

TR 2006/D12 - Income tax: consolidation: errors in tax cost setting amounts of reset cost base assets



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This document has been finalised by TR 2007/7.

There is an Erratum notice for this document.



Draft Taxation Ruling

Income tax: consolidation: errors in tax cost setting amounts of reset cost base assets

Contents	Para
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**PROPOSED LEGALLY
BINDING SECTION:**

What this Ruling is about	1
----------------------------------	----------

Ruling	5
---------------	----------

Date of effect	38
-----------------------	-----------

**NOT LEGALLY BINDING
SECTION:**

Appendix 1:

Explanation	39
--------------------	-----------

Appendix 2:

Alternative views	61
--------------------------	-----------

Appendix 3:

Your comments	66
----------------------	-----------

Appendix 4:

Detailed contents list	67
-------------------------------	-----------

① This publication provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

What this Ruling is about

1. This Ruling considers the treatment under Subdivision 705-E and section 104-525 of the *Income Tax Assessment Act 1997* (ITAA 1997) of errors the head company of a consolidated group or multiple entry consolidated (MEC) group makes in working out, in purported compliance with Division 705 of the ITAA 1997, tax cost setting amounts (TCSAs) of reset cost base assets of an entity that becomes a subsidiary member of the group.

2. Subdivision 705-E of the ITAA 1997 provides that, subject to certain conditions being satisfied,¹ those TCSAs that are affected by the errors are taken to be correct for the purposes of:

- the ITAA 1997 except Subdivision 705-E;
- the *Income Tax Assessment Act 1936* (ITAA 1936); and
- the *Taxation Administration Act 1953* (TAA) except for certain offences and administrative penalty provisions.²

¹ These conditions are set out in section 705-315 of the ITAA 1997. See also paragraphs 42 and 43 of this Ruling.

² The exceptions are listed in subsection 705-320(2) of the ITAA 1997. See also paragraphs 45 and 46 of this Ruling.

However, Subdivision 705-E does not limit the operation of Part IVA of the ITAA 1936 and does not apply if the errors were to any extent caused by fraud or evasion.

3. Where there is a net overstated amount or net understated amount in relation to the TCSAs that are taken to be correct under Subdivision 705-E of the ITAA 1997, a capital gain or capital loss arises respectively under CGT event L6 in accordance with section 104-525 of the ITAA 1997.
4. The Ruling, in particular, addresses the following issues:
 - (a) the meaning of 'in purported compliance with' Division 705;
 - (b) what is considered to be an error in working out a TCSA;
 - (c) when it is not reasonable to require recalculations to correct such errors; and
 - (d) whether the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen.

Ruling

The meaning of 'in purported compliance with'

5. The errors that Subdivision 705-E of the ITAA 1997 deals with are made in working out a TCSA of a reset cost base asset in 'purported compliance' with Division 705 of the ITAA 1997.
6. The Commissioner considers that the meaning of 'purported compliance' in subsection 705-315(2) of the ITAA 1997 presupposes a reasonable attempt by the head company to comply with the tax cost setting rules in Division 705 of the ITAA 1997, even though unintended errors have been made in the calculations.

What is considered to be an error in working out a TCSA

7. For the purposes of Subdivision 705-E of the ITAA 1997, an error is made in working out the TCSA of a reset cost base asset when that amount deviates from its correct amount.
8. An error in working out the TCSA of a reset cost base asset may arise as a result of the head company of a consolidated group or MEC group:
 - making a mistake in working out the allocable cost amount (ACA);
 - making a mistake in allocating the ACA to the reset cost base assets;

- making a mistake in applying rules capping the TCSA of a reset cost base asset that is trading stock, a depreciating asset or a revenue asset;
- making a mistake in arriving at the market value of a reset cost base asset;
- incorrectly characterising an asset (for example, characterising a reset cost base asset as a retained cost base asset, or vice versa);
- incorrectly including or excluding assets in the TCSA calculations; or
- inadvertently failing to recognise an asset.

