TD 2005/53 - Income tax: consolidation: exit tax cost setting rules: where an accounting liability added at subsection 711-45(1) of the Income Tax Assessment Act 1997 is modified by the operation of subsections 711-45(3) and (5), does the amount determined under subsection 711-45(5) override the adjustment made by subsection 711-45(3)?

Taxation Determination

Income tax: consolidation: exit tax cost setting rules: where an accounting liability added at subsection 711-45(1) of the *Income Tax Assessment Act 1997* is modified by the operation of subsections 711-45(3) and (5), does the amount determined under subsection 711-45(5) override the adjustment made by subsection 711-45(3)?

Preamble

The number, subject heading, date of effect and paragraphs 1 to paragraphs 2 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

*[**Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

1. Yes. Where subsections 711-45(3) and 711-45(5) of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] both apply to a particular accounting liability that is added at subsection 711-45(1), the amount determined under subsection 711-45(5) overrides any adjustments made to that liability because of the operation of subsection 711-45(3).

2. The subsection 711-45(5) amount is the replacement amount at subsection 711-45(1) for that particular accounting liability.

Accounting liability added at subsection 711-45(1)

3. Step 4[2] of the exit allocable cost amount (ACA) subtracts amounts in respect of accounting liabilities of a leaving entity just before the leaving time, as well as particular amounts that are treated as liabilities of the leaving entity under the exit ACA rules of the consolidation law. The purpose of subtracting these liabilities under step 4 of the exit ACA process is to ensure that the old group's ACA for the leaving entity reflects those liabilities that cease to be the responsibility of the old group at the leaving time.

[1] All legislative references are to the ITAA 1997, unless otherwise indicated.
[2] For how the law in relation to step 4 (section 711-45) applies to an entity that left a consolidated group before 10 February 2010, refer to the Full Federal Court decision in *Handbury Holdings Pty Ltd v. Commissioner of Taxation* [2009] FCAFC 141.

4. The starting point in working out the exit step 4 amount is subsection 711-45(1). That subsection provides that the amount of each thing that is an accounting liability (in accordance with the leaving entity's accounting principles for tax cost setting) of the leaving entity just before the leaving time is taken into account in working out the step 4 amount of the exit ACA.

Note: the leaving entity's ***accounting principles for tax cost setting*** are the * accounting principles that the group would use if it were to prepare its financial statements just before the leaving time (disregarding subsection 701-1(1) (the single entity rule)). See subsection 711-45(1A).

5. Subsection 711-45(1) is substantially the same as subsection 705-70(1) of the ITAA 1997 at step 2 of the entry ACA process. Subsection 705-70(1) is the starting point for working out the amounts to be added at step 2 of the entry ACA for accounting liabilities of a joining entity. This is similar to subsection 711-45(1) which, as discussed above, is the starting point in working out the leaving entity's accounting liabilities that are taken into account in the exit ACA calculation process. Subsection 711-45(1) should, therefore, be interpreted in a corresponding manner to subsection 705-70(1).

6. Taxation Rulings TR 2004/14 and TR 2006/6 provide guidance as to the interpretation of subsection 705-70(1) and the various phrases used in that subsection. The guidance in TR 2004/14 is equally applicable in interpreting subsection 711-45(1).

An accounting liability and the operation of subsections 711-45(3) and (5)

7. An accounting liability that is taken into account under subsection 711-45(1) could be modified or adjusted by the operation of subsections 711-45(2) to (5) and (8).

8. In some circumstances, an accounting liability counted at subsection 711-45(1) is adjusted by the operation of both subsections 711-45(3) and (5). A reduction to the accounting liability counted at subsection 711-45(1) is made by subsection 711-45(3) to discount the amount of the liability by the component of that liability which would give rise to a future tax deduction for the leaving entity. The amount counted for the accounting liability after the application of subsection 711-45(3) is replaced by the amount worked out under subsection 711-45(5), where the latter also applies.

