



Taxation Determination

Income tax: consolidation: cost setting: is a joining entity's entitlement to claim a deduction for (or to otherwise deal with) a tax loss an asset for the purposes of section 705-35 of the *Income Tax Assessment Act 1997* if:

- (a) the tax loss is the subject of a loss transfer agreement entered into after the joining entity became a member of the consolidated group;
- (b) the loss transfer takes effect prior to that time; and
- (c) the joining entity is entitled to a subvention payment?

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Ruling

1. Yes. An entitlement to claim a deduction for (or to otherwise deal with) a tax loss would be a commercial or business asset of a joining entity at the joining time for which a purchaser of its membership interests would be willing to pay where there is a reasonable likelihood of a future economic benefit (such as a subvention payment) being received in respect of the tax loss. Where a tax loss is to be transferred by a written agreement entered into after the joining time, in respect of an income year prior to the joining time, a commercial or business asset representing the economic value of the loss would generally

be an excluded asset under subsection 705-35(2) of the *Income Tax Assessment Act 1997* (ITAA 1997) because of a reduction in the joining entity's allocable cost amount (ACA) under step 1 in the table in section 705-60 of the ITAA 1997 in respect of the asset.¹ However the asset representing the economic value of the loss would not be an excluded asset where a subvention payment is payable. In this case the asset would be a reset cost base asset.

2. In circumstances where the future income tax benefit asset is a reset cost base asset or where the allocable cost amount has been adjusted by the full amount of the tax loss under subsection 705-65(3), no step 5 (section 705-100) or step 6 (section 705-110) adjustment is required.

3. An equivalent treatment to that discussed in this Taxation Determination for tax losses applies to net capital losses.

Example 1

Subvention payment received for the transfer of the tax loss

4. On 1 July 2001 Head Co capitalises wholly owned subsidiaries Sub Co 1 and Sub Co 2 with share capital of \$100 each. For the year of income ended 30 June 2002 Sub Co 1 makes a taxable accounting profit of \$10, while Sub Co 2 incurs an economic and tax loss of \$10. Head Co elects to form a consolidated group from 1 July 2002. Shortly after the joining time, Sub Co 2 enters into a written agreement in accordance with section 170-50 to transfer the tax loss of \$10 in the 2002 year of income to Sub Co 1 under Subdivision 170-A in return for a subvention payment of \$3. Sub Co 2 could prepare the following notional statement of financial position at the formation time on the basis that as at 1 July 2002 no written agreement to transfer the tax loss has been entered into:

Sub Co 2			
Cash	90	Paid up Capital	100
FITB/Transferable tax loss	3	Accumulated losses	(7)
	93		93

5. The cost base of the shares in Sub Co 2 would be adjusted for the purposes of step 1 of the ACA under subsection 705-65(3). The cost base and reduced cost base of the shares would be the original CGT cost base of \$100, less the amount of the tax loss transferred of \$10, plus the subvention payment of \$3 (see paragraphs 170-210(3)(a), (b), (c) and (d)). The ACA of Sub Co 2 would be \$93 (as none of the other steps in the table in section 705-60 are relevant).

6. The future income tax benefit asset should be treated as a reset cost base asset that absorbs the ACA of \$3. This approach produces the correct outcome. If the future income tax benefit asset was treated as an excluded asset, it would not absorb the ACA and an inappropriate outcome would be produced. In this case there are no other reset cost base assets, and consequently CGT Event L4 loss of \$3 would happen under section 104-515.

¹ All references are to the ITAA 1997 unless otherwise stated.

7. The reason that the future income tax benefit asset is not an excluded asset in these circumstances is that the amount of the subvention payment to be received for the realisation of this asset is taken into account under paragraph 170-210(3)(d). The amount of the subvention payment represents the economic value of the future income tax benefit asset. Paragraph 170-210(3)(d) takes out of the reduction that would otherwise be made to the cost base and the reduced cost base of the membership interests in the joining entity the economic value represented by the future income tax benefit asset. The ACA of Sub Co 2 is, therefore, not reduced by an amount in respect of that asset, so it does not meet the requirements under subsection 705-35(2) for it to be an excluded asset.

8. Having regard to the purpose and effect of the adjustments to the ACA it would follow that in the circumstances described in this example, a step 5 (section 705-100) adjustment would not be required in respect of the transferred losses. An adjustment under this step would be inappropriate as any duplication of the economic loss is prevented because of the treatment of the future income tax benefit asset as a reset cost base asset.

Example 2

No subvention payment received for the transfer of the tax loss

9. Assume the same facts as in example 1 except that after the joining time Sub Co 2 has entered into a written agreement in accordance with section 170-50 to transfer the tax loss of \$10 in the 2002 year of income to Sub Co 1 under Subdivision 170-A and that the agreement does not provide for a subvention payment. The cost base of the shares in Sub Co 2 would be adjusted for the purposes of step 1 of the ACA under subsection 70-65(3). The cost base and reduced cost base of the shares would be the original CGT cost base of \$100, less the amount of the tax loss transferred of \$10 (see paragraphs 170-210(3)(a), (b), and (c)). The ACA of Sub Co 2 would be \$90 (as none of the other steps in the table in section 705-60 are relevant).

