

## Treatment of special classes of assets

### Internally generated assets

Internally generated assets that are depreciating assets are treated as reset cost base assets. Special rules may apply where a joining entity brings an internally generated asset into a consolidated group and the joining entity was a continuing majority-owned entity. A joining entity is a continuing majority-owned entity if 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. An internally generated asset is an asset for which more than 50% of the total expenditure incurred in constructing or creating it was of a revenue nature and was deductible to the joining entity.

A dual 'cost' is ascribed on consolidation for a depreciating, internally generated asset where:

- its terminating value is less than its tax cost setting amount, and
- for each balancing event that occurred for that asset before the continuing majority-owned entity became a subsidiary member of the group there was rollover relief under section 40-340 of the ITAA 1997.

This dual cost consists of:

- a cost that is used when working out the decline in value under Division 40 of the ITAA 1997 and which is based on the entity's terminating value for the asset, and
- a cost that is used when a balancing adjustment event occurs or if the asset leaves the group with a leaving entity, and which is based on the asset's tax cost setting amount less any decline in value that has since been calculated.

When the head company ceases to hold the internally generated asset, the head company is allowed to either claim a deduction or increase the exit ACA for the shortfall between the deductions for the asset's decline in value and the deductions that would have been worked out using the asset's actual tax cost setting amount.

→ 'Continuing majority-owned entity and internally generated assets', C2-5-810; section 701A-10, IT(TP)A 1997; Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 1), paragraphs 1.118 – 1.120 and 1.131-1.174; 'Applying the continuing majority-owned entity test to multi-tiered structures' C2-4-855

## Pre-CGT assets

### Treatment of pre-CGT assets on entry

Generally, any pre-CGT asset (that is, an asset acquired before 20 September 1985) of the joining entity at the formation or joining time will continue to be a pre-CGT asset in the consolidated group.

### Pre-CGT membership interests

The pre-CGT status of the membership interests acquired by the group before 20 September 1985 is preserved by attaching a pre-CGT factor to each asset (other than current assets) of the joining entity. This allows a proportion of the membership interests in a leaving entity to be treated as pre-CGT assets by reference to the pre-CGT factors attached to the assets that leave with it.

#### On formation

The pre-CGT status of membership interests held directly by the head company (that is, in the first subsidiary) is preserved by attaching a pre-CGT factor to the assets (other than current assets) of the first subsidiary at the formation time.

If, on formation, the first subsidiary holds membership interests in another subsidiary member (the second subsidiary), the pre-CGT factor must first be worked out for the first subsidiary's assets before any pre-CGT factor can be worked out for the second subsidiary's assets.

The market value of each membership interest owned by the first subsidiary in the second subsidiary is multiplied by the pre-CGT factor that was worked out and attached to the first subsidiary's assets. → 'Pre-CGT factor for assets where subsidiary has membership interests in another member – formation', C2-4-820

### Consolidated group joins another consolidated group

Section 705-125 of the ITAA 1997 is modified to make it clear that pre-CGT factors formerly worked out for assets of entities when they became subsidiary members of the acquired group cease to have any relevance. They are replaced with new pre-CGT factors determined under section 705-125 if the acquiring group holds any pre-CGT membership interests in the acquired group.

→ section 705-205, ITAA 1997

### Linked entities join a consolidated group

Where there has been a loss of pre-CGT status of membership interests in a linked entity, the tax cost setting amount for certain assets is reduced.

→ section 705-240, ITAA 1997

The rules for determining the pre-CGT factors for assets of the linked entities are also modified. → section 705-240, ITAA 1997

### Pre-CGT status of membership interests in a discretionary trust

When working out the pre-CGT factor to be attached to the non-current assets of a trust joining a group, any pre-CGT membership interests of the group that are discretionary interests in that trust are disregarded.

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Conversely, when a trust leaves a group any membership interests that are discretionary interests in that trust are disregarded for the purposes of determining the number of membership interests in the leaving trust to which the pre-CGT proportion is to be applied. → paragraph 711-15(1)(d), ITAA 1997

### Treatment of pre-CGT assets on exit

When a leaving entity takes with it an asset that was a pre-CGT asset immediately before the leaving time, it generally remains a pre-CGT asset after the entity leaves the group. Where, just before the leaving time, any of the assets the leaving entity takes with it had a pre-CGT factor, a proportion of the membership interests in the leaving entity held by members of the group will be treated as pre-CGT membership interests.

### Goodwill

On entry, goodwill owned by the joining entity is treated as one of its reset cost base assets, whether or not an amount has been recognised in its accounting statements. → Taxation Ruling TR 2005/17

When an entity leaves the group, goodwill lost to the group as a consequence is used, along with other reset cost base assets, to derive the group's cost base of membership interests in the leaving entity.

