TR 2004/D26 - Income tax: consolidation: retained cost base assets consisting of Australian currency or right to receive a specified amount of such currency

This document has been finalised by TR 2005/10.

Draft Taxation Ruling

Income tax: consolidation: retained cost base assets consisting of Australian currency or right to receive a specified amount of such currency

Contents Para

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 Rulings that represent authoritative statements by the Australian Taxation Office.*

What this Ruling is about

1. This Ruling considers when an asset of a joining entity will be a retained cost base asset in terms of paragraphs 705-25(5)(a) and (b) in Part 3-90 (Consolidated groups) of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. This Ruling does not consider:

- a retained cost base asset consisting of a pre-paid service entitlement in terms of paragraph 705-25(5)(c) of the ITAA 1997;
- the impact, if any, of the functional currency translation rules in Subdivision 960-D of the ITAA 1997 on the meaning of Australian currency;
- the additional retained cost base assets for a joining entity that is a life insurance company covered by section 713-515 of Subdivision 713-L of the ITAA 1997; or
- the modifications to Part 3-90 of the ITAA 1997 for assets consisting of trading stock of a continuing majority-owned entity in terms of section 701A-5 of the *Income Tax (Transitional Provisions) Act 1997*.

Date of effect

3. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the final Ruling 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 final Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Ruling

4. A retained cost base asset must first be a separately identified asset of a joining entity at the joining time. See generally Taxation Ruling TR 2004/13, *Income tax: the meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997*.

5. The reference to 'Australian currency' in paragraph 705-25(5)(a) of the ITAA 1997 only covers Australian currency of a joining entity and not such currency which the joining entity has a right to receive.

6. The reference to 'Australian currency' in paragraphs 705-25(5)(a) and (b) of the ITAA 1997 is limited to Australian notes issued by the Reserve Bank of Australia or Australian coins issued on the authority of the Federal Treasurer.

7. Australian coins will come within the definition of a collectable in subsection 108-10(2) of the ITAA 1997 where they are 'used or kept mainly for your or your *associate's personal use or enjoyment'. Such Australian coins will therefore come within the specific exclusion for collectables in paragraph 705-25(5)(a) of the ITAA 1997.

8. Australian coins or notes used as legal tender do not come within the specific exclusion for trading stock in paragraph 705-25(5)(a) of the ITAA 1997 as they are not 'held for the purposes of manufacture, sale or exchange in the ordinary course of a business' in accordance with the definition of trading stock at section 70-10 of the ITAA 1997.

9. Subject to the specific exception for marketable securities within the meaning of section 70B of the *Income Tax Assessment Act 1936* (ITAA 1936), a retained cost base asset in terms of paragraph 705-25(5)(b) of the ITAA 1997 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.

10. Where a joining entity holds a debt instrument in satisfaction for an underlying debt asset which has only been conditionally discharged by the debt instrument, then the underlying debt asset remains the relevant asset of the joining entity for consolidation cost-setting purposes.

11. Where a joining entity holds a debt instrument, but not the underlying debt asset that gave rise to the debt instrument (such as where the debt instrument has absolutely discharged the underlying debt under the terms of the relevant contract or the debt instrument was acquired on a secondary market), then the debt instrument is the relevant asset for consolidation cost-setting purposes.

Explanation

Separately identifiable asset

12. Taxation Ruling TR 2004/13 explains how the tax cost setting rules in Divisions 701 and 705 of the ITAA 1997 are based on an asset-based model which aligns the cost of the assets of a joining entity with the cost to the group of acquiring membership interests in the joining entity. This alignment is achieved by effectively allocating the direct and indirect costs of acquiring a joining entity (the 'allocable cost amount' or ACA) to each of its underlying assets. It follows that any retained cost base asset that gets allocated ACA in accordance with the operative provisions contained in Division 705 must first be an asset of a joining entity at the joining time. Therefore, in accordance with paragraph 5 of Taxation Ruling TR 2004/13, a retained cost base asset must be a thing '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'. Also, in accordance with paragraph 26 of that Ruling, a retained cost base asset must be an asset that should be separately identified. This requirement is of particular importance where a debt instrument is held in satisfaction for a debt and the question arises whether it is the underlying debt or the debt instrument which is the relevant asset. This issue is dealt with later in this Ruling at paragraphs 34 to 43.

