High-level worked example

Partnership – *all* partners join consolidated group

Description

The cost setting process for a partner joining a consolidated group depends on whether:

- at least one (but not all) of the partners in the partnership joins a particular consolidated group → 'Partnership – *not all* partners join consolidated group', C2-2-155, or
- all partners in the partnership join the same consolidated group.

This high-level example shows how the cost setting process applies to set the tax costs of the partnership assets when all partners in the partnership join the same consolidated group.

Commentary

Due to the characteristics of a partnership, the basic case rules that apply to entry into a consolidated group are modified in the case of a partnership to achieve a comparable outcome to other entry circumstances → Subdivision 713-E, *Income Tax Assessment Act 1997* (ITAA 1997). Specifically:

- A 'partnership cost pool' (PCP) replaces the allocable cost amount (ACA) in the tax cost setting process for the partnership assets. The PCP is worked out based on the sum of all the cost bases or tax costs for all of the partners' fractional interests in the partnership → section 713-210, ITAA 1997. These fractional interests are known as partnership cost setting interests (PCSI) → section 713-210, ITAA 1997.
- If a partner in the partnership joins the consolidated group at the same time as the partnership, the tax cost setting amounts (TCSA) are worked out for the assets of the partner (including PCSIs) before TCSAs are worked out for the assets of the partnership. C2-2-155 'Partnership – *not all* partners join consolidated group' shows how to work out the TCSAs for a partner's assets including the partnership cost setting interests.
- PCSIs in the partnership held by the head company cease to be recognised once the partnership joins the group. Tax costs are set for the partnership's underlying assets, which become the only partnership assets recognised by the head company.

Example

Facts

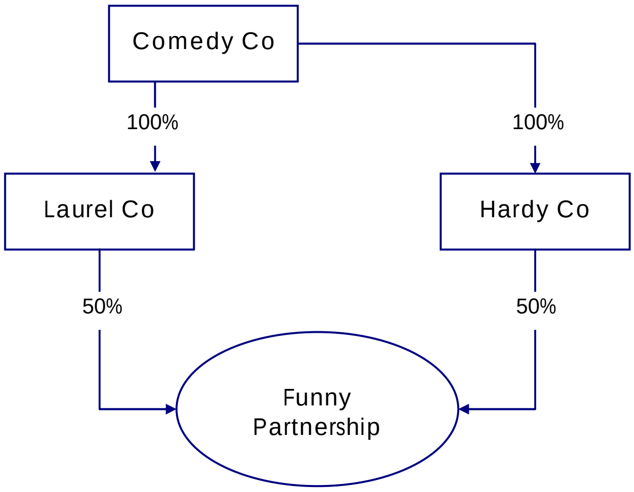
On 1 July 2002, Comedy Co acquires:

- 100% of the shares in Laurel Co, and
- 100% of the shares in Hardy Co.

Comedy Co forms a consolidated group on 1 July 2003. On that date, Laurel Co and Hardy Co each have a 50% interest in the assets of Funny Partnership. As a consequence, all three entities join Comedy Co's consolidated group.

→ figure 1

Figure 1



Funny Partnership has the following assets on 1 July 2003:

- $1,800 cash
- recording studio with a market value and an opening adjustable value at the joining time of $1,500 and a cost of $1,900
- recording equipment with a market value of $700, an opening adjustable value of $500, and a cost of $700.

Before setting the tax costs for Funny Partnership's assets it is necessary to calculate TCSAs for the assets of Laurel Co and Hardy Co (including their PCSIs) by applying the general cost setting rules and the modifications in Subdivision 713-E of the ITAA 1997. This process is required even though the PCSIs in Funny Partnership will not be recognised by Comedy Co and ultimately only the underlying assets of Funny Partnership will be recognised as assets of Comedy Co. C2-2-155 'Partnership – *not all* partners join consolidated group' demonstrates how to calculate the tax costs for Laurel Co and Hardy Co's assets. The TCSA and market value of Laurel Co and Hardy Co's PCSIs in Funny Partnership at the joining time are shown in table 1.

Table 1: TCSAs of the PCSIs of Laurel Co and Hardy Co

Partnership cost setting interest	Market value at 1 July 2003 ($)	TCSA ($)
Laurel Co		
Cash	900	900
Recording studio	750	750
Recording equipment	350	250
Hardy Co		
Cash	900	900
Recording studio	750	750
Recording equipment	350	250

The tax cost of each of Laurel Co and Hardy Co's PCSIs in the assets of Funny Partnership at the joining time is set at the asset's tax cost setting amount → subsection 701-10(4), ITAA 1997.

