Worked example

Calculating the ACA for non-chosen subsidiary partly held by chosen transitional entity

Description

Where a chosen transitional entity[1] holds interests in one or more non-chosen subsidiaries in a consolidated group, the chosen transitional entity is treated as a head company for the purpose of calculating the allocable cost amount (ACA) for the non-chosen subsidiaries. This example shows how, at formation, the head company and sub-groups headed by chosen transitional entities calculate the ACA under section 701-20 of the IT(TP)A 1997 for a non-chosen subsidiary in which they hold the membership interests.

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Commentary

The head company and each sub-group headed by a chosen transitional entity calculate separate notional ACAs (in the case of the head company, the 'adjusted allocable amount') for the non-chosen subsidiary, each disregarding the interests held by the other.

The head company's adjusted allocable amount is the amount that would be the non-chosen entity's ACA if the interests held by the head company at formation (excluding interests held by any chosen transitional entity) were the only interests in the non-chosen entity, with the amount calculated by multiplying each of the ACA step 2 to step 7 amounts by the following fraction:

$$\frac{\text{Market value of the head company's interest in the non-chosen subsidiary (excluding interests held by any chosen transitional entity)}}{\text{Market value of the consolidated group's total interests in the non-chosen subsidiary}}$$

The sub-group's 'notional allocable cost amount' is the amount that would be the non-chosen entity's ACA if the chosen transitional entity were the head company of a smaller consolidated group that included the non-chosen subsidiary, and the interests held by the chosen transitional entity and its sub-group at formation (i.e. of the larger group) were the only interests in the non-chosen subsidiary, with the amount calculated by multiplying each of the ACA step 2 to step 7 amounts by the following fraction:

$$\frac{\text{Market value of the chosen transitional entity's interest in the non-chosen subsidiary}}{\text{Market value of the consolidated group's total interests in the non-chosen subsidiary}}$$

[1] That is, a subsidiary for which the head company has chosen the transitional option of retaining the existing tax values for its assets instead of applying the cost setting rules.

The consolidated group's ACA for the non-chosen subsidiary is the sum of the head company adjusted allocable amount and the sub-group's notional allocable cost amount.

Example

Facts

ACo is a wholly-owned subsidiary of HeadCo. ACo in turn owns all the shares in two further subsidiary companies, BCo and CCo.

DCo is incorporated on 1 July 2000 with issued capital of $100,000 and with 20% of its shares issued to CCo and the remaining 80% issued to an unrelated company, XCo.

DCo immediately borrows $50,000 and acquires assets to commence a business. DCo's financial position is as follows:

Table 1: DCo – financial position at 1 July 2000 ($)

Land	110,000	Capital	100,000
Cash	40,000	Liabilities (loan)	50,000
	150,000		150,000

During the first year DCo makes a trading loss of $20,000 which is also a tax loss. Assume the value of the land remains unchanged.

Table 2: DCo – financial position at 30 June 2001 ($)

Land	110,000	Capital	100,000
Cash	20,000	Liabilities (loan)	50,000
		Loss	(20,000)
	130,000		130,000

On 1 July 2001, CCo purchases a further 40% of the shares in DCo from XCo. CCo pays $34,400 for the shares ($32,000 for the assets and $2,400 for the losses). During the year ending 30 June 2002 the value of the land is again constant but DCo makes a further trading loss (which is also a tax loss) of $10,000.

Table 3: DCo – financial position at 30 June 2002 ($)

Land	110,000	Capital	100,000
Cash	10,000	Liabilities (loan)	50,000
		Accumulated losses	(30,000)
	120,000		120,000

On 1 July 2002, HeadCo and BCo together purchase the shares XCo still holds in DCo, each taking a 20% interest in DCo. HeadCo and BCo each pay $15,800 for their 20% interest ($14,000 for the assets and $1,800 for the losses).

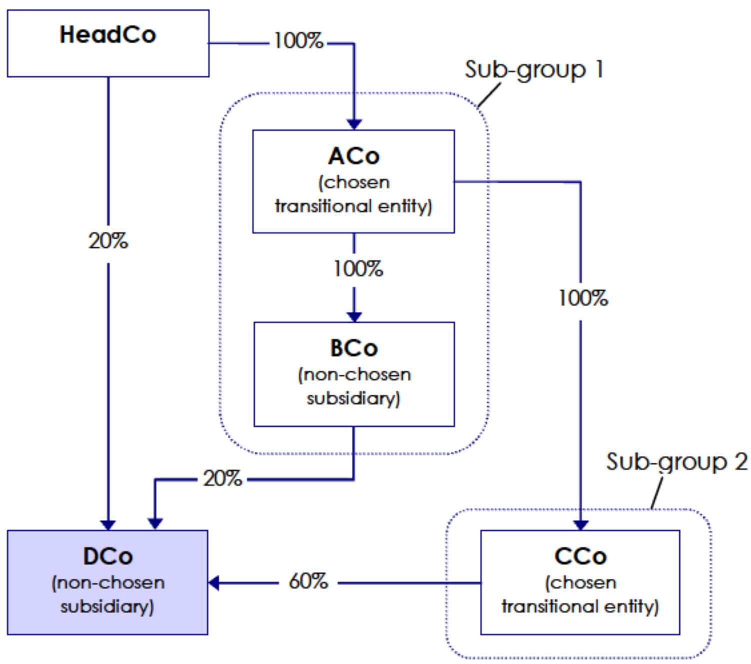
HeadCo, ACo, BCo, CCo and DCo form a consolidated group on 1 July 2002 and HeadCo chooses that ACo and CCo be chosen transitional entities. BCo's financial position at formation is as follows:

Table 4: BCo – financial position at 1 July 2002 ($)

Cash	34,200	Capital	50,000
Shares in D	15,800		
	50,000		50,000

For the purpose of working out the ACA for DCo there are two sub-groups: ACo and its non-chosen subsidiary BCo form one sub-group, and CCo constitutes a second sub-group.

