

## Allocating the entry ACA (steps B to E)

B – Subtract values of, and allocate to, retained cost base assets

The ACA is reduced by subtracting the sum of the tax cost setting amounts (TCSAs) of the following assets, which are retained cost base assets:

- Australian currency or a right to receive a specified amount of Australian currency (other than a right that is a marketable security under section 70B, ITAA 1936)*  
 The TCSA is the amount of Australian currency concerned, except where the asset is a qualifying security under Division 16E of Part III of the ITAA 1936. A special rule applies to these securities to obtain a tax neutral result at the joining time → section 705-30, ITAA 1997.  
*Note.* Any Australian currency that is also trading stock or a collectable of a joining entity is not a retained cost base asset → subsection 705-25(5), ITAA 1997; Taxation Ruling TR 2005/10.  
*Note.* A receivable would be a retained cost base asset where there is an indefeasible, present right to the receipt of a fixed, nominal amount of Australian currency → Taxation Ruling TR 2005/10. Where the joining entity has such receivables that are reduced by a provision or allowance for doubtful debts, the receivables are retained cost base assets even where the market value of the receivables is substantially less than the face value.
- An entitlement that is subject to a prepayment*  
 The TCSA for this asset is equal to the sum of deductions that the head company would be entitled to because of the entity history rule.  
 → subsection 705-25(4) and section 705-30, ITAA 1997
- Trading stock in certain circumstances*  
 While ordinarily a retained cost base asset, trading stock is treated as a *retained* cost base asset where the joining entity was a continuing majority-owned entity. A joining entity is a continuing majority-owned entity where a person or persons continued to be majority beneficial owners (directly or indirectly) of it from the start of 27 June 2002 until the joining time. The TCSA for trading stock as a retained cost base asset is equal to the joining entity's year-end valuation. → section 701A-5, IT(TP)A 1997; 'Applying the continuing majority-owned entity test to multi-tiered structures', C2-4-855; 'Accounting for trading stock on entry', C9-5-320

The head company will make a capital gain if the sum of the TCSAs for all the joining entity's retained cost base assets is greater than the ACA for the joining entity. The capital gain (made under CGT event L3) is equal to the difference between the total TCSAs of the retained cost base assets (as defined by paragraph 705-35(1)(b)) and the entity's ACA. The head company makes the gain just after the entity becomes a subsidiary of the consolidated group or the MEC group. → section 104-510, ITAA 1997

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## Note

### Treatment of doubtful debts

The treatment of doubtful debts for cost setting purposes is modified to allow for the reduction of any CGT event L3 capital gain in respect of doubtful debts as retained cost base assets with a corresponding reduction to the tax cost setting amount of the head company's outstanding debts. These modifications apply from 10 February 2010, unless a written choice to apply the changes from 1 July 2002 is made within the prescribed time by the head company of the group.

→ section 705-27, ITAA 1997

Note that paragraph 705-59(5)(b), item 4, which relates to the treatment of linked assets and linked liabilities, can operate to exclude linked retained cost base assets from paragraph 705-35(1)(b). → 'Linked assets and liabilities', C2-1-310

A head company will make a capital loss if a joining entity does not have any reset cost base assets and not all of the ACA in respect of that entity can be allocated to the joining entity's retained cost base assets. The capital loss the head company makes is the unusable portion of the ACA. The head company makes the capital loss under CGT event L4 just after the entity becomes a subsidiary of the consolidated or MEC group. → section 104-515, ITAA 1997

### Application of de minimis principle

For the purpose of determining whether a loss is available under CGT event L4, where the sum of the costs of reset cost base assets and the sum of their market values are very small or trifling those assets could be ignored for the purpose of allocating ACA under section 705-35. This will depend on the facts and circumstances of each case → Taxation Determination TD 2005/54. Where both the sum of the costs of all of the assets of a non-operating joining entity and the sum of their market values are less than \$5,000, the ATO will accept that the assets are *de minimis*, and they can be ignored.

C – Apportion remaining ACA over reset cost base assets, adjusting for revenue-like assets

Any asset that is not a *retained* cost base asset, or an *excluded* asset, is a *reset* cost base asset. The remaining ACA is allocated to the entity's reset cost base assets in proportion to their market values.

The TCSA calculated up to this point may be altered because of five rules that cap the TCSA of certain classes of reset cost base assets (and in one case redistributes the excess to other reset cost base assets), as shown in table 1.

