High-level worked example

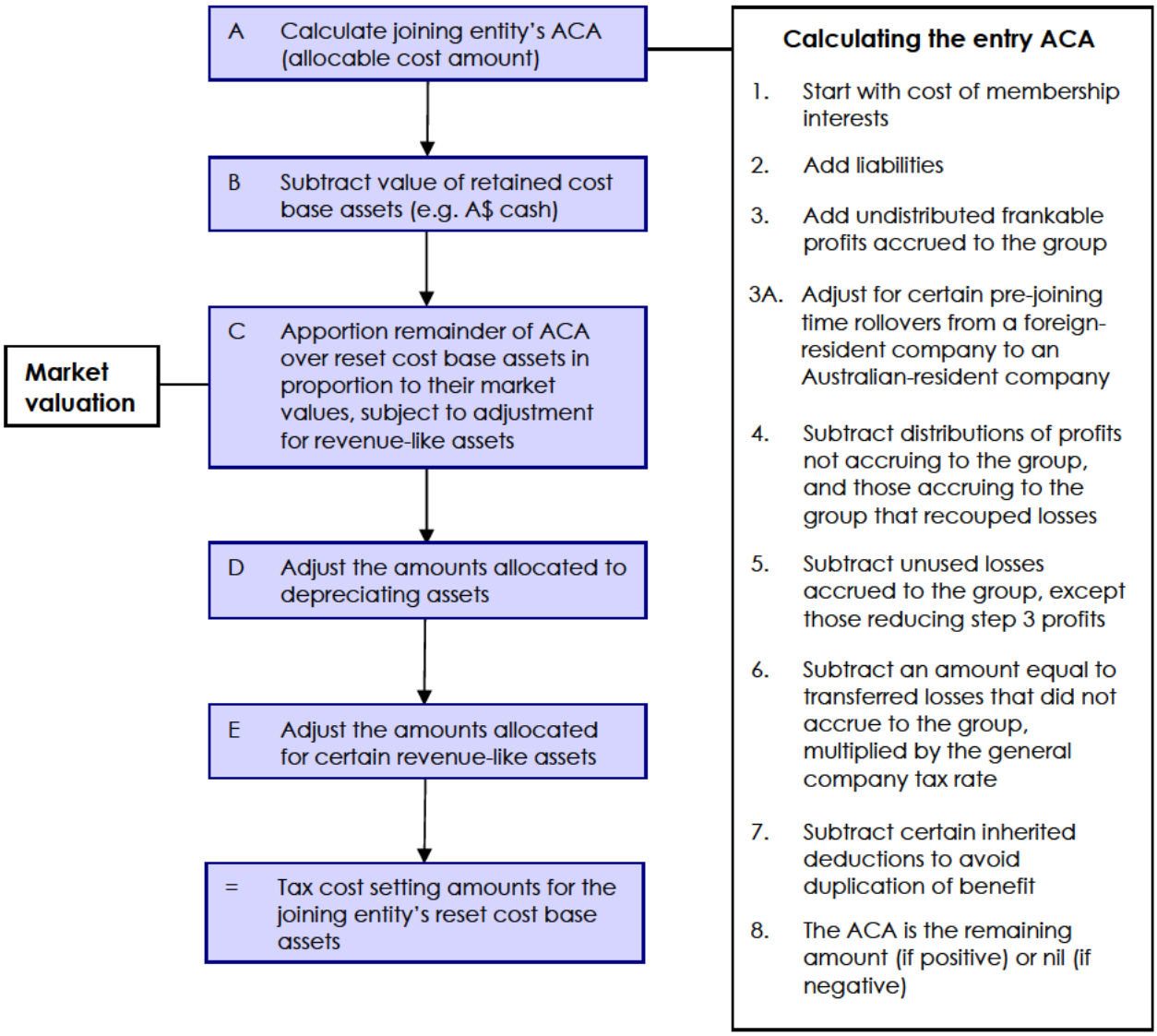
The cost setting process on entry

Description

New tax costs must be obtained for the assets that a subsidiary brings into a consolidated group. The new tax costs are obtained by application of the cost setting rules (unless the head company opts to apply the transitional option of retaining existing tax values). This high-level example shows how the cost setting rules are applied through the steps shown in figure 1 – from the calculation of the allocable cost amount (ACA) through to ascertaining the tax cost setting amount for each of the joining subsidiary's assets.