Operative provisions

13. Paragraphs 705-25(5)(a) and (b) of the ITAA 1997 define a retained cost base asset as follows:

> **705-25(5)** A ***retained cost base asset*** is:
>
> (a) Australian currency, other than *trading stock or *collectables of the joining entity; or
>
> (b) a right to receive a specified amount of such Australian currency, other than a right that is a marketable security within the meaning of section 70B of the *Income Tax Assessment Act 1936*; or
>
> Example: A debt or a bank deposit.
>
> (c) …

The mechanism for determining what is the tax cost setting amount for a retained cost base asset covered by paragraph (a) or (b) is set out in subsection 705-25(2) of the ITAA 1997 as follows:

> *Australian currency*
>
> **705-25(2)** If the *retained cost base asset is covered by paragraph (a) or (b) of the definition of that expression and is not covered by another subsection of this section, its *tax cost setting amount is equal to the amount of the Australian currency concerned.

Where the retained cost base asset is a qualifying security within the meaning of Division 16E of Part III of the ITAA 1936, it receives a tax neutral transfer value in accordance with subsections 705-25(3) and 705-30(2) of the ITAA 1997.

Policy objective

14. According to paragraphs 5.22 and 5.24 of the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No.1) 2002 (the EM), the policy objective for treating certain assets of a joining entity that come within the terms of paragraphs 705-25(5)(a) and (b) of the ITAA 1997 as retained cost base assets is:

> To simplify compliance, a head company's cost for certain assets (retained cost base assets) is set equal to the joining entity's cost for those assets.
>
> ...
>
> This will avoid the compliance costs that would arise in dealing with these assets if their 'cost' was set at an amount that was different to their nominal value.

15. This compliance simplification policy objective is achieved by the operation of subsection 705-25(2) of the ITAA 1997, whereby the tax cost setting amount for these retained cost base assets is 'the amount of Australian currency concerned'. This will not be the joining entity's cost for the asset where the joining entity acquired the asset at a discount or premium to its nominal value. The reference in paragraph 5.22 of the EM to setting the cost of retained cost base assets 'equal to the joining entity's cost for those assets' must, then, be taken to be only referring to the general case. For example, discounted securities (not being qualifying securities) that are retained cost base assets in terms of paragraph 705-25(5)(b) of the ITAA 1997 will get a tax cost setting amount equivalent to their nominal value and not the discounted cost to the joining entity of acquiring them. Depending on the asset profile of the joining entity, this may result in timing differences in bringing any gain on such discounted securities to account for head company tax purposes.

Australian currency

16. What is encompassed by 'Australian currency' is set out in Taxation Determination TD 2002/25, *Income tax: is Australian currency a CGT asset under section 108-5 of the Income Tax Assessment Act 1997 if it is used as legal tender to facilitate a transaction?*. Consistent with that Taxation Determination, the reference to 'Australian currency' in paragraphs 705-25(5)(a) and (b) of the ITAA 1997 is considered to only encompass Australian notes issued by the Reserve Bank of Australia or Australian coins issued on the authority of the Federal Treasurer. Australian currency does not refer to cheques (including bank cheques) and money orders or other forms of debt instruments such as promissory notes or bills of exchange that are denominated in Australian currency. Nor does it cover foreign currency.

17. Paragraph 705-25(5)(a) of the ITAA 1997 only covers Australian currency of the joining entity and not Australian currency which the joining entity has a right to receive. As the legislative example indicates, Australian currency that a joining entity has deposited with a bank is no longer Australian currency of the joining entity, but would need to be considered as a right to receive a specified amount of Australian currency in terms of paragraph 705-25(5)(b) of the ITAA 1997.

18. Australian coins will come within the definition of a collectable in subsection 108-10(2) of the ITAA 1997 where they are 'used or kept mainly for your or your *associate's personal use or enjoyment'. Such Australian coins will therefore come within the specific exclusion for collectables in paragraph 705-25(5)(a) of the ITAA 1997.

19. Australian coins or notes used as legal tender do not come within the specific exclusion for trading stock in paragraph 705-25(5)(a) of the ITAA 1997 as they are not 'held for the purposes of manufacture, sale or exchange in the ordinary course of a business' in accordance with the definition of trading stock at section 70-10 of the ITAA 1997. This follows from Taxation Determination TD 2002/25 which states that Australian currency held as legal tender only serves as a medium of exchange to facilitate a transaction and is not a CGT asset.