9. Therefore, where an accounting liability is subject to the modifications contained in subsections 711-45(3) and (5), the adjustment made by subsection 711-45(5) overrides the previous reduction made to the accounting liability under the operation of subsection 711-45(3).

10. This treatment is consistent with the order of application of the corresponding legislative provisions in step 2 of the entry ACA process.

Example

11. *HeadCo is the head company of a consolidated group. The consolidated group forms on 1 January 2005. On 2 January 2005, HeadCo incorporates ACo for $300,000 (1000 ordinary shares at $300 each). ACo buys a block of land for $200,000 and does not derive any assessable income. On 31 May 2005 ACo makes a provision for annual leave of $10,000 with respect to one of its employees and recognises a deferred tax asset (DTA) of $3,000 for the provision. On 30 June 2005, ACo leaves the group when HeadCo sells all of the membership interests in ACo for $293,000.*

12. *ACo's statement of financial position just before the leaving time is shown in Table 1.*

Table 1: ACo's Statement of Financial Position at 30 June 2005 ($)

Cash	100,000	Equity	300,000
Land	200,000	Retained Earnings (loss)	(7,000)
DTA (Annual Leave)	3,000	Provision for Annual Leave	10,000
	303,000		**303,000**

13. The exit ACA is shown in Table 2.

Table 2: Exit ACA calculation for ACo ($)

Step 1	Add: Terminating values of the leaving entity's assets just before the leaving time		$300,000
Step 4	less liabilities		($0)
	711-45(1) - accounting liability	$10,000	
	711-45(3) - reduction for future deduction	($3,000)	
	711-45(5) - adjustment to accounting liability	$0	
Step 5	ACA		**$300,000**

14. The exit step 1 amount is the head company's terminating value of cash ($100,000) and land ($200,000). The DTA for the provision for annual leave cannot contribute to the step 1 amount in the exit ACA calculation because the DTA has a terminating value of $nil under section 711-30.

15. The liability to be considered under exit step 4 is the provision for annual leave of $10,000. The accounting liability amount of $10,000 which is counted under subsection 711-45(1) is reduced by $3,000 under subsection 711-45(3) to reflect the amount that would be allowed as a deduction to ACo when the liability is met for income tax purposes. The amount of the provision for annual leave is $7,000 after the reduction under subsection 711-45(3).

16. The amount of the provision for annual leave is adjusted to $nil by subsection 711-45(5). This is to remove distortions that would otherwise be caused by the inclusion in the ACA calculation of accounting liabilities that are recognised for income tax purposes at a later time than is the case in accordance with the Australian accounting standards.

17. Subsection 711-45(8) does not apply in this example as the accounting liability of $10,000 was not taken into account in the entry ACA calculation of any subsidiary member of the consolidated group.

18. The exit ACA of $300,000 is allocated to the membership interests in ACo. When ACo is sold, the tax position of the group in respect of the disposal of membership interest in ACo reflects the group's economic position which is an economic loss of $7,000.

Date of effect

19. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
21 December 2005

Previous draft:

TD 2005/D19

Related Rulings/Determinations:

TR 92/20; TR 2004/14; TR 2006/6

Subject references:

- accounting liability
- accounting principles for tax cost setting
- accounting standards
- allocable cost amount
- consolidation
- exit tax cost setting
- leaving entity
- leaving time
- order of application
- statement of financial position
- tax cost setting amount

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 701-1(1)
- ITAA 1997 705-70(1)
- ITAA 1997 711-30
- ITAA 1997 711-45
- ITAA 1997 711-45(1)
- ITAA 1997 711-45(1A)
- ITAA 1997 711-45(2)
- ITAA 1997 711-45(3)
- ITAA 1997 711-45(5)
- ITAA 1997 711-45(8)

Case references:

- Handbury Holdings Pty Ltd v. Commissioner of Taxation [2009] FCAFC 141

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