Table 1: Assets for which the TCSA is capped

Asset class	See for more information ...
Assets held on revenue account	This step; section 705-40, ITAA 1997
Accelerated depreciation assets	'D – Adjust the amounts allocated to depreciating assets', p. 5; section 705-45, ITAA 1997
Certain privatised assets	'D – Adjust the amounts allocated to depreciating assets', p. 5; section 705-47, ITAA 1997
Over-depreciated assets	'D – Adjust the amounts allocated to depreciating assets', p. 5; former section 705-50, ITAA 1997
Assets held on revenue account where there is a loss of pre-CGT status of membership interest in the joining entity	'E – Adjust the amounts allocated to certain revenue-like assets', p. 7; section 705-57, ITAA 1997

The first four of these 'capping rules' are applied in the order listed above, unless the head company elects that they apply in another order → section 705-55, ITAA 1997. The fifth rule is always applied last → subsection 705-57(6), ITAA 1997.

#### On formation

For the purpose of allocating the ACA among the reset cost base assets, the value to be used as the market value of an asset of a subsidiary that constitutes direct or indirect membership interests in another subsidiary is modified if the lower subsidiary has profits that will be added under step 3 of the ACA calculation or losses that will be deducted under step 5. → section 705-160 ITAA 1997 'Adjustment for ACA allocation at formation to membership interests in linked subsidiaries with losses (step C)', C2-4-540

#### Note

Step C is modified for linked entities in a similar way to formation. → 'Modifications to entry cost setting rules', C2-1-040  
 Step C may also be modified by the operation of the rules for linked assets and liabilities. → section 705-59, ITAA 1997; 'Linked assets and liabilities', C2-1-310

### Adjust the amounts allocated to revenue-like assets

Where the TCSA calculated up to this point for a reset cost base asset that is a revenue-like asset (i.e. trading stock, depreciating assets and revenue assets) exceeds both the market value and the terminating value of the asset, the TCSA is reduced to the greater of those two amounts. The excess is redistributed to other reset cost base assets → section 705-40, ITAA 1997. This reduction does not apply to trading stock treated as a retained cost base asset.

This reduction addresses the potential for unrealised capital losses to be converted to revenue losses or smaller revenue gains when an entity joins a consolidated group. This relates to situations where assets still held by a subsidiary entity have declined in value after the group purchases membership interests in it.

A head company may make a capital loss where all the reset cost base assets of the joining entity are revenue-like assets. The amount of ACA that can be allocated to such assets is limited to the greater of the asset's market value and its terminating value → section 705-40, ITAA 1997. If this limit results in some of the ACA not being allocated (because there are no reset cost base assets other than revenue-like assets) the head company will make a capital loss equal to the amount of ACA not allocated. This will give rise to a CGT L8 event.

→ section 104-535, ITAA 1997

→ 'CGT events arising out of the cost setting rules', C2-1-410

### Finance leases

Where the joining entity is the lessor or lessee under a lease of a depreciating asset (the underlying asset) to which Division 40 of the ITAA 1997 applies, and the lease is classified according to accounting standards as a finance lease, special cost setting rules apply depending on whether or not the joining entity holds the underlying asset under that Division. These rules are set out in table 2. → section 705-56, ITAA 1997

Table 2: Treatment of underlying asset

Joining entity is ...	Cost setting treatment
<i>lessor and holds the underlying asset</i>	The underlying asset has its tax cost set at the joining time. The asset that is the right to receive lease payments ('Lease Receivable') is not taken into account for cost setting purposes and its TCSA is taken to be nil. → subsection 705-56(2), ITAA 1997
<i>lessor and does not hold the underlying asset</i>	The underlying asset is not taken into account for cost setting purposes and its TCSA is taken to be nil. The asset that is the Lease Receivable is taken to be a retained cost base asset with a TCSA equal to its market value just before the joining time. → subsection 705-56(3), ITAA 1997
<i>lessee and holds the underlying asset</i>	The underlying asset has its tax cost set at the joining time. The liability that is the obligation to make lease payments (Lease Payable) is taken into account at step 2 of the ACA calculation. → note to subsection 705-56(4), ITAA 1997
<i>lessee and does not hold the underlying asset</i>	The underlying asset is not taken into account for cost setting purposes and its TCSA is taken to be nil. The liability that is the Lease Payable is not taken into account at step 2 of the ACA calculation. → subsection 705-56(4), ITAA 1997

