

Worked example

Adjustment for certain inherited deductions (exit ACA step 2)

Description This example shows how, at step 2 of the allocable cost amount (ACA) calculation on exit, an amount is added for certain unclaimed deductions of the head company that become available to the leaving entity because of the exit history rule.

Commentary The exit history rule provides that the tax history in relation to any asset, liability, business or registration for particular research and development activities that leaves the consolidated group with a leaving entity is inherited by that leaving entity. This tax history can include the history inherited by the head company as a result of the entry history rule.

An amount is added at step 2 on exit to ensure that the value of the deduction is reflected in the ACA.

The relevant deductions at this step are those for which the leaving entity becomes entitled under section 701-40 of the *Income Tax Assessment Act 1997* (ITAA 1997) as a result of it ceasing to be a subsidiary member of the consolidated group, other than a deduction for expenditure:

- that is, forms part of or reduces, the cost of an asset that becomes an asset of the leaving entity because subsection 701-1(1) of the ITAA 1997 (the single entity rule) ceases to apply
- to which section 110-40 of the ITAA 1997 (expenditure on assets acquired before 7.30pm on 13 May 1997) applies, or
- under section 43-15 of the ITAA 1997 (which relates to undeducted construction expenditure), if the joining entity acquired the asset to which the deduction relates at or before 7.30pm on 13 May 1997.

→ subsection 711-35(2)&(3), ITAA 1997

An unclaimed deduction for expenditure that would be included in the cost of an asset of the leaving entity, or would reduce it, is not included at step 2.

Unclaimed Division 43 deductions Unclaimed deductions for allowable capital expenditure on assessable-income-producing buildings and other capital works under Division 43 of the ITAA 1997 that were previously available to the head company and become available to a leaving entity when it leaves a consolidated group do not increase the exit ACA at step 2. When an entity joins a consolidated group, unclaimed Division 43 deductions do not reduce the entry ACA at step 7, and when an entity leaves a group, unclaimed Division 43 deductions do not increase the exit ACA at step 2. → 'Adjustment for certain inherited deductions (ACA step 7)', C2-4-340

Amount added at step 2

For exits occurring on or after 10 February 2010, the amount added is obtained by multiplying all of the deductions covered in step 2 by the corporate tax rate. → *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 9; Explanatory Memorandum to *Tax Laws Amendment (2010 Measures No. 1) Bill 2010*, paragraphs 5.245 to 5.246

For exits that occurred before 10 February 2010, the step 2 amount is worked out using the formula: Owned deductions + (Acquired deductions x Corporate tax rate).

Acquired deductions are those that were acquired deductions at step 7 of the entry ACA when an entity became a subsidiary member of the consolidated group. → 'Adjustment for certain inherited deductions (ACA step 7)', C2-4-340

Owned deductions are deductions that are not acquired deductions.
→ former subsection 711-35(1)

Example

Facts On 1 July 2008 all of the membership interests in ACo are acquired by HCo, the head company of a consolidated group.

Before joining the consolidated group, ACo:

- purchased land on 1 July 1996 and then constructed an income producing building at a cost of \$100,000, which gave rise to Division 43 deductions of \$4,000 in each year; and
- borrowed \$200,000 on 1 July 2007 to use in its business for which it incurred \$20,000 borrowing costs claimable over 5 years under section 25-25 of the ITAA 1997. HCo's ACA for ACo was reduced by \$4,800 (\$16,000 x 0.3) at step 7 when ACo joined the consolidated group.

On 30 June 2010, the group sells its membership interests in ACo with the result that ACo leaves the consolidated group.

Table 1: ACo – financial position at 30 June 2010 (\$'000)

Income producing property	200	Equity	102.4
Depreciating assets	100	Liability	200
Deferred tax asset	2.4		
	<u>302.4</u>		<u>302.4</u>

Note: The deferred tax asset is for unclaimed borrowing costs of \$8,000 fully expensed in the accounts. The terminating value of the property is \$200,000 and the cost of depreciating assets is \$100,000.

Calculation Step 1

Start with the sum of the terminating values of the leaving entity's assets, i.e. \$300,000.

Step 2

This step is concerned with unclaimed deductions for which the leaving entity becomes entitled. The leaving entity becomes entitled to unclaimed deductions for borrowing expenses of \$8,000 as a result of the exit history rule. No amount is added for the unclaimed deductions available under Division 43. Therefore, the amount added at step 2 is \$2,400 ($\$8,000 \times 0.3$).

The result after this step is \$302,400.

Step 3

There is no step 3 amount.

Step 4

Deduct ACo's liabilities of \$200,000 that leave the group with ACo.

Step 5

The group's ACA for the leaving entity is \$102,400.

References

Income Tax Assessment Act 1997, section 701-1; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *Tax Laws Amendment (2007 Measures No. 4) Act 2007* (No. 143 of 2007), Schedule 1

Income Tax Assessment Act 1997, section 701-40; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 11

Income Tax Assessment Act 1997, section 711-20; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 2
- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 21
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 1

Income Tax Assessment Act 1997, section 711-25; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *Tax Laws Amendment (2004 Measures No. 2) Act 2004* (No. 83 of 2004), Schedule 2
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 1

Income Tax Assessment Act 1997, section 711-35; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 7, Division 1 and Part 9

Income Tax Assessment Act 1997, section 711-45; as amended by:

- *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1
- *New Business Tax System (Consolidation, Value Shifting Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 2
- *Tax Laws Amendment (2004 Measures No. 6) Act 2005* (No. 23 of 2005), Schedule 1

- *Tax Laws Amendment (2004 Measures No. 7) Act 2005* (No. 41 of 2005), Schedule 6
- *Financial Sector Legislation Amendment (Restructures) Act 2007* (No. 117 of 2007), Schedule 3
- *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Parts 7, 8, and 9.

Income Tax Assessment Act 1997, sections 711-40 and 711-55; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Income Tax Assessment Act 1997, section 110-40

Explanatory Memorandum to New Business Tax System (Consolidation) Bill No. 1, paragraph 5.142

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.188 – 5.197 and paragraphs 5.245 – 5.247

Revision history

Section C2-5-240 first published 15 November 2006.

Further revisions are described below.

Date	Amendment	Reason
26.6.07	Note on proposed changes to clarify both the valuation of liabilities and the accounting principles to be used, and proposed changes to the treatment of certain inherited deductions, p. 3.	Reflect announcement on 8 May 2007 by Assistant Treasurer in media release no. 50.
6.5.11	Changes to Commentary and Example to reflect modification of the step 2 calculation and to clarify the facts in the Example. Removal of note on proposed changes to clarify both the valuation of liabilities and the accounting principles to be used, and proposed changes to the treatment of certain inherited deductions. Changes to Commentary to reflect changes to the treatment of certain inherited deductions.	Legislative amendments.