

Worked example

Cost setting rules for assets of a MEC group – at joining and formation times

- Description** This example explains how:
- broadly, the cost setting rules apply to multiple entry consolidated (MEC) groups in the same way as they do for the head company and subsidiary members of a consolidated group → 'Treatment of assets', C2-1, and
 - exceptions exist for those subsidiary members that are eligible tier-1 companies of a MEC group.

Commentary

Overview The legislation for the cost setting rules is structured to cover the basic case of an entity joining a consolidated group, with modifications and some additional rules for the following situations:

- a the formation of a consolidated group
- b where a consolidated group joins an existing consolidated group, and
- c where entities that are linked by membership interests join an existing consolidated group.

The rules above are then further modified so that there is an appropriate application to similar situations involving MEC groups.

Resetting the costs of assets at the joining and formation time

For the formation of a MEC group, the cost setting rules are applied by considering:

- 1 the rules associated with the formation of a consolidated group – that is, the joining entity rules modified for the formation case
→ 'Treatment of assets', C2-1
- 2 any further modifications that apply to MEC groups.

The assets of the head company of a MEC group retain their terminating values at the formation time – they are treated in the same manner as assets of a head company of a consolidated group. → 'Determining asset values', B2-2

At joining or formation time, a subsidiary member's cost base of its membership interests plus liabilities (with some adjustments) is used to allocate a cost to its assets. The cost setting rules are modified for eligible tier-1 companies of a MEC group because those companies are treated in the same manner as a head company of a consolidated group. This treatment applies even where there are some membership interests held in an eligible tier-1 company by members of the MEC group. (Note, however, that two sets of rules apply when such an eligible tier-1 company leaves the group → 'An eligible tier-1 company leaving a MEC group', C10-2-430.)

Broadly, there is no modification to the cost setting rules for those subsidiary members that have all of their membership interests directly owned by the other members of the MEC group.

The cost setting rules for those entities that are subsidiary members because of the interposed foreign resident entity rules are still being developed.

Summary Table 1 summarises the asset cost setting treatment for a MEC group.

Table 1: Asset cost setting treatment for MEC group

Type of entity	Asset treatment for cost setting purposes	Legislation
Head company – an eligible tier-1 company that has all its membership interests owned outside the MEC group and has been jointly nominated by the other eligible tier-1 companies of the MEC group.	Terminating values of assets are used – that is, assets are treated like the assets of a head company of a consolidated group.	Division 701
Subsidiary members – which are the remaining eligible tier-1 companies and may have some of their membership interests held by MEC group members.	Assets are treated like assets of a head company of a consolidated group.	Division 701 Division 705 Subdivision 719-C
Subsidiary members – with all membership interests directly owned by MEC group members.	Cost setting rules are used to reset costs – that is, assets are treated like the assets of a subsidiary member of a consolidated group.	Division 705 Subdivision 719-C
Subsidiary members – who are members of the MEC group under the interposed foreign resident entity rules.	Treatment still being considered.	

Transitional cost setting rules election

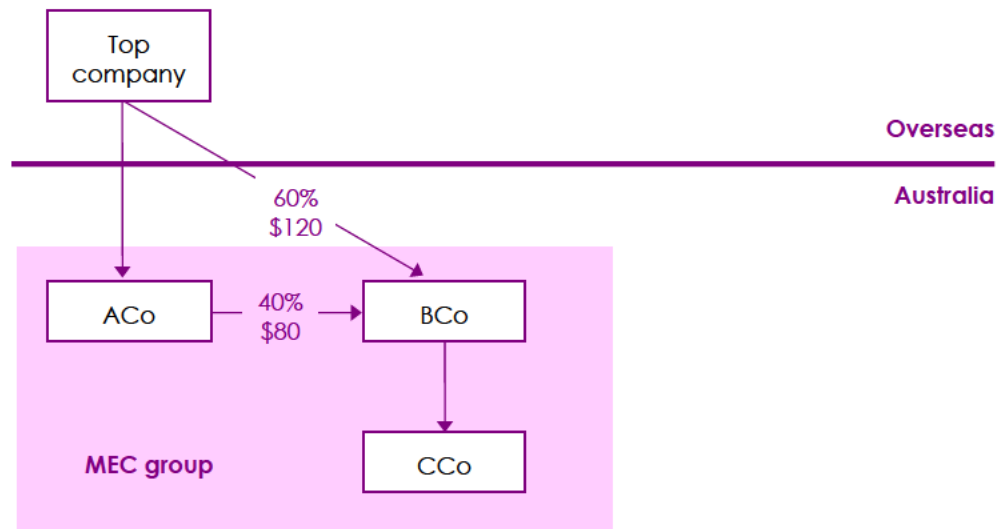
Where a MEC group is formed during the transitional period (1 July 2002 to 30 June 2004) and certain conditions are satisfied by a subsidiary member, the head company may elect to use the terminating values of the assets of certain subsidiary members – on a subsidiary member by subsidiary member basis – instead of applying the cost setting rules.

