Worked example

Provisional head company

Description

This example explains:

- how a company qualifies to be a provisional head company (PHC) of a multiple entry consolidated (MEC) group
- how a PHC is nominated
- a PHC's income tax obligations, and
- how a PHC may be replaced, and what happens when it is replaced.

Commentary

Only an eligible tier-1 company can be a PHC of a MEC group. To qualify as the PHC, the eligible tier-1 company must have all its membership interests owned by entities outside the MEC group.

All eligible tier-1 companies that choose to form the MEC group must jointly nominate one of themselves to be the PHC of the group. The notice to consolidate must include the appointment of the nominated PHC.

When a consolidated group converts to a MEC group as a result of a special conversion event (→ ''Choice on formation and special conversion events', C10-2-110), the eligible tier-1 companies of the converted MEC group are taken to have appointed the head company of the consolidated group as the PHC of the MEC group.

The provisional head company remains the PHC until it ceases to exist or ceases to satisfy the qualifying conditions for being a PHC.

Income tax obligation of a PHC

The PHC of the group at the end of the income year is taken to be the head company of the MEC group for the whole income year. The head company fulfils the end-of-year income tax obligations of the group, including lodging one income tax return for the group and reconciling PAYG instalments.

During the year, the PHC is also responsible for maintaining the:

- franking account
- foreign dividend account, and
- attribution and attributed tax accounts, etc.

A frankable dividend paid by a subsidiary member of the MEC group to an entity that is not a member of the MEC group is taken to have been paid by the PHC for the purposes of applying the franking rules.

Replacing a PHC

Once a MEC group is formed, circumstances may change whereby the group no longer has a PHC. An example is where a PHC ceases to be a wholly-owned subsidiary of the top company. Such a change will not necessarily affect the ongoing existence of the group. A replacement PHC can be nominated by the remaining eligible tier-1 companies of the group – provided it has all its membership interests owned by entities outside the group and the Commissioner of Taxation is notified within the specified period (generally 28 days).

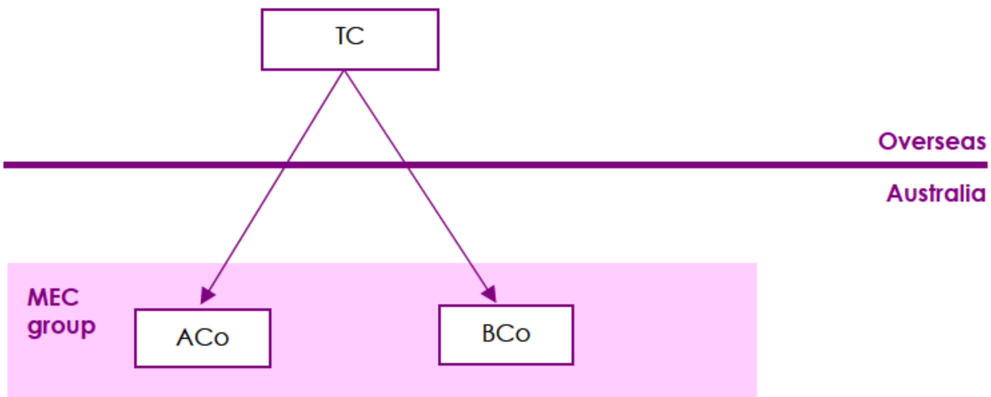
Certain tax attributes (for example, losses and foreign tax credits) of the old head company will be inherited by the new head company under the 'transfer of history' rule. → sections 719-85 and 719-90 of the *Income Tax Assessment Act 1997* (ITAA 1997); paragraphs 3.117 to 3.129 of Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002.

When a new head company is appointed and the Commissioner is notified within the specified period, the franking account balance (including franking deficit) and foreign dividend account of the former head company are transferred to the new head company just before the cessation event. → sections 719-430 and 719-905 of the ITAA 1997

Example 1 Nomination of a provisional head company

TC is the top company. Either ACo or BCo can be the provisional head company as neither has any membership interests owned by another member of the MEC group. In this example, ACo and BCo are both eligible tier-1 companies and jointly nominate ACo to be the PHC of the MEC group.

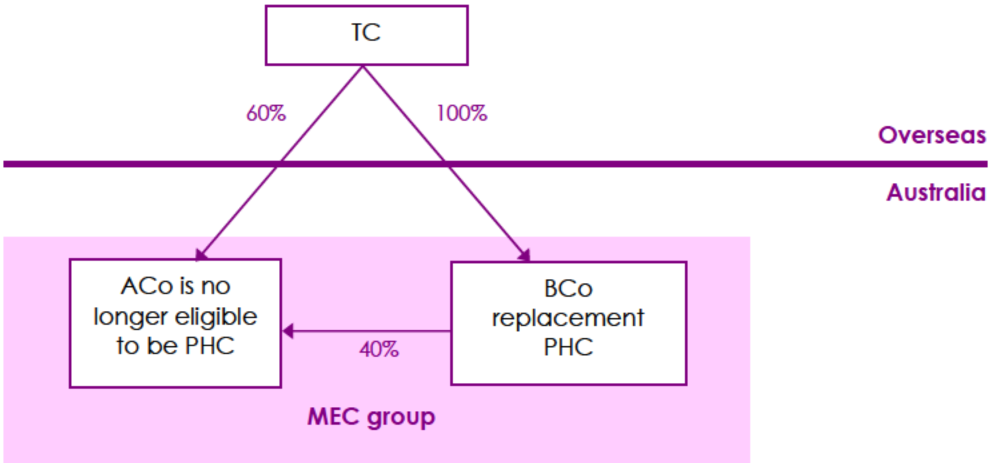
Figure 1: MEC group



Example 2 Replacement of a provisional head company

Within 28 days, ACo must notify the Commissioner of its failure to satisfy the conditions for being a PHC and ACo and BCo must notify the Commissioner of BCo's appointment as the PHC. → 'MEC groups – notifiable events', C10-1-110

Figure 2: Replacement of provisional head company



If no replacement PHC is appointed the MEC group will cease to exist.

When ACo as the head company at the end of one year is replaced by BCo as the new head company at the end of the following year, everything that happened to ACo before the changeover is taken to have happened to BCo. This is referred to as the 'transfer of history rule'. This rule also allows BCo to inherit everything that ACo inherited under the 'entry history rule' and the 'single entity rule' → sections 701-5 and 701-1 respectively, ITTA 1997. The purpose of the transfer of history rule is to enable the new head company to calculate its income tax liability or tax losses for the income year including the period before the changeover time.

References

Income Tax Assessment Act 1997, sections 701-1, 701-5, 719-60, 719-65, 719 –80; 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, paragraphs 4.87–105

Income Tax Assessment Act 1997, sections 719-85 and 719-90; 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 3.117 to 3.129

Income Tax Assessment Act 1997, sections 719-430 and 719-905; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedules 5, 9 and 24

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2), Chapters 7, 8 and 9