Worked example

Original and new eligible tier-1 companies of a MEC group

Description

This example explains the differences between 'original' and 'new' eligible tier-1 companies and how those differences apply when a MEC group expands. A MEC group may expand when it (or its top company) acquires another MEC group, a consolidated group or other eligible tier-1 companies. Note that only the head company of the acquiring group can choose to expand. The acquired group cannot choose to expand.

Commentary

Broadly, original eligible tier-1 companies of a MEC group are those eligible tier-1 companies that:

- were party to the choice to form the MEC group and have continued to be eligible tier-1 companies of the top company since that formation, or
- joined at the time when a consolidated group can convert to a MEC group under the special conversion event rules and have continued to be eligible tier-1 companies of the top company since that conversion.

In the second situation, the head company of the consolidated group would also be an original eligible tier-1 company of the converted group.

Note

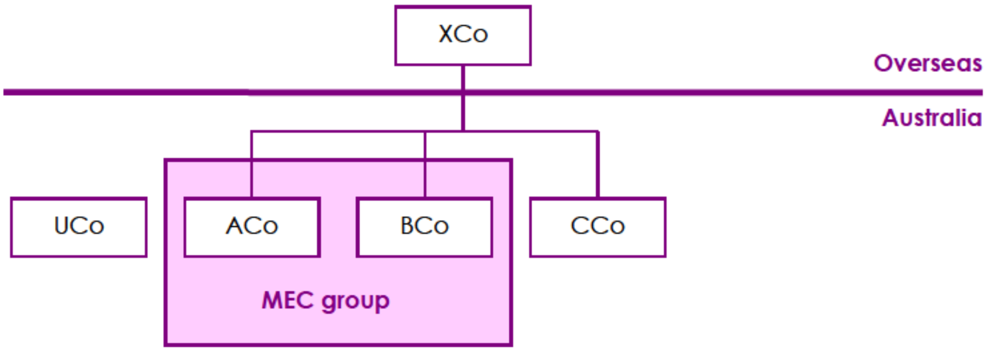
Notifying the Commissioner

When a MEC group expands, or a consolidated group converts to a MEC group by including other eligible tier-1 companies, the provisional head company or head company of the old group must notify the Commissioner within the applicable period. → 'MEC groups – notifiable events', C10-1-110

Example 1 Original eligible tier-1 companies when a MEC group forms by choice

In figure 1, ACo, BCo, and CCo are eligible tier-1 companies of the top company XCo. UCo is an unrelated Australian-resident company. ACo and BCo have chosen to form a MEC group, but CCo has not chosen to form part of the MEC group.

Figure 1: MEC group formed by choice

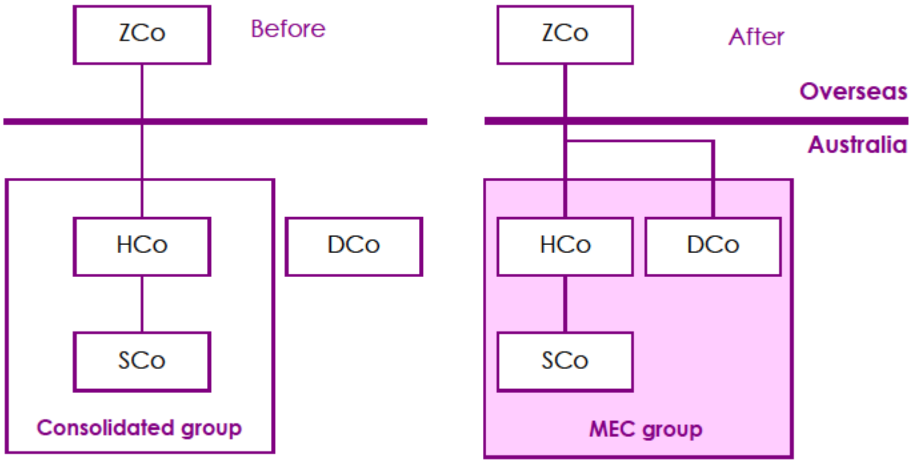


ACo and BCo are original eligible tier-1 companies of the MEC group. CCo cannot later join this MEC group as an eligible tier-1 company because it did not become an eligible tier-1 company of the top company after the group formed. Nor can it join the MEC group if the group expands because other companies become eligible tier-1 companies of the group.

Example 2 Original eligible tier-1 companies after a special conversion event

In figure 2, HCo is the head company of a consolidated group formed with its wholly-owned subsidiary SCo. HCo is the wholly owned Australian-resident subsidiary of the foreign parent, ZCo.

Figure 2: MEC group formed by special conversion event



HCo is also an eligible tier-1 company of a potential MEC group with ZCo as its top company.

