Worked example

Consumables brought into a group (cost setting case)

Description

This example illustrates how the head company treats consumables that are brought into the group by a joining entity under the cost setting rules in Division 705.

Note

The case where a chosen transitional entity brings consumables into a consolidated group at their existing tax values is dealt with separately.
→ 'Consumables brought into a group (transitional option)' C9-5-341

Commentary

The income tax treatment of assets commonly referred to as 'consumables' is not expressly provided for by the ITAA. True consumables are things that are destroyed or cease to exist as soon as they are used, such as fuel. They are not depreciating assets as defined in subsection 40-30(1). They are also distinguished from trading stock which includes raw materials and other assets, such as parts, that are incorporated into a final product. While consumables fall within the definition of CGT assets, expenditure on them is often of a revenue nature.

It has been the Commissioner's practice, as espoused in *Taxation Ruling* IT 333, to allow a deduction for consumables on either an incurred basis or a usage basis, depending upon the circumstances. Where consumables are acquired to meet current needs, deductions may be claimed in the income year in which the expenditure was incurred (typically this will be where they have a relatively short life, e.g. 3 months, or where the quantity held is sufficient only to enable the business to be carried on efficiently). Where the taxpayer builds up a store or stockpile of consumables in excess of normal requirements, deductions may be claimed only as the consumables are used up. → *Taxation Ruling* IT 333

Apart from the transitional option under Division 701 of the *Income Tax (Transitional Provisions) Act 1997*, an asset of a joining entity has its tax cost reset at the joining time at the asset's tax cost setting amount. The setting of the tax cost at the tax cost setting amount has different implications for different purposes under the Act. → section 701-55, ITAA 1997

When a consumable is brought into a consolidated group and has its tax cost reset, for deductibility purposes this means its cost is equal to its tax cost setting amount. → subsection 701-55(6), ITAA 1997

For CGT purposes, setting the consumable's tax cost means that its cost base or reduced cost base is increased or reduced at the joining time to an amount equal to its tax cost setting amount. → subsection 701-55(5), ITAA 1997

Note

A consumable is *not* a revenue asset since its cost, rather than a net loss, is allowed as a deduction. Unlike trading stock, depreciating assets and revenue assets, the tax cost setting amount of a consumable is *not limited* to the greater of its market value or its terminating value. → sections 977-50, 705-40, ITAA 1997

Incurred basis

When a consumable becomes an asset of the head company at the joining time under the single entity rule and has its tax cost reset, the head company does not become entitled to deduct its cost.

In order to be entitled to a deduction under section 8-1, the head company must have incurred a loss or outgoing in respect of the consumable. The mere fact that the tax cost of the consumable is reset at the joining time does not mean that the head company has incurred that cost.

A loss or outgoing in respect of consumables acquired to meet current needs is incurred when the consumables are initially acquired. Consequently, a loss or outgoing in respect of them cannot also be incurred at a later time. This is confirmed by the entry history rule under which the head company is taken to have claimed a deduction for the consumable on an incurred basis.

For the purposes of the CGT provisions, the cost base or reduced cost base of the consumable is increased or reduced at the joining time to an amount equal to its tax cost setting amount. → subsection 701-55(5), ITAA 1997

When the consumable is used up, CGT event C1 occurs and, since the capital proceeds are nil, there is a capital loss to the head company equal to the consumable's reduced cost base.

Usage basis

For the reasons as given above, the head company does not become entitled at the joining time to deduct the cost of the consumable.

Under the entry history rule, the asset is taken to be a consumable of the head company in respect of which there has been no prior deduction. When the consumable is used up, the head company is entitled to a deduction for its cost. Its cost is an amount equal to its tax cost setting amount.

Note

- The head company's deduction cannot exceed the tax cost setting amount even if the original cost of the item was greater.
- Entitlement to a deduction reduces the reduced cost base of the asset to nil so that when the asset is used up there is no capital loss to the head company.

