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Ruling Compendium – TD 2008/30

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D10 – Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*, is the CGT asset that an entity has contracted to buy from another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Entity/ies commenting	Issue raised	Tax Office Response/Action taken
1	1	<i>Identifying an asset arising under the contractual arrangement</i> Paragraph 2 of the draft Determination acknowledges that it may be possible to recognise another asset in relation to the contractual arrangements as an asset of the joining entity or leaving entity. Could the ATO provide guidance on the basis upon which any right which may exist at the joining or leaving time is brought to account.	Example 2 of the final Determination has been modified to clarify when an asset arising under the contractual agreement may be found to exist at the entity's joining or leaving time. Part C2-1-070 of the <i>Consolidation Reference Manual</i> provides further guidance on identifying assets arising out of contractual arrangements.
2	1 and 2	<i>Valuing the asset arising under the contract</i> Is the market value of the asset arising under the contract, such as a right, to be calculated on a net or gross basis for the purposes of allocating the allocable cost amount to the joining entity's assets in an entry-buy case?	The basis upon which an asset arising under the contractual arrangement can be tested for recognition as an asset for consolidation cost setting purposes is discussed more fully in Part C2-1-070 of the <i>Consolidation Reference Manual</i> . However, the Tax Office does not consider that a joining entity entering a straddle contract before the joining time ordinarily gives rise to a financial asset and a financial liability at the joining time. Section 705-58 of the ITAA 1997 refers to amounts that are set off under accounting standards. Relevant accounting standards allow amounts to set off in accounts where there is a legal right of set off.

		There are two methods by which the right may be valued: 1. net contract approach – the value of the right is determined net of any obligations which arise under the contract, or 2. gross right approach – any obligations exist under the contract are ignored in determining the value of the right. Section 705-59 of the ITAA 1997 sets out the rules that are to be applied where an entity has a set of linked assets and liabilities which, in accordance with accounting standards, are set off against each other and the net amount recognised in the entity's accounts. Where section 705-59 does not apply, section 705-58 will apply such that each asset and liability is recognised separately for tax consolidation purposes. From an accounting perspective, the recognition of a separate asset and liability for a straddle contract is generally found in AASB 139. A party that enters into an 'unconditional' contract for the receipt of an asset would recognise a financial liability at the time of entering into the contract. Alternatively, a party that enters into a 'conditional' contract for the receipt of an asset would recognise the financial liability when the asset is delivered.	A legal right to set off can only apply to legal liabilities. A legal liability will only arise when the consideration under the contract becomes payable. It follows that section 705-58 has no application to the circumstances of straddle contracts. Section 705-59 of the ITAA 1997 has no application either as it only applies to amounts that have been set off in the sense meant at section 705-58. This issue is discussed in more detail in the Tax Office discussion paper titled Legally enforceable right to set off.
3	2	Business combination accounting and asset values for ACA Under business combination accounting for certain assets, there is less focus on an asset's market value and a greater focus on whether the future benefits generated from having the asset in the future are at least equal to the amounts yet to be paid to acquire the asset. Does this impact on the ATO view for valuing the	Section 705-35 of the ITAA 1997 requires that the ACA be allocated to reset cost base assets in accordance with their market value. Market valuation has regard to both future benefits and costs in relation to an asset. See Part C2-1-070 of the <i>Consolidation Reference Manual</i>.

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		bundle of rights?	
4	2	<i>Business combination accounting: onerous contracts</i> There may be straddle contracts that could be viewed as 'onerous contracts' for business combination accounting purposes. For example, in an entry-buy case, the joining entity may have contracted to buy an asset for \$100 but it is now determined that the asset will generate only \$60 worth of economic benefits. The consolidated accounts of the acquiring group might show a \$40 liability making the possible application of section 705-70(1A) relevant.	This issue is outside the scope of the Determination which is concerned with the identification of assets of the joining or leaving entity. In the example provided, no asset would be recognised at the entity's joining time.
5	2	<i>Cost base of CGT asset acquired</i> The draft Determination would benefit from further guidance on the legislative mechanism by which amounts that are still to be paid under the contract are incorporated into the cost base of the CGT asset acquired under the contract.	This issue is outside the scope of the Determination which is concerned only with asset identification issues. To further assist taxpayers, worked examples setting out the income tax consequences for straddle contracts, including cost base calculations for CGT assets acquired under such contracts, will be included in the <i>Consolidation Reference Manual</i>.
6		Further exclusion from the Determination's scope	Paragraph 3 of TD 2008/30 clarifies that the acquisition or disposal of assets through the use of finance leases are not within the scope of the Determinations. Such situations raise a different set of issues to those addressed in the Determinations. The Tax Office will give further consideration to the way the law operates in these cases.
7	1	The Tax Office's view on the interaction of the consolidation provisions and straddle contracts are in 3 draft Determinations, a Discussion Paper and section C2-1-070 of the <i>Consolidation Reference Manual</i> which makes it difficult for taxpayers to form a comprehensive view of the income tax consequences for straddle contracts. We ask that the Tax Office give some consideration to how these documents interact and provide textual linkages between the documents.	The Tax Office acknowledges the comment. To further assist taxpayers, worked examples setting out the income tax consequences for straddle contracts will be included in the <i>Consolidation Reference Manual</i>.