Determining asset values

Key points

On consolidation, the assets of subsidiary members are treated as if they were assets of the head company, and may be transferred between members of the group without any income tax consequences. Intragroup debt and shareholding are also ignored for income tax purposes.

New tax values must be determined for the assets that a subsidiary brings into a consolidated group. Head companies of groups forming during the transitional period (1 July 2002 to 30 June 2004) may have two options for doing this:

- retaining existing tax values (transitional option), or
- resetting asset values according to the cost setting rules.

Treatment of assets under single entity principle

The consequence of the single entity principle for the treatment of assets is that:

- The assets of the subsidiary members are treated as if they were assets of the head company.
- Assets acquired or disposed of by a subsidiary member are considered to be acquired or disposed of by the head company.
- Assets may be transferred between members of the same group without triggering capital gains or requiring cost base adjustments for membership interests.
- Intragroup debt and shareholdings are not recognised for income tax purposes.

Cost setting

When a consolidated group forms or one or more entities join a consolidated group, new tax costs (or tax values) for the assets of each joining subsidiary are calculated, based on the tax costs of the membership interests (or equity) in that subsidiary.[1] The cost base of the membership interests in the joining entity is effectively transferred to the assets of the entity, aligning the tax costs of the entity's assets with the costs of its membership interests. → figure 1, p. 2

This calculation is made by way of the cost setting process, which allocates the cost of the membership interests in the subsidiary to the assets it brings into the group in proportion to their market values.

On exit from the group, the process is reversed and the group's cost base of the equity is derived from the net assets of the leaving entity at the leaving time, as this is what is actually being taken out of the consolidated group.

[1] Other than when a consolidating group exercises the transitional option of retaining existing asset values.

Note

Head company's assets

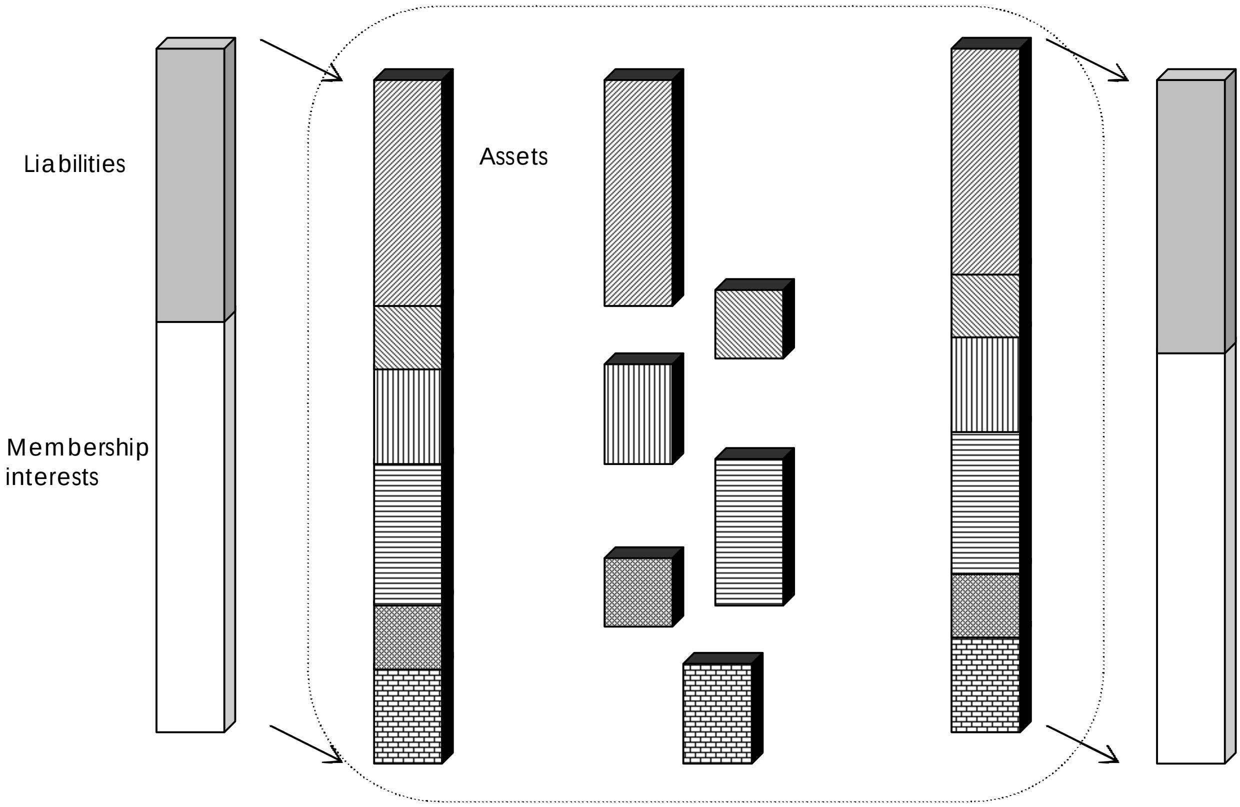
The head company will always enter consolidation with existing asset values. When a consolidated group is formed, no changes are made in relation to the head company's assets, other than to the intragroup debt and intragroup membership interests it holds, which are not recognised for income tax purposes after consolidation.

