

Effect of Subdivision 165-CD for consolidated groups

The purpose of Subdivision 165-CD of the ITAA 1997 is to prevent loss duplication on certain direct and indirect interests in a company that has an alteration time and has realised and unrealised losses at that time.

In a consolidated environment, the effect of Subdivision 715-B is that under the single entity rule (extended for Subdivision 165-CD purposes) only the head company can have an alteration time.

This section provides an overview of the impact a Subdivision 165-CD alteration time may have in a consolidated environment, including:

- the impact of an alteration time that happens before formation of a consolidated group
- the impact of an alteration time where it occurs during consolidation
- the consequences of a company leaving a consolidated group, whether or not the leaving time is an alteration time, and
- the consequences where the leaving entity is a trust.

Broadly, Subdivision 165-CD can apply where an alteration time occurs in relation to a loss company. An alteration time can occur when certain changes in the control or ownership of the loss company occur or the liquidator of a loss company declares that shares in the company are worthless.

Notice of alteration time

Subsections 165-115ZC(4) and (5) of the ITAA 1997 require an entity that has a controlling stake in the loss company, or the loss company itself, to give a notice to associates that have a relevant interest in the loss company. The notice must contain information on the alteration time and the nature and extent of the loss company's losses.

The purpose of the notice is to ensure that recipients have sufficient information to comply with their obligations under Subdivision 165-CD. However, the recipient entity is required to comply with this Subdivision even if it does not receive the notice.

The notice requirements in section 165-115ZC(4) and (5) of the ITAA 1997 are modified during the consolidation transitional period by section 165-115ZC(5) of the IT(TP)A 1997.

→ sections 165-115ZC of the ITAA 1997 and 165-115ZC of the IT(TP)A 1997; paras 1.168– 1.182 of the Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2005.

Alteration time before formation

When a consolidated group forms there is generally no need to adjust membership and debt interests of the head company or a chosen transitional entity that are direct or indirect interests in a company that had an alteration time before formation. This will be the case where Subdivision 165-CD has applied using the individual asset method to make adjustments to the adjustable values of those interests.

However, where the global method of asset valuation for Subdivision 165-CD purposes has been used to determine the unrealised losses, there is a special rule in subsections 705-65(3A) and 705-75(3) that may require further adjustments to membership and debt interests in a joining entity.

Also, formation time adjustments to interests (e.g. membership and debt interests) held in a chosen transitional entity are not required because the allocable cost amount method is not used to calculate the tax value of its assets.

The comments above also apply to membership interests and debts the head company has in a joining entity where they are direct or indirect interests in a company that had an alteration time.

Alteration time during consolidation

Division 715 ensures that the loss integrity principles in Subdivision 165-CD apply to consolidated groups by extending the scope of the single entity rule in section 701-1(1) and the entry history rule in section 715-5 for all the purposes of Subdivision 165-CD. The broad effects of this extension of the single entity principle are that:

- only the head company of a group can have a Subdivision 165-CD alteration time, and
- only interest in the head company will be subject to reductions and other consequences under Subdivision 165-CD.

The head company will be the only loss company for Subdivision 165-CD purposes. However, because the loss company calculation embraces the single entity principle it will be necessary to include the assets and losses of all of its subsidiaries in the calculation.

Either the individual asset method or global method of working out the adjusted unrealised loss in Subdivision 165-CD can be used to work out whether the head company is a loss company.

Where the head company meets the loss company criteria, adjustments are made to the direct and indirect interests of certain controlling entities in the head company. Although no adjustments are made to membership interests in each subsidiary, there can be consequences when entities leave the consolidated group.

Company leaving a consolidated group

When a leaving entity has an alteration time and is a loss company – section 715-255

Where a company leaves a consolidated group it will be necessary to ensure that loss duplication is appropriately prevented when recognition of the membership interests in the leaving entity are resumed under Division 711.

Step 1: Determine if there has been an alteration time for the leaving entity

(A) Ownership or control of a leaving entity has altered since the head company's last alteration time, or formation

Broadly, if there is a change in ownership of 50% or more or a change in control of a leaving entity since the later of the head company's last alteration time or formation, the leaving entity has an alteration time at the leaving time as set out in section 715-245.

