TD 2004/57 - Income tax: consolidation tax cost setting rules: will an amount be subtracted under step 4 of the allocable cost amount under subparagraph 705-95(b)(ii) of the Income Tax Assessment Act 1997 where there has been a distribution of profits accrued to the joined group that recouped losses accrued to the group?

Taxation Determination

Income tax: consolidation tax cost setting rules: will an amount be subtracted under step 4 of the allocable cost amount under subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997* where there has been a distribution of profits accrued to the joined group that recouped losses accrued to the group?

Preamble

The number, subject heading, date of effect and paragraph 1 to paragraph 2 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.*

1. Yes. Where a joining entity makes a distribution prior to the joining time out of profits that accrued to the joined group (owned profits), and those profits recouped losses for income tax purposes that accrued to the joined group (owned losses), the distribution is subtracted at step 4 of the allocable cost amount (ACA) calculation process under subparagraph 705-95(b)(ii) of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. The purpose of step 4 is to prevent the ACA reflecting a return of part of the amount paid to acquire the membership interests in the joining entity (step 4 column 2 in the table in section 705-60). In particular, subparagraph 705-95(b)(ii) prevents the ACA reflecting an amount paid for membership interests in the joining entity that was later (but before it became a member of the joined group) lost and, following the recoupment of the loss, the profit that recouped the loss was distributed. In the absence of this adjustment the loss for income tax purposes would effectively be reinstated. See paragraph 5.87 (and the last paragraph of Example 5.10) of the Explanatory Memorandum to the New Business Tax System (Consolidation) Bill 2002 (May EM).

Example

3. On 1 July 2005 Beta Co is incorporated as a wholly-owned subsidiary of HCo, with an initial capitalisation of $100,000 (100 shares at $1,000 each). In the year ended 30 June 2006 Beta Co made a tax loss of $50,000. Beta Co made an accounting loss of $35,000 (after creation of a deferred tax asset (DTA) of $15,000 in respect of the tax loss). In the year ended 30 June 2007 Beta Co made an accounting profit of $35,000 (after reversing the DTA). Assessable income was $50,000 and, after recouping the tax loss, the taxable income was $nil. Beta Co paid the 2006-2007 profits as an unfranked interim

dividend on 30 June 2007. HCo then elects to form a consolidated group. At the joining time BCo's market value is $65,000.

4. Beta Co's statement of financial position is as follows:

Table 1: Beta Co – Financial Position at 1 July 2007 ($)

Cash	65,000	Equity	100,000
		Retained earnings (Loss)	(35,000)
	65,000		65,000

5. Beta Co's ACA would be as follows:

Table 2: ACA calculation for Beta Co ($)

Step 1	Add cost of membership interests		100,000
Step 4	Less Pre-joining time distributions out of certain profits		
	• Subparagraph 705-95(b)(i) distributions of acquired profits: 0;	0	
	and		
	• subparagraph 705-95(b)(ii) distributions of profits accrued to joined group that recouped losses accrued to the group: 35,000	35,000	(35,000)
Step 8	ACA		65,000

6. In the above table the step 4 amount is $35,000. All of the profits were untaxed as they recouped the prior year tax loss. By subtracting the distribution of profits that accrued to the joined group of $35,000 at step 4, the ACA does not effectively reinstate the tax loss.

7. The tax cost setting amount for the retained cost base assets (that is, cash) is $65,000. There is no shortfall or excess of ACA.

Date of effect

8. 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
27 October 2004

Previous draft:

TD 2004/D34

Related Rulings/Determinations:

TR 92/20

Subject references:

- ACA
- acquired profits
- allocable cost amount
- consolidation
- cost setting
- losses
- recouped losses
- step 4
- tax cost setting amount

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 705-60
- ITAA 1997 705-95(b)(i)
- ITAA 1997 705-95(b)(ii)

Other references:

- Explanatory Memorandum to the New Business Tax System (Consolidation) Bill 2002

ATO references

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