Pre-CGT assets

The pre-CGT status of assets and membership interests in the joining entity is preserved. → 'Treatment of assets', C2-1

Figure 1: Treatment of assets in consolidation

1. On entry to a consolidated group, the tax costs of the subsidiary's membership interests and liabilities become the tax costs of its assets for the head company
2. While a subsidiary is a consolidated group member, its assets are effectively treated as assets of the head company for income tax purposes and can be transferred between group members without any income tax consequences



3. On exit from a consolidated group, the process is reversed – the tax costs of the assets that a subsidiary takes with it, less its liabilities, become the tax costs of the membership interests in the subsidiary

Transitional concessions

Transitional concessions provide compliance cost savings for groups consolidating during the transitional period (1 July 2002 to 30 June 2004).

In particular, the head company can choose on formation to retain the existing tax values for a subsidiary's assets instead of applying the cost setting rules, provided that the subsidiary is wholly owned on or before 30 June 2003 (and once wholly owned after 1 July 2002 it must remain so until the group consolidates). → 'Treatment of assets', C2-1

Cost setting on formation and entry

On formation or entry the tax cost of each asset of a joining subsidiary is based on a share of the allocable cost amount (ACA) of that subsidiary. The ACA consists of the cost of the membership interests in the entity together with its liabilities, which become liabilities of the group. Adjustments are made to reflect certain undistributed profits, distributions and losses of the joining entity and certain deductions to which the head company becomes entitled.

Part of the ACA is allocated to the subsidiary's *retained* cost base assets (i.e. assets such as cash that retain their cost bases at the joining time). The remainder of the ACA is then apportioned to the subsidiary's *reset* cost base assets in proportion to their market values, subject to further adjustments for revenue-like assets and over-depreciated assets. → figure 2, p. 4

Note

Treatment of goodwill

Goodwill owned by the joining entity is treated as a reset cost base asset of the joining entity, whether or not an amount has been recognised in its accounting statements.

Goodwill is determined as the sum of the differences between (a) the market value of each business of the joining entity and (b) the market value of the net identifiable assets of each business of the joining entity.