#### Note

##### Exception for demutualised general insurance company

Where a general insurance company that has demutualised joins a consolidated group and was wholly owned by the same group during the period from demutualisation to the joining time, a goodwill asset of the company just before the joining time is treated as a retained cost base asset. → section 713-705, ITAA 1997

### Legislative framework

Goodwill is one of the assets that has a tax cost allocated to it under subsection 705-35(1) of the ITAA 1997. Subsection 705-35(3) provides special rules to apply to certain synergistic goodwill when an entity joins a consolidated group. When a subsidiary member leaves a group, subsection 711-25(1) deals with the goodwill of the leaving entity generally. Subsection 711-25(2) applies to a specific type of synergistic goodwill in the leaving case.

Taxation Ruling TR 2005/17 shows in detail how these provisions apply to the treatment of goodwill when a subsidiary member joins or leaves a consolidated group (including the formation case).

#### **Synergistic goodwill existing in a business of the joined group due to its ownership or control of the joining entity**

In economic terms, not all the value of the goodwill paid for on acquisition of an entity or making up the market value of an entity may be reflected in a goodwill asset of that entity. At subsection 705-35(3) the legislation anticipates an argument that in certain circumstances some proportion of the amount paid for the joining entity may have been paid in expectation of benefits accruing to a business of the acquirer. In this view the source of such benefits is an asset

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of the joined group rather than asset of the joining entity and is not therefore addressed by subsection 705-35(1).

Where objective analysis shows that some of the goodwill acquired with the joining entity is an asset of the joined group at the joining time, subsection 705-35(3) applies. However, as subsection 705-35(3) is essentially an integrity measure, it has no role if all the goodwill underlying the value of a joining entity is identified under subsection 705-35(1) as an asset of the joining entity.

*Working out whether 705-35(3) applies to an asset*

Assets recognised for cost setting purposes under Part 3-90 of the ITAA 1997 take their ordinary meaning as commercial or business assets.

Synergistic goodwill is identifiable as an asset if it has a value at the joining time. Australian Accounting Standards Board (AASB) 1013 paragraph 5.1.3 provides a useful, though not definitive, reference point for commercial or business practice in recognising assets. It states that goodwill can be recognised as an asset if:

- it is expected that the future benefits in the unidentifiable assets will eventuate, and
- it possesses a cost or other value that can be reliably measured.

(AASB 1013 does not apply after 31 December 2004.)

→ Taxation Ruling TR 2004/13

Synergistic goodwill addressed by subsection 705-35(3) only crystallises as an asset where its value at the joining time can be determined by objective analysis. Such an analysis would typically take into account the time in the future when such benefits can be expected to emerge, the cost of achieving the benefits and the probability that the synergies will be realised taking into account the likely risks. Potential benefits that are costly to achieve, remote in time or have a low probability of occurring could be expected to have little or no value as an asset at the joining time. A commercial or business asset cannot be said to exist unless it can be demonstrated, using objective analysis, that a commercial value can be attributed to it.

The goodwill addressed by subsection 705-35(3) only crystallises as an asset of an acquirer once economic control has passed to the acquirer. While control may be achieved before an entity joins a group it is certain to exist at the joining time because of the 100% ownership rule. The test for whether an asset exists is applied at the joining time although the provisions require that the asset is valued at just after this time for cost allocation purposes. Subsection 705-35(3) is not applied in the formation case. → Taxation Ruling TR 2005/17

#### Note

For information about **market valuation** issues in relation to goodwill see → 'Market valuing goodwill' in 'Market valuation guidelines' C4-1.

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## References **Legislation**

*Income Tax Assessment Act 1997*, section 40-340

*Income Tax Assessment Act 1997*, section 705-35, as inserted by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

*Income Tax Assessment Act 1997*, subsection 705-35(1), as amended by *Taxation Laws Amendment Act (No. 6) 2003* (No. 67 of 2003), Schedule 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

*Income Tax Assessment Act 1997*, sections 705-205; as inserted by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 4

*Income Tax Assessment Act 1997*, sections 705-240; as inserted by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 4

*Income Tax Assessment Act 1997*, sections 711-15; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 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

Explanatory Memorandum to the New Business Tax System (Consolidation and other Measures) Bill (No. 1) 2002, paragraphs 1.118 – 1.120 and 1.131 - 1.174

### **Tax rulings**

TR 2004/13 – Income tax: the meaning of an asset for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*

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*

### **Revision history**

Section C2-1-070 first published as separate section 26 June 2007.

### **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](http://www.treasury.gov.au) (Treasury papers on refinements to the consolidation regime).