Calculating the TCSAs for the partnership assets

The tax cost of the partnership assets is set by applying the general cost setting provisions of section 701-10 and Subdivision 705-A of the ITAA 1997 (including any provisions that modify Subdivision 705-A) – as modified by Subdivision 713-E, which contains the special cost setting rules for partners and partnerships. Although this is a formation case, for the purposes of this example the modifications to the basic case for a group formation in Subdivision 705-B of the ITAA 1997 have been disregarded.

The TCSAs for Funny Partnership's assets are worked out as follows:

Step 1

The partnership cost pool (PCP) is worked out by adding up all of the subsection 713-240(2) amounts for all of the partnership cost setting interests in the partnership at the joining time.

Table 2: Working out the subsection 713-240(2) amount

Item	If the market value of the partnership cost setting interest is ...	the subsection (2) amount for the partnership cost setting interest is ...
1	equal to or greater than its cost base	its cost base
2	less than its cost base but greater than its reduced cost base	its market value
3	less than or equal to its reduced cost base	its reduced cost base

In this example, because both the partners join the consolidated group at the same time as the partnership, the cost base of each of the PCSIs in Funny Partnership's assets will equal its TCSA calculated at the joining time.

The PCP calculation is set out in table 3.

Table 3: Working out the partnership cost pool (PCP)

Asset	Market value ($)	Cost base ($)	Subsection 713-240(2) amount ($)
Laurel Co			
PCSI in cash	900	900	900
PCSI in recording studio	750	750	750
PCSI in recording equipment	350	250	250
Hardy Co			
PCSI in cash	900	900	900
PCSI in recording studio	750	750	750
PCSI in recording equipment	350	250	250
Partnership cost pool			**3,800**

The PCP ($3,800) is the sum of all of the subsection 713-240(2) amounts for Laurel Co and Hardy Co.

Note: Where it is necessary to determine the cost base and reduced cost base of a PCSI that the head company held before the partnership joined the group, so as to determine the subsection 713-240(2) amount, it should be assumed for the purposes of that comparison that a CGT event happens at that time → sections 110-25 and 110-55, ITAA 1997.

Step 2

Work out the tax cost setting amounts for the retained cost base assets in accordance with section 705-25 of the ITAA 1997.

The TCSA of Funny Partnership's cash is equal to the amount of Australian currency concerned ($1,800) → subsection 705-25(2), ITAA 1997. This is subtracted from the PCP amount ($3,800). The remaining PCP ($2,000) is allocated to the reset cost base assets.

Step 3

Work out the TCSA for the reset cost base assets in accordance with sections 705-35, 705-40 and 705-45 – as modified by subsection 713-240(3).

Funny Partnership has two reset cost base assets (the recording studio and recording equipment), both of which are depreciating assets.

The remaining PCP ($2,000) is apportioned to the reset cost base assets according to the following formula:

$$\text{PCP} \quad \times \quad \frac{\text{market value of asset}}{\text{total market value of reset cost base assets}}$$

Table 4: Allocation of PCP to Funny Partnership's assets

Asset	Terminating value (TV) ($)	Market value (MV) ($)	PCP apportioned ($)	Assets held on revenue account – excess over greater of TV or MV	TCSA ($)
Recording studio	1,500	1,500	1,364	0	1,364
Recording equipment	500	700	636	0	636
Total	2,000	2,200	2,000	0	2,000

The recording studio and the recording equipment are both depreciating assets. The TCSA for a reset cost base asset that is a depreciating asset must not exceed the greater of its market value and its terminating value → section 705-40, ITAA 1997.

References

Income Tax Assessment Act 1997, Subdivision 713-E; as inserted by *Taxation Law Amendment Act (No. 6) 2003* (No. 67 of 2003)

Revision history

Section C2-2-150 first published 14 July 2004.

Proposed changes to consolidation

Proposed changes to consolidation announced by the Government are not incorporated into the *Consolidation reference manual* until they become law. In the interim, information about such changes can be viewed at:

- **http://assistant.treasurer.gov.au** (Assistant Treasurer's press releases)
- **www.treasury.gov.au** (Treasury papers on refinements to the consolidation regime).