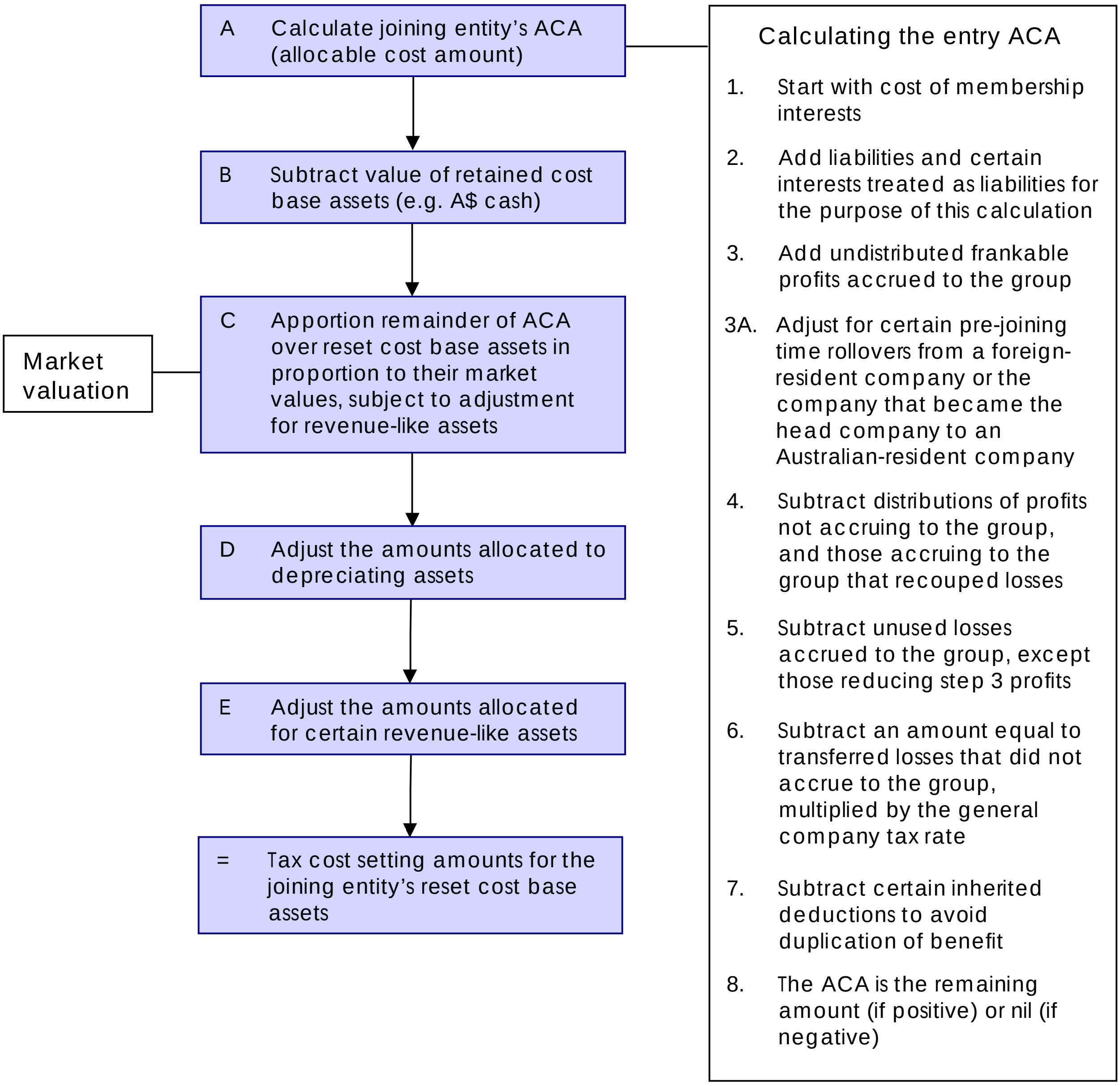
In addition, any goodwill arising from any increase in the value of the businesses of the other group entities due to the entity joining the group (synergistic goodwill) is treated as an asset of the joining entity. If this goodwill has a market value, a portion of the joining entity's ACA is allocated to it like any other reset cost base asset.

→ 'Goodwill' in 'Treatment of assets', C2-1; Taxation Ruling TR 2005/17

Exception for demutualised general insurance company

Where a general insurance company that has demutualised joins a consolidated group and was wholly owned by the same group during the period from demutualisation to the joining time, a goodwill asset of the company just before the joining time is treated as a retained cost base asset. → section 713-705, ITAA 1997

Figure 2: Cost setting process on formation and entry



Example

Assume a joining entity has the following assets and there was no distribution of profits:

	Tax value	Market value
Cash	$100	$100
Land	$100	$320
Machine	$100	$80

Assume that the ACA is $300. Cash, as a retained cost base asset, retains its tax value: $100.

