

Multiple entry consolidated (MEC) groups

Eligibility A foreign-owned group of Australian entities may be able to consolidate despite not having a single Australian head company. The resulting group, known as a multiple entry consolidated (MEC) group, is treated as a consolidated group for income tax purposes – that is, as a single entity. The types of entities eligible to be members of a MEC group are the same as those eligible to be members of a consolidated group. → ‘Choosing’, B1-1

The MEC group rules enable foreign-owned groups with multiple entry points of investment into Australia to get the benefits of consolidation.

The membership of a MEC group is determined by reference to the ultimate foreign parent company, referred to as the ‘top company’. The Australian-resident companies that constitute the top company’s first tier of investment into Australia are referred to as ‘tier-1’ companies. If a tier-1 company satisfies all the requirements to be a member of a MEC group, it is known as an ‘eligible tier-1 company’.

Broadly, the membership of the group consists of the eligible tier-1 companies and all their qualifying wholly-owned subsidiaries.

Generally, an entity cannot be a member of a MEC group unless entities interposed between it and the eligible tier-1 companies of the group are also members. However, where a MEC group is formed during the transitional period, a wholly-owned, Australian-resident subsidiary will be a member, even where there are interposed foreign resident entities, if it satisfies the interposed foreign-resident entity (IFRE) tests.

→ ‘Transitional provisions for foreign-held, Australian-resident subsidiaries to be members of a MEC group’, C10-2-120

Requirements to form a MEC group

A MEC group may be formed in one of two ways:

- as a result of two or more eligible tier-1 companies of the top company making a choice to form the group, or
- as a result of a consolidated group converting to a MEC group when certain conditions are satisfied. The conditions would be satisfied where, for example, the head company of a consolidated group is an eligible tier-1 company of the top company and that top company acquires another eligible tier-1 company.

A MEC group comes into existence only if the eligible tier-1 companies nominate one of themselves to be the provisional head company of the group. However, only an eligible tier-1 company that does not have any of its membership interests owned by another member of the MEC group can be nominated to be the provisional head company of a MEC group. The remaining members of the MEC group are subsidiary members of the group.

Example

Forming a MEC group

TC is the top company and ACo and BCo are its wholly-owned, Australian-resident subsidiary companies. ACo and BCo, which are eligible tier-1 companies, together can make the choice to form a MEC group. Either ACo or BCo can be the provisional head company, as neither has any membership interests owned by another member of the MEC group.

Note that unlike the non-MEC group consolidation rules, ACo and BCo are not required to have wholly-owned subsidiaries to form a MEC group. However, there must be at least two eligible tier-1 companies for a MEC group to be formed.

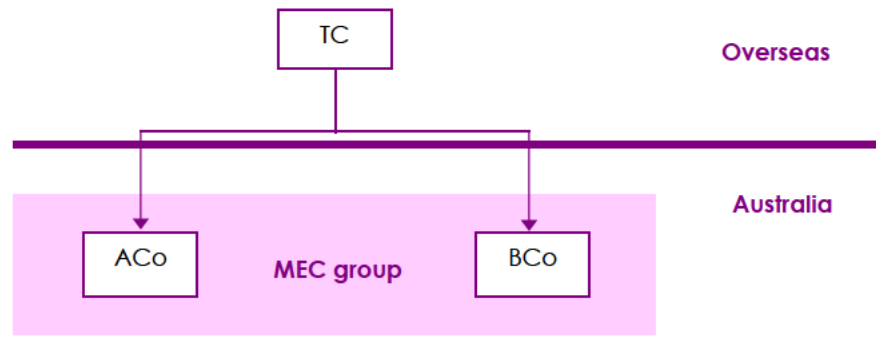


Table 1: Main differences between membership of MEC groups and consolidated groups

