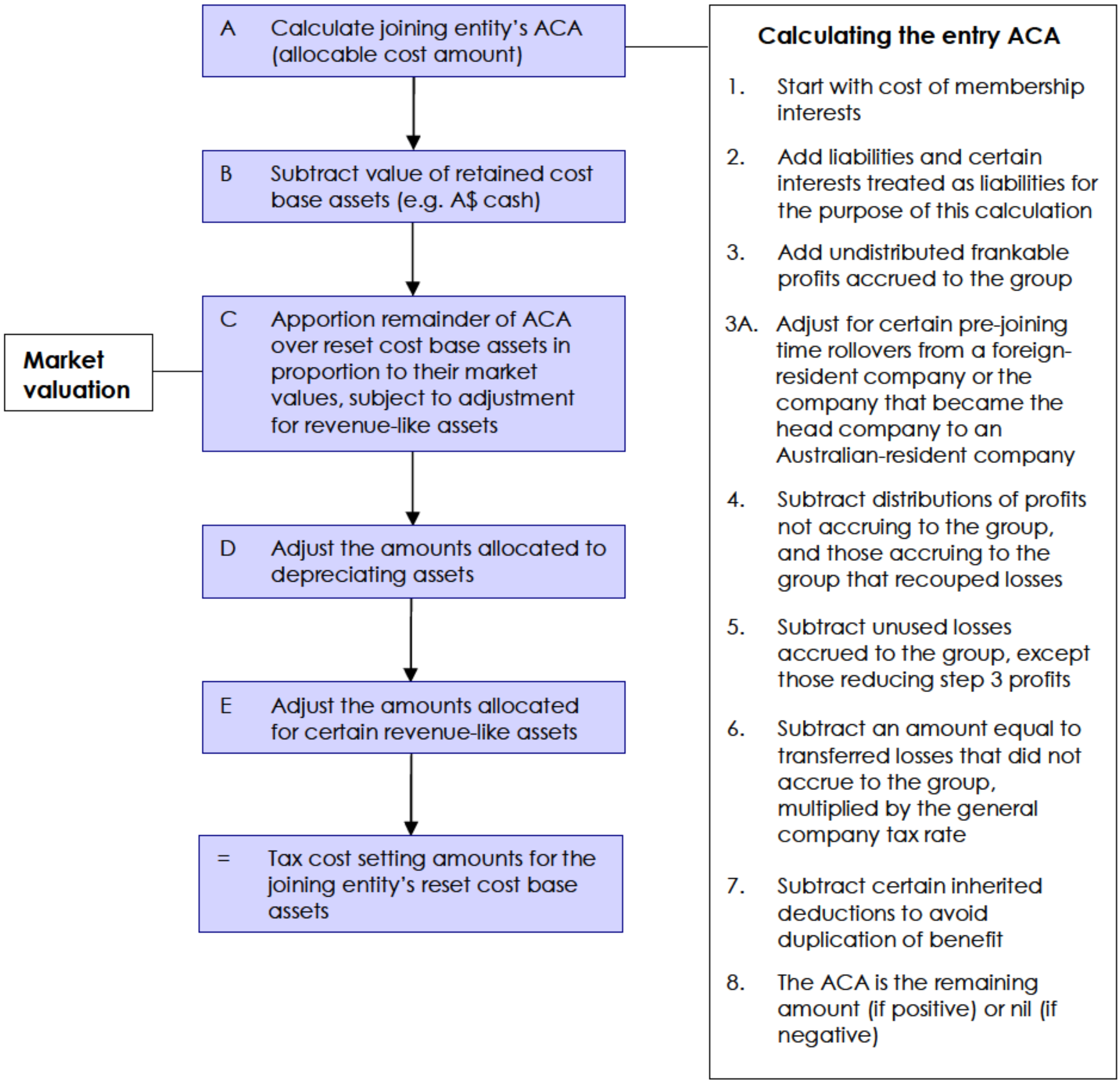
Calculating the entry ACA (step A)

Figure 1: Cost setting process on formation and entry



A – Calculate the entry ACA

The ACA calculation starts with the cost of membership interests, adds the liabilities of the joining entity, then adds undistributed taxed profits that accrued to the joined group, and subtracts certain distributions, losses and inherited deductions. Section 705-60 of the *Income Tax Assessment Act 1997* (ITAA 1997) sets out each of the ACA steps and their particular purpose. The overall purpose is to work out the economic cost to the group of acquiring the joining entity's assets, and to allocate that cost over all of the joining entity's assets, so that when those assets are sold, the group will be taxed on the real economic gain it makes or obtain relief for any real economic loss. The rules aim to prevent double taxation of gains and duplication of losses made by the consolidated group in respect of its interests in a joining entity.

Steps 1 and 2 are about working out the cost of acquiring the joining entity. Step 1 sums the cost of membership interests. Step 2 adds to the step 1 amount the joining entity's liabilities. These liabilities can be considered as further amounts that will be required to be paid for the entity's assets and which should therefore be reflected in the ACA as part of the tax cost of its assets.