9. An error in working out the TCSA of a reset cost base asset may also result from:

- a retrospective amendment to the law that causes the TCSA to differ from its correct amount; or
- the clarification of the law by a Court.

10. The contributory factors listed in paragraphs 8 and 9 of this Ruling are not intended to be exhaustive.

Example 1

11. Sub Co becomes a subsidiary member of a consolidated group of which H Co is the head company on 1 July 2005. H Co chooses to calculate the TCSA of a category of reset cost base assets of Sub Co according to the Commissioner's view as set out in a draft public ruling. H Co lodges its 2005-06 income tax return on 15 January 2007. On 14 March 2007, the final public ruling is published. The TCSAs of those assets calculated in accordance with the final public ruling are less than the corresponding TCSAs H Co calculated in accordance with the draft public ruling.

12. H Co decides that the Commissioner's views as set out in the final public ruling should be followed. Having regard to the factors listed in subsection 705-315(4) of the ITAA 1997, it is not considered reasonable to correct the TCSAs and amend H Co's 2005-06 income tax assessment. H Co notifies the Commissioner of the errors and their amounts.³ The TCSAs worked out according to the draft public ruling are taken to be correct under section 705-320 of the ITAA 1997 and H Co returns a capital gain under CGT event L6 in its 2006-07 income tax return.

³ For information regarding notification requirements, refer to 'Consolidation: notification forms and instructions' on the Consolidation web page at www.ato.gov.au.

Example 2

13. Sub Co becomes a subsidiary member of a consolidated group of which H Co is the head company on 1 July 2005. In working out Sub Co's ACA, H Co chooses to follow a public ruling and lodges its 2005-06 income tax return on 15 January 2007. As a result of a Federal Court decision the Commissioner withdraws the public ruling followed by H Co, notice of which appears in the Commonwealth Gazette on 27 February 2008.

14. By this time, H Co has lodged its 2006-07 income tax return, on 15 January 2008. H Co worked out Sub Co's ACA to be less than its correct value, leading to understatements in the TCSAs of all Sub Co's reset cost base assets. Having regard to the factors listed in subsection 705-315(4) of the ITAA 1997, it is not considered reasonable to correct all of the TCSAs and amend H Co's 2005-06 and 2006-07 income tax assessments. H Co notifies the Commissioner of the errors in the TCSAs and of the amounts of the understatements. All the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997. H Co returns a capital loss under CGT event L6 equal to the net understated amount in its 2007-08 income tax return.

Example 3

15. H Co, an Australian resident company, acquires 60% of the membership interests in an Australian resident company, Sub Co, on 26 June 2002. On 1 July 2003, H Co forms a consolidated group together with its wholly-owned Australian subsidiaries. On 1 July 2004, H Co acquires the remaining membership interests in Sub Co, which joins the group. H Co works out the TCSAs for Sub Co's assets. Some of the assets are items of trading stock, which H Co treats as reset cost base assets. H Co lodges its 2004-05 income tax return on 15 January 2006.

16. Subsequently, H Co realises that because Sub Co is a continuing majority-owned entity as defined in section 701A-1 of the *Income Tax (Transitional Provisions) Act 1997*, it should have treated the items of trading stock as retained cost base assets under section 701A-5 of that Act.

17. The correct TCSAs of the items of trading stock, properly considered as retained cost base assets, work out to be less overall than originally worked out. This means that the trading stock absorbed more of the ACA than it should have, and consequently the TCSAs of all of the reset cost base assets are understated.

18. Having regard to the factors listed in subsection 705-315(4) of the ITAA 1997, it is not considered reasonable to recalculate the TCSAs of the reset cost base assets. H Co notifies the Commissioner that it has made errors in working out those TCSAs and of the amounts of the understatements. Those TCSAs as originally worked out are taken to be correct under section 705-320 of the ITAA 1997. H Co returns a capital loss under CGT event L6 equal to the net understated amount in its 2005-06 income tax return.