Right to specified amount

20. A retained cost base asset in terms of paragraph 705-25(5)(b) of the ITAA 1997 is limited to an asset that is not a marketable security and which consists of 'a right to receive a specified amount of Australian currency'. Each of the elements of that expression is examined below (apart from 'Australian currency' which has already been addressed above). From that examination, we are of the view that this expression is referring to *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*.

Present right

Non-contingent

21. The legislative examples provided of a right to receive a specified amount of Australian currency of a 'debt' or a 'bank deposit' suggest that the type of right referred to in paragraph 705-25(5)(b) is a 'present' right. The ordinary legal usage of the term 'debt', when not expanded by such phrases as 'contingent' or 'future', identifies an obligation to make payment which has been actually incurred, rather than one subjected to a contingency yet to be fulfilled: *Pyramid Building Society (in liq) v. Terry* (1997) 189 CLR 176, per Gaudron and Gummow JJ at 189. A 'debt' is therefore an example of a present right to receive a specified amount of Australian currency where the performance of the corresponding obligation is not contingent.

22. A bank deposit (whether a term deposit, current account or savings account) is a contract of borrower and creditor: *Foley v. Hill and Ors* [1843-60] All ER Rep 16; *Joachimson v. Swiss Bank Corporation* [1921] 3 KB 110. Atkin LJ in *Joachimson's* case concluded that the bank is not liable to pay the customer until the customer demands payment. However, the requirement to demand payment only exists in the case of a current account or of a savings account which provides for payment at call. In the case of a fixed deposit, maturing at a predetermined time (term deposit), the amount involved becomes payable on the designated day. Modern banking practice shows that banks are willing to dispense with the need for a written demand, with customers being able to access their accounts via automated teller machines, a debit card or by remote means, such as via the telephone or over the internet. These modern means of accessing accounts would seem to have overtaken the principle of banking law that a demand for payment must be made at the branch where the account is kept in order to found a cause of action: see EP Ellinger, E Lomnicka and R Hooley, *Modern Banking Law*, 3rd Edition, 2002, Oxford University Press, at pp 95-98 and the decision in *Damayanti Kantilal v. Indian Bank* [1999] 4 SLR 1, 11 (Sing. CA). Therefore, a 'bank deposit' is also an example of a present right to receive a specified amount of Australian currency where performance of the corresponding obligation is non-contingent.

23. It is essential to refer to the particular contractual arrangements in place, any relevant statutory provisions and the operation of the general law in determining whether there is a contingency that needs to be satisfied before a present right to payment arises. The Full Federal Court decision in *Barratt and Ors v. FCT* 36 FCR 222; 92 ATC 4275; (1992) 23 ATR 339 is support for the position that the passage of time or a mere procedure (such as billing a trade debtor or a demand for payment for money held in a bank deposit account) does not amount to a contingency that prevents such a right from being recognised as a present right of the creditor. On the other hand, in *FCT v. Australian Gas Light Co* 83 ATC 4800; (1983)15 ATR 105 the statutory regime in place had the effect that, until various conditions precedent were satisfied (reading the meters and giving notice to customers of what is registered), no such present

right came into existence. Similarly, the Full Federal Court in *Gasparin v. FCT* 50 FCR 73; 94 ATC 4280; (1994) 28 ATR 130 held that in the sale of land, where the purchase price is to be paid at completion and the contract was otherwise unconditional, no accrued liability for the purchaser to pay the purchase price arises until the vendor has satisfied the obligation to effect a transfer of the land on the completion date.

Non-defeasible

24. Again, as the legislative examples of a 'debt' or a 'bank deposit' suggest, the right covered by paragraph 705-25(5)(b) of the ITAA 1997 is also limited to a present right which is not liable to be defeated. It follows that the right must be legally enforceable in the event of non-performance of the corresponding obligation to pay the specified amount of Australian currency. Otherwise, the entity with the corresponding liability to pay the specified amount of Australian currency may choose to pay some other lesser amount because the holder of the right has no legal recourse available.

