Worked example

Adjustment for certain inherited deductions (exit ACA step 2)

Description

This example shows how, at step 2 of the allocable cost amount (ACA) calculation on exit, an amount is added for certain unclaimed deductions of the head company that become available to the leaving entity because of the exit history rule.

Commentary

The exit history rule provides that the tax history in relation to any asset, liability, business or registration for particular research and development activities that leaves the consolidated group with a leaving entity is inherited by that leaving entity. This tax history can include the history inherited by the head company as a result of the entry history rule.

An amount is added at step 2 on exit to ensure that the value of the deduction is reflected in the ACA.

The amount added is the full amount of any relevant 'owned' deductions and an amount reflecting the future tax benefit embedded in any 'acquired' deductions.

The deductions covered in this step of working out the group's ACA for the leaving entity are deductions (both owned and acquired) to which the leaving entity becomes entitled under section 701-40 of the ITAA 1997 as a result of it ceasing to be a subsidiary member of the consolidated group, other than a deduction for expenditure:

- that is, forms part of or reduces, the cost of an asset that becomes an asset of the leaving entity because subsection 701-1(1) (the single entity rule) ceases to apply, or
- to which section 110-40 of the ITAA 1997 (expenditure on asset acquired before 7.30 pm on 13 May 1997) applies.

→ subsection 711-35(2), ITAA 1997

Acquired deductions are those that were acquired deductions at step 7 of the entry ACA when an entity became a subsidiary member of the consolidated group. → Adjustment for certain inherited deductions (ACA step 7), C2-4-340

Owned deductions are deductions that are not acquired deductions.

→ subsection 711-35(1)

An unclaimed deduction for expenditure that would be included in the cost of an asset of the leaving entity, or would reduce it, is not included at step 2.

Unclaimed Division 43 deductions

Unclaimed deductions for allowable capital expenditure on assessable-income-producing buildings and other capital works under Division 43 of the ITAA 1997 that were previously available to the head company and become available to a leaving entity when it leaves a consolidated group do not increase the exit ACA at step 2. When an entity joins a consolidated group, unclaimed Division 43 deductions do not reduce the entry ACA at step 7, and when an entity leaves a group unclaimed Division 43 deductions do not increase the exit ACA at step 2.

Where a consolidated group is not consistent in its treatment of unclaimed Division 43 deductions in the calculation of its entry and exit ACAs, the Tax Office will amend the head company's assessment to reduce the entry ACA at step 7 by any unclaimed Division 43 deductions.

→ See also 'Adjustment for certain inherited deductions (ACA step 7)', C2-4-340

Example

Facts

On 1 July 2004 all of the membership interests in ACo are acquired by HCo, the head company of a consolidated group.

Before joining the consolidated group, ACo:

- purchased land and constructed an income producing building on 1 July 1996. The cost of the building was $100,000, which gave rise to Division 43 deductions of $4,000 in each year; and
- borrowed $200,000 on 1 July 2003 to use in its business for which it incurred $20,000 borrowing costs claimable over 5 years under section 25-25 of the ITAA 1997. HCo's ACA for ACo was reduced by $4,800 ($16,000 x 0.3) at step 7 when ACo joined the consolidated group.

On 30 June 2006 the membership interests the group holds in ACo are sold with the result that ACo leaves the consolidated group.

Table 1: ACo – financial position at 30 June 2006 ($'000)

Income producing property	200	Equity	102.4
Depreciating assets	100	Liability	200
Deferred tax asset	2.4		
	302.4		302.4

Note: The deferred tax asset is for unclaimed borrowing costs of $8,000 fully expensed in the accounts. The terminating value of the property is $200,000 and the depreciating assets is $100,000.

Calculation of the ACA

Step 1

Start with the sum of the terminating values of the leaving entity's assets, i.e. $300,000.

Step 2

This step is concerned with unclaimed deductions for which the leaving entity becomes entitled. The leaving entity becomes entitled to unclaimed deductions for borrowing expenses of $8,000 as a result of the exit history rule. As these are acquired deductions the amount added at step 2 is $2,400 ($8,000 x 0.3). No amount is added for the unclaimed deductions available under Division 43.

The result after this step is $302,400.

Step 3

There is no step 3 amount.

Step 4

Deduct ACo's liabilities that leave the group with ACo of $200,000.

Step 5

The group's ACA for the leaving entity is $102,400.

References

Income Tax Assessment Act 1997, sections 701-1, 701-5, 711-20, 711-25, 711-30, 711-35 and 711-45.

Revision history

Section C2-5-240 first published 15 November 2006.

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).