	MEC groups	Consolidated groups
Who can join	Australian-resident members of a foreign wholly-owned group can be members of a MEC group.	Australian-resident wholly-owned subsidiaries together with their Australian head company can be members of a consolidated group.
Minimum requirements to form	There must be at least two eligible tier-1 companies to form a MEC group.	There must be a head company and at least one wholly-owned subsidiary (company or trust) to form a consolidated group.
Head company	<p>Only an eligible tier-1 company in which no member of the MEC group holds any interests can be a provisional head company of a MEC group.</p> <p>The provisional head company is nominated jointly by all the eligible tier-1 companies of the group.</p> <p>If a provisional head company becomes ineligible, all the eligible tier-1 companies jointly appoint another qualified eligible tier-1 company as the new provisional head company.</p> <p>The company that is the provisional head company at the end of the income year is taken to be the head company of the MEC group for the whole year.</p>	<p>The head company must be a company that is not a wholly-owned subsidiary of an entity that can be a member of a consolidatable or consolidated group.</p> <p>The head company declares itself as the head company.</p> <p>If the head company becomes ineligible, the consolidated group will cease to exist.</p>
Choice to form	Notice of choice to form is given by all the eligible tier-1 companies. Notice must include the nomination of the provisional head company.	Notice of choice to form is given by the head company.

	MEC groups	Consolidated groups
When a group converts or expands	When the last remaining eligible tier-1 company of a MEC group ceases to be an eligible tier-1 company, the MEC group becomes a consolidated group if that company can qualify as the head company.	If a head company of a consolidated group also qualifies as an eligible tier-1 company and subsequently one or more eligible tier-1 companies join the foreign wholly-owned group, the consolidated group can convert to a MEC group. The head company will become the provisional head company and it must notify the Commissioner of Taxation in the approved form. This conversion is called a 'special conversion event'.
	When a parent company of one MEC group (acquiring MEC group) acquires another MEC group, the two MEC groups can continue to exist separately, or the acquiring MEC group may choose to expand by including the other. If the acquiring MEC group chooses to expand, all the eligible tier-1 companies of the acquired group must join the expanded group.	When a 'special conversion event' happens to a consolidated group, if the new eligible tier-1 companies were members of a MEC group before their acquisition and that MEC group is acquired as a whole, then all the eligible tier-1 companies of that group must join.
Cessation	When the provisional head company of a MEC group ceases to be the provisional head company of the group, the group can continue to exist with a new provisional head company. When none of the remaining eligible tier-1 companies are qualified to be the provisional head company, the MEC group ceases to exist.	When the head company of a consolidated group ceases to be the head company, the consolidated group ceases to exist.

Sources: *Income Tax Assessment Act 1997*, Divisions 703 and 719; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
Explanatory Memorandum to the *New Business Tax System (Consolidation) Bill (No. 1) 2002*, Chapters 3 and 4

Change in provisional head company

Once a MEC group is formed it is possible for the provisional head company of the group to change without affecting the ongoing existence of the group. A change in provisional head company may occur, for example, where the provisional head company ceases to be a wholly-owned subsidiary of the top company. The remaining eligible tier-1 companies in the group may nominate one of themselves within 28 days, provided the replacement provisional head company does not have any of its membership interests owned by another member of the group.

Once a replacement has been nominated, some tax attributes of the group such as franking credits and foreign dividend account surpluses are transferred from the former provisional head company to the replacement provisional head company. However, some attributes such as losses are transferred at the end of the income year when head company history is transferred to the new head company.

Joining entities

Broadly, the rules governing the transfer of tax attributes (such as losses and franking credits) when an entity becomes a subsidiary member of a consolidated group apply in the same manner when an entity becomes a subsidiary member of a MEC group.

Cost setting rules

The MEC rules modify the general cost setting rules.

The assets of an eligible tier-1 company enter consolidation with their terminating values because an eligible tier-1 company is treated as if it is a part of the head company of the group. Similarly, the assets of a transitional foreign-held subsidiary (TFHS) enter consolidation with their terminating values because a TFHS is also treated as part of the head company. Assets of other subsidiary members have their tax costs reset in the same way as the assets of subsidiary members of a consolidated group.

Generally, intragroup debts and intragroup membership interests held by an eligible tier-1 company are not recognised for the purposes of Part 3-90 of the ITAA 1997 while it is a member of the group.

