Worked example

Tax cost setting of assets – expansion of a MEC group to include new eligible tier-1 companies

Description

This example explains how the tax cost setting rules apply when a MEC group expands to include new eligible tier-1 companies (ET-1s).

→ Subdivision 719-C; Division 701; Subdivisions 705-A, 705-C and 705-D

Commentary

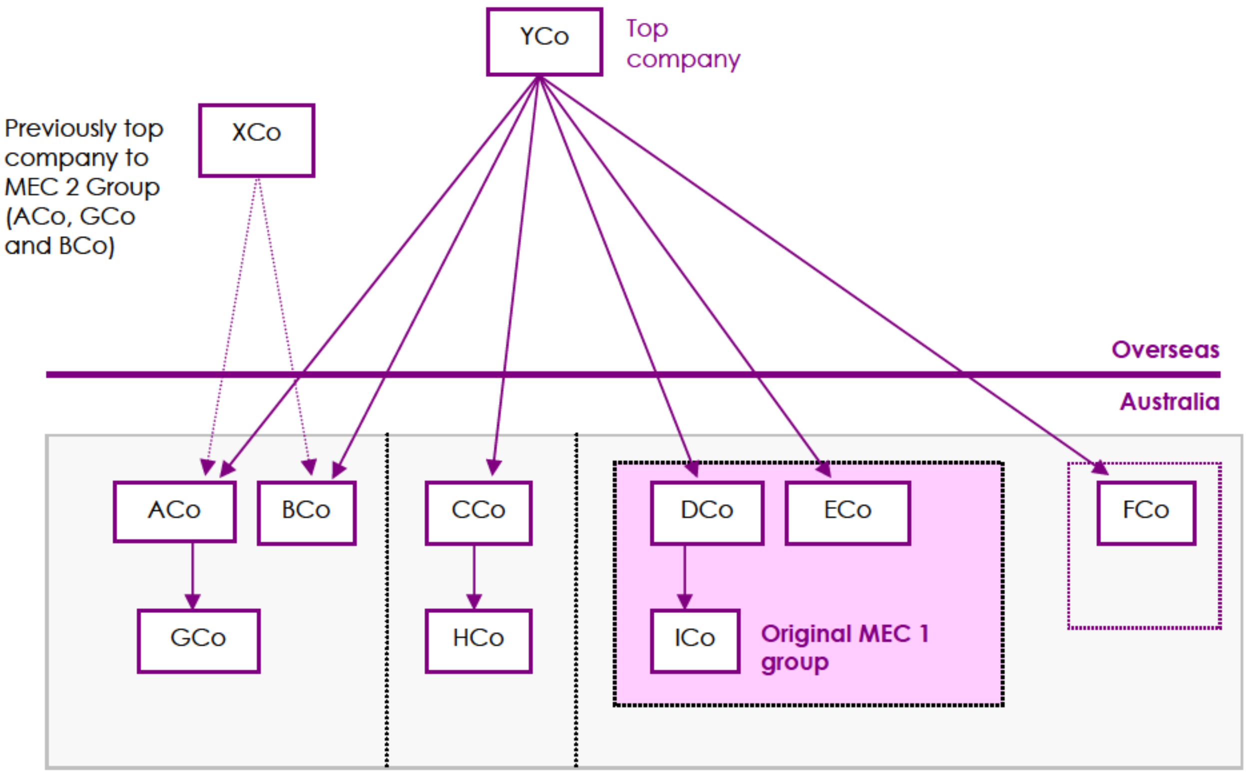
Broadly, the tax cost setting rules are modified for MEC groups so that when a company joins an existing MEC group as an eligible tier-1 company it does not have the cost of its assets reset. This is also the case when member companies of a consolidated group or MEC group join another consolidated or MEC group at the eligible tier-1 company level.

Example

Facts

All entities in figure 1 below are companies that meet the eligibility requirements for consolidation.

Figure 1: MEC group expands



Initially, YCo (a foreign resident) has three wholly-owned Australian subsidiaries: DCo, ECo and ICo. DCo and ECo choose to form a MEC group (MEC 1) consisting of the three companies, with DCo as the provisional head company.

