Cost setting on exit

An entity leaves a consolidated group when one or more membership interests are sold outside the group or the entity becomes otherwise ineligible to be a member.

Where a subsidiary member (the leaving entity) leaves a consolidated group, the head company recognises, just before the leaving time, the membership interests in the leaving entity. These membership interests are not recognised while the entity is a member of the group.

The process at the joining time is now reversed and the group's cost base of membership interests is derived from the net assets of the leaving entity just before the leaving time. This preserves the alignment between the costs for membership interests in the entity and its assets.

The tax cost setting amount for membership interests in the leaving entity is based on the ACA (allocable cost amount) worked out just before the leaving time, and consists of the terminating values of the assets of the leaving entity reduced by its liabilities. Adjustments are made to the ACA to reflect the value of certain inherited deductions and intra-group liabilities.

→ figure 1: Cost setting process on exit

Note that Division 715 and Subdivision 719-T apply loss integrity measures to consolidated and MEC groups.

→ 'Effect of Subdivision 165-CC where an entity leaves a consolidated group', C2-6-120
→ 'Effect of Subdivision 165-CD for consolidated groups', C2-6-130
→ 'Effect of Subdivision 165-CC for MEC groups', C2-6-140
→ 'Effect of Subdivision 165-CD for MEC groups', C2-6-150
→ 'Subdivision 165-CD widely held company concession for an eligible tier-1 company that is a head company of a consolidated or MEC group', C2-6-155

If the head company ceases to be eligible to be a head company of a consolidated group, the group usually ceases to exist → 'Changing group membership', B3-5.

However, with the aim of reducing compliance costs, these rules are modified in the following circumstances to allow the consolidated group to continue:

- where an existing consolidated group acquires another consolidated group → 'Consolidated group joins another consolidated group', in 'Modifications to entry cost setting rules in various circumstances', C2-1-130
- where a shelf company is interposed between the head company and its shareholders. The shelf company must be eligible to be a head company, and must choose that the existing group is to continue its existence. In these circumstances, the shareholders are taken to have chosen rollover relief, and there is no resetting of the tax costs of the group's assets. The

shelf company becomes the group’s new head company, replacing the old head company for the whole of the year in which the interposition occurred. The new head company is treated as deriving group income and expenses for the whole of that year, and the tax attributes of the old head company become those of the new head company.

→ sections 703-65 to 703-80, ITAA 1997

Note that Subdivision 716-G has rules on how to deal with deductions for decline in value for assets in a low value pool and deductions for expenditure on software development pools when a subsidiary member leaves a consolidated group. Under these rules, the head company gets the deduction in the leaving income year and the leaving entity gets the deduction in the subsequent income years.

Also note that when a subsidiary member leaves a consolidated group and takes with it some or all of the head company's notional asset in respect of allowable capital expenditure (ACE), transport capital expenditure (TCE) and exploration or prospecting expenditure, the rules in Subdivision 712-E require the head company to reduce the adjustable value of its notional asset by the adjustable value of the leaving entity's notional asset. This ensures that only the leaving entity gets a deduction for the notional asset that leaves the group.