25. Where the actual right (rather than the amount which the holder of the right may end up receiving), is liable to be defeated or terminated by the operation of a condition subsequent or conditional limitation, it cannot be a retained cost base asset. Nor can a right to receive a specified amount of Australian currency sounded only in notions of fairness, custom or usual business practices be a retained cost base asset. Also, consistent with the reasoning of the Full Federal Court in *BHP Billiton Petroleum (Bass Strait) Pty Ltd v. FCT* 2002 ATC 5169; (2002) 51 ATR 520, where there is an objectively bona fide dispute about a liability to pay a specified amount of Australian currency, the corresponding right will not be a retained cost base asset.

26. It is important to distinguish the situation where payment only is avoided from that where the legal right to that payment is liable to be defeated. For example, a right to receive the agreed price for the sale of an item may not be realised for that amount because of the credit risk of the customer. However, in the absence of specific provision in or variation to the agreement, the credit risk of the customer does not affect the present state of the right of the creditor to legally enforce recovery of the agreed amount, but only whether payment of that amount will be received. Therefore, the mere writing off of a debt as bad does not prevent the legal right to recover the debt if the financial position of the debtor subsequently improves or the circumstances which led to the debt being written off alter: see paragraph 39 of Taxation Ruling TR 92/18, *Income tax: bad debts*.

Receive

27. Given that there is no definition of 'receive' in the consolidation provisions, it remains to consider whether the use of that term in paragraph 705-25(5)(b) of the ITAA 1997 will also encompass a constructive receipt. Constructive receipt is where an amount is treated as received by an entity as soon as the entity gets benefit from it, although the entity has not actually received it. Such a consideration may become important in a number of scenarios, including where an entity has agreed for an amount to which it is entitled to be applied or set-off against other debts which it owes.

28. There are a number of factors suggesting that assets consisting of a right to receive a specified amount of Australian currency should also include assets consisting of a right to only the constructive receipt of a specified amount of Australian currency. Firstly, a right to receive a specified amount of Australian currency is itself a capital gains tax (CGT) asset under Part 3-1 of the ITAA 1997, being a legal or equitable right that is not property in terms of paragraph 108-5(1)(b) of the ITAA 1997. That provides a basis for incorporating CGT treatment of 'receipt' into the consolidation cost setting context. The term 'receive' appearing in the CGT rules is specifically given a wider meaning under section 103-10 of the ITAA 1997 to include money or other property that has been applied for an entity's benefit (including by discharging all or part of a debt it owes) or as the entity directs. Secondly, in the context of the compliance simplification policy objective for retaining the cost of certain assets, there is no basis for treating assets consisting of a right only to a constructive receipt differently from those assets consisting of a right to an actual receipt of a specified amount of Australian currency.

Specified amount

29. Under subsection 705-25(2) of the ITAA 1997, if the retained cost base asset is covered by paragraphs 705-25(5)(a) or (b) and is not covered by another subsection of section 705-25, its tax cost setting amount is equal to the amount of the Australian currency concerned (that is, the 'specified amount' of Australian currency). The Macquarie Dictionary (revised 3rd ed.) defines 'specify' in the following terms:

> **1.** to mention or name specifically or definitely; state in detail **2.** to give a specific character to; **3.** to name or state as a condition.

The amount of Australian currency concerned for a retained cost base asset in terms of paragraph 705-25(5)(b) will, then, be the specific or definitive amount which there is a right to receive. This also follows from the fact there must a fixed, nominal amount that can be identified for the purposes of applying subsection 705-25(2) to arrive at a tax cost setting amount.

30. A fixed, nominal amount would include a dollar amount that can be definitively arrived at by the use of a formula, rather than an expressly stipulated dollar amount, provided that it is not a self adjusting formula that could result in differing amounts to which there is a right to receive after the date of the agreement: see the obiter comments of Merkel J (Lee and Finn JJ agreeing) in *Harts Australia Ltd v. FC of T* 2001 ATC 4394; (2001) 47 ATR 371 about what is a 'specified amount' for the purposes of loss transfer agreements in accordance with section 80G of the ITAA 1936.

31. An amount does not cease to be a fixed, nominal amount in terms of paragraph 705-25(5)(b) of the ITAA 1997 where the amount which has to be actually paid to satisfy the right to that amount is subject to variation, such as where a discount is offered to a customer for prompt payment of a debt. A prompt payment discount arrangement introduces a contingency that only affects the amount which has to be paid to satisfy the debt, but not the fact that there is a presently owing debt for the full invoice price: see paragraphs 36 to 38 of Taxation Ruling TR 96/20, *Income tax: assessability and deductibility of prompt payment discounts offered by traders of goods to their customers and certain other discounts*.