19. However, the incorrect TCSAs originally worked out for the items of trading stock are not taken as correct under section 705-320 of the ITAA 1997 because those items are not reset cost base assets and so the condition in subsection 705-315(2) of the ITAA 1997 is not satisfied. H Co must request the Commissioner to amend its 2004-05 income tax assessment in order to correct any errors resulting from those incorrect TCSAs.

When it is not reasonable to require calculations to correct the errors

20. The question of when it is not reasonable to require recalculations to correct errors affecting TCSAs for reset cost base assets for the purposes of subsection 705-315(4) of the ITAA 1997 is answered upon making an objective judgment, in the circumstances of a particular case, having regard to:

- the net size of the errors relative to the ACA for the joining entity;
- the number of TCSAs that would have to be recalculated and the difficulty of doing so;
- the number of adjustments in assessments that could be amended; and
- the difficulty in obtaining the necessary information.

21. The relative weighting to be given to each of the prescribed factors in subsection 705-315(4) of the ITAA 1997, which are listed in paragraph 20 of this Ruling, will depend on the particular circumstances of each case.

22. An objective judgment of whether or not it is reasonable to require a recalculation of the amounts involved may be influenced by the stated object of Subdivision 705-E of the ITAA 1997, which is to avoid the time and expense involved in correcting the errors. If this would involve little time and expense, it is more likely that it would be reasonable in the circumstances to require recalculation of the amounts involved.

23. It would be less reasonable to require the TCSAs to be recalculated as:

- the proportion of the ACA represented by the net size of the errors get smaller;
- the number of TCSAs that have to be recalculated get larger;
- the number of adjustments required in assessments gets larger; and
- it becomes more difficult to obtain the necessary information to perform the recalculations.

24. 'Net size of the errors' is not a defined term. The reference to net size of the errors in paragraph 705-315(4)(a) is understood in a practical sense to be equivalent to the 'net overstated amount' or 'net understated amount' as defined in subsection 104-525(3) of the ITAA 1997 (see the second dot point of paragraph 39 of this Ruling) assuming that the conditions in subsection 705-315 of the ITAA 1997 (see paragraphs 42 and 43 of this Ruling) were satisfied.⁴

25. Recalculations to correct errors affecting TCSAs are required to be made in all cases where the errors were to any extent due to fraud or evasion. Recalculations in the TCSAs may also be required where the Commissioner applies Part IVA of the ITAA 1936.

Example 4

26. On 1 July 2004, Sub Co, an Australian-resident company, joins a consolidated group of which H Co is the head company. Sub Co owns a large number of depreciating assets. H Co works out Sub Co's ACA to be \$50 million, which it allocates to its assets according to the cost setting rules in Division 705 of the ITAA 1997. It lodges its 2004-05 income tax return on 15 January 2006.

27. While preparing its 2008-09 income tax return, H Co discovers that it had made an error in working out the ACA, which should have been \$51 million. Due to the effect of over-depreciation adjustments in respect of some of the depreciating assets under section 705-50 of the ITAA 1997, not all of the \$1 million shortfall in the ACA translates into a net understated amount in the TCSAs, which H Co works out to be \$0.8 million. H Co informs the Commissioner of the errors in the approved form and lodges its 2008-09 income tax return on 11 January 2010 on the basis that the erroneous TCSAs of its reset cost base assets are taken to be correct, and returns a capital loss of \$0.8 million.

28. H Co is justified in doing this because although it has the necessary information and ability to readily recalculate the TCSAs, it would not be reasonable to recalculate all the amounts involved on the grounds that:

- the net size of the errors is small compared to the ACA,⁵ and
- the adjustable values and the deductions claimed for the decline in value of a large number of depreciating assets over a four year period would need to be recalculated, and would require a large number of adjustments to the income tax assessments over that period.

⁴ There is an alternative view of the meaning of 'net size of the errors' – see Appendix 2.

⁵ In Examples 5.1 and 5.2 in Chapter 5 of the Explanatory Memorandum to New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, a net understated amount of \$300,000 was considered to be 'only a small fraction of the ACA'. In those examples, the ACA was initially worked out to be \$6.2 million, but should have been \$6.5 million.