This example shows how the cost setting rules apply if YCo acquires:

- FCo (by acquiring all the membership interests in that company)
- CCo and HCo (by acquiring all the membership interests in CCo), or
- ACo, BCo and GCo (by acquiring all the membership interests in ACo and BCo).

In each case, assume the decision is made to expand MEC 1.

Calculation

Acquisition of a single company at ET-1 level

When YCo acquires all the membership interests in FCo, FCo becomes an eligible tier-1 company. For the purposes of tax cost setting, an eligible tier-1 company is treated as part of the head company. Therefore, when FCo becomes a member of the MEC group, the tax cost of its assets is not reset (i.e. the assets retain their terminating values). → Subdivision 705-A as modified by Subdivision 719-C

Acquisition of linked companies or a consolidated group at ET-1 level

When YCo acquires all the membership interests in CCo, CCo joins the MEC group as an eligible tier-1 company, and HCo joins as another subsidiary member of the group. As with the acquisition of FCo, the assets belonging to CCo retain their terminating values.

However, cost setting rules apply to the assets of HCo → Subdivision 705-D as modified by Subdivision 719-C. If CCo and HCo had formed a consolidated group before their acquisition by YCo, all the assets of the group would have joined at their terminating values, as all the assets would already belong to the head company of the group (the single entity rule). → Subdivision 705-C as modified by Subdivision 719-C

Acquisition of a number of companies at ET-1 level or acquisition of a MEC group

When YCo acquires all the membership interests in ACo and BCo, they join the MEC group as eligible tier-1 companies. Again, the assets of these entities retain their terminating values.

The assets belonging to GCo would have their tax cost reset at the joining time → Subdivisions 705-A and 705-D as modified by Subdivision 719-C. However, if ACo, BCo and GCo were members of a MEC group (MEC 2) before their acquisition by YCo, all the assets would retain their terminating values. This is because the assets would all belong to the head company of MEC 2 (the single entity rule) before it joined the MEC 1 group. → Subdivision 705-C as modified by Subdivision 719-C

The following table summarises how tax cost setting rules apply in each case:

Table 1: Application of tax cost setting rules

Acquired entities	Consolidation status before acquisition by YCo	Relevant Subdivision	Eligible tier-1 companies	Other member companies	Are tax costs of the entity's assets reset?
FCo	Single company	705-A*	FCo		No
CCo and	Not consolidated	705-D*	CCo		No
HCo (via CCo)				HCo	Yes
CCo and	Consolidated group	705-C*	CCo		No
HCo (via CCo)				HCo	No
ACo, BCo	Not consolidated	705-D*	ACo		No
and GCo		705-D*	BCo		No
(via ACo and BCo)		705-A*		GCo	Yes
ACo, BCo	MEC group	705-C*	ACo		No
and GCo			BCo		No
(via ACo and BCo)				GCo	No

* as modified by Subdivision 719-C

The information in this table will also apply in the following circumstances (because the first tier of the newly acquired companies are eligible tier-1 companies):

- if YCo acquires the new eligible tier-1 companies through one or more interposed foreign-resident entities, or entities that are ineligible to be members of the MEC group (for example, a prescribed dual resident), or
- if a combination of YCo, any of the above interposed entities, and any members of the MEC group is used to acquire the membership interests in the eligible tier-1 companies.

Acquisition at other than ET-1 level

When a subsidiary member is acquired at a level other than the eligible tier-1 company level, the costs of its assets are reset under the relevant subdivision of Division 705 as modified by Subdivision 719-C.

References

Income Tax Assessment Act 1997, Division 705; 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 5

Income Tax Assessment Act 1997, Division 705; as amended by *New Business Tax System (Consolidation, Value Shifting, Demerger and Other Measures) Act 2002* (No. 95 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, Chapter 1

Income Tax Assessment Act 1997, Division 705 and Subdivision 719-C; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedules 4 and 8

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, Chapters 1 and 3

Income Tax Assessment Act 1997, Subdivision 719-C; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedules 11 and 12

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 2