Some steps in the process are expanded on in worked examples included in this section of the Reference Manual.

Figure 1: The cost setting process on formation and entry



Note

Background information

Ledger accounts, calculation of income tax and deferred tax liabilities are included in the background information at the back of this example.

Recent changes to consolidation rules

Recent changes to the cost setting rules ensure that the assets of a joining entity that do not become assets of the head company under the single entity rule have their tax cost reset when the entity joins the consolidated group – see *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (83 of 2004), Schedule 2, Part 4, 'Cost setting for assets that the head company does not hold under the single entity rule'.

Recent changes to the cost setting rules for partners and partnerships leaving a consolidated group were introduced by the *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (83 of 2004), Schedule 2, Part 5.

Commentary

Under consolidation, assets are brought into a consolidated group by a subsidiary member according to the cost setting rules. Among other things, this means that when an entity joins a consolidated group, the total value of the entity's assets for tax purposes is based on the cost of acquiring the entity – the tax values of the entity's assets are aligned with the tax values of the membership interests in the entity. → 'Treatment of assets', C2-1

Example

Facts

On 1 July 2000, Beta Pty Ltd (Beta) is incorporated with issued capital of $1,000 (1,000 ordinary shares at $1.00 per share). Beta immediately borrows further funds and acquired assets to commence business. Beta's financial position is as follows:

Table 1: Beta Pty Ltd – financial position at 1 July 2000 ($)

Land 1	1,200	Capital	1,000
Plant	200	Liabilities (loan)	1,000
Cash	300		
Trading stock	300		
	2,000		2,000

On 1 August 2000, Beta incorporates Gamma Pty Ltd (Gamma) with issued capital of $200 (200 ordinary shares at $1.00 per share). Gamma immediately invests its capital in two blocks of land held for agistment. Gamma's financial position is as follows:

Table 2: Gamma Pty Ltd – financial position at 1 August 2000 ($)

Land 2	100	Capital	200
Land 3	100		
	200		200

On 1 July 2001, Alpha Pty Ltd (Alpha) acquires 60% of the shares in Beta for $765, i.e. 60% of $1,275 (the value of net assets).

Table 3: Value of net assets of Beta at 1 July 2001 ($)

	Market value	
Assets		
Land 1	1,300	
Plant	180	
Shares in Gamma	190	
Trading stock	400	
Cash	158	2,228
Liabilities		
Loan	950	
Deferred tax liability	3	953
Value of net assets		**1,275**

The land and shares are not revalued in Beta's accounts. Beta's financial position is as follows:

Table 4: Beta Pty Ltd – financial position at 30 June 2001 ($)

Land 1	1,200	Capital	1,000
Plant (cost $200)	180	Profits	185
Shares in Gamma	200	Liabilities	
Trading stock	400	– loan	950
Cash	158	– deferred tax liability	3
	2,138		**2,138**

During the income year ending 30 June 2001, Gamma sells Land 3 for $90, making a net capital loss of $10. The market value of Land 2 is unchanged. Gamma does not derive any income during the year.

Table 5: Gamma Pty Ltd – financial position at 30 June 2001 ($)

Land 2	100	Capital	200
Cash	90	Losses	(10)
	190		**190**

On 30 June 2002, Alpha acquires the remaining 40% of shares in Beta for $796 (i.e. 40% of net asset values).

Table 6: Value of net assets of Beta at 30 June 2002 and 1 July 2002

	Market value	
Assets		
Land 1	1,400	
Plant	162	
Shares in Gamma	197	
Trading stock	350	
Cash	481	
Goodwill	304	2,894
Liabilities		
Loan	900	
Deferred tax liability	5	905
Value of net assets		**1,989**

Beta's financial position is as follows:

Table 7: Beta Pty Ltd – financial position at 30 June 2002 ($)

Land 1	1,200	Capital	1,000
Plant	162	Profits (after tax $303)	488
Shares in Gamma	200	Liabilities	
Trading stock	350	– loan	900
Cash	481	– deferred tax liability	5
	2,393		**2,393**

During the year ended 30 June 2002, Gamma makes an after tax profit of $7. Its financial position is as follows:

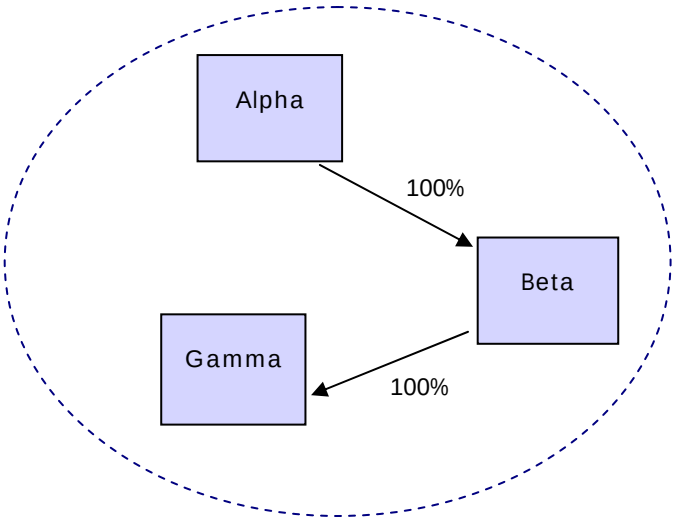
Table 8: Gamma Pty Ltd – financial position at 30 June 2002 ($)

Land 2	100	Capital	200
Cash	100	Net profit	
		– after tax profit	7
		– carry fwd loses	(10)
		Liabilities	
		– income tax	3
	200		200

Choice to consolidate

Alpha chooses to form a consolidated group with effect from 1 July 2002, and notifies the Tax Office within the time and manner specified. The consolidated group is structured as follows:

Figure 2: Structure of consolidated group



Application of cost setting rules

When a consolidated group is formed, no changes are made in relation to the assets of the head company (except that intragroup membership interests and debts are ignored after formation). The cost setting rules establish the tax cost setting amounts for assets of subsidiaries.

Alpha must first apply the cost setting rules to Beta, before applying them to Gamma. → section 705-145, *Income Tax Assessment Act 1997* (ITAA 1997)

Setting tax costs of Beta's assets

A: Calculate Beta's ACA

ACA step 1: Add up the cost of each membership interest

On 1 July 2001, Alpha acquires 60% of membership interests in Beta (Interest 1) for $765. On 1 July 2002, Interest 1 has a market value of $1,193, and Alpha acquires the remaining 40% of membership interests (Interest 2) for $796. There are no outstanding cost base adjustments for membership interests, such as for earlier value shifting or loss transfers. → subsection 705-65(3), ITAA 1997 and Explanatory Memorandum to New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraph 5.60

Worksheet: Step 1 – Add up the cost of each membership interest

		$ Interest 1	$ Interest 2	$ Interest 3	$
P	Cost base (CB) at the joining time or formation time(JT) (Note: cost of pre-CGT interests not indexed)	765	796		
Q	Reduced cost base (RCB) at JT (ignoring reductions for rebatable dividends: section 160ZK(5) ITAA 1936 or section 110-55(7) ITAA 1997), and adding back any adjustments under section 165-115ZA(3) ITAA 1997 to the extent the relevant losses will reduce ACA under steps 5 & 6)	765	796		
R	CB (line P) as adjusted for value shifting or loss transfer	765	796		
S	RCB (line Q) as adjusted for value shifting or loss transfer, or section 165-115ZD ITAA 1997	765	796		
T	Market value (MV) at the joining time	1,193	796		
	Tests: If MV (line T) ≥ adjusted CB (line R), use line R If MV (line T) ≤ adjusted RCB (line S), use line S If adjusted RCB (line S) < MV (line T) < adjusted CB (line R), use line T				
	***Result* for each membership interest (sum is entry ACA step 1 amount)**	765	796		**1,561**

ACA step 2: Add liabilities that can or must be recognised in the balance sheet

The loan is shown as Liability 1 in the worksheet below. The deferred tax liability is shown as Liability 2. No reductions or adjustments are required. There are no employee shares, no rights or options issued by Beta and no debt interests that are regarded as equity for general accounting purposes.

Worksheet: Step 2 – Add liabilities etc.

