


TA 2005/3 - Income Tax - Consolidation Application of the tax cost setting rules to copyright

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Taxpayer Alert

TA 2005/3

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the Tax Office's position through a Private Ruling. (It should be noted that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: INCOME TAX - CONSOLIDATION

Application of the tax cost setting rules to copyright

This Taxpayer Alert describes an arrangement where an inflated tax cost setting amount is worked out in relation to copyright ('the copyright') said to subsist in assets containing significant amounts of knowledge and/or information when an entity joins a consolidated group or a consolidated group is formed. The head company of the consolidated group seeks to claim under Division 40 of the *Income Tax Assessment Act*

1997 (ITAA 1997), a capital allowance for the decline in value of the copyright based on the inflated tax cost setting amount of that copyright as a depreciating asset under that Division.

Assets containing significant amounts of knowledge and/or information may include, for example, client lists or records, procedural manuals, industrial processes, secret formulae, or staff training packages. Such assets may be found in small, medium and large enterprises in a wide range of industries.

The arrangement is of particular concern where any copyright has little or no commercial value, in contrast to the commercial value inherent in the knowledge or information asset.

DESCRIPTION

The alert applies to arrangements having the following features:-

1. Company A ('CoA'), a service provider entity, owns an asset ('the asset') containing significant amounts of knowledge and/or information, for example, a client list, which it has either acquired or created.
2. CoA claims that copyright subsists in the asset and that it also owns the copyright. In some cases, the asset has been disaggregated in an attempt to come within the low value pooling of depreciable asset provisions of Subdivision 40-E of the ITAA 1997.
3. CoA is an eligible member of a group of companies that consolidate, or joins an existing consolidated group.
4. In some cases, prior to consolidation, CoA has not identified the copyright as a valuable asset for accounting or tax purposes.
5. The head company ('HeadCo') of the consolidated group identifies the copyright as a reset cost base asset.
6. HeadCo purports to ascribe a market value to the copyright which has been determined by reference to some or all of the market value of the asset.
7. In some cases, no appropriate methodology for valuing the copyright has been applied by HeadCo.
8. The allocable cost amount for CoA, calculated in accordance with the consolidation legislation, is allocated proportionally to the asset with reference to its market value.
9. HeadCo works out the tax cost setting amount for the copyright to be an inflated amount reflecting some or all of the value of the asset.

10. HeadCo then claims a deduction under Division 40 of the ITAA 1997 for the decline in value of the copyright based on the inflated tax cost setting amount.

FEATURES WHICH THE TAX OFFICE CONSIDERS GIVE RISE TO TAXATION ISSUES

The Tax Office considers that the arrangement outlined above gives rise to taxation issues which include whether:-

- (a) section 701A-10 of the *Income Tax (Transitional Provisions) Act 1997* applies;
- (b) copyright in an asset that contains knowledge and/or information, is a separate asset or a number of separate assets (distinguishable from the asset or assets that contains the knowledge and/or information) for the purpose of Part 3-90 of the ITAA 1997;
- (c) an amount is deductible under Division 40 of the ITAA 1997 for the decline in value of the copyright under the circumstances described in this alert;
- (d) an amount is deductible under the low value pooling of depreciating assets provisions of Subdivision 40-E of the ITAA 1997;
- (e) the value proposed for the copyright where it subsists in an asset that contains the knowledge and or/information, accurately reflects the market value of the copyright, and is supported by an appropriate valuation methodology.

The Australian Taxation Office is examining these arrangements.

<i>subject references:</i>	consolidation, consolidation – valuations, copyright, cost setting rules, capital allowances
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<i>legislative references:</i>	<i>Division 40 of Income Tax Assessment Act 1997 (ITAA 1997)</i> <i>Part 3-90 of ITAA 1997</i> <i>Subdivision 40-E of ITAA 1997</i> <i>Division 705 of ITAA 1997</i> <i>Section 701A-10 of the Income Tax (Transitional Provisions) Act 1997</i>
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<i>related rulings/determinations</i>	<i>Taxation Ruling TR2004/13</i> <i>Taxation Determination 2005/1</i>
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<i>related taxpayer alerts:</i>	<i>Taxpayer Alert TA 2004/5</i>
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<i>related media releases:</i>	<i>Media Release - Nat 04/015</i>
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file references:

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