

Worked example

Consumables brought into a group (transitional option)

Description This example illustrates how the head company treats consumables that are brought into the group by a joining entity under the transitional option in Division 701 of the *Income Tax (Transitional Provisions) Act 1997*.

The example assumes that a consumable was acquired after 7:30 pm on 13 May 1997.

Commentary For general commentary on the income tax treatment of consumables, refer to the Commentary in the worked example for the cost setting case.

→ 'Consumables brought in a group (cost setting case)', C9-5-340

Where a head company chooses to treat a transitional entity as a chosen transitional entity under Division 701 of the *Income Tax (Transitional Provisions) Act 1997*, all the entity's assets are brought into the group at their existing tax values. This is because section 701-10, which resets the tax cost of assets, does not apply. → section 701-15, IT(TP) Act 1997

By virtue of the entry history rule, consumables of a chosen transitional entity retain their existing tax costs on becoming assets of the head company under the single entity rule.

Note

The rules in section 701-55, which override the entry history rule, have no application unless an asset's tax cost is set at its tax cost setting amount.

Incurred basis Under the entry history rule, for the head company core purposes, everything that happened to the joining entity prior to the joining time is taken to have happened to the head company. → section 701-5, ITAA 1997

This means that a consumable on hand at the joining time is taken to have been acquired by the head company at its original acquisition time and for the same cost. Any deduction claimed by the joining entity is likewise taken to have been claimed by the head company.

Where a joining entity has already deducted the cost of a consumable on the incurred basis, it follows that the head company is not entitled to claim any further deduction.

A consumable is also a CGT asset for CGT purposes. Under the CGT cost base provisions, its reduced cost base in the hands of the joining entity is reduced by the amount of the deduction claimed, resulting in a reduced cost base of nil. → 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

The head company inherits the reduced cost base of nil under the entry history rule. → section 701-5, ITAA 1997

When the asset is eventually used up, CGT event C1 produces no capital loss to the head company.

Usage basis

Where a joining entity has not previously claimed a deduction because it applied a usage basis to the consumable, the head company inherits this history

The head company is entitled to deduct its cost for the income year in which the consumable is used up.

Note

This is not an inherited deduction for the purposes of ACA step 7. Entitlement to the deduction does not arise until the consumable is used up.

There is no capital loss because the reduced cost base is accordingly reduced to nil as the consumables are used up. When the consumable is used up, CGT event C1 occurs. In applying the CGT provisions, the head company must reduce the reduced cost base of the consumable to the extent of any deduction to which it is entitled. → sections 110-45, 110-55, ITAA 1997

Example 1: incurred basis

Facts

Subco is a wholly-owned subsidiary of Headco. The two entities are 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.

One quarter of the fuel remains unused at the joining time. The cost to Subco of that fuel was \$2,500 (one quarter of \$10,000).

Headco consolidates the group with effect from 1 July 2003 and chooses to apply the transitional option to Subco so that Subco's assets are brought into the group at their existing tax costs.

Subco's 2002-03 income tax return

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

Headco's 2003-04 income tax return

Under the entry history rule, Headco is taken to have bought the fuel on hand at 1 July 2003 for \$2,500 on 1 June 2003 and to have deducted \$2,500 in respect of it.

It follows that Headco is not entitled to any further deduction.

Any CGT implications that might arise from the consumption of the asset are neutralised by its revenue treatment. Its reduced cost base at the joining time is nil and the capital proceeds from CGT event C1 are also nil.

Example 2: usage basis

Facts Subco is a wholly-owned subsidiary of Headco. The two entities are 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 and applies the transitional option to Subco so that Subco's assets are brought into the group at their existing tax costs.

All of the consumable remains stockpiled at the joining time.

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 the consumable is used up, the expenditure is not deductible to Subco.

Headco's 2003-04 income tax return

Under the entry history rule, Headco is taken to have acquired the consumable on 21 June 2003 at a cost of \$500 and to have held it up to the joining time as a consumable deductible on a usage basis. For deductibility purposes, the tax cost of the consumable to Headco remains at \$500.

When the consumable is used, its tax cost is deductible to Headco. Headco is entitled to a deduction of \$500.

Any CGT implications that might arise from the consumption of the asset are neutralised by its revenue treatment. Its reduced cost base is reduced to nil in the hands of Headco because of the deduction; the capital proceeds from CGT event C1 are also nil.

References

Income Tax Assessment Act 1997, sections 110-45, 110-55

Income Tax Assessment Act 1997, sections 701-5, 701-55, 705-40, 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
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 11

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- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 23

Income Tax (Transitional Provisions) Act 1997, section 701-15; as amended by

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 7
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 9

Revision history

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