Figure 1: HeadCo's consolidated group at formation



Calculation – HeadCo's adjusted allocable amount for DCo

For HeadCo's 20% interest in DCo the step 1 amount is $15,800.

Steps 2 and 6 of the ACA calculation are also relevant. The step 2 and step 6 amounts are first calculated disregarding interests held in DCo by any sub-group; i.e. treating HeadCo's 20% interest as if it were a 100% interest in DCo acquired on 1 July 2002. On this basis the step 2 amount is $50,000 (the loan owed by DCo) and the step 6 amount is $9,000 (30% of DCo's tax losses of $30,000).

The step 2 and step 6 amounts are then multiplied by the fraction obtained by dividing the market value (at the time the consolidated group comes into existence) of HeadCo's membership interests in DCo, excluding the interests it holds through the sub-groups, by the market value of the consolidated group's total membership interests in DCo. This fraction is $15,800/$79,000. The step 2 and step 6 amounts are therefore reduced to $10,000 and $1,800 respectively.

The head company adjusted allocable amount is therefore:

$15,800 + $10,000 – $1,800 = $24,000

Calculation – sub-group 2's notional ACA for DCo

CCo paid $54,400 ($20,000 + $34,400) for its 60% interest in DCo. The step 1 amount in its sub-group's notional ACA calculation is therefore $54,400.

In this sub-group's case, the amounts at steps 2 to 7 are calculated as if the 60% of DCo's shares it held at 1 July 2002 were 100% of the issued shares in DCo. On this basis the step 2 amount is again $50,000.

Assuming for this calculation that the 60% of DCo's shares held by CCo at 1 July 2002 were 100% of the issued shares in DCo, one-third of the loss that DCo incurred in the year ending 30 June 2001 would have accrued to shares held by CCo and all of the loss it incurred in the year ending 30 June 2002 would have accrued to the shares held by CCo. That is, the 20% interest CCo held in 2000-01 and the 40% interest it acquired in 2001-02 would each be increased by 100/60. On this basis, sub-group 2 calculates a step 5 amount, in relation to DCo's tax losses, as follows:

(20% × 100/60 × $30,000) + (40% × 100/60 × $10,000) = $16,667

There is also a step 6 amount, calculated as if two-thirds of DCo's loss in the year ending 30 June 2001 had accrued to shares not held at that time by CCo. The step 6 amount is calculated as follows:

40% × 100/60 × $20,000 × 30% = $4,000

Each of these step 2, 5 and 6 amounts is then multiplied by the fraction obtained by dividing the market value (at formation time) of sub-group 2's membership interests in DCo by the market value of the consolidated group's total membership interests in DCo; i.e. $47,400/$79,000. The step 2, 5 and 6 amounts are reduced to $30,000, $10,000 and $2,400 respectively.

The sub-group's notional ACA is:

$54,400 + $30,000 – ($10,000 + $2,400) = $72,000

Calculation – sub-group 1's notional ACA for DCo

Before sub-group 1's notional ACA for DCo can be calculated, the ACA for BCo (a non-chosen subsidiary) must be calculated, followed by the tax cost setting amounts for BCo's assets, including BCo's membership interests in DCo. Since ACo holds its entire interest in DCo indirectly through BCo, the notional ACA for sub-group 1's interest in DCo is based only on the membership interests held by BCo.

The cost base, reduced cost base and market value of ACo's 100% membership interests in BCo are all $50,000, so the step 1 amount is $50,000. As none of steps 2 to 7 apply in this case, BCo's ACA is $50,000.

The tax cost setting amount for BCo's retained cost base assets (cash) is $34,200. This amount is subtracted from the ACA. The remainder of the ACA of $15,800 is allocated to BCo's reset cost base assets – the shares it holds in DCo. This becomes the step 1 amount in BCo's notional ACA for DCo.

Next calculate BCo's notional ACA for DCo. The step 1 amount is the tax cost setting amount already calculated for the shares in DCo, i.e. $15,800. Steps 2 and 6, relating to DCo's borrowings and the accumulated tax losses, are also relevant. The amounts at these steps are calculated in the same way as for steps 2 and 6 in the calculation of HeadCo's adjusted allocable amount, and are equal to the amounts calculated by HeadCo.

Sub-group 1's notional ACA for DCo is therefore $24,000.

Consolidated group's ACA for DCo

The consolidated group's ACA for DCo is the sum of the head company adjusted allocable amount and the sub-groups' notional ACAs, i.e.:

$24,000 + $72,000 + $24,000 = $120,000

Allocating the ACA among DCo's assets

The tax cost setting amount for DCo's cash, a retained cost base asset, is $10,000. After subtracting this amount from the total ACA of $120,000, $110,000 remains for allocation to the land, a reset cost base asset.

References

Income Tax (Transitional Provisions) Act 1997, Division 701; 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 2003* (No. 16 of 2003)

Taxation Determination TD 2004/73 – Income tax: consolidation: where the head company and a chosen transitional entity in a consolidated group hold separate membership interests in a non-chosen subsidiary, how does the group calculate the allocable cost amount for the non-chosen subsidiary?

Revision history

Section C2-4-205 first published 12 May 2004.

Revisions are described below.

Date	Amendment	Reason
26.10.05	Reference to new taxation determination.	
26.6.07	Note on proposed changes to clarify both the valuation of liabilities and the accounting principles to be used.	Reflect announcement on 8 May 2007 by Assistant Treasurer in media release no. 50.
6.5.11	Removal of note on proposed changes to clarify both the valuation of liabilities and the accounting principles to be used.	Legislative amendment.