The remaining $200 is then allocated to Land and the Machine based on their proportion of the total market value of reset cost base assets.

	Market value	ACA apportioned according to market value	New cost base
Land	$320	$200 x ($320 / $400) =	$160
Machine	$80	$200 x ($80 / $400) =	$40
	$400		

→ 'Assets', C2-0, includes detailed examples of these calculations

Market valuation

The cost setting process requires market valuing of a joining subsidiary's assets at the joining time. → Step C in figure 2, p. 4

However, to reduce compliance costs, valuation short cut options allow existing tax values to be used for:

- a depreciating asset (not including intangible assets) whose adjustable value is 1% or less of the joining subsidiary's ACA
- trading stock (other than livestock or growing crops) that is not a retained cost base asset, and
- employee share acquisition scheme (ESAS) shares or unlisted shares that have previously been market valued.

→ *Market valuation for tax purposes* at www.ato.gov.au

Note

Market valuations for loss calculations

Market valuations may also be required to calculate the amount of a loss transferred from a joining subsidiary that can be utilised by a head company.
→ 'Transferring and using losses', B2-3

Cost setting on exit

An entity leaves a consolidated group when one or more membership interests are sold outside the group or the entity becomes otherwise ineligible to be a member.

Where a subsidiary member leaves a consolidated group, the head company recognises, just before the leaving time, the membership interests in the leaving entity. These membership interests are not recognised while the entity is a member of the group.

The process at the joining time is now reversed and the group's cost base of membership interests is derived from the net assets of the leaving entity at the leaving time, as this is what is actually being taken out of the consolidated group. This preserves the alignment between the costs for membership interests in the entity and its assets.

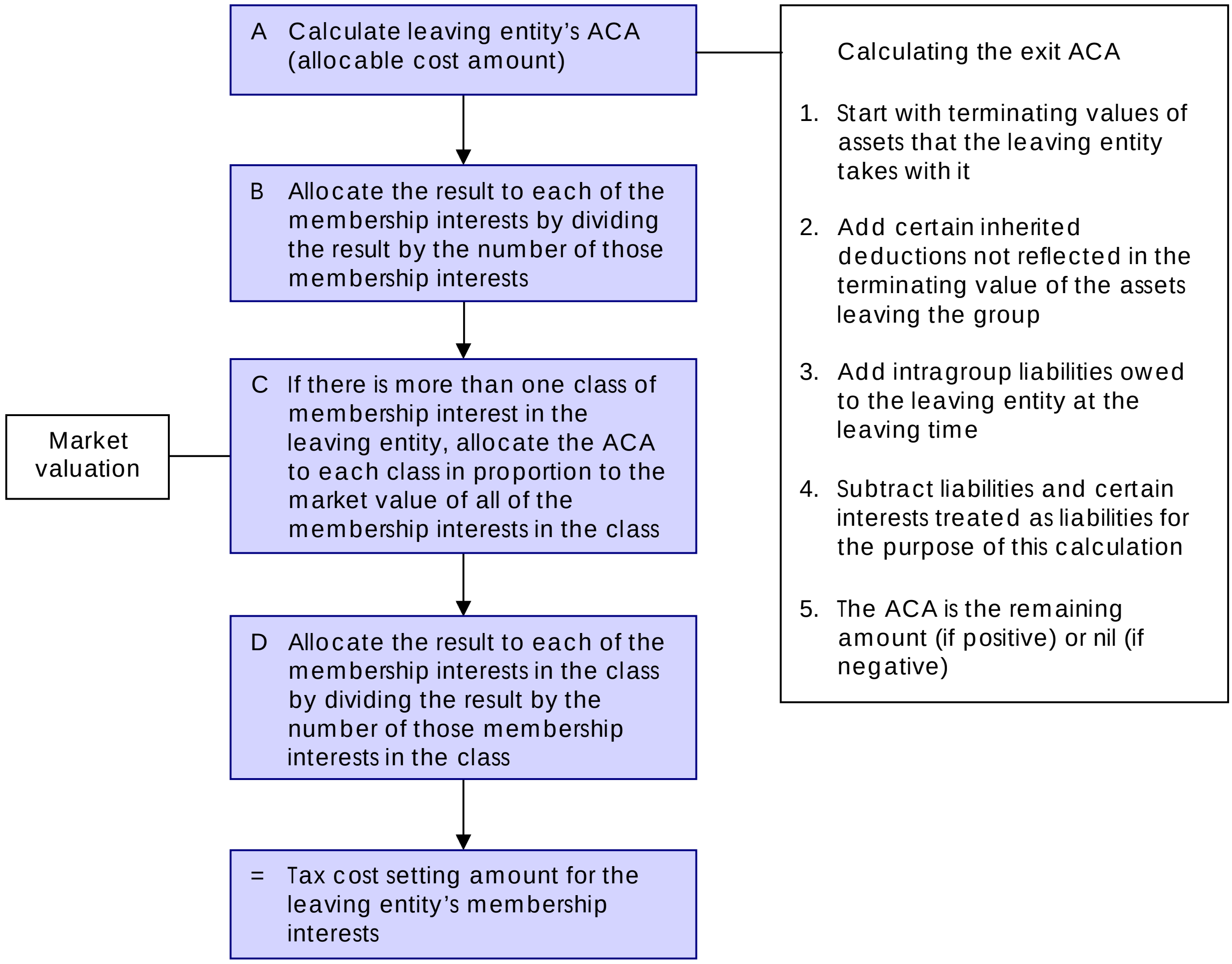
The tax cost setting amount for membership interests is based on a share of the ACA on exit, which consists of the terminating values of the assets that the leaving entity takes with it, less its liabilities. Adjustments are made to reflect the value of certain inherited deductions and intragroup liabilities.