32. A right to receive an uncertain amount (for example, unliquidated damages) cannot be a retained cost base asset in terms of paragraph 705-25(5)(b) of the ITAA 1997. Nor does it follow that there will be a retained cost base asset where there is a corresponding presently existing pecuniary liability, because a presently existing pecuniary liability can arise before the amount to be paid can be precisely ascertained: *FC of T v. Mercantile Mutual Insurance (Workers Compensation) Ltd* 99 ATC 4404; 42 ATR 8; *Commonwealth Aluminium Corporation Limited v. FC of T* 77 ATC 4151; (1977) 7 ATR 376.

33. Similarly, unbilled revenue may be recognised for accounting purposes even though the amount to be received is only capable of estimation. Paragraph 6.1.5 of the Australian Accounting Standards Board's standard on recognition of revenue (AASB 1004: Revenue) provides the example of where estimated revenue from the sale of minerals is recognised before the final assay. However, such estimated amounts of revenue that are recognised for accounting purposes will not amount to a right to receive a specified amount of Australian currency in terms of paragraph 705-25(5)(b) of the ITAA 1997. More generally, the fact that a right to payment may be treated as revenue for accounting purposes cannot be used as a substitute for giving the words in paragraph 705-25(5)(b) their intended meaning and effect.

Debt instruments

34. Debt instruments such as cheques, bills of exchange and promissory notes may be held by a joining entity in satisfaction for an underlying debt. It is our view that in these circumstances the contract that gave rise to the debt and satisfaction of that debt by a debt instrument is the one transaction. The reasons for this view are set out below. First, by way of background, a brief overview is given in the following discussion of what is a security and qualifying security in terms of subsection 159GP(1) of Division 16E of the ITAA 1936 and a marketable security within the meaning of section 70B of the ITAA 1936.

Security

35. The term 'security' as defined in subsection 159GP(1) of Division 16E of the ITAA 1936 means:

(a) stock, a bond, debenture, certificate of entitlement, bill of exchange, promissory note or other security;

(b) a deposit with a bank or other financial institution;

(c) a secured or unsecured loan; or

(d) any other contract, whether or not in writing, under which a person is liable to pay an amount or amounts, whether or not the liability is secured.

The term 'security' has therefore been defined very widely, and includes items that may not be usually regarded as securities, for example, contracts, so as to encompass various arrangements that may give rise to a deferral in the payment of income: see p. 58 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1986 which introduced Division 16E into the ITAA 1936. Therefore, any contract for the provision of property or services in the course of carrying on a business will itself be a security in terms of paragraph 159GP(1)(d) where it gives rise to a debt.

Eligible return

36. Broadly, the term of a security and its rate of 'eligible return' will determine whether the security is a qualifying security, marketable security or neither. In general, a security has an 'eligible return' if it is issued at a discount, redeemable at a premium, or bears interest that is deferred for a period of at least one year and it is reasonably likely at the time of issue, having regard to the terms of the security that the sum of all payments (other than 'periodic interest') under the security will exceed the issue price: see subsection 159GP(3) of the ITAA 1936. Interest is 'periodic interest' if it is expressed to be payable not more than one year from the time it commences to accrue: see subsection 159GP(6) of the ITAA 1936.

Qualifying security

37. Qualifying securities are subject to financial accruals taxation treatment under Division 16E of the ITAA 1936 and, among other things, are issued for a term that exceeds, or is reasonably likely to exceed, one year. For the purposes of the retained cost base asset provisions it is important to distinguish between a qualifying security that is a 'fixed return security' and a qualifying security that is a 'variable return security' as defined at section 159GP of the ITAA 1936. A qualifying security will be a 'fixed return security' where it has an 'eligible return' that exceeds 1.5 per cent that is precisely ascertainable at the time of issue of the security. A qualifying security will be a 'variable return security' where the amount or amounts payable do not consist of a specified amount or specified amounts and/or the method of calculation of which involves an interest or indexation rate or other factor that varies or may vary during the term of the security. A variable return security is not, then, a right to receive a specified amount and cannot be a retained cost base asset in terms of paragraph 705-25(5)(b) of the ITAA 1997.