## Note

### Partly constructed assets

An asset is a depreciating asset if it has a limited effective life and it can reasonably be expected to decline in value over the time it is used. → section 40-30(1)

If, on commencement of construction of an asset, a conclusion is reached that it will have a limited effective life, the partly constructed asset will satisfy the definition of depreciating asset. Such a partly constructed asset is a reset cost base asset that is a revenue-like asset. → 'Reduction for revenue-like assets (Step C)', C2-4-530

Where an asset was not previously depreciated (as is the case with partly constructed assets), section 40-65 allows the head company to choose which method to use in working out the asset's decline in value once it is completed and installed. The head company is required to adopt an effective life under section 40-95 from that time. This allows the reset cost of such an asset, together with additional costs incurred by the head company in bringing the asset to completion, to be claimed under Division 40.

## D – Adjust the amounts allocated to depreciating assets

### Choice of retaining accelerated depreciation rates

The head company may choose under section 705-45 to reduce the TCSA of a depreciating asset acquired before 21 September 1999 to equal its terminating value. Where a depreciating asset's TCSA does not exceed its terminating value, section 701-80 permits the head company to use the accelerated depreciation provisions. → sections 705-45 and 701-80, ITAA 1997; 'Capital allowances – with accelerated depreciation', C9-5-310

Unlike the adjustment to the TCSA for revenue-like assets in step C above, the excess after exercising the choice to reduce TCSAs to terminating value is not reallocated to other assets, but is lost to the group.

Note that special rules dealing with the treatment of allowable capital expenditure (ACE), transport capital expenditure (TCE) and exploration and prospecting assets allow taxpayers to retain accelerated depreciation concessions available for ACE and TCE before 1 July 2001. → Subdivision 716-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,

### Adjust the amounts allocated to privatised depreciating assets

A privatised depreciating asset is a depreciating asset in respect of which, as a result of a past or simultaneously occurring privatisation, Division 58 of the ITAA 1997 (or another similar regime) directly or indirectly affects the amount the joining entity could deduct for decline in value of the previously exempt asset.

Where the TCSA calculated up to this point for a privatised depreciating asset exceeds the terminating value of the asset, the TCSA is reduced to the terminating value. → section 705-47, ITAA 1997; 'Reduction for privatised depreciating assets (at step D)', C2-4-605

Unlike the adjustment to the tax cost setting amount for revenue-like assets in step C above, the amount of the reduction is not reallocated to other assets.

The purpose of this adjustment is to ensure that the limiting of decline in value deductions under privatised assets provisions (such as Division 58 of the ITAA 1997) is not over-ridden by the consolidation tax cost setting process. Reducing the TCSA to the joining entity's terminating value for the asset ensures that decline in value deductions allowable to the head company for such privatised depreciating assets continue to be appropriately limited.

This adjustment *does not* apply where the privatised depreciating asset has been held for at least 24 months by an earlier consolidated group that is not an associate of the joined group.

#### Adjust the amounts allocated for over-depreciated assets

A further reduction may apply where a depreciating asset's market value, at formation or joining time, exceeds its adjustable value at that time. Where the joining entity paid an unfranked dividend after it acquired the asset, and the dividend attracted the intercorporate dividend rebate, there is potential for indefinite deferral of tax on the income sheltered by the over-depreciation.

In these situations the over-depreciation will not have been fully 'clawed back' in the form of lower depreciation deductions in relation to the asset, and an adjustment may be made to reduce the head company's TCSA for the depreciating asset. Amounts that have already reduced the ACA at steps 4 and 5 are not counted again here. → former section 705-50, ITAA 1997; Taxation Determination

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A worked example shows how to work out the over-depreciation reduction for each asset. → 'Reduction for over-depreciated assets (step D)', C2-4-610

Unlike the adjustment to the TCSA for revenue-like assets in step C above, the excess is not reallocated to other assets, but is lost to the group.

In cases where taxpayers do not have sufficient information available to work out the reduction for over-depreciation on an asset-by-asset basis, an administrative short-cut may be used. Some acceptable methods are shown in a worked example → 'Reduction for over-depreciated assets (step D) – administrative short-cuts', C2-4-640.

#### On formation

There will also be a reduction in the TCSAs for over-depreciated assets where the transitional provisions applied to step 3 of the ACA. That is, where the step 3 amount has been increased for undistributed unfrankable pre-formation profits, there may be a reduction to the extent that those unfranked profits related to over-depreciation.