Step 3 adds the amount of undistributed, taxed profits that accrued to the joined group. After the acquisition time, but before the joining time, the joining entity may have made profits that remain undistributed. The value of the joining entity will have been enhanced to this extent and this value will be reflected in new assets held by the joining entity. Where tax has been paid on the undistributed profits, if there is not a reflection of this enhanced value in the ACA, the full amount of the future sale proceeds of the assets will be subjected to tax should they be subsequently disposed of. Conversely, no ACA uplift would be warranted for the undistributed profits that have not borne tax because they would otherwise be permanently sheltered from tax as costs of the assets.

Looking at step 3 another way, the undistributed profits could otherwise have been distributed to shareholders as they accrued. Had the shareholders re-invested these distributed profits, which then became reflected in the assets of the joining entity, the after-tax amount would have become part of the step 1 amount as a cost to the shareholders of its membership interests. If these distributed profits had been untaxed (and not franked) the recipient shareholders would receive, in economic value, only the after-tax amount. In this case only the net amount would have been available for re-investment and would therefore be reflected in the ACA at step 1.

Whichever way step 3 is looked at, it is the after tax amount that accrued to the membership interests between acquisition time and joining time that is added at step 3.

Where an entity joins a group as a result of it being progressively acquired, the profits accrued to the membership interests of the group would only be a portion of the profits derived since its first acquisition of membership interests. See 'Determining undistributed, taxed (frankable) profits accrued to group before joining time (ACA step 3)', C2-4-261 for details on what is meant by a profit accrued to the joined group in such a situation.

Step 3A adds or subtracts an adjustment in respect of pre-joining time CGT rollovers to a subsidiary member of the consolidated group from a foreign-resident company or the company that became the head company of the group.

At step 4, certain distributed profits are subtracted. The purpose of step 4 is to prevent the ACA reflecting the return of part of the amount paid to acquire the membership interests in the joining entity. → subparagraph 705-95(b)(i), ITAA 1997

This step requires the subtraction of all distributions made by the joining entity since the acquisition time, but before the joining time, out of acquired profits → subparagraph 705-95(b)(i). These acquired profits are the undistributed profits of the joining entity that would attach to membership interests when the membership interests were acquired. The cost to the group of the acquired profits will be reflected in the step 1 amount. If these are subsequently paid out before the joining time, the step 1 amount would be effectively overstated.

The step also requires subtraction of distributions of accrued profits that recouped losses of any sort that accrued to the group before the joining time → subparagraph 705-95(b)(ii). A profit can only ‘recoup’ a loss of any sort if it has been included as part of the assessable income against which the loss of any sort has been allowed as a deduction or otherwise set-off. If the accounting loss gives rise to the loss of any sort referred to in subparagraph 705-95(b)(ii) and assessable income is reflected in the accounting profit that recoups the earlier accounting loss, that profit will not have been taxed.

The reduction for distributed accrued profits which recouped accrued losses under step 4 requires working out whether distributed profits have recouped losses for income tax purposes. This reduction deals with the situation where the relevant loss is not subtracted at step 5 because the loss has been utilized.

Steps 4 and 5 both deal with ‘losses of any sort’. The phrase is defined in subsection 701-1(4) of the ITAA 1997 and encompasses, broadly, tax losses within Division 36 and certain other particular kinds of losses calculated under the *Income Tax Assessment Act* 1936 (ITAA 1936) and the ITAA 1997.

Step 5 deals with losses that have not been utilised (in the sense that a deduction or other set-off has not been allowed in respect of them), but a loss is not to be taken into account under step 5 to the extent that it has reduced the undistributed profits comprising the step 3 amount. Step 5 subtracts the losses accrued to the joined group.

Step 6 subtracts an amount equal to losses transferred to the head company that did not accrue to the joined group multiplied by the general company tax rate.

Step 7 subtracts certain inherited deductions or part of them to avoid duplication of benefit.

Note that where a particular amount could be taken into account more than once when calculating the entry ACA, section 705-62 may apply to eliminate duplication. → ‘No double counting of amounts in the ACA’, p. 13

The result after all seven steps in the calculation is the entry ACA.

Note

Asset rollover

The ACA calculation will disregard an asset rollover if:

- the rollover was under Subdivision 126-B or under item 4 of the table in subsection 40-340(1) of the ITAA 1997
- the rollover was after 16 May 2002
- the group consolidates after the rollover but before 1 July 2004, and
- because of the rollover, the tax values of the assets of the group are different from what they would have been had the rollover not happened. (However, certain exceptions exist where a foreign-owned group restructures by rolling over membership interests in its subsidiaries, or where the roll-over is in connection with a demerger.)
  → sections 701-35 and 719-163, IT(TP) Act 1997)

Non-chosen subsidiary held by chosen transitional entity

In the formation case, the ACA calculation is modified for a non-chosen subsidiary member where some or all of its membership interests are held (directly or indirectly) by a chosen transitional entity. → 'Overview of cost setting process on formation and entry (including transitional rules)', C2-1-010