	$ Liability 1	$ Liability 2	$ Subtotals	$
				Cfwd 1,561
Accounting liabilities				
Start with statement of financial position	900	5		
Adjust where liability valued differently for group – subsection 705-70(1A)				
This adjustment is not required for transitional entities, such as Beta is in this example – see section 701-32 of the IT(TP)A 1997 and 'Commentary' in C2-4-242.				
Reduce to $nil if attached to an asset				
Reduce for future income tax deductions				
Reduce for intra-group debt (add back reductions under section 165-115ZA(3) before comparison)				
Adjust for unrealised gains or losses				
Sum of reduced or adjusted amounts	900	5	905	
Add for employee shares				
MV of disregarded shares				
Reduce by reduction amount				
Add for rights & options				
Add market value of rights or options held by third parties				
Add equity treated as debt				
Add market value of equity for accounting purposes but debt for tax purposes (under debt/equity rules)				
Step 2 amount				
Sum of the sub-totals				905
Entry ACA result after step 2				**2,466**

ACA step 3: Add undistributed profits that accrued to the group

As Alpha elects to consolidate from 1 July 2002, in the first year of the two-year transitional period, and Beta is a wholly-owned subsidiary on that date, the transitional rule for ACA step 3 applies → section 701-30, *Income Tax (Transitional Provisions) Act 1997*. All undistributed profits accrued to the group are included.

To apply the rule, calculate how much of the undistributed profits accrued to the group, how much did not accrue to the group and the extent to which they could be franked.

Beta's profit for the 2000–01 year is $185, of which $178 could have been distributed in a frankable form. None accrues to the group, as Alpha does not acquire an interest in Beta until 1 July 2001. Beta's profit for the 2001–02 year is $303, of which $296 could have been distributed in a frankable form (as per franking account → table 12). Alpha owns 60% of Beta during the year, so the amount that accrues to Alpha is $182, of which $178 ($296 x 60%) is in a frankable form. This $182 is included in step 3. The amount not accruing to the group is $121, of which $118 ($296 x 40%) is in a frankable form.

Worksheet: Step 3 – Add undistributed profits accrued to the group

	$	$
		Cfwd 2,466
Ongoing rule		
Add undistributed *frankable* profits accrued to group at the JT	178	
and		
Transitional rule for subsidiaries that are non-chosen transitional entities, and group has consolidated before 1 July 2003:		
Add *all* undistributed *unfrankable* profits accrued to group at the joining time	4	182
Entry ACA result after step 3		**2,648**

ACA steps 3A, 4, 5, 6 and 7

There are no rollovers or distributions of profits, so step 3A and 4 do not apply. Steps 5 and 6 are not applicable because there are no realised and unrecouped tax losses or net capital losses at the joining time. Step 7 is not applicable as the head company will not be entitled to any deductions because of acts or transactions of the joining entity before the joining time.

Entry ACA Step 8

The ACA is $2,648.

B: Subtract value of retained cost base assets

First determine the tax cost setting amounts for Beta's retained cost base assets. → section 705-25, ITAA 1997

Beta's retained cost base assets are Cash and Trading Stock.

The tax cost setting amount for the Cash asset equals the amount of Australian currency involved, $481. The tax cost setting amount for the Trading Stock equals the amount of its terminating value (on the basis that Beta used the cost base method to value its stock), i.e. $350. These amounts for retained cost base assets is subtracted from the ACA ($2,648), leaving $1,817. → section 705-35, ITAA 1997, and sections 701A-1 and 701A-5, IT(TP)A 1997

C: Apportion remaining ACA over reset cost base assets

The remainder of the ACA ($1,817) is then apportioned among Beta's remaining assets other than excluded assets (i.e. its reset cost base assets) according to their market values.

The market value of Beta's shares in Gamma will need to be adjusted where there is an adjustment at steps 3 or 5 of the ACA calculation for Gamma. (In this example, Gamma has a step 3 adjustment – i.e. the profit adjustment amount.)

Beta's interest in the profit adjustment amount is worked out by dividing the market value of Beta's shares in Gamma ($197) by the market value of all shares in Gamma ($197), and then multiplying the result by the amount to be included in Gamma's ACA calculation under step 3 ($4). The result – i.e. ($197/$197) x $4 = $4 – is subtracted from the $197 market value of Beta's shares in Gamma, which gives a revised market value of $193.