When the consumable is used up, CGT event C1 occurs. However, the consumable's reduced cost base is reduced to nil under the CGT cost base rules because of the head company's entitlement to the deduction. → sections 110-45, 110-55, ITAA 1997

> **Note**
>
> Different rules apply to assets acquired at or before 7.30 pm on 13 May 1997. → section 110-40, ITAA

There is no capital loss to the head company.

Example 1: incurred basis

Facts

Subco is a wholly-owned subsidiary of Headco. The two entities comprise a consolidatable group.

On 1 June 2003, Subco acquires a quantity of fuel for use in its transport business for $10,000. It deducts its expenditure on fuel on an incurred basis.

Headco chooses to consolidate with effect from 1 July 2003 but does not apply the transitional option to Subco. Headco therefore must reset the tax cost of all the assets of Subco that are taken to become its assets because of the single entity rule.

One quarter of the fuel remains unused at the joining time. Subco's terminating value for the fuel is $0. → subsections 705-30(5) and 110-45(2)

The market value of the remaining fuel at the joining time is $2,650.

Under the cost setting rules, Headco works out a tax cost setting amount for the fuel of $3,000.

Subco's 2002-03 income tax return

In completing its income tax return for the 2002-03 income year, Subco is entitled to deduct $10,000 for its expenditure on the fuel.

Headco's 2003-04 income tax return

Headco has incurred no expenditure for the fuel and cannot claim a deduction at the joining time.

Under the entry history rule, Headco is taken to have acquired the remaining fuel on 1 June 2003 and to have claimed a deduction in respect of it.

> **Note**
>
> Only history that is relevant for the head company core purposes is inherited under the entry history rule.

Because Headco is taken to have already deducted the cost of the fuel on an incurred basis, it cannot also claim a deduction when the fuel is used up after consolidation.

The fuel is a CGT asset to which the CGT provisions apply. Its reduced cost base is increased to $3,000 at the joining time on 1 July 2003. → subsection 701-55(5)

When the fuel is used up, CGT event C1 happens. There is a capital loss to Headco equal to the difference between the reduced cost base ($3,000) and the capital proceeds (nil).

There is a capital loss to Headco of $3,000.

Example 2: usage basis

Facts

Subco is a wholly-owned subsidiary of Headco. The two entities comprise a consolidatable group.

On 21 June 2003, Subco acquires a consumable at a fire sale for $500 and stockpiles it for use in its business. This expenditure is deductible on a usage basis.

Headco chooses to consolidate with effect from 1 July 2003 but does not apply the transitional option to Subco. Headco therefore resets the tax cost of Subco's assets under the cost setting rules.

The consumable remains stockpiled at the joining time. Subco's terminating value for the asset is $500.

The market value of the consumable at the joining time is $600.

Headco works out a tax cost setting amount for the consumable of $580.

The consumable is used up in the 2003-04 income year.

Subco's 2002-03 income tax return

As Subco is not entitled to claim a deduction for the expenditure until it uses the consumable, the expenditure is not deductible to Subco.

Headco's 2003-04 income tax return

Headco has incurred no expenditure for the consumable and cannot claim a deduction at the joining time.

Under the entry history rule, Headco is taken to have acquired the consumable on 21 June 2002 and to have held it up to the joining time as deductible on a usage basis.

For deductibility purposes, the cost of the consumable to Headco is its tax cost setting amount of $580.

When the consumable is used, its tax cost is deductible to Headco. Headco is entitled to a deduction of $580.

For the purposes of the CGT provisions, the consumable's cost base or reduced cost base is increased to $580 at the joining time. However, when the consumable is used up, the reduced cost base is reduced to the extent of the deduction, that is, by $580. The asset's reduced cost base after the joining time is therefore reduced to nil.

When the consumable is used up, CGT event C1 occurs. Since there are nil capital proceeds from the destruction of the asset and its reduced cost base is nil, there is no capital loss to Headco.

References

New Business Tax System (Consolidation) Act (No. 1) 2002 (No. 68 of 2002)

New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002 (No. 117 of 2002)

Income Tax Assessment Act 1997, sections 110-45, 701-5, 701-55, 705-40, 977-50

Revision history

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