Formation time treatment of assets owned by head company from a pre-consolidation changeover time

Where a head company chooses to form a consolidated group and that formation time is not a changeover time under Subdivision 165-CC of the ITAA 1997, it will be necessary for the head company to determine if it still owns assets or Subdivision 170-D deferred losses from its most recent changeover time. Where the head company still owns the relevant assets or amounts, Division 715 may cause a loss denial pool to be created in the head company.

Note

For additional information see:

- 'Effect of Subdivision 165-CC for steps 1 and 2 of the allocable cost amount calculation at formation and joining times', C2-6-110
- 'Effect of Subdivision 165-CD for MEC groups', C2-6-150
- 'Pre-formation changeover times – application of Subdivision 165-CC at formation (transitional period)', C2-6-520
- 'Treatment of assets owned by head company at both formation time and pre-consolidation changeover time (no changeover time at formation)', C2-6-530.

Commentary

A loss denial pool can only be created if the conditions in section 715-60 are satisfied. Very broadly, these conditions are:

- the formation is not changeover time
- the head company owned at least one 165-CC tagged asset at the formation time that it owned at the relevant changeover time
- the asset is not a membership interest held in a member of the group or a right or option (including a contingent right or option), created or issued by a member of the group, to acquire such a membership interest, or constituted by a liability owned to the head company by a member of the group
- the head company's final residual unrealised net loss (RUNL) just before the formation time (reduced by any relevant reductions under sections 715-50 and 715-55) is greater than nil, and
- the head company fails the adjusted same business test (SBT) outlined in section 715-60.

The SBT is that the head company does not satisfy the test for:

- the period consisting of the head company's trial year, and
- the time just before the changeover time.

When a loss denial pool is created it consists of those CGT assets described above – that is, when a head company loss denial pool is created for its own assets at formation time it only consists of assets it owned at its last changeover time and that are not membership interests in, or constitute debts owed to the head company by, another member of the group. In addition, Subdivision 170-D deferred loss amounts are added to the pool in certain circumstances → section 715-355.

If there are no assets for section 715-60 purposes but there is a Subdivision 170-D deferred amount (→ subsections 715-355(3) and (4)), a loss denial pool may be created.

The pool's loss denial balance equals the head company's final RUNL just before formation time. Note, however, that the balance may be reduced if Division 715 applies to 165-CC tagged assets of the head company that are relevant to the tax cost setting process (membership interests at step 1, and intragroup debt at step 2). Sections 715-50 and 715-55 discuss how the tax cost amount of those assets is reduced and how the reductions affect the balance of the loss denial pool.

This loss denial pool is distinct from any other loss denial pool of the head company. For example, it is separate from a pool that might be created where the assets of a chosen transitional entity become those of the head company → section 715-70.

Example

On 3 December 2001, the head company had a changeover time under Subdivision 165-CC. The five assets held at changeover time yield an unrealised net loss of $6 million for the head company. This is the unrealised net loss of the company at that time.

Asset 4 was sold in June 2002 for $1 million. The RUNL balance became $1 million ($6 million – $5 million).

Table 1: Assets held by the head company at the changeover time

Asset	Cost base or reduced cost base of assets	Market value at changeover time	Notional gain or loss at changeover time
Asset 1	$8 million	$10 million	$2 million
Asset 2	$5 million	$3 million	($2 million)
Asset 3	$4 million	$3 million	($1 million)
Asset 4	$6 million	$1 million	($5 million)
Asset 5	$1 million	$1 million	$0
Total			**($6 million)**

Note that these assets are *not* membership interests or intragroup debt interests.

On 1 July 2002, the head company chooses to form a consolidated group. There is no new Subdivision 165-CC changeover time for the head company or its subsidiaries at that time.

The head company still holds assets 1, 2, 3 and 5 at that time. Upon consolidating, the head company must determine whether the SBT is passed for the trial period and the time just before the changeover time on 3 December 2001. If the SBT is passed, no loss denial pool is required to be established and there are no further Subdivision 165-CC implications for the consolidated group in respect of the 3 December 2001 changeover time.

If the SBT is failed, the head company will have a loss denial pool consisting of assets 1, 2, 3, and 5 and a loss denial balance of $1 million. Later, when one of those assets is sold at a loss the amount in the loss denial pool will reduce any loss claim[*]. If, for example, asset 3 is later realised for a $2 million capital loss, that loss will be denied to the extent of the balance of the pool[*]. That is, $1 million of the $2 million loss is allowed, the remaining $1 million of the loss is denied and the loss denial pool is reduced to zero and ceases to exist.

References

Income Tax Assessment Act 1997:

- Division 705
- 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

[*] Note that there is no further same business testing on realisation of each asset because that test has already been failed at formation time.