Linked assets and liabilities

There are special rules for cost setting in relation to linked assets and liabilities. A set of linked assets and liabilities consists of at least one asset and one liability that the accounting standards or authoritative pronouncements of the Australian Accounting Standards Board require to be set-off against each other in preparing an entity's statement of financial position, and presented as a net amount.
→ subsection 705-59(2), ITAA 1997

The linked assets and liabilities rules can affect:

- the amount of the step 2 liabilities that are added
- allocation of the ACA to linked retained cost base assets
- the inclusion of linked reset cost base assets in the allocation of the ACA
- market values of linked reset cost base assets used to allocate the ACA

→ section 705-59

Apart from these special rules, the consolidation regime treats assets and liabilities that the accounting standards require to be set-off as separate assets and liabilities. That is, in general the linked assets and liabilities are not netted; their gross amounts are used. → section 705-58, ITAA 1997

The application of these rules is explained in detail in a later section.
→ 'Linked assets and liabilities', C2-1-310

An amount not to be included at both step 1 and step 2

In relation to the ACA calculation, the law is not intended to allow more than one tax benefit flowing from a single outlay; that is, if an amount could be categorised as a cost of membership interest for step 1 and as a liability for step 2, the intent is that it be included only once in either step 1 or step 2. → Taxation Determination TD 2004/74

Step 1: Start with the cost of membership interests

Add up the total cost of all membership interests that the consolidated group holds in the joining entity.

When a single entity is joining an existing consolidated group, the calculation will be adjusted:

- to set a single cost base where the reduced cost base is different from the cost base (this will occur where some of the interests were acquired before 21 September 1999, and in some other cases) → subsection 705-65(1), ITAA 1997
- but no amount is added for indexation when determining the cost base of pre-CGT membership interests → subsection 705-65(2)
- by application of the value shifting or loss transfer provisions as if some of the joining entity's membership interests had been disposed of, just before the joining time → subsection 705-65(3), and
- by adding back adjustments to the reduced cost base of membership interests for rebatable dividends, and certain reductions under Subdivision 165-CD of the ITAA 1997 → subsections 705-65(3A), (5) & (5A); 'Treatment of assets owned by head company at both formation time and pre-consolidation changeover time (no changeover time at formation)', C2-6-530.

Non-membership equity interests held by members of the group in the joining entity are treated as membership interests for the purposes of step 1. → section 705-65(6)

Where the head company makes a deferred acquisition payment (i.e. after the joining time it pays money or gives property, or an obligation arises for it to make a payment or give property, in relation to acquiring membership interests in the joining entity), the head company must recalculate the step 1 amount to take account of the deferred payment. This could happen, for example, if a commercial arrangement for the acquisition of the entity required such a payment on the contingency that the acquired entity met a certain profit forecast. → subsection 705-65(5B), ITAA 1997; paragraphs 2.100 – 2.106, Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 2) Bill 2004

On formation

On formation, the amount used for membership interests in the joining entity will be either:

- calculated in the same way as for a single entity joining an existing consolidated group (this applies in respect of interests held directly by the head company), or
- where the tax cost setting amount (new tax cost) has already been set for the membership interests (as a result of the completion of the cost setting process for a subsidiary further up the chain), that amount is treated as the cost of the membership interests to be used in this step. This amount is *not* adjusted by application of the value shifting or loss transfer provisions → subsections 705-145(3) & (4), ITAA 1997.

On formation, non-membership equity interests are similarly treated as if they were membership interests. → subsection 705-145(5), ITAA 1997

Note

Discretionary interests in a trust are treated differently. → 'Modifications to entry cost setting rules', C2-1-040

Step 2: Add liabilities

A joining entity's liabilities at the formation or joining time are part of the group's cost of the entity's assets. The liabilities are therefore added to the amount worked out in step 1. Generally the amount added is the total of the joining entity's liabilities in accordance with its accounting principles for tax cost setting. The joining entity's accounting principles for tax cost setting are the accounting standards or authoritative pronouncements of the Australian Accounting Standards Board that the entity would use if it were to prepare its financial statements just before the joining time. → subsection 705-70 (1), subsection 705-70(3) and section 995-1, ITAA 1997; Taxation Ruling TR 2004/14; Taxation Ruling TR 2006/6

Adjustments may be made to this amount:

- where the joining entity owns linked assets and liabilities – the linked liabilities may be reduced or excluded → section 705-59, ITAA 1997; 'Linked assets and liabilities', C2-1-310
- where the amount of the accounting liability of the joining entity would be different when it becomes an accounting liability of the joined group – the latter amount is treated as the amount of the liability → subsection 705-70(1A), ITAA 1997, and worked example: 'Determining the amount of a deferred tax liability to be used at ACA step 2, including use of administrative short cuts', C2-4-242. (However, this adjustment is not required in the case of a transitional entity. → section 701-32, IT(TP)A 1997; paragraphs 1.156 – 1.162, Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004)
- to exclude an amount that is inextricably linked to an asset of the joining entity → subsection 705-70(2), ITAA 1997; Taxation Determination TD 2004/72
- to reduce the amount for some or all of a liability that will become an income tax deduction to the head company → subsection 705-75(1), ITAA 1997
- to reduce the amount of the liability for amounts owed to a member of the group → subsection 705-75(2), ITAA 1997; 'Effect of Subdivision 165-CC for steps 1 and 2 of the ACA calculation at formation and joining times', C2-6-110; 'Treatment of assets owned by head company at both formation time and pre-consolidation changeover time (no changeover time at formation)', C2-6-530
- where there is a timing difference between income tax provisions and accounting standards in recognising the liability – there may be an increasing or decreasing adjustment → section 705-80, ITAA 1997; 'Adjustment at ACA step 2 to allow for timing differences between accounting and tax recognition of liabilities', C2-4-245; Taxation Determination TD 2004/70; Taxation Determination TD 2004/71; Taxation Determination TD 2004/77; Taxation Determination TD 2004/78; and
- by adding the amount received from the issue of non-membership equity interests to a person who is not a member of the group → subsection 705-85(3), ITAA 1997.

Membership interests in the joining entity that are not held by members of the group (that is, disregarded employee shares) are treated in a similar way to a liability. The market value of these membership interests is added to the amount of liabilities. → 'Adjustment for employee shares (in ACA step 2)', C2-4-241

Note

Finance leases

Where the joining entity is a lessee under a lease of a depreciating asset, the liability represented by the obligation to make lease payments is only taken into account at step 2 if, just before the joining time, the joining entity holds the depreciating asset under Division 40 of the ITAA 1997. If the lessee doesn't hold the depreciating asset just before the joining time it does not have a step 2 amount for that lease liability. → subsection 705-56(4), ITAA 1997

Provision for doubtful debts

A provision (or allowance) for doubtful debts does not constitute a liability under accounting standards or concepts, notwithstanding that the doubtful debts expense which relates to the provision reduced the amount of taxed profits that accrued to the joined group at step 3 of the entry ACA calculation. A modification in section 705-27 of the ITAA 1997 allows for the reduction of any CGT event L3 capital gain in respect of doubtful debts treated as retained cost base assets with a corresponding adjustment to the tax cost setting amount of the debts.

Step 3: Add undistributed taxed and accrued profits

Undistributed profits at the formation or joining time that accrued to direct or indirect membership interests that the group held continuously, and that could be distributed as a fully franked dividend, are added to the ACA. The purpose of this adjustment is to allocate a cost to assets acquired by undistributed taxed profits. → section 705-90, ITAA 1997

This amount is further adjusted to exclude certain income years where the joining entity was previously a member of a consolidated group. → subsection 705-90(5), ITAA 1997

Undistributed profits are the cumulative retained profits of the joining entity that would be recognised in its financial statements if those statements were to be prepared at the joining time. This is an accounting concept and is in essence a net amount in that it may be an amalgam of accounting profits and accounting losses for the accounting periods before the joining time, including pre-acquisition accounting periods. → subsection 705-90(2), ITAA 1997; Taxation Determination TD 2004/55 and Addendum TD 2004/55A

Retained profits may include reserves that have been created out of a Retained Profits Account (RPA). However, reserves that have a source other than retained profits, such as Asset Revaluation Reserve (ARR) and Foreign Currency Translation Reserve, are not considered to be part of retained profits for the purposes of subsection 705-90(2). Generally, retained profits should not include any unrealised gains transferred from ARR. However, where an asset has been disposed of, and the resulting realised gain has been transferred from ARR to RPA in accordance with the accounting standards, the realised gain does not need to be excluded from the balance of the RPA.

→ Taxation Determination TD 2004/55 and Addendum 2004/55A

In working out the undistributed profits, any losses that did not accrue to the joined group are not counted. → subsection 705-90(2A), ITAA 1997; see paragraphs 1.149 – 1.155, Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004 for further information and examples

The extent to which tax is paid on undistributed profits is based on the balance of the franking account that would be available to be fully franked according to the current corporate tax rate → subsection 705-90(3), ITAA 1997. This puts a ceiling on the amount of undistributed profits that can be subsequently dealt with → subsection 705-90(3), ITAA 1997. (Throughout this manual, taxed profits are referred to as frankable profits and untaxed profits as unfrankable profits where there would be no franking credit available.)

Subsection 705-90(6) of the ITAA 1997 then requires the taxed amount to be apportioned between pre-acquisition undistributed profits and post-acquisition profits. The calculation may be seen as a netting-off of accounting profits and accounting losses (if any) over the various accounting periods from the acquisition time to the joining time to see what proportion of the undistributed profits have accrued during that period (accrued profits).