Example 5

29. H Co is the head company of a consolidated group. On 1 July 2004, H Co acquires the balance of the membership interests of an Australian-resident company, Sub Co, that it did not already own, and Sub Co thereupon joins the group. H Co calculates the ACA of Sub Co to be \$200 million. H Co lodges its 2004-05 income tax return on 20 December 2005.

30. On 5 July 2006, H Co discovers that it has made an error in working out the ACA, which should have been \$220 million. As a result, the TCSAs of all of its reset cost base assets are understated by a net \$20 million. In deciding whether or not it is reasonable for H Co to recalculate the amounts involved, the following circumstances are taken into account:

- the net size of the errors in the TCSAs is not an insignificant proportion of the ACA;
- the information necessary to recalculate the amounts involved is readily available;
- amendments are required only for the income tax assessment for the 2004-05 income year; and
- H Co has the computing resources to recalculate the TCSAs without difficulty.

31. It is considered that, in these circumstances, H Co is required to recalculate the amounts involved and to request an amendment to its 2004-05 income tax assessment.

Whether the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen

32. Erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen.

33. Where there are both overstated amounts and understated amounts for a subsidiary member for the purposes of subsection 705-315(3) of the ITAA 1997 and they net off to zero, CGT event L6 does not happen because there is no net overstated amount or net understated amount for the subsidiary member for the purposes of subsection 104-525(1) of the ITAA 1997.

Example 6

34. Sub Co becomes a subsidiary member of a consolidated group of which H Co is the head company on 1 July 2005. The ACA for Sub Co is \$20 million of which \$2 million relates to retained cost base assets leaving \$18 million to be allocated to Sub Co's numerous reset cost base assets in proportion to their market values. A keying error causes the market value of one of these assets (asset X) to be recorded as being \$200,000 instead of its correct value of \$220,000. This incorrect value is then used in working out the TCSAs of the reset cost base assets. The total market value recorded for all of the reset cost base assets is \$20 million.

35. Because the \$18 million is allocated to the reset cost base assets in proportion to their market values, the TCSAs of those assets are all incorrect, but nevertheless sum correctly to \$18 million.⁶ The error in the market value of asset X causes the TCSA of asset X to be understated by \$17,802 and the TCSAs of all the other reset cost base assets to be overstated by amounts totalling \$17,802.

36. It is not considered reasonable to require a recalculation of the amounts involved because the net of the errors is nil, numerous TCSAs would have to be recalculated and a number of adjustments would have to be made to H Co's 2005-06 income tax assessment. H Co is required to notify the Commissioner of the errors as soon as practicable after becoming aware of the errors. In the absence of fraud or evasion, section 705-320 of the ITAA 1997 would apply as all the conditions in section 705-315 of the ITAA 1997 have been satisfied, resulting in incorrectly worked out TCSAs being taken to be correct.

37. As no net overstated amount or net understated amount arises, the third condition in subsection 104-525(1) of the ITAA 1997 is not satisfied, therefore CGT event L6 does not happen.

Date of effect

38. It is proposed that when the final Ruling is issued, it will apply both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraph 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation29 November 2006

⁶ It is assumed that none of the TCSAs of the reset cost base assets is reduced subsequent to the application of section 705-35 of the ITAA 1997 by provisions such as sections 705-40, 705-45, 705-47, 705-50 and 705-57 of the ITAA 1997.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Background

39. Where a head company of a consolidated group or MEC group makes errors in calculating the TCSA of a reset cost base asset of an entity that becomes a subsidiary member of the group and the conditions in section 705-315 of the ITAA 1997 are satisfied:

- the TCSA is taken to be correct under subsection 705-320(1) of the ITAA 1997 for the purposes of the ITAA 1936, the ITAA 1997 (apart from Subdivision 705-E of that Act) and the TAA;⁷ and
- the overstated amounts and understated amounts for the TCSAs of all reset cost base assets of the entity to which section 705-320 applies are netted off, and if there is a net overstated amount or a net understated amount, a capital gain or a capital loss arises respectively under section 104-525 of the ITAA 1997 (CGT event L6) at the start of the income year in which the Commissioner becomes aware of the errors.

