Worked example

Tax cost setting amount for goodwill

Description

This example shows the calculation of the tax cost setting amount for goodwill when an entity joins a consolidated group. The goodwill of a joining entity, as well as the synergistic goodwill that arises out of the entity joining the group, is treated as a reset cost base asset of the joining entity. Some of the entry allocable cost amount (ACA) will be allocated to each part of the goodwill.

Commentary

When a subsidiary joins a consolidated group, the head company becomes the holder for income tax purposes of the assets brought into the group by the subsidiary. Each asset's tax cost setting amount is worked out by allocating the entry ACA among the assets. After allocation to retained cost base assets, the remainder of the entry ACA is apportioned to the reset cost base assets in proportion to their market values. For this purpose, the goodwill of the subsidiary is a reset cost base asset. It does not matter whether or not this goodwill is recognised in the subsidiary's accounts.

Goodwill includes synergistic goodwill, which is goodwill created as a result of businesses combining, and is part of the goodwill treated as a reset cost base asset of the joining entity.

→ Taxation Ruling TR 2005/17; Taxation Determination TD 2007/1; 'Market valuing goodwill' in 'Market valuation guidelines', C4-1

Example

Facts

HeadCo (the head company of a consolidated group) acquires all of the shares in SubCo on 1 July 2003 for $320,000. The financial position of SubCo on joining the group is shown in Table 1.

Table 1: SubCo – financial position at 1 July 2003

Asset 1 (MV $150,000)	$100,000	Capital	$200,000
Asset 2 (MV $100,000)	$80,000		
Cash at bank	$20,000		
	$200,000		$200,000

Note: MV = market value

As at the joining time, SubCo has built up business goodwill of $30,000 not reflected in its accounts. As a consequence of the group's ownership and control of SubCo, some of the synergistic goodwill accrues to the business of another group operating subsidiary. This component of synergistic goodwill has a market value of $20,000. For the purpose of allocating the ACA, this goodwill is also treated as an asset of SubCo at the joining time.

The goodwill of the group before SubCo joined had a cost base of $50,000.

Calculation

Assume the entry ACA is $320,000. The tax cost setting amount for the retained cost base assets will be $20,000 for Cash. The remainder of the ACA is $300,000. This will be allocated to the reset cost base assets in proportion to their market values.

Table 2: SubCo's tax setting amounts

Asset	Market value	Apportionment of remainder of entry ACA	Cost setting amount
Asset 1	$150,000	150,000/300,000x300,000	$150,000
Asset 2	$100,000	100,000/300,000x300,000	$100,000
Goodwill (business)	$30,000	30,000/300,000x300,000	$30,000
Goodwill (synergies)	$20,000	20,000/300,000x300,000	$20,000
Total	**$300,000**		

Record keeping tip: It is necessary to record amounts of goodwill used in setting the tax costs of a joining entity's assets, as well as details of how goodwill has been calculated for this purpose. It is also useful to keep track of the cost setting amounts calculated on entry for subsequent income tax assessments. For example, a head company will need to know the cost base of any goodwill disposed of or lost because an entity leaves a consolidated group.

References

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

Explanatory Memorandum accompanying the New Business Tax System (Consolidation) Bill (No 1) 2002, paragraph 5.34

Taxation 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*

Taxation Determination TD 2007/1 – Income tax: consolidation: in working out the market value of the goodwill of each business of an entity that becomes a subsidiary member of a consolidated group, should the value of related party transactions of each business of the entity be recognised on an arm's length basis?

Revision history

Section C2-4-520 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
26.10.05	Reference to new tax ruling.	
26.6.07	Reference to new tax determination.	

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).