→ 'Cost setting rules for assets of a MEC group – at joining and formation times', C10-2-210

→ 'Determining asset values', B2-2

Franking credits

The head company of a MEC group is responsible for operating the franking account of the group. However, some membership interests in eligible tier-1 companies and transitional foreign-held subsidiaries are held by entities that are not members of the MEC group. To allow these entities to frank distributions made to their shareholders, any distributions made by a subsidiary member of the group to an entity outside the group will be taken to be made by the head company of the group.

Losses

In recognition of the special characteristics of MEC groups, Subdivision 719-F of the ITAA 1997 modifies the rules about transferring and utilising losses within those groups. It also covers the application of the continuity of ownership test (COT) under section 165-12, which helps to establish whether a loss can be utilised.

Applying the COT to a MEC group

The loss rules cannot be applied to a MEC group in the same way as a consolidated group because, if the COT was applied by reference to the head company of the MEC group, the outcome could change depending on which of the eligible tier-1 companies was chosen to be head company. Applying the COT by reference to all the eligible tier-1 companies collectively is also unworkable, as the COT is designed to trace the ownership of a single loss entity and not a group of loss entities.

In effect, the COT is applied to a MEC group by reference to the group's top company instead of its head company. Ownership changes in the transferor company up to and including the joining time are also recognised in certain circumstances.

In order to apply the COT to a MEC group for the purpose of determining whether a loss can be utilised, a company (the 'test company') identified in

relation to the focal company, is assumed to have incurred the loss. It is also assumed that:

- the test company made the loss for a particular income year
- if certain events occur, parts of the ownership structure are considered 'frozen', and
- in certain circumstances, the test company is considered to have failed the COT in relation to the loss (and therefore the focal company is also considered to have failed the COT in relation to the loss).

Satisfaction or failure of the COT by the test company in relation to a loss, is attributed to the head company of the MEC group.

- 'Identifying the test company to determine continuity of ownership of the focal company in a MEC group (COT transfer of losses)', C10-2-330
- 'Identifying the test company to determine continuity of ownership of the focal company in a MEC group (SBT satisfied)', C10-2-340
- 'Determining the start of a test company's loss year to assess the continuity of ownership of the focal company in a MEC group (COT transfer of a loss)', C10-2-350
- 'Determining the start of a test company's loss year to assess continuity of ownership of the focal company in a MEC group (special conversion event)', C10-2-360
- 'Freezing the ownership of the test company – COT transfer of a loss to the head company of a MEC group', C10-2-370
- 'Freezing the ownership structure of a MEC group – when a loss-making company becomes head company of the group', C10-2-380
- 'Continuity of a potential MEC group when the identity of the top company changes – assumptions about the test company failing the COT', C10-2-390

Calculating available fractions

The available fractions for MEC groups are generally calculated and adjusted in the same way as for consolidated groups, but specific rules apply when a MEC group expands because a new eligible tier-1 company joins, or because a consolidated group converts to a MEC group.

If a new eligible tier-1 company joins the group, the MEC group's existing available fractions are adjusted. In addition, an available fraction must be calculated for any prior year (group) losses generated before the new eligible tier-1 company joins.

Existing available fractions are adjusted when a new eligible tier-1 company joins a MEC group because the expansion increases the group's income generating capacity. This is because the MEC group has not expended cash or assets in order for the new eligible tier-1 company to join. (the company is a new eligible tier-1 company of the MEC group solely because of its relationship with the top company). The existing available fractions no longer represent the correct proportion of group income considered to be generated by the entities that transferred the losses.

Also, when a new eligible tier-1 company joins a MEC group, an available fraction is calculated for the prior year group losses at that time. Broadly, this is to ensure that the losses will only be offset against the proportion of the

(expanded) group's income considered to have been generated by the entities in the group at the time the losses were made.

These calculations and adjustments to the available fractions are also required when a consolidated group converts to a MEC group because, in order for the conversion to take place, another company must become an eligible tier-1 company of the top company.

