



TD 2004/71 - Income tax: consolidation: can section 705-80 of the Income Tax Assessment Act 1997 apply to a liability (or a change in a liability) that is recognised for accounting purposes because of an event that occurred after the joining time that provides new evidence of conditions that existed at the joining time?

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 March 2011*



Taxation Determination

Income tax: consolidation: can section 705-80 of the *Income Tax Assessment Act 1997* apply to a liability (or a change in a liability) that is recognised for accounting purposes because of an event that occurred after the joining time that provides new evidence of conditions that existed at the joining time?

Preamble

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

[Note: *This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

1. Yes. If:
 - a liability (or a change in a liability) is recognised for accounting purposes because of an event that occurs after the joining time; and
 - the event provides new evidence of conditions that existed at the joining time,

then section 705-80 of the *Income Tax Assessment Act 1997* (ITAA 1997) will apply to the liability or change in liability taking into account the facts as now known.

Explanation

2. The purpose of section 705-80 is to ensure that, where necessary, an adjustment for unrealised gains and losses is made to the amount added under subsection 705-70(1) at Step 2 of the process for calculating the allocable cost amount (ACA) of a joining entity. The adjustment made by section 705-80 is for an unrealised gain or loss that arises where:

an accounting liability, or a change in the amount of an accounting liability, (other than one owed to a *member of the joined group) is taken into account [for income tax purposes] at a later time than is the case in accordance with the joining entity's *accounting principles for tax cost setting

Two examples of this form of liability are accrued employee leave entitlements and foreign exchange gains and losses.

3. Where an accounting liability (or a change thereof) is identified under paragraph 705-80(1)(a), subsection 705-80(1) requires that:

- a notional ACA be worked out under the assumption that the accounting liability is taken into account for income tax purposes at the same time as it is taken into account in accordance with the joining entity's accounting principles for tax cost setting; and
- if the notional ACA differs from the ACA calculated without making this assumption, the amount added under subsection 705-70(1) is to be increased or decreased (as the case requires) by the amount of the difference.

4. In working out an amount at a particular time or in respect of a particular period for the purposes of subsection 705-80(1), subsection 705-80(2) requires that the most reliable basis for estimation available be used.

Application of accounting standards to events occurring after the joining time

5. Subsection 705-70(1) of the ITAA 1997 applies an accounting framework to step 2 of the ACA process. The step 2 amount is worked out by adding up the accounting liabilities (including those to which section 705-80 applies) that, in accordance with the joining entity's accounting principles for tax cost setting, is a liability of the joining entity at the joining time.

6. In order to recognise and measure the accounting liabilities in a financial statement at the joining time in accordance with subsection 705-70(1), the joining time has to be treated, effectively, as a reporting date. In accordance with the principles in Accounting Standard AASB 110 *'Events after the Reporting Period'* only events occurring after the joining time and before the lodgment of the next consolidated income tax return after the joining time are to be considered.

7. AASB 110 states at paragraph 8 that 'an entity shall adjust the amounts recognised in its financial statements to reflect *adjusting events after the reporting period.*' An *adjusting event after the reporting period* is defined in paragraph 3 of that Standard as being an event which happens after the end of the reporting period but before the date when the financial statements are authorised for issue which provides evidence of the conditions that existed at the end of the reporting period.

8. Paragraph 10 of AASB 110 makes it clear that amounts in financial statements are not adjusted to reflect conditions that arise after the reporting period. The Standard acknowledges, however, that these conditions may need to be disclosed.

9. The application of the accounting standard AASB 110 *'Events after the Reporting Period'* in recognising and measuring liabilities under subsection 705-70(1) is discussed at paragraphs 83-86 of Taxation Ruling TR 2006/6.

10. For the purpose of making adjustments to step 2 of the ACA process in accordance with section 705-80 of the ITAA 1997, an event occurring after the joining time but before the lodgment of the first subsequent consolidated income tax return is only taken into account if:

- it provides new evidence of conditions that existed at the joining time; and
- the new evidence causes an adjustment to the accounting liability or requires the accounting liability to be recognised for the first time.

Example 1

11. On 1 April 2010, Jenny becomes an employee of ZCo. On 1 July 2010 ZCo joins a consolidated group of which HCo is the head company. By this time, Jenny has accrued one week of annual leave. However, ZCo omitted to make provision for the accrued leave. The oversight is noticed after the joining time but before the ACA process is carried out for the purpose of lodging the consolidated income tax return. The recognition by ZCo that it should have made provision for the leave and did not is an event that provides additional information of conditions that existed at the joining time. Therefore, the liability for the accrued annual leave must be taken into account for the purposes of section 705-80 of the ITAA 1997.

Example 2

12. On 1 July 2010 XCo joins a consolidated group of which HCo is the head company. Before the joining time, XCo had made a provision for long service leave in its accounts of \$10,000 for an employee, Fred, who is in his tenth year of employment at XCo. Fred's contract of employment stipulates that in order to receive the entitlement, he must serve for at least ten years. Further, there is no pro rata payout of the long service leave if Fred ceases employment before the ten years have passed unless his employment is terminated due to redundancy, illness, age retirement or death.

13. Fred voluntarily resigns in good health on 15 August 2010 having served only 9 years 8 months. Therefore XCo's liability with respect to Fred's long service leave entitlement ceases to exist. Nevertheless HCo still takes into account the \$10,000 liability for the purposes of section 705-80 of the ITAA 1997 because Fred's resignation is not an event that relates to conditions that existed at the joining time.

Date of effect

14. 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).

Commissioner of Taxation

1 December 2004

Previous draft:

TD 2004/D61

Related Rulings/Determinations:

TR 92/20; TR 2004/14

Subject references:

- AASB
- accounting expenses
- accounting liabilities
- accounting principles

- accounting standards
- Australian Accounting Standards Board
- calculation of the allocable cost amount
- consolidation
- deferred expenses
- deferred tax liabilities
- joining entity
- joining entity's accounting principles for tax cost setting

Legislative references:

- TAA 1953 Pt IVA

TD 2004/71

- ITAA 1997 705-70(1)
- ITAA 1997 705-80
- ITAA 1997 705-80(1)
- ITAA 1997 705-80(1)(a)
- ITAA 1997 705-80(2)

Other references:

- Accounting Standard AASB 110 'Events after the Reporting Period'

ATO references

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