High-level worked example

Franking accounts in consolidated groups

Description

This high-level example illustrates the operation of the head company's single franking account in a consolidated group and the transactions in the subsidiary members' franking accounts on joining. For general information on the treatment of franking credits see → 'Treatment of franking credits', C5-1.

Commentary

While a group is consolidated, the head company maintains a single franking account for the group, and the franking accounts of subsidiary members are inoperative.

When a subsidiary member joins a consolidated group, any surplus in its franking account is transferred to the head company's franking account. If, on joining, a subsidiary member's franking account is in deficit the subsidiary will be liable to pay franking deficit tax.

While a subsidiary is a member of a consolidated group, any franking credits or debits that would have arisen if it were not a member are attributed to the franking account of the head company.

Example

Facts

- HCo (the head company) and ACo comprise a consolidated group that comes into existence on 1 July 2002.
- Just before that time, HCo had a $200 franking account surplus and ACo had a $300 franking surplus.
- On 1 August 2002, ACo acquires 100% of the shares in BCo which becomes a subsidiary member of the group.
- Just before that time, BCo had a $100 franking account deficit.

Treatment of franking surplus or deficit on entry into consolidation

HCo maintains a single franking account for the consolidated group. When the group forms, ACo's franking account surplus is transferred into HCo's franking account by way of a $300 franking credit to HCo's franking account and a $300 franking debit to ACo's franking account. The debit to ACo's franking account brings its balance to nil.

As BCo's franking account was in deficit just before it joined the consolidated group, it becomes liable to pay franking deficit tax. A corresponding credit arises in BCo's franking account at the joining time, which brings its balance to nil.

The resulting franking account entries are as follows (all entries being in terms of tax paid in accordance with the simplified imputation system):

Table 1: HCo – franking account

Date	Transaction details	Debit	Credit	Balance
1.7.02	Balance just before joining time			$200
1.7.02	Transfer surplus balance from ACo		$300	$500

Table 2: ACo – franking account

Date	Transaction details	Debit	Credit	Balance
1.7.02	Balance just before joining time			$300
1.7.02	Transfer surplus balance to HCo	$300		$0

Table 3: BCo – franking account

Date	Transaction details	Debit	Credit	Balance
1.8.02	Balance just before joining time			($100)
1.8.02	Liability for franking deficit tax		$100	$0

Additional facts

These income tax transactions occur in relation to the consolidated group:

- On 28 July 2002, ACo pays a $150 PAYG instalment for the quarter ended 30 June 2002.
- On 14 August 2002, ACo receives a $100 refund resulting from an amendment to its 2000–01 income tax assessment.
- On 28 October 2002, HCo pays a $350 PAYG instalment for the quarter ended 30 September 2002.
- On 1 December 2002, HCo pays $200 in relation to its 2001–02 income tax assessment.

Treatment of subsidiary's franking account during consolidation

While ACo and BCo remain subsidiary members of a consolidated group their franking accounts are inoperative. This means that neither credits nor debits can arise in their accounts, although the accounts still exist.

Treatment of head company's franking account during consolidation

The first two transactions above would, if ACo were not part of the consolidated group, result in entries arising in the franking account of ACo. However, given that ACo's franking account is inoperative, the entries arise in HCo's franking account. This is the case even though the transactions relate to the period before consolidation.

The remaining transactions relate to HCo. They give rise to entries in HCo's franking account in the same way that other credits or debits arise in the ordinary course of its activities as a taxpayer and a franking entity.

The franking account entries resulting from these transactions are as follows.

Table 4: HCo – franking account

Date	Transaction details	Debit	Credit	Balance
1.7.02	Balance brought forward			$500
28.7.02	Payment of fourth 2001–02 PAYG instalment – ACo		$150	$650
14.8.02	Refund on 2000–01 income tax assessment – ACo	$100		$550
28.10.02	Payment of first 2002–03 PAYG instalment – HCo		$350	$900
1.12.02	Payment of 2001–02 income tax assessment – HCo		$200	$1,100

Additional facts

ACo pays dividends to its shareholders on 15 December 2002. It pays $7,000 to HCo and $70 in relation to employee shares that have been disregarded for consolidation membership purposes.

Treatment of distributions made by a subsidiary during consolidation

The $7,000 payment made by ACo to HCo is an intragroup dividend which, as a consequence of the single entity rule, is not subject to the franking regime. As far as the $70 dividend is concerned, the general rule in consolidated groups is that a subsidiary member cannot frank distributions to entities outside the group. However, frankable distributions made by a subsidiary member in regard to the employee shares are treated as a frankable distribution by the head company for the purposes of the imputation rules.

On the basis that a $30 franking credit can be allocated to the $70 dividend paid on the employee shares, the following franking account entries result:

Table 5: HCo – franking account

Date	Transaction details	Debit	Credit	Balance
1.12.02	Balance			$1,100
15.12.02	Franking credit allocated in relation to dividend paid to ACo employee shareholders	$30		$1,070

References

Income Tax Assessment Act 1997, Subdivision 709-A; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, paragraph 2.18 and chapter 10

New Business Tax System (Imputation) Act 2002 (48 of 2002), Division 205

Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002, chapter 4