

Worked example

Choice on formation, special conversion events and acquisition of new eligible tier-1 companies

Description This example shows what happens when:

- a top company with existing consolidated, multiple entry consolidated (MEC) groups and unconsolidated eligible tier-1 companies acquires a new eligible tier-1 company
- two or more companies become eligible tier-1 companies of the top company of both a consolidated and a MEC group
- the top company of a MEC group acquires another consolidated MEC group
- there is a special conversion event – the top company of a MEC group which is also the top company of a consolidated group, acquires a consolidated or MEC group, and
- only some of the eligible tier-1 companies of a MEC group with a different top company join a consolidated or a MEC group.

Commentary A MEC group can be formed in one of two ways:

- 1 when two or more eligible tier-1 companies of a top company make the choice to form a MEC group, or
- 2 when a consolidated group converts to a MEC group. This is known as a special conversion event.

Once a decision is made by two or more eligible tier-1 companies to consolidate, the options for any remaining eligible tier-1 companies are to:

- form another MEC group
- form one or more consolidated groups, or
- remain outside consolidation.

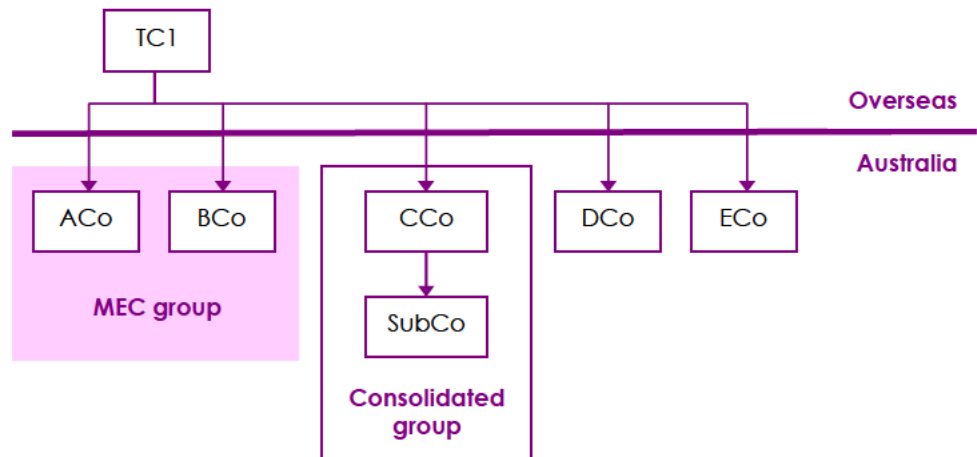
There are additional rules that apply to any new eligible tier-1 companies.

Examples

Assume that TC1 is the top company and ACo, BCo, CCo, DCo and ECo are eligible tier-1 companies, that is, they satisfy the residency and ownership requirements to consolidate.

Formation of a MEC group

Figure 1: Consolidation options of eligible tier-1 companies



Initially, all the eligible tier-1 companies have several ways to choose to consolidate:

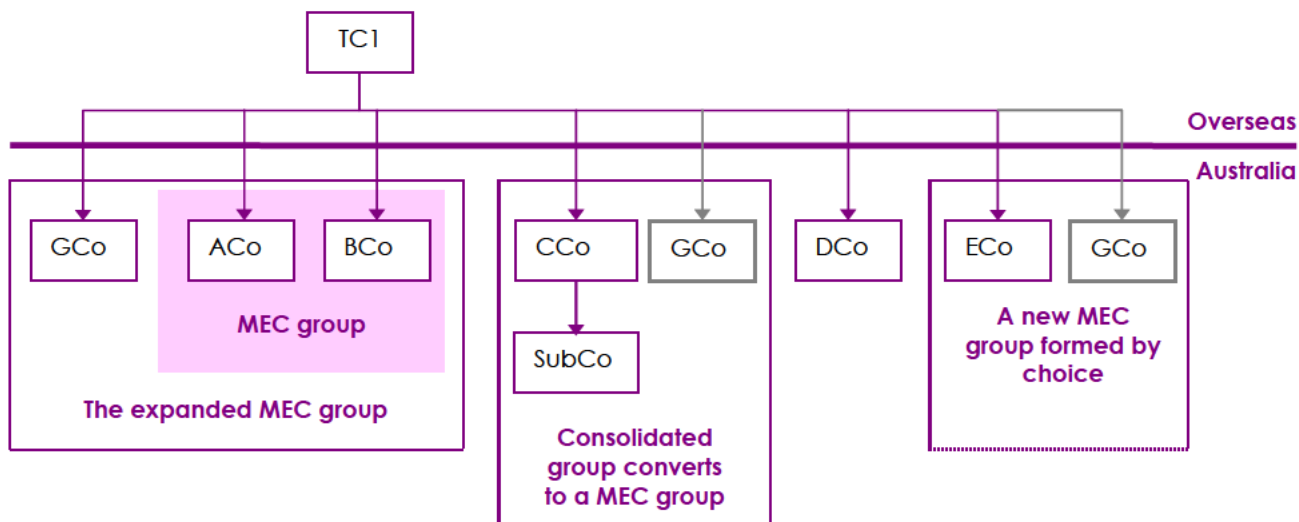
- Any two or more eligible tier-1 companies can choose to form a MEC group. Example: ACo and BCo.
- Each eligible tier-1 company together with a wholly-owned subsidiary can form a consolidated group with itself as the head company. Example: CCo and SubCo.
- Any eligible tier-1 company can choose not to consolidate. Example: DCo or ECo.

