Worked example

Application of the single entity rule to a consolidated group that includes a life insurance company

Description

Under consolidation, the single entity rule means that the head company of a consolidated group is the only entity recognised for income tax purposes. All subsidiary members are taken to be parts of the head company, rather than separate entities.

The application of this rule to a group that includes a life insurance company may affect the treatment of assets, held as virtual PST or segregated exempt assets, and the treatment of income generated by those assets.

This example shows the consequences of applying the single entity rule to a consolidated group that includes a life insurance company.

Commentary

Under section 701-1 of the ITAA 1997, the single entity rule treats all subsidiary members of a consolidated group as parts of the head company for income tax purposes. When one member is a life insurance company, the shares and units it holds in subsidiary entities are ignored and the assets and liabilities of subsidiary entities are treated as assets and liabilities of the head company. If, for the purposes of Division 320 of the ITAA 1997, the life insurance company's virtual PST assets (pre-consolidation) include membership interests in its own wholly-owned subsidiaries, the consequences of the life insurance company joining a consolidated group will be:

- the virtual PST component of the complying superannuation class of taxable income will include income derived from the underlying assets of subsidiary companies rather than dividend income derived from shares in the subsidiary companies
- the virtual PST component of the complying superannuation class of taxable income will include income derived from the underlying assets of subsidiary unit trusts rather than income derived from distributions made by these trusts
- the virtual PST assets of the head company will be the underlying assets of the subsidiary company and not the shares held in the subsidiary company, and
- the virtual PST assets of the head company will be the underlying assets of the subsidiary trust and not the units held in the subsidiary trust.

The same principle applies to the life insurance company's assets of the ordinary class of taxable income and to its segregated exempt assets.

If there is more than one life insurance company in the group, the head company maintains a single virtual PST and a single pool of segregated exempt assets on behalf of the group.

Example

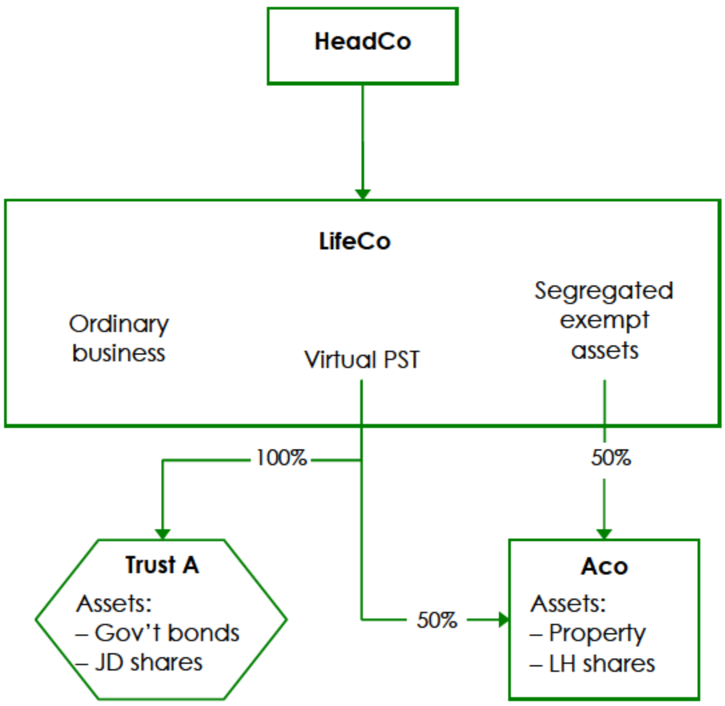
Facts

HeadCo beneficially owns 100% of the membership interests in LifeCo (an ordinary Australian-resident company), a life insurance company registered under the *Life Insurance Act 1995*.

LifeCo beneficially owns 100% of the membership interests in trust A (an Australian-resident fixed trust) and ACo (an ordinary Australian-resident company).

All of the membership interests in trust A are held by LifeCo as virtual PST assets. 50% of the membership interests in ACo are held by LifeCo as virtual PST assets. The remaining 50% of the membership interests are held as segregated exempt assets.