→ section 705-160, ITAA 1997

The profit adjustment amount for Gamma (step 3 amount) is based on the extent to which the profits have accrued to the head company. Alpha owns 60% of Beta (held continuously), and Beta owns 100% of Gamma (held continuously), so the adjustment is 60% of Gamma's profits (60% x $7 = $4). Therefore, the market value of shares in Gamma should be reduced by $4.

Table 9: Apportionment according to market value ($)

Reset cost base assets	Terminating value (TV)	Market value (MV)	Apportionment of remainder	Assets held on revenue account – excess over greater of TV or MV	Tax cost setting amount for asset
Land 1	1,200	1,400	1,233		1,233
Plant	144	162	143	0	143
Shares in Gamma	200	193	170		170
Goodwill	0	304	268		268
Totals	**1,544**	**2,059**	**1,814**	**0**	**1,814**

None of the tax cost setting amounts for assets held on revenue account exceed the greater of terminating value or market value of those assets, so no reduction in those tax cost setting amounts is necessary → section 705-40, ITAA 1997. Note that had it been necessary to reduce the tax cost setting amount for an asset held on revenue account, the amount of the reduction would have been allocated to the other assets in proportion to their market values.

→ 'Reduction for revenue-like assets (step C)', C2-4-530

Note also that part of the ACA is allocated to goodwill, notwithstanding that goodwill has not been shown in the accounts and has a nil terminating value.

D: Adjust for over-depreciated assets

Consider now whether a reduction (or further reduction) to the amount is required for over-depreciated assets. → section 705-50, ITAA 1997

For the purposes of this example, the depreciation status of Beta's plant will be examined.

Worksheet: Is an asset (Beta's plant) over-depreciated?

	At the joining time:	Test satisfied?	$ Excess amount
M	Does market value exceed adjustable value?	Yes	18
N	Does the cost exceed adjustable value?	Yes	56
	If the answer is YES to both questions, the asset is over-depreciated by the lesser of M and N		**18**

At the joining time the market value is $162 and the adjustable value $144. Therefore, the excess is $18. The cost is $200, an excess over the adjustable value of $56. Beta's plant is over-depreciated by $18 (the lesser of these two excesses).

Next, test to determine whether the tax cost setting amount needs to be reduced. → Worksheet: Over-depreciation reduction

The tax cost setting amount for an over-depreciated asset is reduced by the least of the over-depreciation amount (calculated above), the excess of the tax cost setting amount over its terminating value, and the tax deferral amount.

Worksheet: Over-depreciation reduction

	Test for each over-depreciated asset		$ amount
	Over-depreciation amount		
(a)	Over-depreciation amount from previous table		18
	Tax cost setting amount exceeds terminating value		
(b)	Excess of the tax cost setting amount over its terminating value		0
	Tax deferral amount		
(c)	*Start with* the amount of unfranked dividends paid by the joining entity before the joining time, that were subject to section 46 or section 46A rebate	0	
(d)	The amount of the profits paid as dividends in (c) above – (the *qualifying profits amount*) that was not subject to tax because of the over-depreciation of the asset – *but* count only to the extent it was not counted in ACA step 4 and to the extent the deductions for over-depreciation did not form part of a loss that reduced the ACA under step 5, were not counted in ACA step 4 (but the depreciation did not generate a tax loss to be subtracted from the entry ACA at step 5)	0	
(e)	The extent to which the dividend in (c) – adjusted to amount in (d) – was *not* further distributed (directly or indirectly) to a taxpayer who was *not* entitled to such a rebate. This is the *tax deferral amount*	0	
	Transitional rule on formation		
(f)	*Add* – The tax deferral amount is increased to include any unfrankable **undistributed** profits accrued to head company and included in ACA step 3 (under transitional rules) to the extent that those profits were not subject to tax because of deductions for depreciation representing over-depreciation, and the deductions did not form part of a loss that reduced the ACA under step 5 (subsection 701-30(3) IT(TP)A)	4	
(g)	Is there a tax deferral amount? How much?	Yes	4
	Reduction of tax cost setting amount is the lesser of (a), (b) and (g)		0

Note: The amount of $4 against test (f) above is the amount of undistributed unfrankable profits in the 2001–02 year that accrue to the group. That amount is unfrankable because of over-depreciation of the item of plant. This amount was included in Step 3 of the ACA calculation under the transitional rules.

The tax cost setting amount for the plant will not be reduced. (Note the tax cost setting amount, $143, is less than terminating value, $144.)

