

Single entity treatment

When a consolidated group is formed, the group is treated as a single entity for income tax purposes¹. Broadly, this means that on joining a consolidated group the subsidiary members lose their individual income tax identities and are treated as parts of the head company of the consolidated group (rather than as separate entities) for the purposes of determining the head company's income tax liability.

In effect, the consolidated group is treated as if it were a single divisional company. Intragroup assets and liabilities and intragroup transactions have no income tax consequences. The head company is the only entity the income tax law recognises for the purposes of working out the group's income tax liability or losses.

Some of the consequences of the single entity rule for the income tax treatment of consolidated groups are:

- the head company lodges a consolidated income tax return – subsidiary members no longer lodge returns
- the assets and liabilities of subsidiary members are treated as if they were assets and liabilities of the head company
- the actions of subsidiary members in respect of entities outside the group (e.g. acquisition or disposal of assets) are treated as if they had been undertaken by the head company
- intragroup transactions are ignored for income tax purposes
- where an intragroup asset² is sold to an entity outside the group, it is treated in accordance with its economic substance from the point of view of the group as a whole
- a group company can be liquidated without the possibility of triggering either a deemed dividend or a capital gain or loss, and
- generally, the income tax law will apply to the head company of the consolidated group (of which subsidiary members are treated as parts) in the same way as to any single company.

Note

Proposed changes to consolidation rules

Proposed changes to consolidation rules will clarify the tax treatment of debts owed to a company before it joins a consolidated group that are written off as bad after the joining time – see Treasury Position Paper No. 16, *Interaction between consolidation and bad debt rules* on the Consolidation CD or at www.treasury.gov.au

¹ Section 701-1 ITAA 1997.

² That is, an asset that exists because of a transaction between group members.

This section describes the consequences of single entity treatment for:

- trading stock
- interest paid by a head company for funds on-lent to a subsidiary, and
- the sale of an intragroup asset to a non-member.

Trading stock

In a consolidated group, assets that were previously held by individual members as trading stock may change character in the hands of the head company. This is because the assets of all members of a consolidated group become the assets of the head company and the purpose for which they are held is determined by reference to the economic substance for the group as a whole.

For example, depending on the purpose for which the asset is taken to be held by the head company, the asset could be treated for income tax purposes as a consumable (if the trading stock is held for sale only within the consolidated group), a CGT asset or a depreciating asset.

Deductibility of interest

Where a holding company borrows money to lend to a subsidiary, the basis of deductibility of interest paid by the holding company differs in consolidated and non-consolidated situations, although the result may be the same. In a consolidated group, intragroup transactions have no income tax consequences. The deductibility of interest paid to a non-member is determined by looking at the economic substance for the group as a whole of the purpose of the loan and the use to which it is put – that is, income tax law applies to the interest as if the head company was a single company undertaking the borrowing.

→ 'Single entity treatment – deductibility of interest', C9-5-220 (worked example)

Sale of intragroup asset to non-member

A transaction between group members may give rise to an 'intragroup asset', such as an option, interest stream or debt. When an intragroup asset is sold or assigned to an entity outside the consolidated group, there are no income tax consequences from the transaction that gave rise to the intragroup asset but the transaction with the outside party is recognised for the purposes of working out the head company's income tax.

The transaction with the outside party is treated according to its economic substance for the group as a whole, without regard to internal transactions. From this perspective, the asset is treated as if it is newly created when sold or assigned outside the group. The asset may therefore be treated (for the purposes of working out the head company's income tax) as something different from its legal form for non income tax purposes.

→ 'Single entity treatment – sale of intragroup asset to non-member', C9-5-230

Note

Sale of membership interests

Special rules apply where membership interests in a subsidiary member are sold to a non-member by the head company.

Is the head company 'in the business' of the subsidiary?

One result of the single entity rule, and of the consequent ignoring of intragroup transactions, is that businesses undertaken by a subsidiary may not be recognised as being carried on by the head company. Where a subsidiary's business involves solely intragroup activity, it will not be relevant to working out the head company's income tax.

For example, a consolidatable group may include a subsidiary that is a finance company and conducts a business of lending exclusively to other entities in the group.

When the group consolidates, the intragroup lending activity does not have any income tax consequences. The head company of the group is not treated as carrying on the business of a finance company for the purpose of working out its income tax position, and the character of its assets and liabilities held through the finance company is determined from the perspective of the head company.

Note

More information

- 'Single entity treatment – deductibility of interest', C9-5-220 (worked example)
- 'Single entity treatment – sale of intragroup asset to non-member', C9-5-230 (worked example)

References

Income Tax Assessment Act 1997 – as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), section 701-1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 2

Revision history

Section C9-1-110 first published 3 December 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on proposed changes to consolidation rules, p. 1.	Proposed legislative amendments.

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).