→ 'Adjusting available fraction – a new eligible tier-1 company joins a MEC group', C10-2-310

→ 'Apportioning the use of losses – new eligible tier-1 company joins part-way through income year', C10-2-320

Leaving entities

An entity, including the provisional head company (PHC), leaves a MEC group if it no longer satisfies the eligibility tests for being a member of the group. This would occur, for example, where:

- there ceases to be a direct or indirect wholly-owned relationship between the entity and the top company, or
- an ineligible entity is interposed between parts of the existing MEC group.

Calculating cost of membership interests

An entity's departure from a MEC group does not affect the continuation of the group unless the exit results in one of the events that causes the group to cease existing (for example, where a PHC leaves a MEC group and none of the remaining eligible tier-1 companies qualify to be a replacement PHC).

The treatment of the membership interests when an entity leaves a MEC group depends on the type of entity and whether the membership interests are owned by members of the MEC group or owned outside the MEC group. Very broadly, there are separate rules for:

- a company that is the head company:
 - Because the MEC rules require the head company of a MEC group to be wholly owned outside the MEC group, when the head company leaves the group special rules referred to as pooling rules apply to reset the cost of those membership interests. Those reset costs are the amounts used for tax purposes such as calculating the capital gain or loss.
- a company that is an eligible tier-1 company, but not the head company:
 - The treatment of the membership interests at leaving time will depend on whether or not the owner of the membership interests is a member of the MEC group. The new cost of those membership interests owned by members of the MEC group is calculated with reference to Division 711 leaving entity rules modified by Subdivision 719-J → 'An eligible tier-1 company leaving a MEC group', C10-2-430. The cost of those membership interests held outside the MEC group that are pooled interests are reset using the pooling rules in Subdivision 719-K → 'Pooling of external membership interests', C10-2-420.

- an entity that is a subsidiary member of the MEC group but is not an eligible tier-1 company:
 - The method used to calculate the new cost of membership interests is in the leaving entity rules in Division 711. This includes entities that are members of the MEC group as transitional foreign-held indirect subsidiaries (TFHIS).
 - For transitional foreign-held subsidiaries (TFHS), Division 711 applies as modified by sections 701C-40 and 701C-50 of the *Income Tax (Transitional Provisions) Act 1997*.
- 'Cost setting rules for assets of a MEC group – at joining and formation times', C10-2-210
- 'Transitional provisions for foreign-held, Australian-resident subsidiaries to be members of a MEC group', C10-2-120
- 'Determining asset values', B2-2
- 'The cost setting process on exit', C2-2-210
- Division 711, ITAA 1997

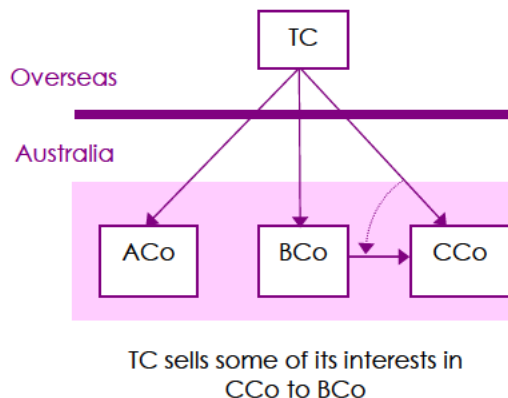
Membership interests in eligible tier-1 companies

Because assets may be transferred between members of the MEC group without tax consequences, the costs of pooled membership interests are reset each time either one or both events that trigger the pooling rules happen to a pooled interest (pooled interests are only held in eligible tier-1 companies). Recalculation of the cost of pooled interests is triggered when either or both of the following events happen:

- an eligible tier-1 company leaves the MEC group
 - a CGT event happens to the pooled interests in an eligible tier-1 company of the group.
- 'Events that trigger pooling in a MEC group', C10-2-410
- 'Pooling of external membership interests', C10-2-420

Example

A CGT event happens to some of the pooled interests in an eligible tier-1 member of the MEC group but it does not leave the group



MEC group ceases to exist

A MEC group will cease to exist when:

- there is no longer a provisional head company for the MEC group
- there is no longer at least one eligible tier-1 company in the group
- the top company changes and the eligible tier-1 companies in the MEC group are no longer the same, or
- the top company changes and all the eligible tier-1 companies of the MEC group (the first MEC group) become members of another MEC group; after the change the first MEC group ceases to exist.