An accrued profit is a profit that would be received by the head company of a group in respect of membership interests that it continuously held, either directly or via interposed entities, on the assumption that a distribution had been made in relation to those membership interests as that profit accrued → subsection 705-90(7), ITAA 1997. This is sometimes referred to as an ‘owned’ profit. Profits that do not accrue to the head company in this way are sometimes referred to as ‘acquired’ profits.

The amount remaining after the subsections 705-90(2), (3) and (6) calculations is the undistributed profits that have accrued to the consolidated group from its continuously held membership interests as limited by the available franking credits. This amount cannot be more than the amount calculated under subsection (3). The cost to the group of pre-acquisition profits will already have been recognised at step 1.

To help reduce the costs of compliance, subsection 705-90(9) allows the amount of profit that accrued to the joined group in a particular period to be worked out using the most reliable basis for estimation that is available. This recognises that detailed records may not always be available to permit a precise calculation of the profits (or losses) that accrued to the group. One such reliable basis for estimation is specifically provided for by subsection 705-90(10). This permits a last-in-first-out (LIFO) method of sourcing dividends to the profits of individual years. → ‘Estimating undistributed, frankable profits accruing to group before joining time (ACA step 3)’, C2-4-260

Continuously held membership interests are membership interests of the joining entity held (directly or indirectly) by the head company from the acquisition date to the formation or joining time. A membership interest will be taken not to have been held continuously in certain situations even if there was no disposal of the membership interest (for example, when the membership interest stops being a pre-CGT asset). → section 705-105, ITAA 1997

On formation

A transitional group may increase the ACA at step 3 for undistributed, untaxed profits that accrued to the group for a non-chosen subsidiary member. This applies to a transitional group that comes into existence on or before June 2003.

It also applies to a transitional group that comes into existence in the period starting 1 July 2003 and ending 30 June 2004 if the day it comes into existence is on or before the first day of the head company's income year that started after 30 June 2003. → *Tax Laws Amendment Act (2010 Measures No. 1) Act 2010*

This period allows such a group to benefit from an increase in the ACA regardless of whether the head company has a substituted accounting period or an ordinary accounting period. → former section 701-30, IT(TP)A 1997; Taxation Determination TD 2004/62 and Addendum 2004/62A

Note: For the purpose of determining the ACA of entities forming a group, a profit of a higher-tier entity in the group will not be held to have accrued to the group where it has arisen from a dividend paid by a lower-tier entity out of profits that did not accrue to the group (acquired profits). This will also apply where multiple linked entities join a group. → Taxation Determination TD 2004/53 and Addendum 2004/53A

Note

Step 3 is modified for trusts. → 'Modifications to entry cost setting rules', C2-1-040

Step 3A: Pre-joining time rollover from a foreign-resident company or the company that becomes the head company

An adjustment to the ACA is made where there is a pre-joining time rollover from a foreign-resident company or the company that became the head company to a resident company that then joins a consolidated group. The adjustment is an increase or a reduction to the ACA depending on whether a capital loss (prior to loss deferral provisions) or a capital gain is rolled over.

→ sections 705-93, 705-147 and 705-227, ITAA 1997

Broadly, where there was a pre-joining time rollover of a CGT asset under Subdivision 126-B (ITAA 1997), or former section 160ZZO (ITAA 1936), from a foreign-resident company or from the company that became the head company to an Australian-resident group company and the entity that holds the asset then joins the group, there will be a step 3A amount if that entity was either the recipient of the asset or received the asset as a result of a further rollover. If a capital gain is rolled over, the step 3A amount is the amount of the deferred rollover gain; and if a capital loss is rolled over, the step 3A amount is the amount of the deferred rollover loss. However, no adjustments are made where the rollover asset is both a non-membership interest and a pre-

CGT asset, or if the recipient of the rollover was the company that became the head company of the consolidated group.

The purpose of this provision is to offset any effect that a rollover would otherwise have in altering a group's aggregate cost for its assets. Where this step applies to more than one rollover asset, the ACA is increased or reduced by the net result after taking into account all reduction (that is, deferred rollover gain) and increase (that is, deferred rollover loss) amounts.

Where after applying step 3A, the result of the ACA calculation so far is negative, CGT event L2 will happen. The head company will make a capital gain equal to the negative amount → section 104-505, ITAA 1997; 'CGT events arising out of the cost setting rules', C2-1-410 If this happens you do not need to proceed with the remaining steps of the ACA calculation. The tax cost setting amount of your assets will be set to nil.

On formation

Step 3A adjustment

An adjustment is made to the ACA where there is a pre-formation time rollover from a foreign-resident company or the company that became the head company to an Australian-resident company that joins a consolidated group at the formation time and the rollover asset becomes that of the head company under the single entity rule → section 705-93. An adjustment is also made where the rollover asset is a membership interest in an entity that becomes a subsidiary member → section 705-93 as modified by section 705-147.

If the rollover amount was a capital gain (deferred rollover gain), the ACA is reduced. If the rollover amount was a capital loss (deferred rollover loss), the ACA is increased. However, if the rollover is disregarded because of the operation of the transitional provisions (→ section 701-35, IT(TP)A) 1997), this rule does not apply.

