Worked example

Capital allowances – *with* accelerated depreciation

Description

This example shows how an accelerated depreciation asset brought into a consolidated group by a joining subsidiary is treated for capital allowances purposes.

Commentary

When an entity becomes a member of a consolidated group the tax costs of its assets are set under the cost setting rules (other than when the transitional option of retaining existing tax values has been applied).

When the tax cost of a depreciating asset is set, certain capital allowances provisions[1] apply as if certain things had happened in relation to the asset's date of acquisition and cost at that date, the method used for working out the asset's decline in value, and its effective life. → paragraphs 701-55(2)(a), (b) and (e), *Income Tax Assessment Act 1997* (ITAA 1997)

These deemed occurrences override the entry history rule. → 'Introduction to consolidation', B0-2

Under the capital allowances provisions, accelerated depreciation may be used where a depreciating asset was acquired before 11:45 am, ACT time, on 21 September 1999. However, this basic requirement is no longer met where a depreciating asset is taken to have been acquired by the head company at the joining time. The core rules therefore contain an exception to allow the head company to preserve accelerated depreciation under the following conditions:

- the asset was acquired by the joining entity at or before 11:45 am, ACT time, on 21 September 1999, and
- the asset's tax cost setting amount is not more than its terminating value.

→ section 701-80, ITAA 1997

Where the tax cost setting amount is more than the terminating value of the asset, the cost setting rules allow the head company to choose a tax cost setting amount equal to the terminating value. This means that the head company is able to bring the asset within the accelerated depreciation exception in the core rules. However, the head company must forfeit the excess from the original tax cost setting amount and cannot reallocate it among other assets. → section 705-45, ITAA 1997

Note: Where a head company chooses the transitional option for a transitional entity, the tax costs of the entity's assets are not reset under the cost setting rules. Because of the entry history rule, the head company is taken to have done everything in relation to the entity's depreciating assets that the entity did. A depreciating asset's date of acquisition, method of working out decline in

[1] Subdivisions 40-A to 40-D, sections 40-425 to 40-445 and Subdivision 328-D, ITAA 1997

value, effective life and adjustable value will be the same for the head company just after the joining time as they were for the joining entity just before the joining time, with the result that any accelerated depreciation is not lost. The following treatment does *not* apply to such assets.

Example

Facts

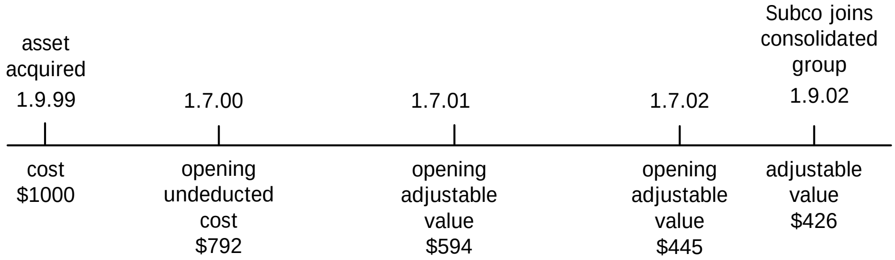
SubCo, a 90%-owned subsidiary of HeadCo, acquires depreciating Asset A on 1 September 1999 at a cost of $1000. The effective life of the asset is 10 years. SubCo chooses to depreciate the asset using the diminishing value method and applies the accelerated depreciation rate of 25%.

HeadCo chooses to consolidate on 1 July 2002.

On 1 September 2002, HeadCo acquires the remaining 10% of SubCo's shares, bringing SubCo into the consolidated group.

The adjustable value of Asset A in SubCo's hands just before it joins the consolidated group is $426. → figure 1

Figure 1



The adjustable value just before the joining time is Asset A's terminating value.

→ subsection 705-30(3), ITAA 1997

HeadCo calculates a tax cost setting amount for Asset A of $440 under Division 705.

Capital allowances treatment

When HeadCo sets the tax cost of Asset A, the capital allowances provisions operate as if:

- HeadCo acquired Asset A on 1 September 2002 for a payment equal to its tax cost setting amount of $440
- the diminishing value method were chosen, and
- Asset A's effective life were the same as in the hands of SubCo – 10 years.

→ paragraphs 701-55(2)(a), (b) and (e), ITAA 1997

Accelerated depreciation

For HeadCo to preserve accelerated depreciation for Asset A, the section 701-80 exception conditions must be met (→ p. 1); that is:

- the asset must have been acquired by the joining entity at or before 11:45 am, ACT time, on 21 September 1999, and
- the asset's tax cost setting amount must not exceed its terminating value.

In the case of Asset A, the first condition is met.

The second condition is not met because Asset A's tax cost setting amount of $440 is more than its terminating value of $426.

Even though the second condition is not met initially, HeadCo can choose under section 705-45 of the ITAA 1997 to limit Asset A's tax cost setting amount to its terminating value.

Scenario 1

HeadCo chooses to apply section 705-45 and limit the tax cost setting amount for Asset A to $426. The excess of $14 from the original tax cost setting amount of $440 is forfeited and cannot be reallocated to other assets.

Because both of its conditions are now met, the exception at section 701-80 applies. Under this provision, the component of the formula in subsection 40-70(1) of the ITAA 1997 that includes the asset's effective life is substituted with the accelerated depreciation rate used by SubCo.

For the 2003 income year, HeadCo will work out Asset A's decline in value under the formula in subsection 40-70(1), modified to include the accelerated depreciation rate of 25% and based on the reduced tax cost setting amount:

$$\$426 \quad \times \frac{303 \text{ days}}{365 \text{ days}} \times \quad 25\% \quad = \quad \$88 \textit{ rounded}$$

Scenario 2

HeadCo does not choose to apply section 705-45. The original tax cost setting amount of $440 for Asset A is retained.

The conditions for the exception at section 701-80 are not met and HeadCo cannot apply accelerated depreciation to Asset A.

For the 2003 income year, HeadCo will work out Asset A's decline in value under subsection 40-70(1) based on the original tax cost setting amount of $440 and an effective life of 10 years as follows:

$$\$440 \quad \times \frac{303 \text{ days}}{365 \text{ days}} \times \frac{150\%}{10 \text{ years}} = \$55 \textit{ rounded}$$

References

Income Tax Assessment Act 1997, Subdivisions 40-A to 40-D, sections 40-425 to 40-445, Subdivision 328-D

Income Tax Assessment Act 1997, sections 701-5, 701-10; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (68 of 2002), Schedule 1

Income Tax Assessment Act 1997, sections 701-55, 701-80, 705-30, 705-45; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 2

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraphs 2.53, 2.78–80

Income Tax (Transitional Provisions) Act 1997, section 701-15; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7