Worked example

Applying the continuing majority-owned entity test to multi-tiered structures

Description

This example shows how the continuing majority ownership test in subsections 701A-1(1) and 701A-1(2) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997) applies to entities in multi-tiered ownership structures.

Commentary

When an entity joins a consolidated group, its trading stock and any depreciating assets (including internally generated assets) are generally treated as reset cost base assets under Division 705.

However, where the entity is a 'continuing majority-owned entity', trading stock is a retained cost base asset and internally generated assets have a dual cost base. → subsections 701A-5 and 701A-10

This is an integrity measure to ensure that the cost setting rules do not provide unintended tax benefits to groups during the transition to consolidation. Without it, tax benefits could be realised as a consequence of resetting the value of trading stock held prior to consolidation, or providing a tax value for internally generated assets where the asset did not have a tax value prior to consolidation.

A 'continuing majority-owned entity' is an entity that was majority owned at all times by a person or persons from the start of 27 June 2002 until the entity became a subsidiary member of a consolidated group. (This period includes the joining date.) → paragraph 701A-1(b)

The integrity measures in sections 701A-5 and 701A-10 do not apply to an entity's trading stock and certain internally generated assets where there has been a change in the entity's majority owners after the start of 27 June 2002. That is, the integrity measures only apply to joining entities that were majority owned, either directly or indirectly through one or more interposed entities, from the start of 27 June 2002, and remained majority owned until the group consolidated.

In determining whether there was a change in the majority ownership of joining entities during this period it will be necessary to trace the ultimate beneficial owners, ignoring any entities interposed between the ultimate beneficial owners and the joining entity. In most cases it will be clear whether or not there has been a change in the majority ultimate beneficial ownership of an entity. However, where it may be difficult to determine this, the taxpayer or their adviser should approach the Tax Office with the aim of identifying an approach that will minimise compliance costs in tracing ownership.

→ Taxation Determination TD 2004/88

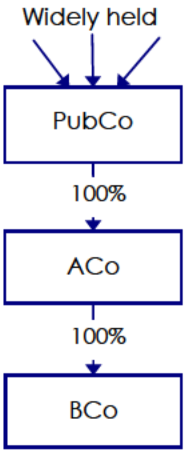
These integrity measures will continue to apply beyond the transitional period of 1 July 2002 to 30 June 2004.

Example Majority ownership test for multi-tiered structures (widely held ownership of head company)

Facts

As at 26 June 2002, PubCo, a publicly listed corporation on the Australian Stock Exchange, owns 100% of the shares in ACo, an Australian-resident company. On that date BCo, an Australian-resident company, is a wholly-owned subsidiary of ACo, and holds trading stock and internally generated assets.

Figure 1: PubCo group at 26.6.2002

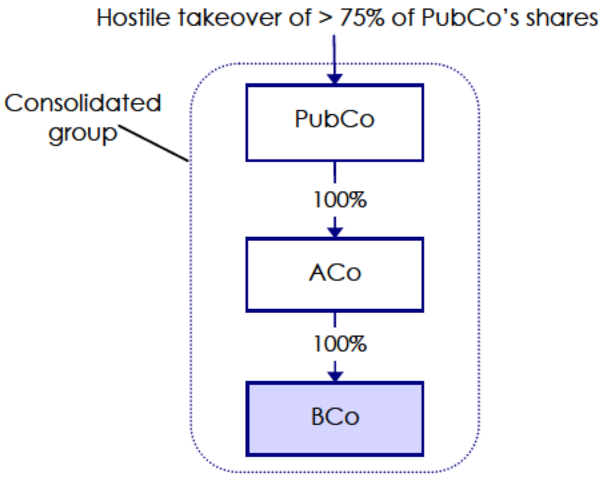


On 31 December 2002, a hostile takeover of more than 75% of PubCo's listed shares takes place, resulting in a change in majority ownership of PubCo.

On 1 July 2003, PubCo forms a consolidated group comprising itself as head company with subsidiary members ACo and BCo.

There are no changes to PubCo's membership interests in ACo and ACo's membership interests in BCo from 26 June 2002 until the consolidation time of 1 July 2003.

Figure 2: PubCo group on consolidation



Applying the test

From 26 June 2002 until 30 December 2002, PubCo was the majority owner of ACo. PubCo was also the majority owner of BCo during this period because it beneficially owned (indirectly through ACo), shares representing more than 50% of the market value of all the membership interests in BCo.

On 31 December 2002, a hostile takeover of PubCo resulted in a change in ownership of PubCo at the ultimate beneficial ownership level. Although there has been no change in PubCo's ownership of ACo or BCo, the test for majority ownership in section 701A-1 of the IT(TP)A 1997 requires a 'bottom-up' analysis (through widely held or public companies, including publicly listed companies) to the ultimate beneficial owners to determine whether or not the integrity measures apply.

Given the change in majority beneficial ownership has taken place at the ultimate beneficial ownership level, PubCo, ACo and BCo do not qualify as continuing majority-owned entities. As a result, the integrity measures do not apply to BCo's trading stock and internally generated assets for the purpose of cost setting.

References

Income Tax Assessment Act 1997, Division 705

Income Tax (Transitional Provisions) Act 1997, sections 701A-1, 701A-5, 701A-10, subsection 701A-1(1)

Explanatory Memorandum to the New Business Tax System (Consolidation and other measures) Bill (No. 1) 2002, paragraphs 1.118 – 1.141

Taxation Determination TD 2004/88 – Income tax: consolidation: does the continuing majority-owned entity test in subsections 701A-1(1) and 701A-1(2) of the *Income Tax (Transitional Provisions) Act 1997* require tracing through interposed entities to the ultimate beneficial owners to determine whether there has been a change in the majority ownership of an entity during the period from 27 June 2002 until the entity becomes a subsidiary member of a consolidated group?

Revision history

Section C2-4-855 first published 12 May 2004.

Further revisions are described below.

Date	Amendment	Reason
26.10.05	Reference to new taxation 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).