→ Subdivision 712-E of IT(TP)A 1997

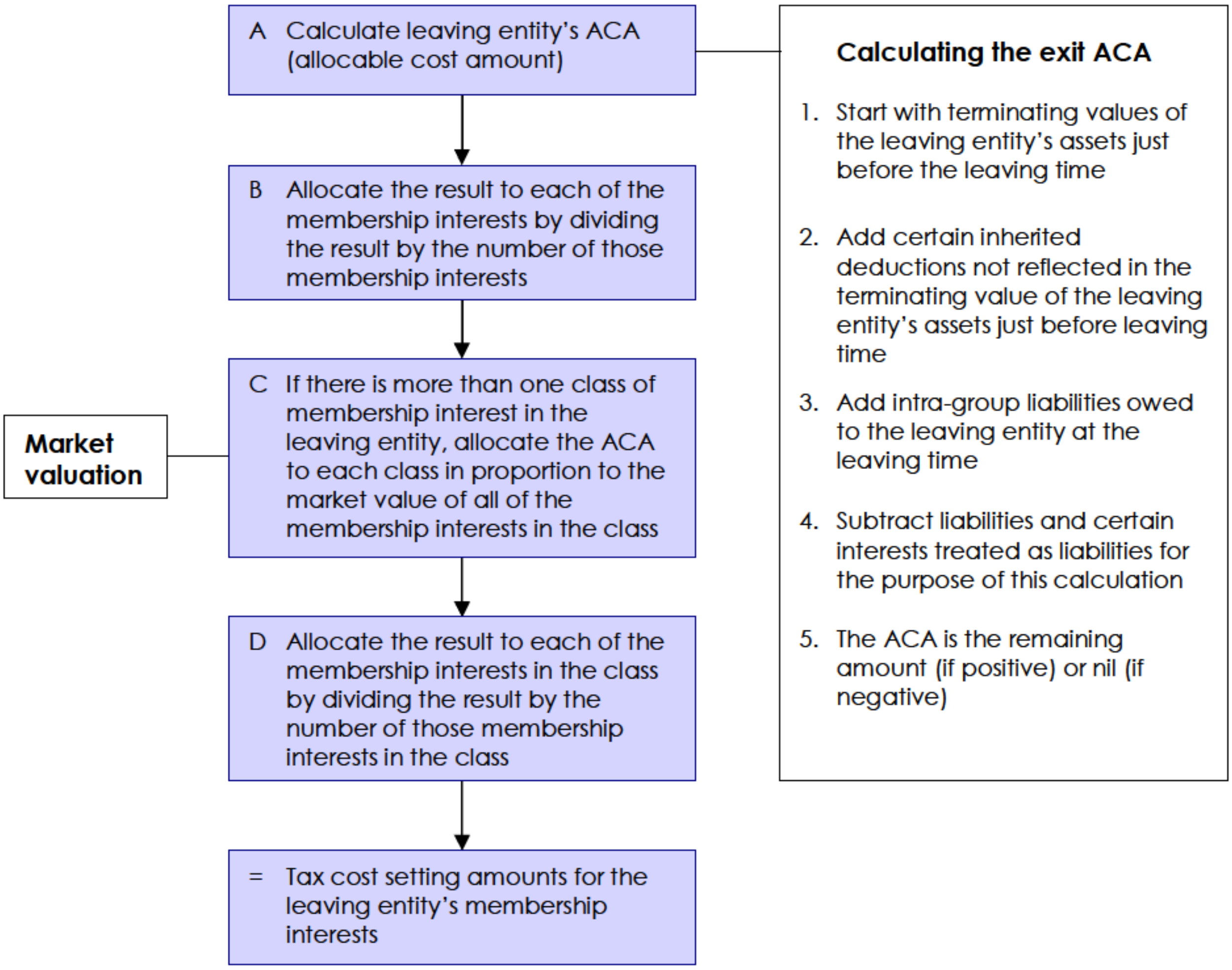
Multiple leaving entities

Where the leaving entity holds membership interests in another subsidiary member of the consolidated group, that subsidiary will also cease to be a member at the leaving time.

The cost of the membership interests in each of the leaving subsidiary members must be worked out on a bottom-up basis, as the membership interests in the lower level entity (which represent an asset of the higher level entity) must be given a cost which is used in turn to calculate the cost of membership interests in the higher level entity.

→ section 711-55, ITAA 1997; Explanatory Memorandum to New Business Tax System (Consolidation) Bill (No. 1), paragraph 5.142

Figure 1: Cost setting process on exit



The exit cost setting process

A – Calculate exit ACA

→ Figure 1: Cost setting process on exit

→ 'Effect of Subdivision 165-CD for consolidated groups', C2-6-130

Step 1: Add up the terminating values of the leaving entity's assets just before the leaving time

Add up the head company's terminating values of all the assets that it holds just before the leaving time because the leaving entity is taken to be part of the head company. → section 711-25, ITAA 1997

There is an increase in the step 1 amount for certain privatised depreciating assets leaving the group that either:

- had their tax cost setting amount reduced under section 705-47 of the ITAA 1997 when an entity joined the group, or
- had their first element of cost reduced because of subsection 58-70(5) of the ITAA 1997 when they were acquired by the group.

