

TD 2005/D21 - Income tax: consolidation: how is the tax cost of goodwill referred to in subsection 711-25(2) of the Income Tax Assessment Act 1997 identified?

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This document has been finalised by TD 2007/27.



Draft Taxation Determination

Income tax: consolidation: how is the tax cost of goodwill referred to in subsection 711-25(2) of the *Income Tax Assessment Act 1997* identified?

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. If at the leaving time a head company holds goodwill identified under subsection 705-35(3) of the *Income Tax Assessment Act 1997* (ITAA 1997), because of its control and ownership of the leaving entity, and loss of control or ownership would result in a decrease in the market value of that goodwill, the cost base of such goodwill is added to the step 1 amount by subsection 711-25(2) of the ITAA 1997 in working out the old group's tax cost setting amount for the membership interests in the leaving entity under sections 711-15 and 711-20 of the ITAA 1997
2. Division 711 of the ITAA 1997 addresses how to work out a consolidated group's cost of membership interests in entities that cease to be subsidiary members of a consolidated group. The tax cost setting amount for each membership interest that the old group holds in a leaving entity is worked out under sections 711-15 and 711-20 of the ITAA 1997. The first step in working out the tax cost setting amount for membership interests under section 711-25 of the ITAA 1997 (the step 1 amount) is to add up the terminating values of assets that the leaving entity takes with it when it ceases to be a subsidiary member. The terminating value of an asset that a head company holds at the leaving time (other than trading stock, qualifying securities and depreciating assets) is equal to its cost base (section 711-30 and subsections 705-30(4) and 705-30(5) of the ITAA 1997) or its reduced cost base where subsection 711-20(2) applies.
3. Subsection 711-25(2) of the ITAA 1997 provides that, if loss of control and ownership of the leaving entity by the head company would decrease the market value of the goodwill of the old group, the head company's cost base of goodwill (that it holds at the leaving time because of its control and ownership of the leaving entity) is added to the step 1 amount. The goodwill identified by subsection 711-25(2) of the ITAA 1997 if it remains at the leaving time can only be identified at the joining time under subsection 705-35(3) of the ITAA 1997 (subsection 705-35(3) goodwill) assuming there is goodwill of this character. However, businesses may split or merge over time. For the purpose of identifying the cost base of such goodwill under subsection 711-25(2) of the ITAA 1997, the cost base of

subsection 705-35(3) goodwill may split into two or more amounts or merge with other subsection 705-35(3) goodwill in accordance with changes to the organisation of the businesses, as is the case with goodwill generally (refer Taxation Ruling TR 99/16, Income tax: capital gains: goodwill of a business at paragraphs 63-65 and paragraphs 70-79 for a summation of goodwill merger and split rules respectively).

4. To determine if subsection 711-25(2) of the ITAA 1997 applies when a particular entity leaves the consolidated group it is necessary to determine whether a business of that entity gave rise to a subsection 705-35(3) goodwill asset in the head company. In a simple case, a joining entity and the consolidated group may carry on one business each. In other cases, the goodwill may arise from synergies between multiple businesses of a joining entity and the consolidated group.

5. Goodwill of a head company can only be added to the step 1 amount under subsection 711-25(2) where it has been established that this goodwill of the business of the head company matches at least in part the goodwill asset previously identified under subsection 705-35(3). As a minimum the records of the group should show:

- the total amount of economic benefits expected to accrue to group members at the joining time from control and ownership of a joining entity and the basis on which that amount was determined;
- the entities and their respective businesses that gave rise to each amount of subsection 705-35(3) goodwill (a head company can have more than one goodwill asset);
- the market value of amounts of subsection 705-35(3) goodwill attributable to each business of the group just after the joining time and the basis on which the values were worked out or sufficient information to work out these values; and
- details of any split or merger of subsection 705-35(3) goodwill and of the changes to a business or businesses of the head company that subsequently affected that goodwill.¹

Example

6. *H Co is the head company of a consolidated group. H Co carries on a manufacturing business. H Co purchases 100% of A Co which carries on business as a distributor. H Co's goodwill is existing goodwill from its manufacturing business and subsection 705-35(3) goodwill from its control and ownership of A Co. Similarly A Co has goodwill consisting of its own existing goodwill from its distribution business and may have synergistic goodwill from its relationship with the consolidated group.*

7. *H Co sells all of its shares in A Co and synergies between the businesses are destroyed. The value of H Co's goodwill in its business is reduced but not destroyed in this case.*

8. *Under subsection 711-25(2) of the ITAA 1997 the cost base of the section 705-35(3) goodwill that the head company holds at the leaving time because of its control and ownership of A Co is added to the step 1 amount to work out the old group's tax cost setting amount for membership interests in the leaving entity, A Co.*

¹ Ceasing to be a member of a consolidated group may cause a CGT event to happen. If a head company sells shares in an entity and the sale of shares is on capital account, CGT event A1 (disposal of a CGT asset) may occur. Ceasing to be a member of a group may have revenue consequences if the sale of shares is on revenue account (for example, if the head company holds the membership interests for a profit making purpose). The head company will therefore need to keep records in accordance with 262A of the *Income Tax Assessment Act 1936* and section 121-20 of the ITAA 1997.

Date of effect

9. 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).

Your comments

10. 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

29 June 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- accounting & record keeping
- accounting records
- allocable cost amount
- capital gains tax
- CGT records
- consolidation
- consolidation – assets consolidation
- consolidation – exiting
- cost of membership interests
- documentation & records
- goodwill

- leaving entity
- synergistic goodwill

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 262A
- ITAA 1997 121-20
- ITAA 1997 705-30(4)
- ITAA 1997 705-30(5)
- ITAA 1997 705-35(3)
- ITAA 1997 Div 711
- ITAA 1997 711-15
- ITAA 1997 711-20
- ITAA 1997 711-20(2)
- ITAA 1997 711-25
- ITAA 1997 711-25(2)
- ITAA 1997 711-30

ATO references

NO: 2005/8295
ISSN: 1038-8982
ATOLaw topic: Income Tax ~~ Consolidation ~~ assets