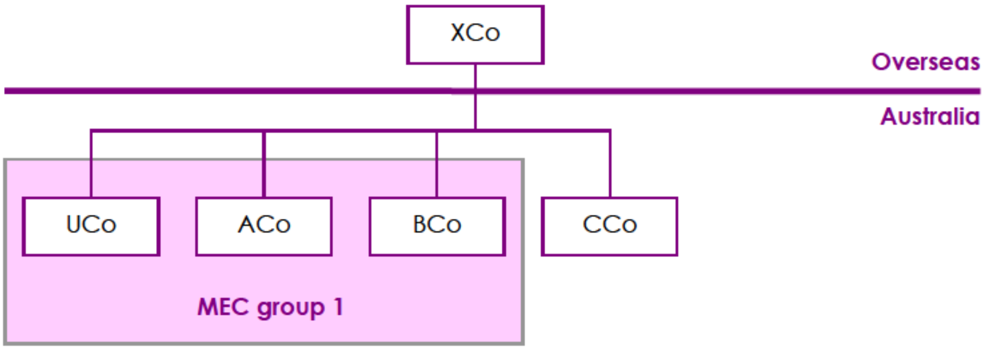
DCo is an unrelated Australian-resident company.

If ZCo acquires all the membership interests in DCo, the latter would also become an eligible tier-1 company of ZCo. HCo, as the head company of the consolidated group, may inform the Commissioner that DCo is to become a member of the group, thereby converting the consolidated group to a MEC group. This is known as a special conversion event. Both HCo and DCo will be original members of the converted MEC group.

Example 3 New eligible tier-1 companies of a MEC group

Broadly, new eligible tier-1 companies of a MEC group are eligible tier-1 companies that join the group after it has formed. Figure 3 shows how this might apply to the companies described in example 1.

Figure 3: New eligible tier-1 companies of a MEC group



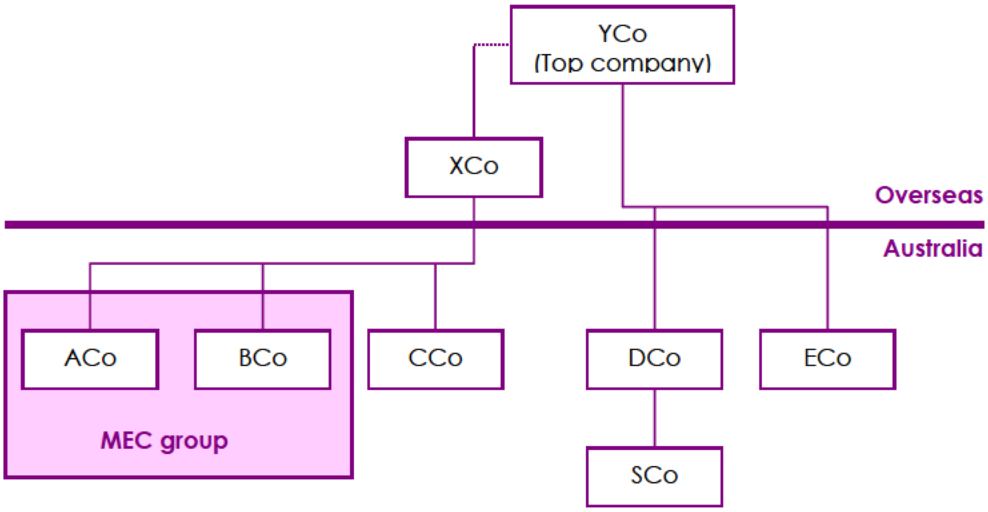
XCo acquires all the membership interests in UCo and informs the Commissioner that UCo is to become a member of the MEC group. UCo will be a new eligible tier-1 company of the MEC group.

CCo can never become a new eligible tier-1 company of the MEC group formed by ACo and BCo, because it did not become an eligible tier-1 company of the top company after the MEC group formed.

Example 4 When a new top company has no consolidated or MEC groups

When the top company of a MEC group is taken over by a new top company whose Australian subsidiaries have not formed either consolidated or MEC groups, a number of outcomes are possible.

Figure 4: The new top company has no MEC or consolidated groups



The following information is known about the companies in figure 4:

- ACo, BCo and CCo are all eligible tier-1 companies of top company XCo.
- ACo and BCo have chosen to form a MEC group, while CCo has not chosen to form part of the MEC group.
- DCo and ECo are eligible tier-1 companies of top company YCo.
- SCo is a wholly-owned subsidiary of DCo.
- DCo and ECo have not formed a MEC group.
- DCo and SCo have not formed a consolidated group.

After the MEC group is formed, YCo takes over XCo and becomes the new top company of the MEC group formed by ACo and BCo. This MEC group continues with ACo and BCo as original eligible tier-1 companies. DCo, ECo and SCo are not members of a MEC group or a consolidated group at the time of YCo taking over XCo so there cannot be an expansion of the MEC group.

CCo cannot join ACo and BCo's MEC group as an eligible tier-1 company, because CCo did not become an eligible tier-1 company of the top company after the group formed. DCo and ECo cannot join as eligible tier-1 companies either because they are not new eligible tier-1 companies with respect to YCo, the top company for the MEC group.