The step 1 amount is increased by the amount of that reduction.

→ subsections 711-25(3) and (4), ITAA 1997; 'Increase for certain privatised depreciating assets (at exit ACA step 1)', C2-5-220

Note

Finance leases

Where the leaving entity is the lessor and just before leaving time has a Lease Receivable that was taken to be a retained cost base asset under subsection 705-56(3) at the joining time, the head company's terminating value of the right is its market value at the leaving time → subsection 711-30(3), ITAA 1997; subsection 705-56(3), ITAA 1997; 'Finance leases', in 'Allocating the entry ACA (steps B to E)', C2-1-030.

Rules for transitional groups

- When a subsidiary leaves a transitional group with an asset that was subject to an over-depreciated asset adjustment on entry, the head company may choose to add back the adjustment to the terminating value of the asset for the purpose of determining its cost base for membership interests.
→ section 701-40, IT(TP)A 1997
- Effective from 1 July 2009, the over-depreciation adjustment in section 705-50 of the ITAA 1997 has been repealed so that it will no longer apply to over-depreciated assets of entities that become subsidiary members of a consolidated group on or after that date. As section 705-50 of the ITAA 1997 has been repealed from 1 July, section 701-40 of the IT(TP)A 1997 has also been repealed so that it will no longer apply to the over-depreciated assets of entities that ceased to be members of a consolidated group on or after 1 July 2009. → *Tax Laws Amendment (2010 Measures No.1) Act 2010* (No.56 of 2010)
- Where subsidiary members leave a transitional group with certain pre-CGT assets that were held by the head company just before the formation time, the head company may choose to use formation time market values, instead of terminating values, when reconstructing the cost bases of membership interests. The pre-CGT assets must not be assets that were transferred to the head entity under rollover. → section 701-45, IT(TP)A 1997
- Where a subsidiary leaves a transitional group with a privatised depreciating asset that was brought into the group by a chosen transitional entity affected by Division 58 of the ITAA 1997 (or another similar regime), the step 1 amount is increased in certain circumstances by an amount representing the extent to which decline in value deductions for the asset were limited under the relevant privatised asset provisions. → section 701-50, IT(TP)A 1997

Step 2: Add certain deductions inherited from the head company

Add an amount for certain unclaimed deductions that the leaving entity inherits from the head company. The purpose of this adjustment is to ensure that the value of the deductions that is not reflected in the terminating value of the leaving entity's assets is reflected in the ACA.

→ section 711-35, ITAA 1997

Step 3: Add liabilities owed by members of the group

Add liabilities owed by members of the group to the leaving entity at the leaving time. The purpose of this adjustment is to ensure that the intragroup liabilities, which were not recognised for income tax purposes while the leaving entity was in the consolidated group, are reflected in the ACA. → section 711-40, ITAA 1997

Step 4: Subtract liabilities of the leaving entity

Subtract the leaving entity's liabilities, including liabilities owed to members of the group and certain interests that are treated as liabilities under this step (such as employee share interests disregarded for the purpose of consolidation and non-membership equity interests). → section 711-45, ITAA 1997

If the amount remaining after step 4 is negative, the head company will make a capital gain equal to that amount at the time the entity leaves the group (CGT event L5). → section 104-520, ITAA 1997; 'CGT events arising out of the cost setting rules', C2-1-410

The amount of a particular liability of the leaving entity included at step 4 under section 711-45 will be adjusted under subsection 711-45(10) if the four conditions in subsection 711-45(8) are satisfied and:

- the liability was previously taken into account in working out the entry ACA for that entity or another entity
- the amount of the liability on entry differs from the amount on exit, and
- the entry ACA would have been different if the amount on exit had been used in working it out.