However, the eligible tier-1 companies of the group must use the terminating values of their assets at all times.

Example Formation case – where some of the membership interests in an eligible tier-1 company are held by members of the MEC group

Following an initial acquisition of 60% of the membership interests in BCo by the top company for \$120, ACo pays \$80 to acquire the remaining 40% of BCo. ACo, BCo and CCo then consolidate as a MEC group, as shown in figure 1. BCo has no liabilities and only one asset, being all the membership interests in CCo.

Figure 1: Formation case



BCo's only assets are all the membership interests in CCo which have a terminating value of \$200. BCo's assets will not have their costs reset as BCo is an eligible tier-1 company and will be taken to be a part of ACo, the head company of the MEC group.

CCo will become a subsidiary member of the MEC group but it is not an eligible tier-1 company. The cost of CCo's assets will be reset, unless the group qualifies under the transitional rules and the head company elects to use terminating values for CCo's assets.

Pre-formation rollover after 16 May 2002 and transitional groups

If there has been a rollover of an asset under Subdivision 126-B or section 40-340, and:

- the rollover was after 16 May 2002
- the group consolidates after the rollover but before 1 July 2004, and
- the tax values of the group's assets change because of the rollover,

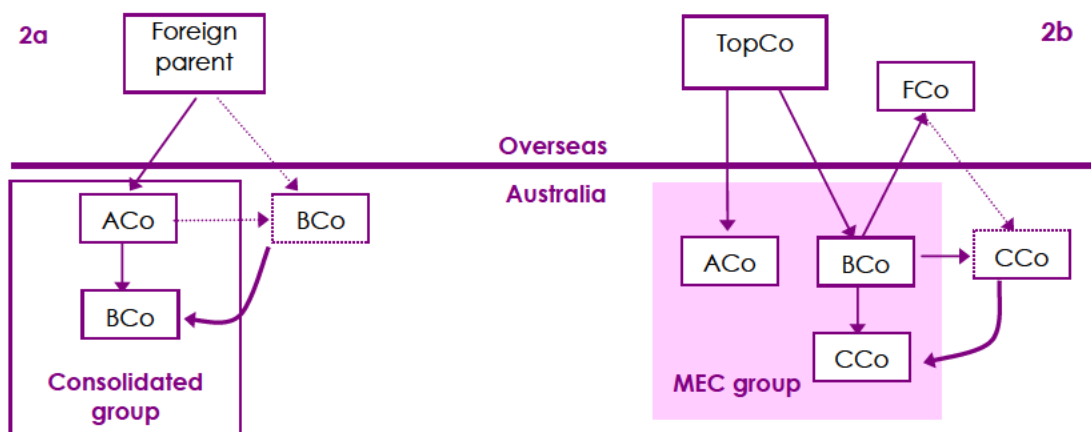
then the rollover is disregarded for tax cost setting purposes on consolidation with certain exceptions. → sections 701-35 and 719-163, IT(IP) Act 1997

The rule is to prevent groups from using rollover relief to maximise their choices for the cost setting of their assets on consolidation.

To enable a foreign-owned group that restructures to reset the cost of its assets on consolidation, an exception exists when the following conditions are satisfied:

- the rollover asset is a membership interest in an entity
- the membership interest is rolled over from a foreign-resident company to an Australian-resident company
- the entity whose membership interests were rolled over becomes a subsidiary member of a consolidated or MEC group at the time of formation
- the group is a transitional group, and
- the entity is not an eligible tier-1 company of a MEC group or an entity in which a foreign-resident company or a non-resident trust holds membership interests.

Figure 2: Rollover of membership interest in a company (Subdivision 126-B)



In figure 2a, the foreign parent rolls over its membership interests in BCo to ACo after 16 May 2002. ACo and BCo form a consolidated group before 1 July 2004. In this case, the rollover of the membership interests is *not* disregarded when the cost of the assets of the group is reset.

In figure 2b, FCo, a foreign subsidiary of BCo, rolls over its membership interests in CCo to BCo after 16 May 2002. ACo, BCo and CCo form a MEC group before 1 July 2004. CCo does not become an eligible tier-1 company of the MEC group. In this case, the rollover of the membership interests is *not* disregarded when the cost of the assets of the group is reset.

References

Income Tax Assessment Act 1997, Division 705; as amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

Explanatory Memorandum to the New Business Tax System (Consolidation) Bill (No. 1) 2002, Chapter 5

Income Tax Assessment Act 1997, Subdivision 719-C; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 8 and *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedules 11 and 12

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, Chapter 3

Income Tax (Transitional Provisions) Act 1997, sections 701-35 and 719-163; as amended by:

- *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 7
- *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003), Schedule 17

Explanatory Memorandum to New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 1.104 to 1.107

Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, paragraphs 5.75 to 5.88