Note

Step 3A is modified for linked entities in a similar way to the modification for formation. → section 705-227, ITAA 1997

Step 4: Subtract adjustments for certain distributions by the joining entity

There are two circumstances where an adjustment is made:

1. First, distributions by the joining entity that would reflect a net return of the cost of membership interests included in the step 1 amount are deducted. The purpose of this adjustment is to reduce the cost of membership interests where some or all of that amount has been returned as a distribution. → subparagraph 705-95(b)(i), ITAA 1997

On formation

Notwithstanding that there have been successive distributions of the same amount, the adjustment is made only in working out the ACA for the entity that distributes profits directly to the head company and in circumstances where profits have been effectively returned to the head company. → 'Adjustment in working out step 4 of allocable cost amount for successive distributions of profits at formation (ACA step 4)', C2-4-280; section 705-155, ITAA 1997

Before the formation time it may be that dividends are paid by a lower-tier member of the group to a higher-tier member out of profits that did not accrue to the group (acquired profits), and those dividends are not paid up to the head company. For the purposes of the ACA calculation at the formation time, those profits will retain the character of 'acquired' profits in the hands of the recipient subsidiary member of the group. This will also apply where multiple linked entities are joining a group.

Note

Step 4 is modified for linked entities in a similar way to the modification for formation. → 'Modifications to entry cost setting rules', C2-1-040

2. Second, distributions by the joining entity of profits that accrued to direct or indirect membership interests that the head company held continuously are deducted. This deduction only applies to the extent that those profits recouped losses that accrued to direct or indirect membership interests that the head company held continuously. The purpose of this step is to reduce the cost of membership interests included in the step 1 amount where some of that cost has been lost and, when recouped, returned as a distribution. → subparagraph 705-95(b)(ii), ITAA 1997; Taxation Determinations TD 2004/57, TD 2004/58, TD 2004/60

Note

Subsection 705-90(10) permits a last-in-first-out (LIFO) method of sourcing dividends to the profits of individual years. → 'Estimating undistributed, frankable profits accruing to group before joining time (ACA step 3)', C2-4-260

Step 5: Subtract the joining entity's losses accruing to the head company

If the joining entity has carry-forward losses (such as tax losses or net capital losses) accruing to continuously held membership interests, those amounts are subtracted. An adjustment is made even where the losses have not been transferred to the head company. → subsection 705-100(1), ITAA 1997

However, a loss is not to be taken into account to the extent that it reduced the undistributed profits comprising the step 3 amount. → subsection 705-100(2), ITAA 1997; Taxation Determination TD 2004/59 and Addendum 2004/59A

The purpose of step 5 is to reflect the losses in the ACA and prevent a double benefit arising from them. Without this adjustment, there would be a reinstatement of the lost value in the ACA. This would result in either reduced gains or increased losses on disposal of the assets brought into the group.

Step 6: Subtract tax benefit from certain losses transferred by the joining entity

If the joining entity is transferring carry-forward losses to the head company at the formation or joining time, work out the extent to which those losses did not accrue to the group joined (and in respect of which their transfer was not cancelled). Multiply the result by the general company tax rate and subtract the answer at this step. → section 705-110, ITAA 1997; 'Adjustments for losses (ACA steps 5 and 6)', C2-4-300

Without this adjustment, the group would get a double tax benefit if it received both an uplift in the terminating values of the assets of the subsidiary entity at the formation or joining time and the ability to utilise those losses against the group's income after that time.

Step 7: Subtract certain inherited deductions to avoid duplication of benefit

Deduct an amount for certain unclaimed deductions inherited by the head company for expenditure incurred by the joining entity before the formation or joining time. The purpose of this adjustment is to stop the group getting benefits both through the tax cost of the joining entity's assets being set and through certain tax deductions of the joining entity being inherited by the head company.

Deductions are not subtracted for expenditure:

- that becomes part of, or reduces the cost of the relevant asset
- to which section 110-40 (about expenditure on assets acquired before 7.30pm on 13 May 1997) applies
- to the extent that it reduced the ACA step 3 amount (e.g. where earlier profits were reduced by an accounting loss), or
- that arises under section 43-15 (which relates to undeducted construction expenditure) if the joining entity acquired the asset to which the deduction

relates at or before 7.30pm on 13 May 1997. → section 705-115, ITAA 1997; 'Adjustment for certain inherited deductions (ACA step 7)', C2-4-340

Note that there are special rules dealing with the treatment of allowable capital expenditure, transport capital expenditure and exploration and prospecting assets to ensure that the value of the notional asset is reduced where real assets are created from this expenditure pool (affects ACA step 7). → Subdivision 705-E, IT(TP)A 1997; *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1, Part 4, 'Expenditure relating to mining or quarrying'; Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004, paragraphs 1.49 – 1.92

Step 8: ACA result

If the amount calculated up to step 7 is positive, it is the joining entity's ACA. If it is negative, the ACA is nil.