This test must be applied for each depreciating asset.

Choice of retaining accelerated depreciation rate

The head company may choose under section 705-45 to reduce the tax cost setting amount of a depreciating asset (acquired before 21 September 1999) to equal its terminating value. Where a depreciating asset's tax cost setting amount does not exceed its terminating value, section 701-80 permits the head company to use the accelerated depreciation provisions. In this example the tax cost setting amount for the plant is less than its terminating value. Therefore, the head company can retain the existing accelerated depreciation rate.

→ sections 705-45 and 701-80, ITAA 1997

Choice of replacing tax cost setting amounts with terminating values

Under the transitional provisions, Alpha may choose to use existing tax values (known as 'terminating values') instead of the amounts calculated under the cost setting rules. This choice is available on a subsidiary-by-subsidiary basis. This is in contrast with the choice of retaining the accelerated depreciation rate, which is available on an asset-by-asset basis. → sections 701-1 and 701-5, IT(TP)A 1997

It is assumed Alpha does not choose to use the terminating values and uses the tax cost setting amounts calculated above.

Setting tax costs of Gamma's assets

A: Calculate Gamma's ACA

ACA step 1: Add up the cost of each membership interest

The tax cost setting amount for the shares Alpha indirectly holds in Gamma via Beta (calculated above as $170) is treated as the cost base and reduced cost base for step 1 of the ACA for Gamma.

Worksheet: Step 1 – Add up the cost of each membership interest

		$ Interest 1	$ Interest 2	$ Interest 3	$
P	Cost base (CB) at the joining time or formation time(JT) (Note: cost of pre-CGT interests not indexed)	170			
Q	Reduced cost base (RCB) at JT (ignoring reductions for rebatable dividends: section 160ZK(5) ITAA 1936 or section 110-55(7) ITAA 1997), and adding back any adjustments under section 165-115ZA(3) ITAA 1997 to the extent the relevant losses will reduce the ACA under steps 5&6)	170			
R	CB (line P) as adjusted for value shifting or loss transfer	170			
S	RCB (line Q) as adjusted for value shifting or loss transfer, or section 165-115ZD ITAA 1997	170			
T	Market value (MV) at the joining time	197			
	Tests: If MV (line T) ≥ adjusted CB (line R), use line R If MV (line T) ≤ adjusted RCB (line S), use line S If adjusted RCB (line S) < MV (line T) < adjusted CB (line R), use line T				
	***Result* for each membership interest (sum is entry ACA step 1 amount)**	170			**170**

ACA step 2: Add liabilities that can or must be recognised in the balance sheet

Gamma's only liability is for income tax. No reductions or adjustments are required. There are no employee shares, no rights or options issued by Beta and no debt interests that are regarded as equity for general accounting purposes.

Worksheet: Step 2 – Add liabilities etc.

	$ Liability 1	$ Liability 2	$ Subtotals	$ Cfwd 170
Accounting liabilities				
Start with statement of financial position	3			
Adjust where liability valued differently for group – subsection 705-70(1A)				
Reduce to $nil if attached to an asset				
Reduce for future income tax deductions				
Reduce for intragroup debt (add back reductions under section 165-115ZA(3) before comparison)				
Adjust for unrealised gains or losses				
Sum of reduced or adjusted amounts	3		3	
Add for employee shares				
MV of disregarded shares				
Reduce by reduction amount				
Add for rights & options				
Add market value of rights or options held by third parties				
Add equity treated as debt				
Add market value of equity for accounting purposes but debt for tax purposes (under debt/equity rules)				
Step 2 amount				
Sum of the sub-totals				3
Entry ACA result after step 2				**173**

ACA step 3: Add undistributed profits which accrued to the group

As Alpha elects to consolidate from 1 July 2002 (i.e. in the transitional period and before 1 July 2003), and Gamma is a wholly-owned subsidiary on that date, the transitional rule for ACA step 3 applies → section 701-30, IT(TP)A 1997. All accrued undistributed profits are included.

Gamma has a profit of $7 in the latest year that it is entitled to distribute in a fully franked form. No losses are recouped. During that year, Alpha indirectly owns 60% of Gamma, so the amount that accrues to Alpha is $4.

