


***TD 2004/D61 - 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?***

 This cover sheet is provided for information only. It does not form part of *TD 2004/D61 - 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?*

This document has been finalised by TD 2004/71.



## Draft 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**

*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. 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 \*accounting standards or statements of accounting concepts made by the Australian Accounting Standards Board [AASB].

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 accounting standards or statements mentioned in paragraph 3; 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. For the purposes of subsection 705-70(1), accounting liabilities (including those to which section 705-80 applies) must be recognised and measured by all joining entities in accordance with accounting standards or statements of accounting concepts made by the AASB.

6. In order to recognise and measure the accounting liabilities for a statement of financial position at the joining time in accordance with subsection 705-70(1), the joining time has to be treated, effectively, as a reporting date. For the purposes of the accounting standard AASB 1002 (AAS 6) '*Events Occurring After Reporting Date*' only, the lodgement of the next consolidated income tax return after the joining time is treated as a reporting date.

7. AASB 1002 states at paragraph 4.2 that:

The financial report must reflect the financial effect of an event occurring after [the] reporting date [but prior to the time of completion of the report] that:

- a) Provides additional evidence of conditions that existed at [the] reporting date; or
- b) Reveals for the first time a condition that existed at [the] reporting date.

Paragraph 4.2.1 of AASB 1002 states that where an event occurring after the reporting date provides further information about the conditions existing at the reporting date, the initial estimates of assets and liabilities are adjusted in accordance with the new information.

8. Paragraph 5.1.1 makes it clear that an event occurring after the reporting date does not give rise to adjustments to assets and liabilities if the event does not relate to conditions existing at the reporting date, although such events may need to be disclosed.

9. Therefore, 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 lodgement 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**

10. *On 1 April 2004, Jenny becomes an employee of ZCo. On 1 July 2004 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**

11. *On 1 July 2004 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.*

12. *Fred voluntarily resigns in good health on 15 August 2004 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**

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).

# TD 2004/D61

## 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.

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## Commissioner of Taxation

8 September 2004

### *Previous draft:*

Not previously issued in draft form

### *Related Rulings/Determinations:*

TR 92/20; TR 2004/D11

### *Subject references:*

- AASB
- accounting expenses
- accounting liabilities
- accounting standards
- Australian Accounting Standards Board
- calculation of the allocable cost amount
- consolidation
- deferred expenses

- deferred tax liabilities

- joining entity

- statements of accounting concepts

### *Legislative references:*

- TAA 1953 Pt IVAAA
- 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 1002 'Events Occurring After Reporting Date'

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## ATO references

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