Worked example

Adjustment at formation for distributions of profits to head company (ACA step 4)

Description

This example shows how the adjustment for distributions by the joining entity at step 4 of the allocable cost amount (ACA) calculation is modified on formation where there has been an effective return of profits to the head company. → 'Treatment of assets', C2-1

Commentary

At step 4 of the ACA calculation, certain pre-joining time distributions by a subsidiary entity are subtracted, in order to reduce the cost of membership interests where some or all of that amount has been returned as a distribution.

This reduction is not made unless the distribution is in respect of the direct membership interests held by the head company, because it is only the cost of these direct interests that is pushed down to the assets of the subsidiary members.

On formation, a reduction is made only in relation to:

- distributions to the head company, or
- effective distributions to the head company, such as where the membership interest in the entity making the distribution (the subject entity) was acquired by the head company from an entity or entities for which rollover relief was obtained, and which had received a distribution from the subject entity.

→ section 705-155, *Income Tax Assessment Act 1997* (ITAA 1997)

Example

Facts

ACo pays $100 to purchase all membership interests in BCo. Then BCo makes a trading profit of $30. Then, on 1 July 2004, HCo pays $130 to purchase all membership interests in ACo.

Table 1: ACo – financial position at 1 July 2004

Shares in B (MV $130)	$100	Equity	$100
	$100		$100

Table 2: BCo – financial position at 1 July 2004

Asset 1 (MV $50)	$50	Equity	$100
Cash	$80	Profits	$30
	$130		$130

Note: MV = market value

On 2 July 2004, BCo pays a $30 dividend to ACo. On 3 July 2004, ACo successively distributes the $30 to HCo. On 4 July 2004, HCo forms a consolidated group with ACo and BCo.

Calculation

Calculation of new tax values of assets in the consolidated group

The step 1 amount of $130 is reduced by $30 at step 4 because there has been a direct pre-formation distribution to the head company. Therefore, $100 is the tax cost setting amount for ACo's sole asset, Shares in B.

This amount is used as the step 1 amount in the ACA calculation for BCo. There will be no adjustment at step 4 of the ACA calculation, giving BCo a total ACA of $100. .

BCo's cash asset retains its $50 value (after the $30 distribution to ACo, BCo has $50 cash left). The remainder of the ACA ($50) is the tax cost setting amount for Asset 1.

References

Income Tax Assessment Act 1997, section 705-155; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, paragraphs 5.53-60