→ subsections 711-45(8), (9) and (10), ITAA 1997

Note

Finance leases

Where the leaving entity is the lessee, no amount is included at step 4 for an accounting liability that is the leaving entity's obligation to make lease payments (Lease Payable) if that liability was not taken into account at step 2 of the entry ACA at the joining time because of subsection 705-56(4). → subsection 711-45(2A), ITAA 1997; subsection 705-56(4), ITAA 1997; 'Finance leases', 'Allocating the entry ACA (steps B to E)', C2-1-030

Step 5: ACA result

If the amount remaining after step 4 is positive, it is the leaving entity's ACA. If it is negative, the ACA is nil.

B – Allocate exit ACA to membership interests

Allocate the exit ACA to each of the membership interests by dividing the ACA by the number of membership interests in the leaving entity. The allocated amount is the tax cost setting amount for each membership interest, and forms the cost base and reduced cost base of those interests. If it is necessary to work out the amount of a capital loss on disposal by the head company of the membership interests at or after the leaving time, the exit ACA must be recalculated using reduced cost bases instead of cost bases at step 1 for assets that use cost base as their terminating value on exit.

→ paragraph 711-15(1)(a), ITAA 1997

C – Multiple classes of membership interests

If there is more than one class of membership interests in the leaving entity, the exit ACA will be first allocated among the different classes in proportion to the aggregate of the market values of each class. → paragraph 711-15(1)(b), ITAA 1997

D – Allocation of exit ACA within each class of membership interests

The allocated amount for each class is then allocated to each of the membership interests in the class by dividing the amount by the number of membership interests in the class. → paragraph 711-15(1)(c), ITAA 1997

If at the leaving time a member of the old group holds a non-membership equity interest in the leaving entity, that interest is treated as if it were a membership interest and a different class than any other membership interest in the leaving entity. → subsection 711-15(2), ITAA 1997

For an example of how the cost setting process on exit is applied from beginning to end see → 'The cost setting process on exit', C2-2-210.

Partnership leaves a consolidated group

When a partnership joins a consolidated group the cost setting rules in Division 705 of the ITAA 1997 are modified. → 'Partnership – *all* partners join consolidated group', C2-2-150

Similarly, when a partnership leaves a consolidated group the rules in Division 711 of the ITAA 1997 are modified → Subdivision 713-E, ITAA 1997. A partnership can cease to be a member of a consolidated group in two ways: either when the partner leaves the group (because, for example, the head company disposes of membership interests in the partner) or when the head company disposes of some or all of its fractional interests in the partnership (that is, its partnership cost setting interests).

In both cases the underlying assets of the partnership cease to be assets of the head company. The assets that the head company recognises just before the leaving time are its partnership cost setting interests. The tax cost setting amount of each of those interests is the partner's share of the terminating value of each of the underlying partnership assets.

Where a partnership leaves as a result of the group disposing of some or all of its partnership cost setting interests, the reset tax costs of the interests are used to calculate any capital gain or capital loss on their disposal.

When a partner leaves the group, its assets just before the leaving time will include its relevant partnership cost setting interests.

Trust leaves a consolidated group

The tax cost setting amount allocated to a membership interest in a trust leaving a consolidated group is reduced to nil where the membership interest:

- is a discretionary interest in the trust (i.e. it is neither a unit nor a fixed interest)
- has no cost base, and
- only began to be held by the beneficiary of the trust because something was settled on the trust.

This effectively ensures membership interests held by discretionary beneficiaries of a trust are given a cost base of nil when the trust leaves the group. → paragraph 711-15(1)(d), ITAA 1997

Application dates for certain amendments

Non-membership equity interests

Legislative changes (enacted in *Tax Laws Amendment (2010 Measures No. 1) Act 2010*) in relation to non-membership equity interests in subsection 711-15(2) of the ITAA 1997, and the insertion of subsection 711-45(6B) of the ITAA 1997 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.