Marketable security

38. A 'marketable security' as defined at subsection 70B(7) of the ITAA 1936 is a 'traditional security' that is covered by paragraph (a) of the definition of 'security'. Broadly, securities will be traditional securities where they either do not have an 'eligible return' or do not have a substantial 'eligible return' (not more than 1.5 per cent), are not Commonwealth securities that do not bear interest and do not form part of the taxpayer's trading stock: see subsection 26BB(1) of the ITAA 1936. A traditional security is, in effect, a security that is not a qualifying security or a deeply discounted (more than 1.5 per cent eligible return) short term (one year or less) security, such as a 90 or 180 day bill of exchange.

39. Subparagraph 4(i) of Taxation Ruling TR 96/14, *Income tax: traditional securities*, states that paragraph (a) of the definition of 'security' is referring to those securities which are generally recognised as 'debt instruments'. Later, at paragraph 29, TR 96/14 elaborates that debt instruments are those types of securities that 'evidence an obligation on the part of the issuer or drawer to pay an amount to the holder or acceptor'. The definition of marketable security is therefore intended to cover instruments such as cheques. Moreover, a cheque is legally a bill of exchange in most cases: see Tyree, AL, 2002, *Banking Law in Australia*, 4th Edn., Butterworths, Sydney, p. 185.

Identification of relevant asset

40. The exclusion of a 'marketable security' at paragraph 705-25(5)(b) of the ITAA 1997 does not necessarily imply that a marketable security held by a joining entity is a reset cost base asset of a joining entity at the joining time in accordance with Taxation Ruling TR 2004/13. Paragraph 26 of that Ruling states that the 'extent and degree to which assets of the entity should be separately identified or treated as composite items would depend on the nature of the asset and the nature of the business being carried on by the entity and the circumstances of the particular case'. It is therefore important to consider whether a marketable security held in satisfaction of a debt, is an asset to be separately identified from the underlying debt asset.

41. The following passage from Vermeesch, R B & Lindgren, KE, 2001, *Business Law of Australia*, 10th Edn, Butterworths, Australia, p. 323 is instructive about what is the relevant asset to be identified for consolidation cost-setting purposes where a debt instrument is held in satisfaction of a debt:

> If payment is made otherwise than by legal tender, eg by a cheque, bill of exchange or promissory note, the debtor will not obtain absolute discharge unless the contract provides for this. If it does not, the discharge will be conditional upon the instrument being honoured. If it is not, the original liability will revive and the creditor may sue on the contract or on the instrument. If a contract provides that settlement shall be made by means of a bill of exchange or promissory note then when the bill of exchange or promissory note is given it operates as a discharge of the contract, and the creditor's only remedy in the event of dishonour is the sue on the bill of exchange or promissory note.

42. Although, the above passage refers to 'payment' by a cheque, bill of exchange or promissory note, strictly speaking, it is not a payment at all where it only conditionally discharges the debt that gave rise to the instrument: see chapter 26 of Tyree (supra). Therefore, where a joining entity holds a debt instrument as 'payment' for an underlying debt asset which has only been conditionally discharged by the security, the underlying debt asset remains the relevant asset of the joining entity for consolidation cost-setting purposes. On the other hand, where a joining entity holds a debt instrument, but not the underlying debt asset that gave rise to the debt instrument (such as where the debt instrument has absolutely discharged the underlying debt under the terms of the relevant contract or the debt instrument was acquired on a secondary market), the debt instrument is the relevant asset for consolidation cost-setting purposes.

43. The following table sets out the outcomes that follow from the above paragraph:

DEBT INSTRUMENT	RELEVANT ASSET	TAX COST
Issued for one year or less with a precisely ascertainable eligible return of more than 1.5% (eg, a 90 or 180 day deep-discount bill of exchange) acquired as conditional discharge of a debt.	Underlying debt	Retained at nominal amount of the underlying debt.
As above, but acquired as absolute discharge of a debt or on a secondary market.	Debt instrument	Retained at nominal amount of debt instrument because it is neither a qualifying nor marketable security.
Issued for any period with an eligible return of 1.5% or less (eg, a shallow or no discount note such as a cheque) acquired as conditional discharge of a debt.	Underlying debt	Retained at nominal amount of the underlying debt.
As above, but acquired as absolute discharge of a debt or on a secondary market.	Debt instrument	Reset on the basis of market-value share of ACA because it is a marketable security.
Issued for a period exceeding one year with a precisely ascertainable eligible return of more than 1.5% (eg, a deep discount promissory note) acquired as conditional discharge of a debt.	Underlying debt	Retained at tax neutral transfer value as the contract giving rise to the debt and the payment arrangement is treated as one transaction being a 'fixed return security'.
As above, but acquired as absolute discharge of a debt or on a secondary market.	Debt instrument	Where this qualifying security is a 'fixed return security' it is retained at the tax neutral transfer value.