Once two or more eligible tier-1 companies form a MEC group or an eligible tier-1 company and its subsidiary or subsidiaries form a consolidated group, the remaining eligible tier-1 companies of the group cannot choose to join either of those particular groups. For example: DCo and ECo cannot choose to join either the MEC group or the consolidated group. While any eligible tier-1 companies remain outside consolidation, they are also prevented from becoming members of the MEC group as eligible tier-1 companies when it expands (example C). Nor can they become members of the consolidated group as eligible tier-1 companies when it converts to a MEC group (example D).

After the formation of a MEC group

(A) A top company with existing consolidated groups, MEC groups and unconsolidated eligible tier-1 companies acquires a new eligible tier-1 company

Figure 2: GCo becomes an eligible tier-1 company after group formation



Assume GCo becomes an eligible tier-1 company of the top company. This could occur through an acquisition of GCo by TC1.

When another company becomes a new eligible tier-1 company of the top company, some of the possibilities are:

- The provisional head company of the MEC group consisting of ACo and BCo can choose to make GCo a new eligible tier-1 company of that MEC group – that is, the MEC group expands.
- The head company of the consolidated group can choose to have the new eligible tier-1 company join as a member, thereby converting from a consolidated group to a MEC group – that is, a special conversion event.
- Either at the joining time of GCo or later, any two or all of DCo, ECo and GCo can choose to form a separate MEC group.
- Either at the joining time of GCo or later, any one of DCo, ECo or GCo can choose to form a consolidated group – provided they have at least one qualifying subsidiary.
- The new eligible tier-1 company, GCo, can remain outside consolidation, similar to DCo and ECo in figure 1.

(B) When two or more companies become eligible tier-1 companies of the top company of both a consolidated group and a MEC group

When two or more companies become eligible tier-1 companies of the top company, some of the possibilities are:

- The provisional head company of the MEC group (see figure 1) can choose to expand to include any one or more of the new eligible tier-1 companies.
- The head company CCo, by including any one or more of the new eligible tier-1 companies, can convert the consolidated group to a MEC group – a special conversion event.
- Some of the new eligible tier-1 companies can be in the expanded MEC group and the others in the MEC group formed by special conversion.
- Either at joining or later, any two or more of DCo, ECo and the acquired eligible tier-1 companies can choose to form a separate MEC group.
- Either at joining time or later, any one of DCo, ECo or the acquired eligible tier-1 companies can choose to form a consolidated group – provided they have at least one qualifying subsidiary.
- All of the new eligible tier-1 companies can remain outside consolidation.

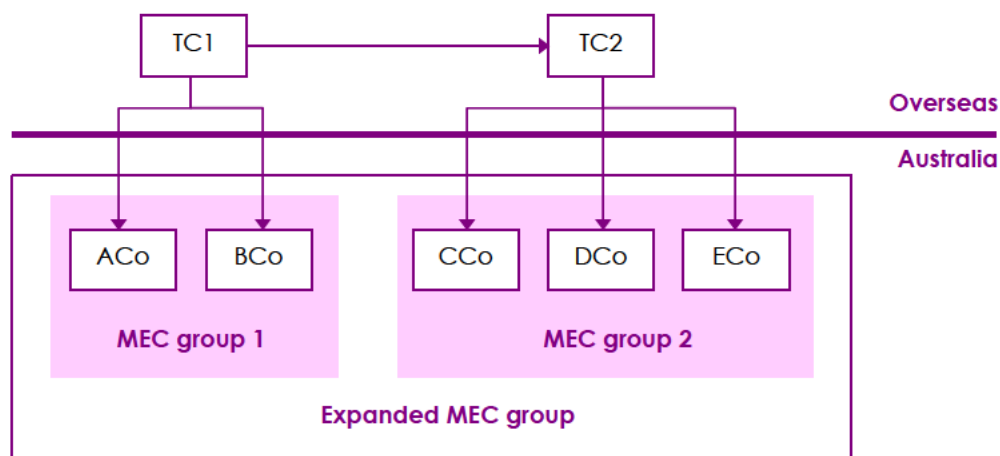
Note that if the new eligible tier-1 companies are members of a MEC group, and the MEC group is acquired as a whole, the provisional head company of the acquiring MEC group or the head company of the acquiring consolidated group must include all the eligible tier-1 companies of the acquired group in the expanded MEC group or the converted consolidated group.