References

Legislation

Income Tax Assessment Act 1997, sections 703-65 to 703-80; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 2

Income Tax Assessment Act 1997, sections 711-35, 711-40 and 711-55; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Income Tax (Transitional Provisions) Act 1997, sections 701-40 to 701-50; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7
- *Tax Laws Amendment (2004 Measures No 2) Act 2004* (No. 83 of 2004), Schedule 2

Income Tax Assessment Act 1997, subsection 711-45(8), (9) and (10); as inserted and amended by:

- *Tax Laws Amendment (2004 Measures No. 7) Act 2005* (No. 41 of 2005), Schedule 6, Part 2 and
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 2

Income Tax Assessment Act 1997, section 711-15; as amended by:

- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 5
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 20

Income Tax Assessment Act 1997, Subdivision 713-E; as amended by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2, Part 5

Income Tax Assessment Act 1997, section 711-25; as amended by:

- *New Business Tax System (Consolidation, Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 1

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

Income Tax Assessment Act 1997, sections 711-20, 711-35, 711-45 and subsection 713-265(4); as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 1 and Part 20

Income Tax Assessment Act 1997, sections 719-740 and 715-265; as inserted by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 16

Income Tax Assessment Act 1997, sections 165-115X, 165-115Y, 715-230, 715-255, 715-270, 715-450 and 715-610; as amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 16

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

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, paragraphs 1.108-1.114

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No 2) Bill 2004, paragraphs 2.246- 2.251

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 7) Bill 2004, paragraphs 6.10 – 6.23

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 175-179

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 2) Bill 2004, paragraphs 2.61 – 2.99

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.180 to 5.186, paragraphs 5.188 – 5.197, paragraphs 5.198 – 5.215, paragraphs 5.325 – 5.348 and paragraphs 5.444 – 5.471

Supplementary Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 2.26 – 2.32

Tax ruling

TR 2005/17 – Income tax: goodwill: identification and tax cost setting for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*

Tax determinations

TD 2005/45 - Income tax: Consolidation: What is the meaning of 'liability owed' in section 711-40 of the *Income Tax Assessment Act 1997*

TD 2005/53 - Income Tax: Consolidation: exit tax cost setting rules: where an accounting liability added at subsection 711-45(1) of the *Income Tax Assessment Act 1997* is modified by the operation of subsections 711-45(3) and (5), does the amount determined under subsection 711-45(5) override the adjustment made by subsection 711-45(3)?

TD 2006/38 - Income Tax: Consolidation: can Division 711 of the *Income Tax Assessment Act 1997* apply for the purpose of the core rules in Division 701 upon an entity ceasing to be a subsidiary member of an acquired consolidated group where Subdivision 705-C operates?

TD 2006/19 - Income Tax: Consolidation: for the purposes of working out step 1 of a consolidated group's exit allocable cost amount in the leaving entity under section 711-25 of the *Income Tax Assessment Act 1997*, is the terminating value for a CGT asset determined under Division 110 for assets that have their tax cost set under subsection 701-10(4)?

TD 2006/53 - Income Tax: Consolidation: exit tax cost setting rules: how is the terminating value of an asset that is treated as if it were a CGT asset under subsection 705-30(5) of the *Income Tax Assessment Act 1997* worked out for the purposes of subsection 711-25(1) of that Act?

TD 2006/58 - Income Tax: Consolidation: will a subsidiary company that is deregistered cease to be a member of a consolidated group with the consequence that it is treated as a leaving entity for the purposes of Division 711 of the *Income Tax assessment Act 1997*?

Revision history

Section C2-1-060 first published as separate section 26 June 2007.

Further revisions are described below.

Date	Amendment	Reason
6.5.11	Figure 1 – change from 'certain membership interests' to 'certain interests'. References to non-membership equity interests, p. 3 & following. References to CGT event L7 deleted. Minor changes to reflect the repeal of section 705-50, effective 1 July 2009. Changes to reflect the changed wordings to clarify 'leaving time' in sections 711-20, 711-25, 711-45 and 713-265. Changes to reflect changed wording in 711-45(8).	Legislative amendments.