## Note

Consolidated group joins another

Step D is modified when a consolidated group joins another consolidated group.  
→ “Modifications to entry cost setting rules”, C2-1-040

Changes to the over-depreciation provisions

The over-depreciation provisions in the tax cost setting rules have been modified for an entity that becomes a member of a consolidated group between 9 May 2007 and 30 June 2009. In this case a head company will only need to look at five years of dividend history immediately before the joining time to determine whether an over-depreciation adjustment is required in relation to the joining entity's asset. Effective from 1 July 2009, the over-depreciation adjustment in section 705-50 has been repealed, so it will no longer apply to over-depreciated assets of entities that become subsidiary members of a consolidated group on or after that date. → *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010)

E - Adjust the amounts allocated to certain revenue-like assets

A further reduction may apply to certain revenue-like assets (i.e. trading stock, depreciating assets and revenue assets), if:

- the asset's TCSA exceeds its terminating value, and
- before consolidation, Division 149 (ITAA 1997) or its predecessor reset the cost bases of pre-CGT membership interests in the joining entity at a higher value (because of a change in the entity's majority ownership)  
→ section 705-57, ITAA 1997.

In these circumstances, the entry ACA will need to be recalculated and reallocated. The first calculation and allocation of the ACA sets the TCSAs for all assets other than those revenue-like assets mentioned above. The second calculation and allocation sets the TCSAs for those revenue-like assets.

Those revenue-like assets will be given reduced TCSAs that remove the effect of the change in majority ownership on the cost bases of membership interests. The reduction amount gives rise to a capital loss for the head company and can be offset against capital gains over a minimum period of five income years. → section 104-500, ITAA 1997

The calculation at this step is shown in worked examples. → ‘Limiting the tax cost setting amounts of revenue-like assets (step E)’, C2-4-710; ‘Pre-CGT factor for assets of a joining entity’, C2-4-810; ‘Pre-CGT status of membership interests in a joining entity – pre-CGT proportion rules’, C2-4-813; section 705-57, ITAA 1997; Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, paragraphs 1.87-1.114

## On formation

A reduction only applies where the cost base or reduced cost base of the direct membership interests of the head company in a subsidiary member has been increased by the operation of Division 149 (ITAA 1997) or its predecessor.  
→ section 705-163 ITAA 1997; Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, paragraphs 1.102 – 1.105

For a high-level example of how the cost setting process on entry is applied from beginning to end see → ‘The cost setting process on entry’, C2-2-110.



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## 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

*Taxation Laws Amendment Act (No. 6) 2003* (No. 67 of 2003), Schedule 3

*Income Tax Assessment Act 1997*, Section 705-56; as inserted by *Tax Laws Amendment (2004 Measures No 6) Act 2005* (No 23 of 2005), Schedule 1, Part 3

*Income Tax Assessment Act 1997*, section 705-125; as inserted by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1, and amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 3

*Income Tax Assessment Act 1997*, section 705-50 and subsection 995-1(1); as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010 (No. 56 of 2010)*, Schedule 5, Part 6, Part 11 and Part 13.

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 the Taxation Laws Amendment Bill (No. 6) 2003

Explanatory Memorandum to the Taxation Laws Amendment (2004 Measures No 6) Bill 2004, paragraphs 1.29 – 1.48

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

### Tax ruling

TR 2005/10 – Income tax: consolidation: retained cost base assets consisting of Australian currency or a right to receive a specified amount of such currency

### Tax determinations

TD 2004/4 – Income tax: Is a dividend paid before 1 July 1987 an unfranked dividend for the purposes of section 705-50 of the *Income Tax Assessment Act 1997*?



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TD 2005/54 – Income tax: consolidation: asset cost setting rules: where the cost and value of the reset cost base assets of a joining entity are so small or trifling that they are de minimis, can they be ignored when determining whether a CGT event L4 loss is available under section 104-515 of the *Income Tax Assessment Act 1997*?

Revision history

Section C2-1-030 first published as separate section 26 June 2007.

Further revisions are described below.

Date	Amendment	Reason
6.5.11	Minor changes to reflect changed wording in former section 705-50.  Removal of note on proposed changes to the treatment of units in a cash management trust.  Link to worked example for pre-CGT proportion rules inserted.  Replacement of note on proposed changes with note on legislated changes to the treatment of doubtful debts for tax cost setting purposes, p. 2.	Legislative amendments.