→ figure 3, p. 7

If the head company ceases to be eligible to be a head company of a consolidated group, the group ceases to exist. → 'Changing group membership', B3-5

Special rules apply when a consolidated group joins another consolidated group. → 'Treatment of assets', C2-1

Figure 3: Cost setting process on exit



More information

More detailed technical information on the treatment of assets under consolidation is provided in Part C of this manual. → 'Treatment of assets', C2-1

References

Income Tax Assessment Act 1997, subsection 701-10(2); as amended by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2, Part 4

Income Tax Assessment Act 1997, section 701-58; as inserted by *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2, Part 4

Income Tax Assessment Act 1997, section 713-705; as inserted by *Tax Laws Amendment (2004 Measures No. 7) Act 2005* (No. 41 of 2005), Schedule 6, Part 5

Income Tax Assessment Act 1997, subsection 705-90(6); as amended by *Tax Laws Amendment (2004 Measures No. 7) Act 2005* (No. 41 of 2005), Schedule 6, Part 3

Income Tax Assessment Act 1997, sections 705-93, 705-147, and 705-227, as amended by *Tax Laws Amendment (2010 Measures) Act 2010* (No. 56 of 2010) Schedule 5, Part 5

Income Tax Assessment Act 1997, subsection 711-45(6B); as inserted by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 20

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, Chapter 5

Explanatory Memorandum to Tax Laws Amendment (2004 Measures No. 2) Bill 2004, paragraphs 2.54 – 2.60

TR 2005/17 – Income tax: goodwill: identification and tax cost setting for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*

Revision history

Section B2-2 first published (excluding drafts) 2 December 2002 and updated 28 May 2003. Further revisions are described below.

Date	Amendment	Reason
14.7.04	Note on proposed changes to consolidation rules.	Proposed legislative amendments.
26.10.05	Reference to insurance companies, p. 3, change to note on goodwill, p. 3 and figure 2, step 3, p. 4.	Legislative amendments.
6.5.11	Changes to steps 2 and 3A in entry ACA (figure 2) and step 4 in exit ACA (figure 3).	Legislative amendments.