When a special conversion event happens, the head company of the consolidated group becomes the provisional head company of the new MEC group.

(C) When the top company of a MEC group acquires another consolidated or MEC group

Assume that initially MEC group 1 and MEC group 2 are separately formed groups and subsequently TC1 acquires TC2.

Figure 3: Top company acquires other top company



When TC1 acquires TC2, the choices are either:

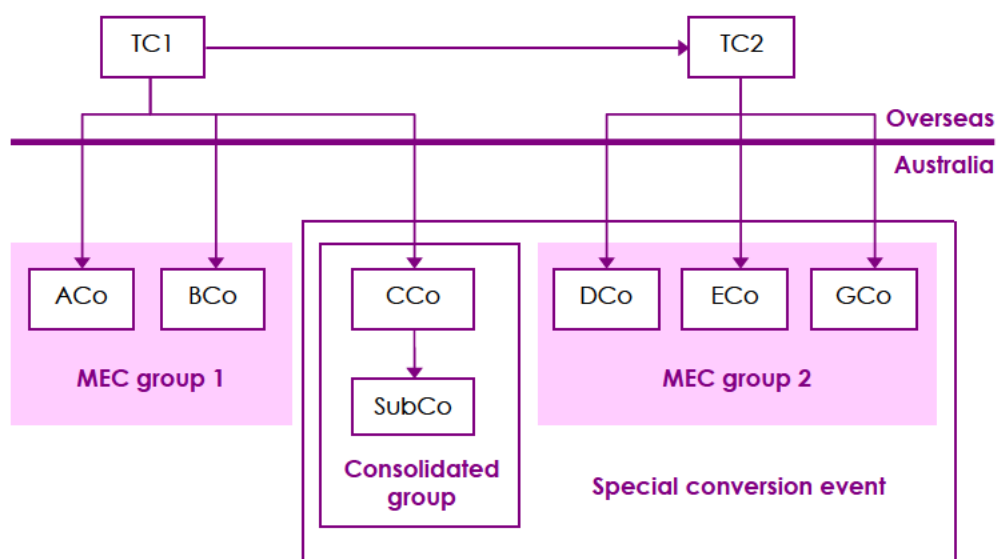
- MEC group 1 and MEC group 2 can remain independently consolidated with respect to each other, or
- the provisional head company of MEC group 1, ACo, can choose to expand to include the eligible tier-1 companies in MEC group 2 to become members of MEC group 1. All the eligible tier-1 companies in MEC group 2 must be included. The expanded MEC group will consist of ACo, BCo, CCo, DCo and ECo.

MEC group 2 ceases to exist from the time its members become members of MEC group 1. The provisional head company of MEC group 1, ACo, will be the provisional head company of the expanded MEC group.

(D) Special conversion event – when a MEC group’s top company that is also the top company of a consolidated group acquires a consolidated or MEC group

Assume MEC group 1 and MEC group 2 are separately formed groups and TC1 acquires TC2. CCo is the head company of a consolidated group and an eligible tier-1 company of TC1 (figure 4).

Figure 4: Special conversion event



When TC1 acquires TC2, the choices are:

- MEC group 1 and MEC group 2 can merge as explained in (C).
- MEC group 1 and MEC group 2 can remain as two separate MEC groups.
- CCo, as the head company of the consolidated group, can choose to make all of the eligible tier-1 companies of MEC group 2 its members and convert to a MEC group. This is known as a special conversion event. CCo will become the provisional head company of the new MEC group. Again, CCo must include all the eligible tier-1 companies of MEC group 2 as members.

(E) When only some of the eligible tier-1 companies of a MEC group with a different top company join a consolidated or a MEC group

In example D above, if instead of acquiring membership interests in TC2, TC1 were to acquire all the membership interests in DCo and ECo but not in GCo, it will be treated like the acquisition of two eligible tier-1 companies by TC1 (see example B). This is because DCo and ECo cease to be members of MEC group 2 as soon as they cease to be wholly-owned subsidiaries of TC2.

Note: GCo should nominate itself as the new provisional head company of MEC group 2.

Some of the options available to the group owned by TC1 on the acquisition of DCo and ECo are:

- The provisional head company of MEC group 1 can choose to expand its group by including DCo or ECo or both in its group.
- CCo can convert to a MEC group by including DCo or ECo or both in its group.
- In a combination of these first two options, one of DCo or ECo could join MEC group 1 as a new eligible tier-1 company, and the other could join CCo's consolidated group, converting it to a MEC group.
- DCo and ECo can form a new MEC group by making a choice to do so.
- DCo and ECo can remain outside consolidation (since neither of them has a wholly-owned subsidiary, they are unable to form their own consolidated group with themselves as the head company).

References

Income Tax Assessment Act 1997, sections 719-5, 719-40 and 719-50; 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, 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, Chapter 8, paragraphs 8.19 to 8.23

Revision history

Section C10-2-110 first published (excluding drafts) 2 December 2002 and updated 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
26.10.05	Extensive changes throughout.	For clarification.

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).