(B) The head company has had an alteration time but ownership and control of the leaving entity has not altered since

Broadly, where the head company has had at least one alteration time since the group formed, and there have not been changes in ownership of 50% or more or changes in control of the leaving entity since that time, the leaving time is taken to be an alteration time.

For the purpose of determining the leaving entity's next alteration time after it leaves the group, the reference time under subsections 165-115L(2) or 165-115M(2) is the time just after the most recent alteration time for the head company before the subsidiary left the group.

Step 2: Determine whether the leaving company is a loss company

A leaving company is considered to be a loss company: Where the leaving time is an alteration time as outlined in step 1(A), the leaving company is a loss company if it has an adjusted unrealised loss in respect of the assets it leaves with (section 715-245).

Where the leaving time is an alteration time as outlined in step 1(B), the leaving company is a loss company if the head company had an adjusted unrealised loss at its most recent alteration time. Only assets held by the head company at its most recent alteration time and that leave with the leaving company are taken into account in working out the adjusted unrealised loss.

Consequences of the leaving entity being a loss company

Where the leaving entity has an alteration time at the leaving time and it is a loss company, the head company must choose whether to:

- reduce the cost setting amount of membership interests just before leaving to nil, or

- reduce the cost setting amount of the membership interests just before the leaving time by making an adjustment worked out under section 165-115ZB as modified by subsection 715-255(3).

The head company's choice must be made within six months after the leaving time, or a further period allowed by the Commissioner. After the relevant period and unless it can be established otherwise the head company is taken to have chosen to reduce the cost setting amounts just before the leaving time to nil.

Where a member of the group holds rights or options created or issued by the leaving entity to acquire membership interests in the leaving entity, those assets are treated as if they are membership interests in the leaving entity; and of a different class to any other membership interest in the leaving entity.

Reference time of a leaving company if no alteration time occurs when it leaves a consolidated group – section 715-260

Where the head company has not undergone an alteration time since formation of the group and before a particular subsidiary leaves the group, and the leaving time is not an alteration time for the leaving entity, section 715-260 sets out how the leaving entity determines its first post-leaving alteration time and the associated reference time. To facilitate the process the additional assumptions in section 715-290 must also be made.

Trust leaving a consolidated group

The assets and losses of a trust that is a member of a consolidated group are subject to Subdivision 165-CD because they are treated as those of the head company under the single entity rule.

When a trust leaves a consolidated group it is treated as a company at that time and is deemed to have an alteration time.

The trust is treated as a loss company at the leaving time if it has an adjusted unrealised loss at that time.

Where the trust is a *loss company* the head company must make a choice about the reductions it will make in respect of the membership interests in the trust.

Broadly, just before leaving time the head company can choose to reduce the cost setting amount of the interests to nil (subsection 715-270(6)) or make an adjustment under section 165-115ZB as modified by section 715-270(7).

If a choice is not made within six months or further period allowed by the Commissioner, it is assumed that the head company's choice was to reduce the tax cost setting amounts to nil.

Note that rights and options are treated as membership interests but will be treated as a different class of membership interests.

References

Income Tax Assessment Act 1997:

- Divisions 705, 701
- Subdivision 165-CD

New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003), Subdivision 715-B

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

Income Tax Assessment Act 1997, section 165-115ZC; as amended by *Taxation Laws Amendment (2004 Measures No. 6) Act* (No. 23 of 2005), Schedule 1, Part 6

Income Tax (Transitional Provisions) Act 1997, section 165-115ZC; as amended by *Taxation Laws Amendment (2004 Measures No. 6) Act* (No. 23 of 2005), Schedule 1, Part 6

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 6) Bill 2004, paragraphs 1.168 – 1.182

Revision history

Section C2-6-130 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on proposed changes to consolidation rules.	Proposed legislative amendments.
26.10.05	Changes to notice requirements, p. 1.	Legislative amendment.

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).