No double counting of amounts in the ACA

Under the tax cost setting process, several adjustments are made to the ACA. In some circumstances a particular amount can be taken into account more than once when calculating the ACA for a joining entity, and as a result, the tax costs allocated to the joining entity's assets can be distorted. Section 705-62 of the ITAA 1997 prevents duplication of amounts when calculating the ACA.

A particular amount can be taken into account more than once because, for example, integrity measures in the income tax law prevent the duplication of losses by reducing the cost base of membership interests. At the time the ACA is calculated, this reduction could cause a potential double adjustment to the ACA by being reflected in the membership interests at step 1, and again in losses at step 5.

Where section 705-62 of the ITAA 1997 applies, the head company may choose to specify which alteration is made to the ACA calculation. The choice must be made, in writing, by the day the head company lodges its income tax return for the income year in which the joining time occurs or within such further time allowed by the Commissioner. If no choice is made, the alteration that is most appropriate, in the light of the object of the cost setting rules, is to be made.

Section 705-62 of the ITAA 1997 applies on or after 10 February 2010 unless the head company makes a written choice, within the prescribed time, to apply the section from 1 July 2002. Should the head company choose to apply section 705-62 retrospectively, it may make a written choice within the prescribed time specifying which alteration it wants to use to ensure there is no double counting of amounts in the ACA calculation.

Note

Retrospective application – *Tax Laws Amendment (2010 Measures No. 1) Act 2010*

There is a choice to apply certain amendments (including Part 20, non-membership equity interests) from 1 July 2002. Making this choice may affect the tax cost setting amounts (TCSAs) of a large number of reset cost base assets of the joining entity. Although these TCSAs may have been worked out correctly according to the law as it stood at the time, they may become incorrect because of the retrospective application of the choice. Rather than recalculating the TCSAs and amending the necessary income tax returns to correct the errors, it may be possible, subject to certain conditions being met, to regard the incorrect TCSAs as being correct and to net off the errors as a single capital gain or capital loss under CGT event L6.

There may be a reduction in the capital gain or capital loss if the ATO becomes aware of the errors outside the period during which it may amend all the returns necessary to correct the errors. If the normal amendment period ends before 3 June 2012, it is extended to that date.

→'Dealing with errors in TCSAs and changes in liabilities when discharged', C2-1-050; Taxation Ruling TR 2007/7; subsection 4(2), *Tax Laws Amendment (2010 Measures No. 1) Act 2010*

References

Legislation

Income Tax Assessment Act 1997, Subdivision 705-A; as amended by:

- *New Business Tax System* (Consolidation*) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *New Business Tax System (Consolidation*, Value Shifting, Demergers and Other Measures) Act 2002 (No. 90 of 2002), Schedule 2
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002 (*No. 117 of 2002), Schedules 3 and 5
- *Tax Laws Amendment Act (No. 6) 2003* (No. 67 of 2003), Schedule 3
- *Tax Laws Amendment Act (2004 Measures No. 6) Act 2005* (No 23 of 2005, Schedule 1

Income Tax Assessment Act 1997, Division 126-B; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 3

Income Tax Assessment Act 1997, sections 40-340 and 110-40

Income Tax (Transitional Provisions) Act 1997, sections 701-35 and 719-163; as amended by:

- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 17
- *Tax Laws Amendment (2006 Measures No 4) Act 2006* (No. 168 of 2006), Schedule 2

Income Tax Assessment Act 1997, subsection 705-65(5B); as inserted by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2, Part 6

Income Tax Assessment Act 1997, Subdivision 705-B; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 3
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 3

Income Tax (Transitional Provisions) Act 1997, sections 701-32 and 701-34; as inserted by *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1, Part 9

Income Tax Assessment Act 1997, subsection 705-90(2A); as inserted by *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1, Part 8

Income Tax Assessment Act 1997, subsection 705-90(10); as inserted by *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1, Part 7

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* and section 160ZZO of the *Income Tax Assessment Act 1936*

Income Tax Assessment Act 1997, section 705-27; as inserted by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 13

Income Tax Assessment Act 1997, section 705-62; as inserted by *Tax Laws Amendment Act (2010 Measures No.1) Act 2010* (No. 56 of 2010), Schedule 5, Part 4

Income Tax Assessment Act 1997, sections 104-505, 705-60, 705-93, 705-147, 705-227 and subsection 995-1(1); as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 5

Income Tax Assessment Act 1997, sections 705-70 and 995-1; as amended by *Tax Laws Amendment (2010 Measures No.1) Act 2010* (No.56 of 2010), Schedule 5, Part 8

Income Tax Assessment Act 1997, section 705-115; as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 9

Income Tax Assessment Act 1997, subsections 705-65(6), 705-85(3) and 705-145(5); as amended by *Tax Laws Amendment (2010 Measures No.1) Act 2010* (No. 56 of 2010), Schedule 5, Part 20

