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

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.

A partly constructed asset that has a limited effective life is a depreciating asset for the purposes of Division 40 of the ITAA 1997.

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. For a partly constructed asset the adjustable value is the cost of the asset to the point of construction 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 $9,400. The retained cost base assets consist of Cash of $650. After this amount is subtracted, the remainder of the ACA ($8,750) is first apportioned to the reset cost base assets according to their market values (Table 1).

Table 1: Allocation 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	8750x1200/7400	1,419			1,419
Land 2	2,000	2,000	2,500	8750x2500/7400	2,956			2,956
Plant 1	500	200	220	8750x220/7400	260	220	40	220
Plant 2	300	160	130	8750x130/7400	154	160	0	154
Partly built Plant 3	1,000	1,000	1,500	8750x1500/7400	1,774	1,500	274	1,500
Partly built Plant 4	800	800	650	8750x650/7400	769	800	0	769
Trading stock 1	800	800	1,000	8750x1000/7400	1,182	1,000	182	1,000
Trading stock 2	200	200	200	8750x200/7400	236	200	36	200
Totals			**7,400**		**8,750**		**532**	

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 $532 must be reallocated against all reset cost base assets that have not had their tax cost setting amounts reduced → section 705-35, *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: 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	532x1200/4480	143	1,419	1,562			1,562
Land 2	2,500	532x2500/4480	297	2,956	3,253			3,253
Plant 2	130	532x130/4480	15	154	169	160	9	160
Partly built Plant 4	650	532x650/4480	77	769	846	800	46	800
Totals	**4,480**		**532**				**55**	

The tax cost setting amounts for plant 2 and partly built plant 4 have exceeded the maximum allowable by a combined total of $55. 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: Second reallocation

	Market value ($)	Apportionment	Share of excess ($)	Share after 2nd cut ($)	Tax cost setting amount with 2nd excess ($)
Land 1	1,200	55x1200/3700	18	1,562	1,580
Land 2	2,500	55x2500/3700	37	3,253	3,290
Totals	**3,700**		**55**		

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: Final ACA allocation

	Allocation ($)	1st reallocation ($)	2nd reallocation ($)	Tax cost setting amount ($)
Land 1	1,419	143	18	1,580
Land 2	2,956	297	37	3,290
Plant 1	220			220
Plant 2	154	6		160
Partly built Plant 3	1,500			1,500
Partly built Plant 4	769	31		800
Trading stock 1	1,000			1,000
Trading stock 2	200			200
Totals	**8,218**	**477**	**55**	**8,750**

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

Revision history

Section C2-4-530 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
3.12.03	Changes to commentary and example to illustrate treatment of partly constructed assets that have a limited effective life as revenue-like assets.	To further expand interpretative information on treatment of revenue-like assets.