

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 appointed
 - 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 appoint one of themselves to be the PHC of the group. The notice to consolidate must include the appointment of the PHC.

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

A frankable dividend paid by an eligible tier-1 company or a transitional foreign-held subsidiary 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.

The head company is an Australian corporate tax entity for the purposes of applying the conduit foreign income provisions in Subdivision 802-A of the *Income Tax Assessment Act 1997* (ITAA 1997). Amounts of conduit foreign income received by subsidiary members of the MEC group are treated as being received by the head company.

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 appointed by the remaining eligible tier-1 companies of the group provided that:

- it has all its membership interests owned by entities outside the group
- broadly, it has been a member of the group since the beginning of the income year in which the cessation event happened, and
- the Commissioner of Taxation is notified within 28 days of the cessation event.

A replacement PHC must take on the same accounting period as that adopted by the former PHC.

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 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.

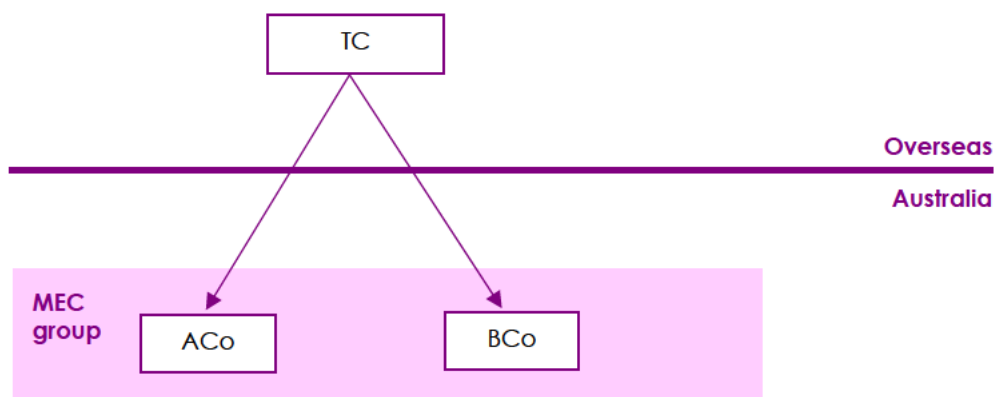
When a new provisional head company is appointed and the Commissioner is notified within the specified period, the franking account balance (including franking deficit) is transferred to the new PHC just before the cessation event.

→ section 719-430 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 appoint ACo to be the PHC of the MEC group.

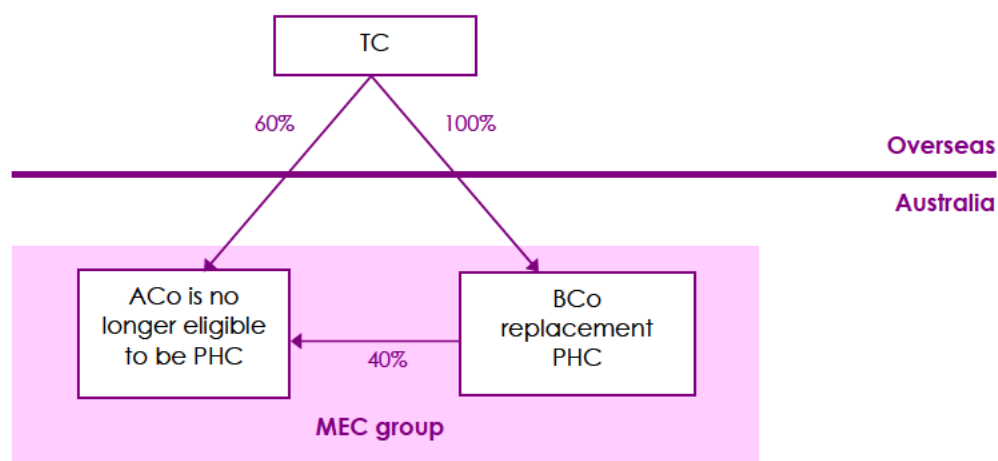
Figure 1: MEC group



Example 2 Replacement of a provisional head company

If BCo acquires 40% of ACo from TC, ACo will fail to satisfy the conditions for being a PHC. Within 28 days, ACo must notify the Commissioner of its failure to satisfy the conditions for being a PHC. ACo remains an eligible tier-1 company therefore ACo and BCo must notify the Commissioner of BCo's appointment as the PHC. → 'MEC groups – notifiable events', C10-1-110

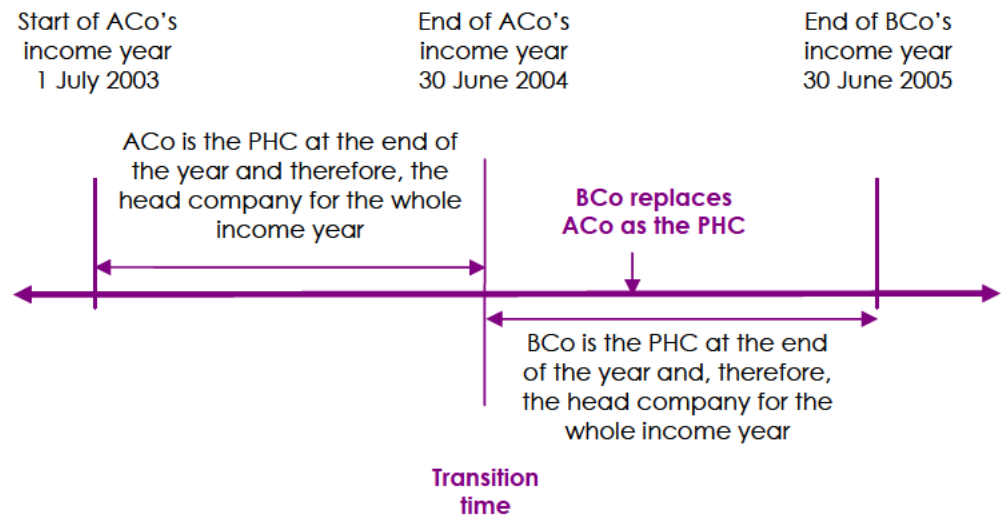
Figure 2: Replacement of provisional head company



If BCo remains as the PHC at the end of the income year, it will be the head company of the MEC group for the entire income year → section 719-75 of the ITA 1997. The time at which BCo replaces ACo as the head company is the start of the income year in which BCo became the PHC, and this is the transition time.

Everything that happened to ACo before the transition time is taken to have happened to BCo → sections 719-85 and 719-90 of the ITA 1997. This is referred to as the transfer of history rule and it 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, of the ITA 1997. The purpose of the transfer of history rule is to enable the new head company to calculate its income tax liability, or tax loss, for the income year in which the PHC is replaced, and any later income years.

Figure 3: Timeline of events



References

Income Tax Assessment Act 1936, Part III, Division 18

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 719-435; 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 8 and 9

Explanatory Memorandum to Tax Laws Amendment (*Loss Recoupment Rules and Other Measures*) Act 2005, paragraphs 5.101 to 5.105

Revision history

Section C10-2-130 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 changes to consolidation rules, p. 2.	Legislative amendments.
26.10.05	Changes throughout reflecting changes in the treatment of foreign dividend accounts.	Legislative amendment.
26.6.07	New text and figure in Example 2.	To clarify meaning of 'transition time'.
	Extensive changes to Commentary in relation to conduit foreign income.	Legislative amendment.

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).