

Worked example

Pooling of excess foreign tax credits

Description This example shows how the excess foreign tax credits (FTCs) of a joining entity are transferred to the head company of the group and may subsequently be used by the head company.

Commentary A resident entity is entitled to a foreign tax credit where its assessable income for an income year includes foreign income on which it has paid foreign tax and for which it was personally liable → section 160AF, *Income Tax Assessment Act 1936*. If the foreign tax paid on a particular class of foreign income exceeds the Australian tax payable on the relevant foreign income, the excess FTCs can be carried forward for up to five years to be offset against Australian tax payable on foreign income of that class → section 160AFE, *Income Tax Assessment Act 1936*. After this time the excess FTCs are lost.

Under the single entity principle, the head company is assessed on foreign income derived by the group. Consequently it must have access to all FTCs of members of the group. To achieve this, all excess FTCs of members joining or forming the group are transferred to the head company and any foreign tax paid by a member of the consolidated group is held to have been paid by the head company.

The transferred FTCs are pooled with other excess FTCs of the group according to the class of foreign income and the income year in which they arose. They remain with the head company if the transferor leaves the group. Excess FTCs transferred from a joining entity cannot be used by the head company until the income year following that in which the entity became a member of the group, unless the joining time is at the start of the head company's income year.

Note

Transitional provision for using transferred excess FTCs

Transitional provisions operating from 1 July 2002 to 30 June 2004 enable wholly-owned groups to use excess FTCs of group members at the end of the income year in which the consolidated group is formed, rather than in the following year as under the general rules, subject to certain conditions.

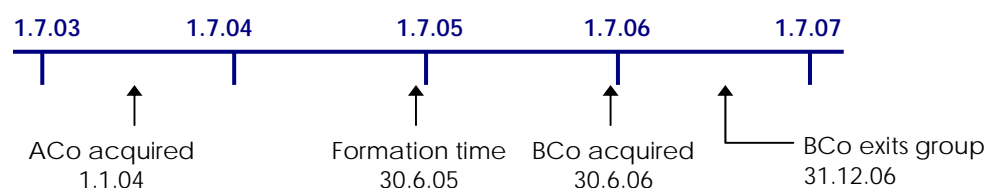
→ 'Treatment of foreign tax credits and attribution surpluses', C6-1

Example

Facts

As shown in figure 1, HCo (the head company) acquires all the membership interests in ACo on 1 January 2004. It chooses to form a consolidated group on 30 June 2005. On 30 June 2006, HCo acquires all the membership interests in BCo, which immediately becomes part of the consolidated group. HCo disposes of all its interests in BCo on 31 December 2006, at which time BCo leaves the group. All three companies have an income year ending 30 June.

Figure 1: Timeline of events



The excess FTCs of HCo and ACo immediately before the group's formation time of 30 June 2005 are shown in tables 1 and 2 respectively.

The excess FTCs held by BCo immediately before the joining time are shown in table 3.

Table 1: Excess FTC balances of HCo

	Year excess credits arose				
	2001	2002	2003	2004	2005
Passive income		\$36		\$53	
Other income					

Table 2: Excess FTC balances of ACo

	Year excess credits arose				
	2001	2002	2003	2004	2005
Passive income	\$75	\$24		\$19	\$88
Other income			\$217		\$101

Table 3: Excess FTC balances of BCo

	Year excess credits arose					
	2001	2002	2003	2004	2005	2006
Passive income		\$32		\$57	\$48	\$33
Other income	\$80	\$4	\$62		\$50	\$97

Assume that the excess FTCs are not used by HCo to offset the Australian tax payable on foreign income of the group derived after consolidation.

Calculation

ACo becomes a member of HCo's consolidated group before the start of HCo's 2006 income year. The five-year limit for carrying forward excess FTCs has not been exceeded. This means all ACo's excess FTCs (transfer credits) are available to HCo to be used to offset the Australian tax payable on foreign income of the group assessable at the end of the 2006 income year.

BCo has not become a member of the consolidated group before the start of HCo's 2006 income year. This means the only excess FTCs available to be used by HCo at the end of its 2006 income year are its own and those transferred by ACo – that is, the balances shown in table 4.

Table 4: Pooled excess FTCs of HCo (available at 30 June 2006)

		Year excess credits arose				
		2001	2002	2003	2004	2005
Passive income	HCo		\$36		\$53	
	ACo	\$75	\$24		\$19	\$88
	Total	\$75	\$60		\$72	\$88
Other income	HCo					
	ACo			\$217		\$101
	Total			\$217		\$101

However, BCo becomes a member of the consolidated group before the start of HCo's 2007 income year. This means the excess FTCs transferred from BCo that arise in the 2002 to 2006 income years are now available to be used by HCo at the end of its 2007 income year. They are available despite the fact that BCo leaves the group before the end of that income year. The excess FTCs that arise in the 2001 income year that have not been or are unavailable to be used by HCo at the end of its 2006 income year exceed the five-year carry-forward limit for excess FTCs and are lost.

Therefore, the excess FTCs available to HCo at the end of its 2007 income year are as shown in table 5.

Table 5: Pooled excess FTC balances of HCo (available at 30 June 2007)

		Year excess credits arose				
		2002	2003	2004	2005	2006
Passive income	HCo	\$36		\$53		
	ACo	\$24		\$19	\$88	
	BCo	\$32		\$57	\$48	\$33
	Total	\$92		\$129	\$136	\$33
Other income	HCo					
	ACo		\$217		\$101	
	BCo	\$4	\$62		\$50	\$97
	Total	\$4	\$279		\$151	\$97

References

Income Tax Assessment Act 1936, sections 160AF and 160AFE – as amended by:

- *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 10
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 15

Income Tax Assessment Act 1997, Division 717, Subdivision 717-A; as amended by *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 6

Income Tax Assessment Act 1997, Division 717; as amended by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2

Income Tax (Transitional Provisions) Act 1997, Division 717; as amended by *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 9

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, Chapter 3

Revision history

Section C6-2-110 first published (excluding drafts) 2 December 2002.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Recent changes to consolidation rules.	Legislative amendments.
3.11.04	Clarify timing of use of transferred FTCs.	Reflect amendments in <i>Tax Laws Amendment (2004 Measures No. 2) Act 2004</i> (83 of 2004).
	Remove 14.7.04 note on recent changes to consolidation rules.	Text amended to reflect the changed rules.

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).