Worksheet: Step 3 – Add undistributed profits accrued to the group

	$	$
		Cfwd 173
Ongoing rule		
Add undistributed *frankable* profits accrued to group at the JT	4	
and		
Transitional rule for subsidiaries that are non-chosen transitional entities and group has consolidated before 1 July 2003:		
Add *all* undistributed *unfrankable* profits accrued to group at the joining time	0	4
Entry ACA result after step 3		177

ACA step 3A: Adjust for pre-joining time rollovers form a foreign resident company

Step 3A is not applicable as there have not been any rollovers.

ACA step 4: Subtract certain distributions and certain undistributed profits

Step 4 is not applicable. There are no actual distributions of profits and no undistributed unfrankable profits on hand at the joining time.

ACA step 5: Subtract unused tax losses that accrued to the head company

Step 5 is not applicable, as the unused net capital loss accrued before Alpha acquired an indirect interest in Gamma.

ACA step 6: Subtract for tax benefit from transferred tax losses not accrued to the group

For the purposes of the case study, it is assumed that Gamma satisfies the modified same business test for the purpose of transferring losses to the head company. Accordingly, $10 in net capital losses is transferred to the head company.

Worksheet: Step 6 – Subtract for tax benefit from transferred losses not accrued to group

			Cfwd $177
Transferred losses of any sort that did not accrue to the group	$10		
Less those losses to the extent that their transfer has been cancelled	$0	$10	
Multiply by the general company tax rate		30%	$3
Entry ACA result after Step 6			**$174**

ACA step 7. There are no inherited deductions so no amount is subtracted at step 7.

ACA step 8. The entry ACA is $174.

Steps B, C and D

First determine the tax cost setting amount for the retained cost base assets. Cash is Gamma's only retained cost base asset. The amount is $100.

The remainder of the ACA, after deducting the sum of the tax cost setting amounts for retained cost base assets, is $74. This is allocated to Land 2, which is the only reset cost base asset. There are no excluded assets.

Intragroup transactions ignored

After consolidation, the group decides to sell 40% of its interest in Land 2, by having Beta sell 40% of its shares in Gamma. Before doing so, Gamma pays its income tax debt of $3, and then transfers its remaining cash of $97 to Beta. The latter transaction is ignored for income tax purposes.

Exit from a consolidated group

Beta sells 40% of its shares in Gamma for $40, reflecting the $100 market value of the underlying asset, Land 2. As Gamma is no longer a wholly-owned member of the group it is treated as having left the group. Alpha is taken to have acquired all of the membership interests in Gamma just before the leaving time, for an amount equal to the cost of the assets leaving the group with Gamma, reduced by Gamma's liabilities. Section 711-20 of the ITAA 1997 lists other adjustments that are relevant in more complex cases. See also the high-level worked example of the cost setting process on exit → C2-2-210.

The only asset leaving with Gamma is Land 2, with a cost base of $74 (calculated above). There are no liabilities. Alpha is taken to have acquired the membership interests (200 shares) for a total of $74 (37 cents per share). The cost base of the 40% sold is $30 (80 shares x 37 cents, rounded), and Alpha has made a net capital gain of $10 ($40 less $30).

As a consequence of the exit history rule, the asset that Gamma takes with it from Alpha (the head company) will have the same cost for tax purposes as it did for Alpha at the time Gamma leaves the group – that is, the cost base of Land 2 will still be $74.

Background information

Beta Pty Ltd

Table 10: Beta – profit & loss ($)

30.6.01	Plant depreciation	20	30.6.01	Trading account	500
30.6.01	Running expenses	200			
30.6.01	Income tax expense	92			
30.6.01	Deferred tax liability	3			
	Net profit	185			
		500			500
30.6.02	Plant depreciation	18	30.6.02	Trading account	700
30.6.02	Running expenses	250			
30.6.02	Income tax expense	127			
30.6.02	Deferred tax liability	2			
	Net profit	303			
		700			700

Table 11: Beta – income tax expense ($)

30.6.01	Cash	92	30.6.01	P&L	92
		92			92
30.6.02	Cash	127	30.6.02	P&L	127
		127			127

***Note*: Income tax expense for 2000–01 calculated as follows:**

Assessable income		
Sales		800
Increase in trading stock		400
		1,200
Less: allowable deductions		
Purchases	700	
Running expenses	200	
Plant depreciation	30	930
Taxable income		**270**