10. In these circumstances the future income tax benefit asset is an excluded asset because of the adjustment made to the ACA under Step 1. This is because subsection 705-65(3) requires the application of paragraphs 170-210(3)(a), (b) and (c). These provisions have the effect of reducing the value of the ACA by an amount that reflects any value of the future income tax benefit asset in respect of the loss in the circumstances where no subvention payment is received.

11. Having regard to the purpose and effect of the adjustments to the ACA under subsection 705-65(3) it follows that in the circumstances described in this example, there should be no step 5 (section 705-100) adjustment in respect of the transferred losses. An adjustment under this step would be inappropriate as any duplication of the economic loss is prevented because of the equity cost base adjustment required under Division 170.

Date of effect

12. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Explanation

13. Assets are recognised for the purposes of the consolidation cost setting rules on the basis that the head company of a consolidated group is acquiring a joining entity. Accordingly, an asset for the purposes of the tax cost setting rules is anything recognised in commerce and business as having economic value to the joining entity at the joining time for which a purchaser of its membership interests would be willing to pay. The business or commercial assets of a joining entity would include the things that would be expected to be identified by a prudent vendor and purchaser as having value in the making of a sale agreement in respect of all the membership interests in an entity and its business.

14. Subsections 701-10(2) and 701-10(4) provide that for each asset that would be an asset of the joining entity at the joining time, the asset's tax cost is set at its tax cost setting amount at that time.

15. Section 705-35 provides the means by which a joining entity works out the tax cost setting amount for each of its assets that are neither a retained cost base asset nor an excluded asset.

16. The joining entity's entitlement to claim a deduction for a tax loss, or to otherwise deal with the tax loss, is something that would be recognised in commerce and business as having economic value and consequently it would be an asset of the joining entity.

17. However, subsection 701-10(3) provides that the object of the tax cost setting rules is to recognise the cost to the head company of an asset of a joining entity as an amount reflecting the consolidated group's cost of acquiring the entity. In addition, subsection 705-10(2) states that the object of the tax cost setting rules is to recognise the head company's cost of becoming the holder of the joining entity's assets as an amount reflecting the group's cost of acquiring the entity.²

18. The question whether a joining entity's entitlement to claim a deduction for (or otherwise deal with) a tax loss is an asset for tax cost setting purposes must be answered by considering the perspective of a hypothetical buyer (including the head company) dealing with a hypothetical seller (including the shareholders of the loss company) and what assets would be paid for (would be attributed with value) in a hypothetical acquisition of the membership interests and business of the joining entity.

19. In adopting this approach where these assets are in respect of losses that have been transferred to other group members in respect of the year of income prior to the formation of the consolidated group, the identification of the relevant assets (if any) and the attribution of value to those assets should be undertaken to achieve the correct outcomes under the tax cost setting process.

² Similar object clauses exist in Subdivisions 705-B (subsection 705-145(1)), 705-C (paragraph 705-175(2)(b)) and 705-D (subsection 705-225(1)).

20. A reasonable valuer would undertake this process by having regard to the objective data and circumstances that exist at the joining time. If the objective data demonstrates that the joining entity has little or no likelihood of gaining value from its losses, it would be reasonable for the head company not to ascribe any value to the joining entity's entitlement to claim a deduction for (or otherwise deal with) the tax loss. In these circumstances no asset would be recognised for the purposes of Part 3-90.

21. However if the objective data demonstrated to the valuer that the joining entity had a reasonable likelihood of gaining value from deducting its losses (or otherwise dealing with them) it would be reasonable for the head company to ascribe the expected value of, say, a future subvention payment or the benefit of a loss deduction, to the entitlement to claim a deduction for (or otherwise deal with) the tax loss. In these circumstances an asset would be recognised for the purposes of Part 3-90.

References

Previous draft:

TD 2005/D50

Related Rulings/Determinations:

TR 2004/13; TD 2006/57

Subject references:

- asset
- consolidation
- consolidated group
- joining entity
- joining time
- losses
- loss transfer
- subvention payment

Legislative references:

- TAA 1953
- ITAA 1997 104-515
- ITAA 1997 Div 170
- ITAA 1997 Subdiv 170-A
- ITAA 1997 170-50

- ITAA 1997 170-210(3)(a)
- ITAA 1997 170-210(3)(b)
- ITAA 1997 170-210(3)(c)
- ITAA 1997 170-210(3)(d)
- ITAA 1997 Pt 3-90
- ITAA 1997 701-10(2)
- ITAA 1997 701-10(3)
- ITAA 1997 701-10(4)
- ITAA 1997 705-10(2)
- ITAA 1997 705-35
- ITAA 1997 705-35(2)
- ITAA 1997 705-60
- ITAA 1997 705-65(3)
- ITAA 1997 705-100
- ITAA 1997 705-110
- ITAA 1997 Subdiv 705-B
- ITAA 1997 705-145(1)
- ITAA 1997 Subdiv 705-C
- ITAA 1997 705-175(2)(b)
- ITAA 1997 Subdiv 705-D
- ITAA 1997 705-225(1)

ATO references

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