Worked example

Reduction for revenue-like assets (step C)

Description

This example shows how the tax cost setting amount for revenue-like assets may be reduced (at step C of the cost setting process). (Note that trading stock, depreciating assets and revenue assets are referred to in the consolidation legislation as 'assets held on revenue account' and 'revenue etc. assets'. In the reference manual, they are generally referred to as 'revenue-like' assets.)

Commentary

At step C of the cost setting process the remaining ACA of the joining entity is allocated among its reset cost base assets in proportion to their market values.

Where the amount allocated to a revenue-like asset (i.e. a revenue asset, item of trading stock or depreciating asset) exceeds the greater of its terminating value or market value, the allocated amount is reduced by the amount of the excess.

- The terminating value of a revenue asset is its cost base just before the entity becomes a member of a consolidated group.
- The terminating value of an item of trading stock is its value at the beginning of the joining entity's non-membership period that precedes the joining time, or its purchase price if acquired during that period. (A non-membership period is a period during an income year in which the entity is not a member of a consolidated group. Note that an entity will have more than one non-membership period in an income year if it leaves and then rejoins the same consolidated group or joins another consolidated group during that year.)
- The terminating value of a depreciating asset is its adjustable value at the joining time.

The excess is then reallocated to the other reset cost base assets in accordance with their market values, but not so as to exceed the limit for any revenue-like assets.

The reduction at this step applies to revenue assets, trading stock and depreciating assets. A CGT asset is a revenue asset if the profit or loss on disposal would be taken into account in calculating taxable income (or losses) other than under the CGT provisions, and the asset is neither trading stock nor a depreciating asset.

The reduction addresses the potential for unrealised capital losses to be converted to revenue losses when an entity joins a consolidated group. This relates to situations where assets still held by a joining entity have declined in value after the group it is joining purchased membership interests in it.

Example

Facts Assume the ACA for a joining entity, ACo, is $6,900. The retained cost base assets consist of Cash of $650. After this amount is subtracted, the remainder of the ACA ($6,250) is first apportioned to the reset cost base assets according to their market values (Table 1).

Table 1: First cut apportionment to reset cost base assets

	Cost ($)	Terminating value ($)	Market value ($)	Apportionment	Tax cost setting amount before reduction ($)	section 705-40 max. amount ($)	Excess for revenue -like assets ($)	Tax cost setting amount after reduction ($)
Land 1	1,000	1,000	1,200	6250x1200/5250	1,429			1,429
Land 2	2,000	2,000	2,500	6250x2500/5250	2,976			2,976
Plant 1	500	200	220	6250x220/5250	262	220	42	220
Plant 2	300	160	130	6250x130/5250	155	160	0	155
Trading stock 1	800	800	1,000	6250x1000/5250	1,190	1,000	190	1,000
Trading stock 2	200	200	200	6250x200/5250	238	200	38	200
Totals			**5,250**		**6,250**		**270**	

Note: The trading stocks 1 & 2 in this example are reset cost base assets. In certain circumstances, trading stocks may be treated as retained cost base assets. → 'Treatment of assets', C2-1; and section 701A-5 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997)

The excess of $270 must be reallocated against all reset cost base assets that have not had their tax cost setting amounts reduced → section 703-35, *Income Tax Assessment Act 1997* (ITAA 1997). For revenue-like assets the reallocation must not result in the tax cost setting amount exceeding the limit set in section 705-40 of the ITAA 1997. The first stage of this reallocation is shown in Table 2.

Table 2: Second cut (first reallocation)

	Market value ($)	Apportionment	Share of excess ($)	Share of 1st cut ($)	Tax cost setting amount with 1st excess ($)	section 705-40 max. amount ($)	Excess for revenue -like assets ($)	Tax cost setting amount after reduction ($)
Land 1	1,200	270x1200/3830	85	1,429	1,514			1,514
Land 2	2,500	270x2500/3830	176	2,976	3,152			3,152
Plant 2	130	270x130/3830	9	155	164	160	4	160
Totals	**3,830**		**270**				**4**	

The tax cost setting amount for plant 2 has exceeded the maximum allowable by $4. This amount must be reallocated against the reset cost base assets whose tax cost setting amounts have not exceeded their limits. This second stage of the reallocation is shown in table 3.

Table 3: Third cut (second reallocation)

	Market value ($)	Apportionment	Share of excess ($)	Share after 2nd cut ($)	Tax cost setting amount with 2nd excess ($)
Land 1	1,200	4x1200/3700	1	1,514	1,515
Land 2	2,500	4x2500/3700	3	3,152	3,155
Totals	**3,700**		**4**		

The final results of step C of the cost setting process for each of ACo's reset cost base assets are shown in table 4. Note that a further reduction may be required for over-depreciated assets (step D) → Worked example: 'Reduction for over-depreciated assets (step D)', C2-4-610. A further reduction for certain revenue-like assets may also be required (step E) → 'Treatment of assets', C2-1; Worked example: 'Limiting the tax cost setting amounts of revenue-like assets (step E)', C2-4-710; and section 705-57, ITAA 1997.

Table 4: Summary of apportionment calculation

	1st cut ($)	2nd cut ($)	3rd cut ($)	Totals ($)
Land 1	1,429	85	1	1,515
Land 2	2,976	176	3	3,155
Plant 1	220			220
Plant 2	155	5		160
Trading stock 1	1,000			1,000
Trading stock 2	200			200
Totals	**5,980**	**266**	**4**	**6,250**

References

Income Tax Assessment Act 1997, sections 705-35 and 705-40; 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 4

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraphs 5.37-5.41

Income Tax Assessment Act 1997, section 977-50; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002 (No. 90 of 2002),* Schedule 15

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 1.28-1.30

Income Tax Assessment Act 1997, section 705-57; as amended by: *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 3

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

H. Coonan (Minister for Revenue and Assistant Treasurer, *Government delivers on business tax reform*, media release C72/02, 27 June 2002