

TD 2005/D19 - Income tax: consolidation exit tax cost setting rules: where an accounting liability added at subsection 711-45(1) of the Income Tax Assessment Act 1997 is modified by the operation of subsections 711-45(3) and (5), does the amount determined under subsection (5) override the adjustment made by subsection (3)?

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This document has been finalised by TD 2005/53.



Draft Taxation Determination

Income tax: consolidation exit tax cost setting rules: where an accounting liability added at subsection 711-45(1) of the *Income Tax Assessment Act 1997* is modified by the operation of subsections 711-45(3) and (5), does the amount determined under subsection (5) override the adjustment made by subsection (3)?

Preamble

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes. Where subsections 711-45(3) and 711-45(5) of the *Income Tax Assessment Act 1997* (ITAA 1997) both apply to a particular accounting liability that is added at subsection 711-45(1), the amount determined under subsection 711-45(5) overrides any adjustments made to that liability because of the operation of subsection 711-45(3).
2. The subsection 711-45(5) amount is the replacement amount at subsection 711-45(1) for that particular accounting liability.

Accounting liability added at subsection 711-45(1)

3. Step 4 of the exit allocable cost amount (ACA) subtracts amounts in respect of accounting liabilities of a leaving entity at the leaving time, as well as particular amounts that are treated as liabilities of the leaving entity under the exit ACA rules of the consolidation law. The purpose of subtracting these liabilities under step 4 of the exit ACA process is to ensure that the old group's ACA for the leaving entity reflects those liabilities that cease to be the responsibility of the old group at the leaving time.
4. The starting point in working out the exit step 4 amount is subsection 711-45(1). That subsection provides that the amount of each thing that is an accounting liability of the leaving entity at the leaving time (identified in the entity's statement of financial position) is taken into account in working out the step 4 amount of the exit ACA.

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5. Subsection 711-45(1) is substantially the same as subsection 705-70(1) of the ITAA 1997 at step 2 of the entry ACA process. Subsection 705-70(1) is the starting point for working out the amounts to be added at step 2 of the entry ACA for accounting liabilities of a joining entity. This is similar to subsection 711-45(1) which, as discussed above, is the starting point in working out the leaving entity's accounting liabilities that are taken into account in the exit ACA calculation process. Subsection 711-45(1) should, therefore, be interpreted in a corresponding manner to subsection 705-70(1).

6. Taxation Ruling TR 2004/14 provides guidance as to the interpretation of subsection 705-70(1) and the various phrases used in that subsection. The guidance in TR 2004/14 is equally applicable in interpreting subsection 711-45(1).

An accounting liability and the operation of subsections 711-45(3) and (5)

7. An accounting liability that is taken into account under subsection 711-45(1) could be modified or adjusted by the operation of subsections 711-45(2) to (5) and (8).

8. In some circumstances, an accounting liability counted at subsection 711-45(1) is adjusted by the operation of both subsections 711-45(3) and (5). A reduction to the accounting liability counted at subsection 711-45(1) is made by subsection 711-45(3) to discount the amount of the liability by the component of that liability which would give rise to a future tax deduction for the leaving entity. The amount counted for the accounting liability after the application of subsection 711-45(3) is replaced by the amount worked out under subsection 711-45(5), where the latter also applies.

9. This treatment is consistent with the order of application of the corresponding legislative provisions in step 2 of the entry ACA process.

10. Therefore, where an accounting liability is subject to the modifications contained in subsections 711-45(3) and (5), the adjustment made by subsection 711-45(5) overrides the previous reduction made to the accounting liability under the operation of subsection 711-45(3) for the amount that would be allowed as a future deduction.

Example

11. HeadCo is the head company of a consolidated group. The consolidated group forms on 1 January 2005. On 2 January 2005, HeadCo incorporates ACo for \$300,000 (1000 ordinary shares at \$300 each). ACo buys a block of land for \$200,000 and does not derive any trading income. On 31 May 2005 ACo makes a provision for annual leave of \$10,000 with respect to one of its employees and recognises a deferred tax asset (DTA) of \$3,000 for the provision. On 30 June 2005, ACo leaves the group when HeadCo sells all of the membership interests in ACo for \$293,000.

12. ACo's statement of financial position at the leaving time is shown in Table 1.

Table 1: ACo's Statement of Financial Position at 30 June 2005 (\$)

Cash	100,000	Equity	300,000
Land	200,000	Retained Earnings	(7,000)
		(loss)	
DTA (Annual Leave)	3,000	Provision for Annual Leave	10,000
	303,000		303,000

13. The exit ACA is shown in Table 2.

Table 2: Exit ACA calculation for A Co (\$)

Step 1	Add: Terminating values of assets that the leaving entity takes with it when it ceases to be a member	\$300,000
Step 4	less liabilities	(\$0)
	711-45(1)	\$10,000
	711-45(3)	(\$3,000)
	711-45(5)	0
Step 5	ACA	\$300,000

14. The exit step 1 amount is the head company's terminating value of cash (\$100,000) and land (\$200,000). The DTA for the provision for annual leave cannot contribute to the step 1 amount in the exit ACA calculation because the DTA has a terminating value of \$nil under section 711-30.

15. The liability to be considered under exit step 4 is the provision for annual leave of \$10,000. The accounting liability amount of \$10,000 which is counted under subsection 711-45(1) is reduced by \$3,000 under subsection 711-45(3) to reflect the amount that would be allowed as a deduction to ACo when the liability is met for income tax purposes. The amount of the provision is \$7,000 after the reduction under subsection 711-45(3).

16. The amount of the provision for annual leave is adjusted to \$nil by subsection 711-45(5). This is to remove distortions that would otherwise be caused by the inclusion in the ACA calculation of liabilities that are recognised for accounting purposes but have not yet been recognised for tax purposes.

17. Subsection 711-45(8) does not apply in this example as the accounting liability of \$10,000 was not taken into account in the entry ACA calculation of any subsidiary member of the consolidated group.

18. The exit ACA of \$300,000 is allocated to the membership interests in ACo. When ACo is sold the tax position of the group reflects the group's economic position, which is an economic loss of \$7,000.

Date of effect

19. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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Your comments

20. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

Due date: 22 July 2005
Contact officer: Thayanee Sathiamoorthy
E-mail address: Thayanee.sathiamoorthy@ato.gov.au
Telephone: (02) 9374 1588
Facsimile: (02) 9374 1629
Address: PO Box 1216
Hurstville NSW 2220

Commissioner of Taxation

22 June 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TR 2004/14

Subject references:

- accounting liability
- accounting standards
- allocable cost amount
- consolidation
- exit tax cost setting
- leaving entity
- leaving time

- order of application

- statement of financial position

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 705-70(1)
- ITAA 1997 711-30
- ITAA 1997 711-45(1)
- ITAA 1997 711-45(2)
- ITAA 1997 711-45(2A)
- ITAA 1997 711-45(3)
- ITAA 1997 711-45(5)
- ITAA 1997 711-45(8)

ATO references

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