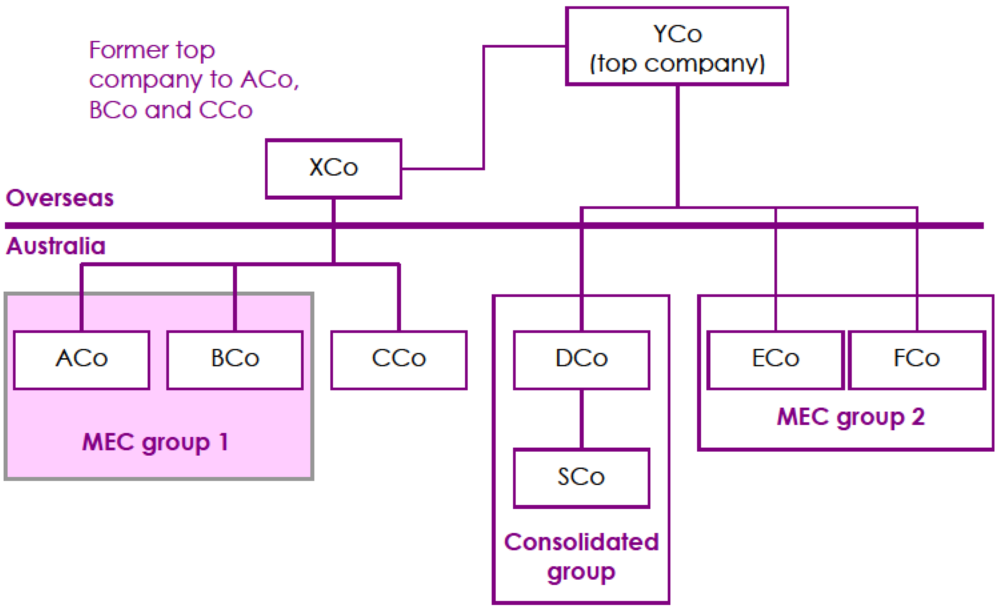
Possible outcomes include:

- DCo and ECo can form a MEC group (they will be original eligible tier-1 companies of that potential MEC group)
- DCo and SCo can form a consolidated group
- DCo and ECo can remain unconsolidated
- CCo can either join with DCo and ECo when they form a MEC group or remain unconsolidated, or
- either DCo or ECo can join with CCo to form a MEC group.

Example 5 When the new top company has MEC groups or consolidated groups

When the top company of a MEC group is taken over by another company that already has MEC or consolidated groups in Australia, a number of outcomes are possible.

Figure 5: The new top company has MEC or consolidated groups



The following information is known about the companies in figure 5:

- ACo, BCo and CCo are eligible tier-1 companies of top company XCo.
- ACo (as provisional head company) and BCo have chosen to form MEC group 1, while CCo did not choose to consolidate.
- DCo, ECo and FCo are eligible tier-1 companies of top company YCo.
- SCo is a wholly-owned subsidiary of DCo.
- DCo (as head company) and SCo have formed a consolidated group.
- Eco (as provisional head company) and FCo formed MEC group 2.

After the groups have formed, YCo takes over XCo and becomes the top company of the MEC group formed by ACo and BCo. Possible outcomes include:

- CCo could join the consolidated group or MEC group 2.
- MEC group 1 could continue as is.
- DCo and SCo's consolidated group could continue as is or expand to include both ACo and BCo as eligible tier-1 members (with their original MEC group 1 ceasing to exist). This special conversion event would create a new MEC group, in which DCo, ACo and BCo would all be original eligible tier-1 companies.
- At the same time, CCo could also now join this new MEC group as an original eligible tier-1 company.
- MEC group 2 could expand to include both ACo and BCo as new eligible tier-1 members (with original MEC group 1 ceasing to exist). ECo and FCo would be the original eligible tier-1 companies of the group.
- At the same time, CCo could also now join MEC group 2 as a new eligible tier-1 company.

Only provisional head companies or head companies of an acquiring group can choose to expand their groups. In this case, ACo and ECo are the provisional head companies of MEC group 1 and MEC group 2 respectively, and DCo is the head company of the consolidated group. Because YCo acquires XCo, the head company and provisional head company of the 'acquiring' groups, DCo and ECo respectively, are able to expand their respective groups by including ACo, BCo and CCo from the 'acquired' group.

Note that, because ACo and BCo are members of a MEC group, they both must be included together in the converted or expanded groups.

References

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

Income Tax Assessment Act 1997, Division 719 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) Bill (No. 1) 2002, Chapter 4

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, Chapter 8, paragraphs 19 to 23

Revision history

Section C10-2-115 first published 28 May 2003.

Further revisions are described below.

Date	Amendment	Reason
26.10.05	Editorial changes.	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).