Worked example

Franking surpluses held by life insurance subsidiaries

Description

Generally, if a joining entity's franking account is in surplus at the joining time, the franking surplus is transferred to the head company's franking account. This is achieved by debiting the joining entity's franking account and crediting the head company's account with an amount equal to the surplus → section 709-60, *Income Tax Assessment Act 1997* (ITAA 1997).

This example shows how the general rule is modified in certain circumstances when a subsidiary entity of a life insurance company (the life insurance subsidiary) joins a consolidated group at the same time as the life insurance company. The modification ensures that the franking surplus is applied to the head company in a way that is consistent with the outcome that would arise if the group did not consolidate.

Commentary

The franking surplus of a life insurance subsidiary that is either directly, or indirectly through one or more interposed entities, wholly or partly owned by a life insurance company is credited to the head company's franking account to the extent that it is attributable to the shareholders of the life insurance company, provided the life insurance subsidiary joins the consolidated group at the same time as the life insurance company. The extent of the attribution is determined by working out the amount of franking credit that would arise in the life insurance company's franking account under item 5 in the table in subsection 219-15(2) of the ITAA 1997 if:

- the life insurance subsidiary made a franked distribution to the life insurance company just before the joining time, and
- the amount of the franking credit on the distribution was equal to the whole amount of the franking surplus.

→ section 713-545, ITAA 1997

Any excess franking surplus, which in essence is attributable to the policyholders of the life insurance company, is dealt with as follows:

- If, immediately before the joining time, all the membership interests in the life insurance subsidiary are either held directly in the segregated exempt assets of the life insurance company or are held directly or indirectly by an interposed entity and the membership interests in that interposed entity are held in the segregated exempt assets of the life insurance company, the head company is entitled to a refundable tax offset equal to the amount of the surplus in the franking account reduced by the amount of the franking credit that is made to the head company's account as a consequence of the deemed franked distribution to the life insurance company. → paragraph 713-545(5)(a)
- If, immediately before the joining time, all the membership interests in the life insurance subsidiary are either held directly in the virtual PST assets of

the life insurance company or are held directly or indirectly by an interposed entity and the membership interests in that interposed entity are held in the virtual PST assets, the head company is entitled to a refundable tax offset equal to:

$$\text{Excess franking account surplus} \times \frac{\text{Complying superannuation class tax rate}}{\text{Ordinary class tax rate}}$$

where the excess franking account surplus is the amount of surplus in the franking account reduced by the amount of franking credit that is made to the head company's account as a consequence of the deemed franked distribution to the life insurance company. → paragraph 713-545(5)(b) and subsection 713-545(6)

- If, immediately before the joining time, all the membership interests in the life insurance subsidiary are assets other than segregated exempt assets or virtual PST assets of the life insurance company, the amount of the tax offset will be nil. → paragraph 713-545(5)(c)

Example 1

Facts AlphaCo, a wholly-owned subsidiary of LifeCo, joins a consolidated group at the same time as LifeCo. All the membership interests in AlphaCo are assets other than segregated exempt assets or virtual PST assets.

At the joining time AlphaCo has a franking surplus of $10,000 in its franking account. If AlphaCo made a distribution to LifeCo that included the whole of the franking surplus, $2,000 would be attributable to the shareholders of LifeCo and $8,000 would be attributable the policyholders of LifeCo.

Consequently, $2,000 will be credited to the head company's franking account and the head company will not be entitled to a refundable tax offset for the remaining $8,000.

Example 2

Facts ElleCo, a wholly-owned subsidiary of LifeCo, joins a consolidated group at the same time as LifeCo. All the membership interests in ElleCo are virtual PST assets of LifeCo.

At the joining time ElleCo has a franking surplus of $7,000 in its franking account. If ElleCo made a distribution to the life insurance company that included the whole of the franking surplus, no amount would be attributable to the shareholders of the life insurance company.

Consequently, no amount will be credited to the head company's franking account. The head company will be entitled to a refundable tax offset of $3,500 (that is $7,000 x 15%/30%).

References

Income Tax Assessment Act 1997:

- section 709-60
- subsection 219-15(2)
- section 713-545
- paragraph 713-545(5)(a)
- paragraph 713-545(5)(b)
- paragraph 713-545(5)(c)
- subsection 713-545(6)

Revision history

Section C9-6-550 first published 15 November 2006.

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).