Transitional rules

Transitional rules apply to groups consolidating during the transitional period (1 July 2002 to 30 June 2004). → section 701-1, *Income Tax (Transitional Provisions) Act 1997*

The transitional rules are applicable to MEC groups with some modifications.

Entry case

The head company of a transitional MEC group can choose that the assets of certain subsidiary members of the group can enter consolidation with their existing 'costs' for tax purposes.

For groups consolidating during the transitional period, the cost setting rules enable the head company to choose terminating values for the assets of certain subsidiaries on consolidation. → 'Treatment of assets', C2-1

For transitional MEC groups, this concession is available to those subsidiaries that are not eligible tier-1 companies or transitional foreign-held subsidiaries.

Even though eligible tier-1 companies other than the provisional head company (PHC) are known as subsidiary members once a MEC group is formed, they are treated for cost setting purposes as part of the head company. The cost of their assets is not reset, so that, like the PHC, terminating values must always be used, whether during the transitional period or later.

Exit case

When an eligible tier-1 company leaves a transitional MEC group, the head company of the group can choose to use formation time market values of certain pre-CGT assets.

When an entity leaves a transitional consolidated group, the head company may choose to use formation time market values instead of terminating values for certain pre-CGT assets.

→ 'Treatment of assets', C2-1

This concession does not apply to those assets held by the head company of the transitional group for which there was a Subdivision 126-B rollover after 11.45 a.m. by legal time in the Australian Capital Territory on 21 September 1999. The asset of the subsidiary that is leaving the group must still have a pre-CGT status just before leaving.

This concession has been extended to apply to pre-CGT assets that satisfy the same conditions as those for consolidated groups but were held by other eligible tier-1 companies of a transitional MEC group at the time it was formed.

- Division 701, *Income Tax (Transitional Provisions) Act 1997*
- Subdivision 126-B, ITAA 1997
- Explanatory Memorandum to New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 1.112 to 1.114
- Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No 2) 2002, paragraph 3.134

Pre-formation rollover after 16 May 2002 and transitional groups

The rollover of an asset under Subdivision 126-B or section 40-340 is disregarded for tax cost setting purposes on consolidation, with certain exceptions, if:

- the rollover takes place after 16 May 2002,
- the group consolidates after the rollover and before 1 July 2004, and
- the rollover changes the tax values of the assets of the group.

→ sections 701-35 and 719-163 IT(TP) Act 1997

This rule is designed to prevent groups from using rollover relief to maximise their choices for cost setting of their assets on consolidation.

→ 'Cost setting rules for assets of a MEC group', C10-2-210

References

Income Tax Assessment Act 1997, Divisions 711 and 719; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 4

Income Tax Assessment Act 1997, Subdivisions 719-J and 719-K; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 8

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, paragraphs 3.50 – 3.71

Income Tax (Transitional Provisions) Act 1997, Division 701 and section 701-35; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*, (No. 90 of 2002), Schedule 7

Income Tax (Transitional Provisions) Act 1997, sections 701-35 and 719-163; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 17

Explanatory Memorandum to New Business Tax System (Consolidated, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 1.104 to 1.107

Income Tax Assessment Act 1997, Subdivision 126-B

New Business Tax System (Consolidation and Other Measures) Act 2003 (No. 16 of 2003), Subdivision 719-H, Schedule 5; Subdivision 719-F, Schedule 13

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapters 9, 5, 4, 3

Revision history

Section C10-1 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on recent changes to consolidation rules (since deleted).	Legislative amendments.
26.10.05	Changes to the cost setting rules on the entry and exit of a transitional foreign-held subsidiary (TFHS), pp. 4, 6. Minor editorial changes.	Legislative amendments.

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).