

Effect of Subdivision 165-CD for MEC groups

Subdivision 715-215 of the ITAA 1997 extends the single entity principle and the entry history rules in sections 701-1 and 701-5 to enable the principles in Subdivision 165-CD to apply to multiple entry consolidated (MEC) groups. To take the special characteristics of MEC groups into account, additional alteration times are provided by Subdivision 719-T to ensure that appropriate adjustments under Subdivision 165-CD can be made.

Modified reference and alteration times

To enable Subdivision 165-CD to apply appropriately, Subdivision 719-T provides a number of modifications. These include:

- modifications to the reference times in sections 165-115L and 165-115M to enable the head company of a MEC group to work out if it has an alteration time under Subdivision 165-CD
- additional alteration times for the head company where:
 - (a) a potential MEC group ceases to exist and just before that time the potential MEC group's membership was the same as the membership of the MEC group
 - (b) something happens in relation to certain membership interests in one or more of the following entities:
 - a member of a MEC group that is an ET-1 company of the top company
 - an entity interposed between an ET-1 company and the top company

and the event does not cause the relevant potential MEC group to cease to exist, but it does cause the identity of the top company of the potential MEC group to change
 - (c) the MEC group ceases because there ceases to be a provisional head company, and
 - (d) an event that triggers pooling happens.

To facilitate the application of Subdivision 165-CD, Subdivision 719-T:

- requires that while the MEC group exists an assumption is made that the top company beneficially owns and controls all the membership interests in the head company regardless of which entity actually owns the interests (→ subsection 719-720(5)), and
- deems a number of occurrences to be alteration times for the purposes of Subdivision 165-CD.

Subdivision 165-CD applies where an alteration time occurs in respect of a loss company. There can be an alteration time for Subdivision 165-CD purposes where certain changes in control or ownership in a loss company occur or a liquidator of a loss company declares that shares in the company are worthless. The additional alteration times for MEC groups ensure the integrity of the system by facilitating appropriate adjustments to certain membership and debt interests of entities that are direct and indirect interests in the top company of a MEC group and, where Subdivision 719-K applies, to 'pooled' interests.

Modifications

The following changes enable sections 165-115L and 165-115M in Subdivision 165-CD to apply on their normal terms to MEC groups.

Modification 1

Section 719-720 overrides the reference times in subsections 165-115L(2) and 165-115M(2) for the purpose of working out if the head company of a MEC group has an alteration time under Subdivision 165-CD. The broad effect is that a change in ownership or control of a head company will be determined using the reference time in subsection 719-720(2) and the assumptions in subsection 719-720(5). Broadly, the effect of the assumption is that the top company beneficially owns and controls the head company.

Subsection 719-720(2), redefines the reference time for the head company as:

- when the group came into existence – for the purpose of working out the head company's first alteration time after formation, or
- just after the head company's last alteration time – in all other cases.

The alteration times resulting from this modification will only be relevant for direct and indirect equity or loan interests in the top company of a MEC group that are relevant equity interests or relevant debt interests in the head company of that group just before alteration time.

Additional alteration times

Additional alteration times for the head company of a MEC group are provided in section 719-725 and are based on the change in ownership rules in section 719-280.

Modification 2

(a) Certain potential MEC groups cease to exist

The head company has an alteration time when a potential MEC group ceases to exist if, just before the group ceased to exist, the potential MEC group's membership was the same as the membership of the MEC group.

The alteration times resulting from this modification will only be relevant for direct and indirect equity or loan interests in the top company of a MEC group that are relevant equity interests or relevant debt interests in the head company of that group just before alteration time. (Note that modification 3 below may also apply to adjust 'pooled' interests under Subdivision 719-K.)

(b) *The head company of a MEC group has an alteration time where something happens to certain membership interests in ET-1 companies and interposed entities*

An alteration time for the head company of a MEC group occurs where:

- something happens to the membership interests in an ET-1 company of the top company or an entity interposed between an ET-1 company and the top company, and
- the potential MEC group (whose membership is the same as the MEC group) does not cease to exist, but there is a change in the identity of the top company of the potential MEC group.

The alteration times resulting from this modification will only be relevant for direct and indirect equity or loan interests in the top company of a MEC group that are relevant equity interests or relevant debt interests in the head company of that group just before alteration time. (Note that modification 3 below may also apply to adjust 'pooled' interests under Subdivision 719-K.)

(c) *An alteration time occurs where a MEC group ceases to exist because there ceases to be an entity eligible to be the provisional head company.*

The alteration times resulting from this modification will only be relevant for direct and indirect equity or loan interests in the top company of a MEC group that are relevant equity interests or relevant debt interests in the head company of that group just before alteration time. (Note that modification 3 below may also apply to adjust 'pooled' interests under Subdivision 719-K.)

Modification 3 – pooling triggered

There is also an alteration time if an event that triggers pooling occurs. The alteration time is just before the thing happens that triggers pooling. In these circumstances, the usual adjustments under sections 165-115ZA and 165-115ZB of Subdivision 165-CD do not apply.

The cost setting rules in Subdivision 719-K are used in reducing the reduced cost base of the pooled interests. Note that it is only pooled interests that are affected by this alteration time – all other interests in the group are unaffected.

Broadly, what would, apart from section 719-735, be a pooled cost amount for the purpose of the formulas in section 719-570(1) and (2), is reduced by the amount of the head company's overall loss under section 165-115R or 165-115S at the alteration time. Note that paragraph 719-735(2)(a) only affects the application of those formulas because of subsection 719-570(3) (to work out the reduced cost base of a membership interest). Note also that the usual 10% relevant equity interest rule does not apply.

Note that in some circumstances direct and indirect equity and loan interests in MEC groups not covered by the above provisions may be covered by the loss reduction method – for example, equity interests held by the top company in an entity interposed between it and an ET-1 company of the MEC group.

→ "Application of the loss reduction method to consolidated and MEC groups", C2-6-160

References

Income Tax Assessment Act 1997:

- Division 705
- Subdivisions 165-CD and 719-K

New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003), Schedule 11 Division 715 and Subdivision 719-T

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