Depreciation plant: cost $200 x 15% = 30

(Adjustable value cfwd = $170)

Income tax payable for 2000–01 is $92 ($270 x 34%)

***Note*: Income tax expense for 2001–02 calculated as follows:**

Assessable income		
Sales		1,100
		1,100
Less: allowable deductions		
Purchases	350	
Decrease in trading stock	50	
Running expenses	250	
Plant depreciation	26	676
Taxable income		**424**

Depreciation plant: adjustable value $170 x 15% = 26

(Adjustable value cfwd = $144)

Income tax payable for 2001–02 is $127 ($424 x 30%)

Table 12: Beta – franking account for imputation purposes

		Debit $	Credit $	Balance
1 July 2000	Opening balance			0
30 June 2001	Payment of tax for 2000-01 (tax 92 x 66/34)		178	178 CR
30 June 2001	Closing balance			178 CR
1 July 2001	Opening balance			178 CR
1 July 2001	**Conversion of Class C A/C to new 30% tax rate**		317	317 CR
	Cancelling existing balance	178		
	Reinstating credit at new rate (178 x 34/66 x 70/30)		214	214 CR
30 June 2002	Payment of tax for 2001-02 (tax 127 x 70/30)		296	510 CR
30 June 2002	Closing balance (actual)			510 CR

Table 13: Beta – deferred tax liability ($)

30.6.01	Balance cfwd	3	30.6.01	P&L	3
		3			3
			1.7.01	Balance bfwd	3
30.6.02	Balance cfwd	5	30.6.02	P&L	2
		5			5
			1.7.02	Balance bfwd	5

***Note*: Deferred tax liability 2000–01.** The temporary difference between the carrying value of plant ($180) and its tax base ($170) multiplied by the tax rate (34%) results in a deferred tax liability of $3.

Deferred tax liability 2001–02. The temporary difference between the carrying value of plant ($162) and its tax base ($144) multiplied by the tax rate (30%) results in a deferred tax liability of $5. The liability needs to be increased by $2.

For the sake of simplicity, changes in the market value of other assets have not been reflected in the accounts for the purposes of this worked example.

Gamma Pty Ltd

Table 14: Gamma – profit & loss ($)

30.6.01	Loss on sale of asset	10	30.6.01	Net loss for year	10
		10			10
30.6.02	Running costs	10	30.6.02	Agistment income	20
30.6.02	Income tax	3			
	Net profit	7			
		20			20

***Note*:** There is no tax effect accounting for the loss on sale of Land 3, as Land 2 still has a market value of $100, so we cannot say it is probable that there will be a future taxable amount against which this entity could offset the net capital loss.

***Note*: Income tax expense for 2001–02 calculated as follows:**

Assessable income		
Agistment income		20
		20
Less: allowable deductions		
Running expenses	10	10
Taxable income		**10**

Income tax payable for 2001–02 is $3 ($10 x 30%)

References

Income Tax Assessment Act 1997, section 701-80; 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

Income Tax Assessment Act 1997, sections 705-35, 705-45, 705-50; 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

Income Tax Assessment Act 1997, section 705-145; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 3

Income Tax Assessment Act 1997, section 705-160; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003)

Income Tax Assessment Act 1997, section 711-20; 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

Income Tax (Transitional Provisions) Act 1997, section 701-30; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 5

Income Tax (Transitional Provisions) Act 1997, sections 701A-1 & 701A-5; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 9

Income Tax (Transitional Provisions) Act 1997, sections 701-1 and 701-5; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7

Explanatory Memorandum to New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraph 5

Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, paragraphs 5.61 to 5.71

Income Tax (Transitional Provisions) Act 1997, section 701-32; 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(6); as substituted by *Tax Laws Amendment (2004 Measures No. 7) Act 2005* (No. 41 of 2005), Schedule 6, Part 3

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. 7) Bill 2004, paragraphs 6.24 – 6.29

Revision history

Section C2-2-110 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on recent and proposed changes to consolidation rules, p. 2.	Recent and proposed legislative amendments.
26.10.05	Changes to figure 1, worksheets for steps 2 and 3 and references, pp. 1, 7, 14, 15.	Legislative amendments.
12.9.06	Change to worksheet step 3 for Betta, p. 8.	Legislative amendment.

Proposed changes to consolidation

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

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