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002

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

Explanatory Memorandum to the New Business Tax System (Consolidation and other Measures) Bill (No. 1) 2002

Explanatory Memorandum to Taxation Laws Amendment Bill (No. 6) 2003, paragraphs 3.4 and 3.9 to 3.47

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 2) Bill 2004, paragraphs 2.100 – 2.106

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004, paragraphs 1.156 – 1.162

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004, paragraphs 1.149 – 1.155

Explanatory Memorandum to Tax Laws Amendment (2006 Measures No 4) Bill 2006

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No.1) Bill 2010, Chapter 5

Tax rulings

TR 2004/14 – Income tax: consolidation: recognising and measuring the liabilities of a joining entity under subsection 705-70(1) of the *Income Tax Assessment Act 1997*

TR 2006/6 – Income tax: consolidation: recognising and measuring the liabilities of a joining entity under subsection 705-70(1) of the *Income Tax Assessment Act 1997* where the joining time occurs in a financial reporting period of the joining entity beginning on or after 1 January 2005

Tax determinations

TD 2004/53 and Addendum TD 2004/53A – Income tax: consolidation tax cost setting rules: are distributions paid up a chain of entities sourced from profits in a lower-tier entity that did not accrue to the joined group added at step 3 of the entry allocable cost amount of the higher-tier entity?

TD 2004/55 and Addendum TD 2004/55A – Income tax: consolidation tax cost setting rules: step 3 of the allocable cost amount: is the 'retained profits' amount referred to in subsection 705-90(2) of the Income *Tax Assessment Act 1997* a cumulative retained profits balance?

TD 2004/57 – Income tax: consolidation tax cost setting rules: will an amount be subtracted under step 4 of the allocable cost amount under subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997* where there has been a distribution of profits accrued to the joined group that recouped losses accrued to the group?

TD 2004/58 – Income tax: consolidation tax cost setting rules: should distributions of profits accrued to the joined group that recoup losses accrued to the group be counted when determining the step 4 amount of the allocable cost amount on formation of a transitional consolidated group?

TD 2004/59 and Addendum TD 2004/59A – Income tax: consolidation tax cost setting rules: how do you work out the amount subtracted at step 5 of the allocable cost amount where the loss taken into account under subsection 705-100(1) of the *Income Tax Assessment Act 1997* has also reduced the step 3 amount?

TD 2004/60 – Income tax: consolidation tax cost setting rules: step 4 of the allocable cost amount: should tax losses or net capital losses transferred to a joining entity be taken into account when determining whether there will be a subtraction at subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997*?

TD 2004/70 – Income tax: consolidation: does the phrase 'is taken into account at a later time' in paragraph 705-80(1)(a) of the *Income Tax Assessment Act 1997* require that an accounting liability, or a change in the amount of an accounting liability, of a joining entity that is first recognised after the joining time be examined when determining whether or not section 705-80 of that Act applies?

TD 2004/71 – Income tax: consolidation: can section 705-80 of the *Income Tax Assessment Act 1997* apply to a liability (or a change in a liability) that is recognised for accounting purposes because of an event that occurred after the joining time that provides new evidence of conditions that existed at the joining time?

TD 2004/72 – Income tax: consolidation: when calculating step 2 of the allocable cost amount for a joining entity, do section 705-75 or 705-80 of the *Income Tax Assessment Act 1997* apply to an accounting liability covered by subsection 705-70(2)?

TD 2004/74 – Income tax: consolidation: can an amount be included in step 1 as well as step 2 of the allocable cost amount calculation in section 705-60 of the *Income Tax Assessment Act 1997*?

TD 2004/77 – Income tax: consolidation: general insurance: are accounting liabilities for unearned premiums adjusted under subsections 705-75(1) and 705-80(1) of the *Income Tax Assessment Act 1997* for the purposes of working out the allocable cost amount for a joining entity that is a general insurance company?

TD 2004/78 – Income tax: consolidation: general insurance: do subsections 705-75(1) and 705-80(1) of the *Income Tax Assessment Act 1997* apply to any part of an accounting liability for outstanding claims for the purposes of working out step 2 of the allocable cost amount for a joining entity that is a general insurance company?

Revision history

Section C2-1-020 first published as separate section 26 June 2007.

Further revisions are described below.

Date	Amendment	Reason
30.6.09	Minor changes including removal of note at step 5 to reflect new rules for treatment of foreign losses.	Legislative amendment.
6.5.11	Changes to commentary to reflect changes to the treatment of certain inherited deductions. Replacement of note on proposed changes with note on legislated changes to the treatment of doubtful debts for tax cost setting purposes. New reference to 'accounting standards for tax cost setting', and consequential minor changes throughout. Removal of note on proposed changes to clarify both the valuation of liabilities and the accounting principles to be used. Revisions to reflect changes to the pre-joining time rollover provisions (step 3A). New section added on the introduction of the no double counting rules for the ACA.	Legislative amendments.
	Removal of references to TD 2005/19 and TD 2006/60.	Tax determinations withdrawn.