losses and foreign tax credits may be available to groups consolidating during the transitional period (1 July 2002 to 30 June 2004). → 'Choosing', B1-1

Figure 2: Consolidation timeline



Revision history

Section B0-2 first published (excluding drafts) 2 December 2002.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on recent changes to consolidation rules.	Legislative amendments.
26.10.05	Deletion of note on recent changes to consolidation rules.	Legislative amendments.
6.5.11	Minor revisions to reflect changes to choice to consolidate rules.	Legislative amendments.