Examples

Note 1: The following examples do not obviate the need to consider in each specific case all the facts, including the terms of the contractual and/or statutory arrangements in place, and the general law.

Note 2: Any conclusion in the following examples that there is a retained cost base asset assumes that there is an asset in the first place in accordance with Taxation Ruling TR 2004/13.

Example 1 – Factored debt

44. Just before joining a consolidated group, Subco (a factor company) acquired a book of mature, unconditional and legally enforceable debts with a face value of $1 million, but which it bought at a discount for $700,000.

45. The debts are retained cost base assets and will receive a tax cost setting amount equivalent to their nominal value of $1 million in accordance with subsection 705-25(2) of the ITAA 1997.

Example 2 – Loan

46. Just before joining a consolidated group, Subco lends $1 million for 10 years at a fixed interest rate with the principal and interest amounts to be paid back monthly as specified in the loan documentation. The loan is not a marketable security.

47. The loan is a retained cost base asset and will receive a tax cost setting amount equivalent to its nominal value of $1 million in accordance with subsection 705-25(2) of the ITAA 1997.

Example 3 – Accrued interest

48. The same facts as in Example 2, however, $10,000, being one month's interest, has accrued under the loan but has yet to be received at the joining time.

49. The $10,000 will be a debt which is treated as a separate retained cost base asset from the loan asset and will get a tax cost setting amount equal to its nominal value of $10,000.

Example 4 – Bank deposit

50. Just before joining a consolidated group, Subco holds a bank account with a balance of $1 million which pays interest on a daily basis and which Subco can make deposits to or withdrawals from at any time. The account can be operated electronically to withdraw or transfer amounts up to $10,000, but for larger amounts signed authorisation by Subco's public officer is required.

51. The need to get signed authorisation for the withdrawal or transfer of amounts over $10,000 is not a true contingency, but only a mere procedure which does not affect the fact that the amounts standing in the bank account to the credit of Subco consist of a 'right to receive a specified amount of Australian currency' in terms of paragraph 705-25(5)(b) of the ITAA 1997.

Example 5 – Right to indemnity

52. Subco is a guarantor for Debtco for $1 million that Debtco has borrowed from Bankco. The contract of guarantee between Subco and Bankco creates a corresponding obligation on Debtco to indemnify Subco. Just before it joins a consolidated group, Subco has not been called upon to make any payments to Bankco under the guarantee.

53. The undertaking to indemnify is an undertaking to reimburse Subco upon the happening of a contingency, viz, payment by Subco to Bankco under the contract of guarantee. Until that contingency happens, there is no debt: see Taxation Ruling TR 96/14 at paragraph 43, referring to *Re A Debtor (No. 627 of 1936)* [1937] 1 All ER 1 at 8.

54. However, had Subco paid Bankco $1 million under the guarantee before the joining time, then Debtco would be liable to pay Subco $1 million. In this case there would be a debt which is a retained cost base asset that will receive a tax cost setting amount equal to its nominal amount of $1 million in accordance with subsection 705-25(2) of the ITAA 1997.

Example 6 – Deferred consideration

55. Just before the joining time, Subco has entered into a binding contract for the sale of a business for $400,000 plus a further amount if the business continues to be successful. This is a divisible contract consisting of a right to receive $400,000 for the sale of the business, and a right to receive a further amount if the business continues to be successful.

56. The right to receive $400,000 under the contract for the sale of the business is a retained cost base asset which will get a tax cost setting amount equal to its nominal amount of $400,000 in accordance subsection 705-25(2) of the ITAA 1997.

57. Subco's right to receive a further amount is not a retained cost base asset because Subco only has a right to a contingent and unascertainable amount. That right may be a separate reset cost base asset.