Figure 1: Pre-consolidation group structure



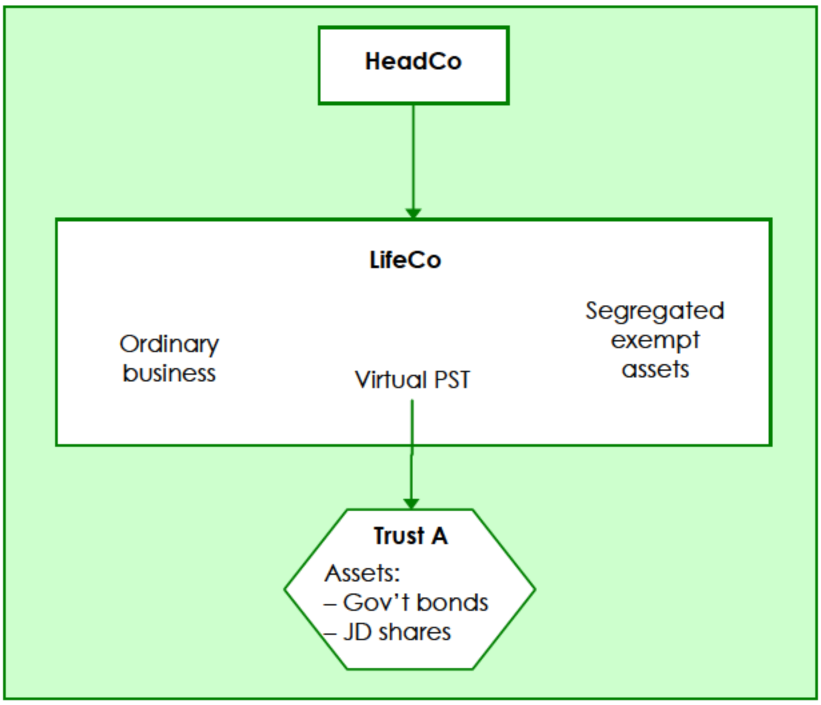
The application of Division 320 to the pre-consolidation group is shown in table 1.

Table 1: Application of Division 320 – pre-consolidation

Which entity is subject to Division 320 of the ITAA 1997 and other provisions of the income tax law that specifically relate to life insurance companies?	Each entity within the group is taxed as a separate entity. Division 320 only applies to life insurance companies registered under the *Life Insurance Act* and thus only applies to LifeCo.
Which assets may be segregated for the purposes of Division 320?	LifeCo may segregate the following assets: • membership interests in trust A and ACo as virtual PST assets, and • membership interests in ACo as segregated exempt assets.
What type of income is generated from these segregated assets?	The virtual PST assets generate distributions from trust A and dividends from ACo. The segregated exempt assets generate dividends from ACo.

If HeadCo chooses to consolidate, the consolidated group will include HeadCo, LifeCo and trust A. ACo cannot be a member of the consolidated group as the membership interests LifeCo holds in it are a mixture of virtual PST assets and segregated exempt assets. → section 713-510

Figure 2: The consolidated group



The application of Division 320 and the effect of the single entity rule on the consolidated group that includes LifeCo is outlined in table 2.

Table 2: Application of Division 320 – post-consolidation

Which entity is subject to Division 320 of the ITAA 1997 and other provisions of the income tax law that specifically relate to life insurance companies?	HeadCo is the only recognised income taxpayer in the consolidated group. HeadCo is treated as a life insurance company because LifeCo is a subsidiary member of the group. → section 713-505 Division 320 of the ITAA 1997 and other relevant income tax provisions apply to HeadCo because LifeCo is treated as part of HeadCo.
Which assets may be segregated for the purposes of Division 320?	Within a consolidated group, membership interests in subsidiary members are ignored. The head company of the group is taken to be the holder of the assets held by the subsidiary entity. Because HeadCo is treated as a life insurance company, and because of the single entity rule, HeadCo may segregate the following assets: • assets held by trust A (government bonds and JD shares) and 50% of the membership interests in ACo as virtual PST assets, and • the remaining 50% of the membership interests in ACo as segregated exempt assets.*
What type of income is generated from these segregated assets?	The virtual PST assets generate interest from government bonds, dividends from JD Shares and dividends from ACo. The segregated exempt assets generate dividends from ACo.

* Because ACo is not a member of this consolidated group, the respective membership interests in it are recognised as virtual PST assets and segregated exempt assets.

References

Income Tax Assessment Act 1997, Division 320

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

Income Tax Assessment Act 1997, sections 713-505 and 713-510; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 2) 2002*, Schedule 6, Part 1

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