

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.

### 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		
	<u>\$200,000</u>		<u>\$200,000</u>

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	$150,000/300,000 \times 300,000$	\$150,000
Asset 2	\$100,000	$100,000/300,000 \times 300,000$	\$100,000
Goodwill (business)	\$30,000	$30,000/300,000 \times 300,000$	\$30,000
Goodwill (synergies)	\$20,000	$20,000/300,000 \times 300,000$	\$20,000
<b>Total</b>	<b>\$300,000</b>		

**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