


TD 2005/D50 - 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 not entitled to a subvention payment?

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This document has been finalised by TD 2006/56.



Draft 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 not entitled to a subvention payment?

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 IVA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. No. An entitlement to claim a deduction for (or to otherwise deal with) a tax loss would be an asset of a joining entity at the joining time. However where the 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, and no subvention payment would be received, the joining entity would not bring this asset into the consolidated group to be held by the head company. In these circumstances, neither the tax loss nor any other economic benefit would be transferred from the joining entity to the head company of the joined group. Notwithstanding that the tax loss still exists in the joining entity at the joining time, the entitlement to claim a deduction (or otherwise deal with) the tax loss could not be said to have any economic value to the head company. On the other hand, if there is likelihood that a subvention payment would be received by the loss company, a reasonable valuer could ascribe economic value to the entitlement to claim a deduction for (or otherwise deal

with) the tax loss because the joining entity would be able to bring the entitlement to the subvention payment into the consolidated group.

Explanation

2. 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.

3. Subsections 701-10(2) and 701-10(4) of the *Income Tax Assessment Act 1997* (ITAA 1997) 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.

4. Section 705-35 of the ITAA 1997 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.

5. 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.

6. However, subsection 701-10(3) of the ITAA 1997 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) of the ITAA 1997 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.¹

7. Therefore, 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) and what assets it would pay for (ascribe value to) in a hypothetical acquisition of the membership interests and business of the joining entity.

8. In adopting this approach the relevant inquiry is how much value would the hypothetical buyer (including the head company) ascribe to the joining entity's asset, being the entitlement to claim a deduction for (or otherwise deal with) the tax loss.

¹ Similar object clauses exist in Subdivisions 705-B (subsection 70-145(1)), 705-C (paragraph 705-175(2)(b)) and 705-D (subsection 705-225(1)) of the ITAA 1997.

9. 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 a history of transferring its tax losses under Division 170 of the ITAA 1997, the joining entity did not receive subvention payments in relation to those transfers, and the directors and management have not altered this practice, 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 of the ITAA 1997.

10. However if the objective data demonstrated to the valuer that the joining entity had a history of transferring tax losses under Division 170 of the ITAA 1997, subvention payments were usually received in relation to those transfers, and the directors and management have not altered this practice, it would be reasonable for the head company to ascribe the expected value of a future subvention payment 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 of the ITAA 1997.

11. An asset of a joining entity comprising an entitlement to claim a deduction for (or to otherwise deal with) a tax loss would be a reset cost base asset for the purposes of section 705-35 of the ITAA 1997, unless it is an excluded asset under subsection 705-35(2) of the ITAA 1997. However if a tax loss has been transferred under a written agreement prior to the joining time in exchange for a subvention payment that has not been paid at the joining time, the right to the subvention payment would be a retained cost base asset if it is a present right to the actual or constructive receipt of a fixed, nominal amount of Australian currency, without the presence of any element of contingency or defeasibility (refer to Taxation Ruling TR 2005/10 Income tax: consolidation: retained cost base assets consisting of Australian currency or a right to receive a specified amount of such currency).

12. When the joining entity transfers the tax loss under Division 170 of the ITAA 1997 in accordance with an agreement entered into after the joining time that takes effect for the income year or non-membership period² ending before the joining time, subsection 170-20(2) of the ITAA 1997 will apply. Under subsection 170-20(2), the loss company (joining entity) can no longer deduct the transferred tax loss and it is taken to have never incurred the tax loss to the extent it was transferred. Where subsection 170-20(2) applies to the joining entity's transferred tax loss, the tax loss will not be included under section 705-100 (step 5) of the ITAA 1997 or section 705-110 (step 6) of the ITAA 1997 in determining the joining entity's allocable cost amount.

Date of Effect

13. 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).

² Defined in section 701-30 of the ITAA 1997.

TD 2005/D50

Your comments

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

Due date: 18 November 2005
Contact officer: Paul Corrie
E-mail address: Paul.Corrie@ato.gov.au
Telephone: (08) 9268 5926
Facsimile: (08) 9268 5616
Address: GPO Box 9990
Perth WA 6001

Commissioner of Taxation

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TR 2004/13; TR 2005/10

Subject references:

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

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Div 170
- ITAA 1997 170-20(2)
- ITAA 1997 Pt 3-90
- ITAA 1997 701-10(2)
- ITAA 1997 701-10(3)
- ITAA 1997 701-10(4)
- ITAA 1997 705-35
- 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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Income Tax ~~ Consolidation ~~ tax cost setting amount
Income Tax ~~ Losses ~~ consolidation
Income Tax ~~ Losses ~~ transfer of losses