

Effect of Subdivision 165-CC for steps 1 and 2 of the ACA calculation at formation and joining times

When the head company chooses to consolidate, or an entity joins an existing consolidated group, it is necessary to determine the cost setting amount for the assets the head company is taken to hold under the single entity principle. The method chosen to set the cost of the assets will depend on a number of factors, including whether the group is formed during or after the transitional period.

Whenever the allocable cost amount (ACA) method is used to calculate the cost setting amount for the head company's first-tier subsidiaries' assets, it may be necessary to make certain adjustments to take account of Subdivision 165-CC changeover times (all legislative references are to the ITAA 1997 unless otherwise stated).

For example, Division 715 modifies the reduced cost bases of the head company's membership interests at step 1 and intragroup liabilities at step 2 of the ACA calculation where there was a Subdivision 165-CC changeover time before formation or joining time and an adjusted same business test (SBT) is failed.

Broadly, if an adjustment is necessary, the reduced cost base of the interests is reduced to market value – but only to the extent of the residual unrealised net loss (RUNL) balance of the entity that owns the interests.

The purpose of the adjustments is to ensure that inappropriate amounts are not pushed down onto the value of the assets under the cost setting rules on consolidation.

The same adjustments can also apply to the membership interests and intragroup liabilities of a chosen transitional entity in a formation case.

The Division 715 provisions may apply to the consolidation cost setting rules in sections 705-65 and 705-75 where the head company (or a chosen transitional entity during the transitional period) has failed the adjusted SBT and had a changeover time at or before the formation or joining time. The reduced cost bases of membership interests at step 1 and intragroup liabilities (e.g. intragroup debt) at step 2 of the ACA calculation may be reduced.

There are no reductions to the reduced cost bases of membership interests or liabilities of a head company (or a chosen transitional entity) at formation or joining time where the entity has not had a changeover time at or before consolidation.

To ensure that potential losses from any 'unrealised assets' and Subdivision 170-D deferred loss amounts from a changeover time are appropriately dealt

with, Division 715 modifies the approach taken in Subdivision 165-CC where a consolidated group forms or entities enter or leave such a group.

Application of
Subdivision
715-A to steps 1
and 2

Subdivision 165-CC has ongoing application to the head company of a consolidated group but not to entities within such a group. It will be necessary for the head company to determine if a Subdivision 165-CC changeover time at or before formation or joining times will have any impact on the calculation of ACAs.

Adjustments may be required where there was such a changeover time and:

- the head company fails the adjusted SBT set out in paragraphs 715-50(1)(d) and 715-55(1)(d), and
- there are membership interests or liabilities in the joining entity that are *165-CC tagged assets* at the relevant time → section 715-30.

The same adjustments can apply to the membership interests and liabilities of chosen transitional entities at formation.

Same business
test adjusted for
consolidation
purposes

In the consolidation environment the SBT under subsections 715-50(1)(d) and 715-55(1)(d) has regard to the trial year before the formation or joining time and the time just before the changeover time. The trial year is defined in section 707-120 and is usually from 12 months before the formation or joining time to just after those times. It is assumed that the entity carried on at and just after the joining time the same business that it carried on just before the joining time.

Examples

In the following examples it is assumed that the head company or a chosen transitional entity has each had a relevant changeover time and failed the SBT.

Head company
formation

Adjustment 1

The reduced cost base of the head company's membership interest in a subsidiary at formation time may be reduced if it is relevant to the step 1 amount.

The amount of the step 1 reduction will depend on the market value of the membership interest at formation time and the formation RUNL (that is, the RUNL amount of the head company just before formation time).

The reduced cost base is adjusted to the market value at formation time but only to the extent of the formation RUNL amount.

Following this adjustment the formation RUNL amount is reduced. If there is any amount of formation RUNL amount remaining after the step 1 reductions, adjustment 2 may be necessary.

Adjustment 2

If after the step 1 adjustments are completed some formation RUNL amount remains, and the reduced cost base of an asset constituted by an intragroup liability is the relevant amount for step 2 purposes (subsection 705-75(2)), then

the reduced cost base of that asset may also be adjusted. The reduction to the step 2 amount will depend on:

- the remaining amount of the formation RUNL, and
- the market value of the asset that is the liability.

The step 2 amount is adjusted to the market value but only to the extent of the formation RUNL.

Following that adjustment the formation RUNL is reduced by that amount.

(If necessary the step 2 amount may be adjusted even though there was no step 1 adjustment.)

Other consequences

Where the above adjustments are completed and the head company has some remaining formation RUNL as well as 165-CC tagged assets or Subdivision 170-D deferred loss amounts, a loss denial pool of the head company may be created if the formation time is not a changeover time for the head company.

Chosen
transitional entity
(CTE) – formation

The rules described above apply in the same way to a subsidiary that is a chosen transitional entity when a consolidated group forms.

Adjustments may be made to the reduced cost bases of a CTE's membership interests and assets that represent intragroup liabilities in a non-chosen subsidiary at formation time. The adjusted reduced cost bases can form part of the CTE's ACA for the non-chosen subsidiary members.

There may also be further consequences if a formation RUNL balance remains after any such adjustments. A separate loss denial pool in respect of each subsidiary may be created in the head company (section 715-70). For this consequence to arise there must also be remaining 165-CC tagged assets or Subdivision 170-D deferred losses and the formation time cannot be a changeover time.

Head company
– entity joins
existing group

Where an entity joins an existing consolidated group there may be consequences for the head company of that group if the SBT, as adjusted for consolidation, is failed. There can be reductions for membership interests or assets that constitute intragroup liabilities of the head company in the entity where the reduced cost bases of the interests are used for ACA purposes and those interests were Subdivision 165-CC tagged assets for the most recent changeover time for the head company.

In these circumstances, the same adjustments 1 and 2 are used as for the head company formation case outlined above.

It is important to note that in these circumstances the trial year for the head company SBT ends immediately after the joining time for the joining entity and starts 12 months before that time. The RUNL just before joining time for the head company is reduced by the adjustments made to the reduced cost bases of membership interests and assets relating to liabilities. When the RUNL

balance is reduced to nil, no further adjustments are necessary. There are no consequences for other 165-CC tagged assets of a joining company. However, a loss denial pool in respect of Subdivision 170-D deferred loss amounts that relate to 165-CC tagged assets of the joining company at a changeover time may be formed in the head company.

Note also that a subsidiary entity becoming a member of an already formed consolidated group cannot be a chosen transitional entity.

References

Income Tax Assessment Act 1997:

- Division 705
- Subdivisions 165-CC, 170-D

New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003), Division 715, Schedule 7

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 11