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## Taxation Determination

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Income tax: consolidation tax cost setting rules: step 3 of the allocable cost amount: is the 'retained profits' amount referred to in subsection 705-90(2) of the *Income Tax Assessment Act 1997* a cumulative retained profits balance?

### **Preamble**

*The number, subject heading, date of effect and paragraph 1 to paragraph 4 of this document are a 'public ruling' for the purposes of Part IVA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner.*

1. Yes. Undistributed profits are the cumulative retained profits of the joining entity that could be recognised in the joining entity's statement of financial position if that statement was prepared as at the joining time. This amount may be limited by subsection 705-90(3) of the *Income Tax Assessment Act 1997* (ITAA 1997) and paragraph 705-90(6)(a) and reduced by paragraph 705-90(6)(b).
2. Profits are determined in accordance with accounting standards as being the difference between revenue and expenses. Retained profits is the accumulation of those recorded profits which have not been distributed to owners, transferred to other reserves, or retrospectively adjusted due to the introduction of new or revised accounting standards. That is, retained profits are increased by net profits and transfers from other reserves, they are decreased by losses (if applicable), transfers to other reserves and distributions to owners. The resulting cumulative amount is the balance of retained profits. See generally, Leo and Hoggett, 'Company Accounting in Australia', (5th ed.) John Wiley & Sons, Australia, Ltd at pages 107 and 114.
3. Reserves created out of retained profits can be transferred back to retained profits in accordance with accounting standards, or statements of accounting concepts. Accordingly these reserves could be recognised in the joining entity's statement of financial position if that statement were prepared as at the joining time and can be counted in the retained profits amount for the purposes of subsection 705-90(2).
4. Reserves, created directly by the upward revaluation of the carrying value of an asset (without being reflected in the statement of financial performance), such as Asset Revaluation Reserve (ARR) or Foreign Currency Translation Reserve (FCTR), are not considered to be part of 'retained profits' for the purposes of subsection 705-90(2).

**Example**

5. On 1 July 2001 BCo is incorporated as a wholly owned subsidiary of ACo, with an initial capitalisation of \$200.00. For the year ended 30 June 2002 BCo made a profit of \$200.00 before tax and paid tax of \$60.00. BCo transfers \$50.00 to a reserve. Accordingly at 30 June 2002, BCo would have assets of \$340.00 of which \$90.00 represents retained profits and \$50.00 of reserves. For the year ended 30 June 2003 BCo made an accounting loss of \$70.00, after creation of a DTA of \$30.00 in respect of a tax loss of \$100.00. ACo elects to form a consolidated group effective from 1 July 2003.

6. In the above example, the retained profits balance under subsection 705-90(2) is \$20.00 (\$90.00 less \$70.00) plus \$50 of reserves created from retained profits that could be transferred back to retained profits and recognised in its statement of financial position.

**Date of effect**

7. 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

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**Commissioner of Taxation**27 October 2004

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*Previous draft:*

TD 2004/D32

*Related Rulings/Determinations:*

TR 92/20

*Subject references:*

- ACA
- allocable cost amount
- consolidation
- cost setting
- profits
- retained profits
- step 3

- undistributed profits

*Legislative references:*

- TAA 1953 Pt IVAAA
- ITAA 1997 705-90(2)
- ITAA 1997 705-90(3)
- ITAA 1997 705-90(6)(a)
- ITAA 1997 705-90(6)(b)

*Other References:*

- Leo and Hoggett, 'Company Accounting in Australia', (5th ed.) John Wiley & Sons, Australia, Ltd

## ATO references

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