Note: This example is based on the decision in *Marren v. Ingles* [1980] 3 All ER 95 referred to in Taxation Ruling TR 93/15, *Income tax: capital gains tax consequences of consideration comprising a lump sum plus a right to a contingent and unascertainable amount*.

Your comments

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

Due date: **4 March 2005**
Contact officer: **Philip White**
E-mail address: **philip.white@ato.gov.au**
Telephone: **(02) 6216 1071**
Facsimile: **(02) 6216 1509**
Address: **PO Box 900, Civic Square, ACT, 2608**

Detailed contents list

59. Below is a detailed contents list for this draft Taxation Ruling:

Commissioner of Taxation
22 December 2004

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/18; TR 92/20; TR 93/15; TR 96/14; TR 96/20; TR 2004/13; TD 2002/25

Subject references:

- asset
- Australian currency
- bank deposit
- cheque
- consolidation
- cost setting
- debt
- debt instrument
- eligible return
- joining entity
- marketable security
- qualifying security
- receive
- retained cost base asset
- security
- specified amount
- subsection 705-25(5)

Legislative references:

- ITAA 1936 26BB(1)
- ITAA 1936 70B
- ITAA 1936 70B(7)
- ITAA 1936 80G
- ITAA 1936 Pt III Div 16E
- ITAA 1936 159GP
- ITAA 1936 159GP(1)
- ITAA 1936 159GP(1)(d)
- ITAA 1936 159GP(3)
- ITAA 1936 159GP(6)
- ITAA 1997 70-10
- ITAA 1997 Pt 3-1
- ITAA 1997 103-10
- ITAA 1997 108-5
- ITAA 1997 108-5(1)(b)
- ITAA 1997 108-10(2)
- ITAA 1997 Pt 3-90
- ITAA 1997 Div 701
- ITAA 1997 Div 705
- ITAA 1997 705-25
- ITAA 1997 705-25(2)
- ITAA 1997 705-25(3)
- ITAA 1997 705-25(5)(a)
- ITAA 1997 705-25(5)(b)
- ITAA 1997 705-25(5)(c)
- ITAA 1997 705-30(2)
- ITAA 1997 Subdiv 713-L
- ITAA 1997 713-515
- ITAA 1997 Subdiv 960-D
- TAA 1953 Pt IVAAA
- IT(TP)A 1997 701A-5

Case references:

- Barratt and Ors v. FCT 36 FCR 222; 92 ATC 4275; (1992) 23 ATR 339
- BHP Billiton Petroleum (Bass Strait) Pty Ltd v. FCT 2002 ATC 5169; (2002) 51 ATR 520

- Commonwealth Aluminium Corporation Limited v. FC of T 77 ATC 4151; (1977) 7 ATR 376
- Damayanti Kantilal v. Indian Bank [1999] 4 SLR 1, 11 (Sing. CA)
- FCT v. Australian Gas Light Co 83 ATC 4800; (1983)15 ATR 105
- FC of T v. Mercantile Mutual Insurance (Workers Compensation) Ltd 99 ATC 4404; 42 ATR 8
- Foley v. Hill and Ors [1843-60] All ER Rep 16
- Gasparin v. FCT 50 FCR 73; 94 ATC 4280; (1994) 28 ATR 130
- Harts Australia Ltd v. FC of T 2001 ATC 4394; (2001) 47 ATR 371
- Joachimson v. Swiss Bank Corporation [1921] 3 KB 110
- Marren v. Ingles [1980] 3 All ER 95
- Pyramid Building Society (in liq) v. Terry (1997) 189 CLR 176
- Re A Debtor (No. 627 of 1936) [1937] 1 All ER 1

Other references:

- AASB 1004: Revenue, Australian Accounting Standards Board
- Ellinger, EP, Lomnicka, E and Hooley, R 2002, Modern Banking Law, 3rd Edition, Oxford University Press
- Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002
- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 2) 1986
- Macquarie Dictionary, revised 3rd edition
- Tyree, AL, 2002, Banking Law in Australia, 4th Edition, Butterworths, Sydney
- Vermeesch, RB and Lindgren, KE 2001, Business Law of Australia, 10th Edition, Butterworths, Australia

ATO references
NO: 2004/13617
ISSN: 1039-0731