40. These measures, contained in Subdivision 705-E of the ITAA 1997, are intended:

...to avoid the time and expense involved in correcting errors affecting tax cost setting amount calculations. This is done by providing for capital gains or capital losses to reverse the errors.⁸

By these measures, and that in section 104-525, it is intended to bring:

... the total amount of the error to account as a single amount rather than as a series of adjustments to the tax values of the joining entity's assets. The same amount will be brought to account in total but its character and the timing could be different.⁹

41. For example, if an error causes the TCSA of an item of trading stock to be overstated, the effect of the error will be reversed by a capital gain rather than a revenue gain. Similarly, if an error has resulted in the TCSA of a depreciating asset being understated, the effect of the error will be reversed by recognising an immediate capital loss. This compensates for the reduced capital allowance deduction that would be claimed over the effective life of the asset.

⁷ A limited number of provisions dealing with offences and penalties in the TAA escape the application of subsection 705-320(1) of the ITAA 1997 – see paragraphs 45 and 46 of this Ruling.

⁸ Section 705-305 of the ITAA 1997.

⁹ Paragraph 5.31 of the Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002.

42. The conditions in section 705-315 of the ITAA 1997 that have to be satisfied before an erroneous TCSA is taken to be correct are set out in subsections (2), (3) and (4) of that section, and are (respectively) as follows:

- (a) the head company worked out the TCSA of a reset cost base asset in purported compliance with Division 705 of the ITAA 1997 (the cost setting rules);
- (b) the head company made one or more errors in working out the TCSA that caused the TCSA to differ from its correct amount;
- (c) it is not reasonable to require a recalculation of the amounts involved, having regard to:
 - (i) the net size of the errors compared to the size of the ACA;
 - (ii) the number of TCSAs that would have to be recalculated and the difficulty of doing so;
 - (iii) the number of adjustments in assessments that could be amended and in future tax returns that would be necessary to correct the errors; and
 - (iv) the difficulty in obtaining the necessary information.

43. However, subsection 705-315(5) of the ITAA 1997 provides that these conditions are not satisfied where the errors were to any extent due to fraud or evasion. In these cases, recalculations are required to be made to correct the errors in the TCSAs of the reset cost base assets and amendments would need to be made to the income tax assessments for the relevant income years insofar as they are affected by the errors.

44. Furthermore, section 705-310 of the ITAA 1997 ensures that Subdivision 705-E of the ITAA 1997 does not limit the operation of Part IVA of the ITAA 1936.

45. Even where there is no fraud or evasion, the head company may still be subject to certain penalties arising from the provisions listed in subsection 705-320(2) of the ITAA 1997. These provisions are:

- section 8N of the TAA (offence of recklessly making false or misleading statements);
- section 284-75 in Schedule 1 to the TAA (liability to administrative penalty for making a false or misleading statement); and
- section 284-145 in Schedule 1 to the TAA (liability to administrative penalty in relation to a scheme benefit).

46. These are the only provisions in the TAA that escape the effect of subsection 705-320(1) of the ITAA 1997 and so recognise the errors in the TCSA.

The meaning of ‘in purported compliance with’

47. The first condition in section 705-315 of the ITAA 1997, set out in subsection (2) of that section, is that the head company worked out the TCSA of a reset cost base asset ‘in purported compliance with’ Division 705 of the ITAA 1997 (see paragraph 42(a) of this Ruling).

48. This condition is satisfied where the head company has at least made a reasonable attempt to work out the TCSA in accordance with Division 705 of the ITAA 1997, but nevertheless made unintended errors in the calculations.

What is considered to be an error in working out a TCSA

49. As the word ‘error’ is not a defined term in either the ITAA 1997 or the ITAA 1936, it takes its ordinary meaning for the purposes of Subdivision 705-E of the ITAA 1997. *The Macquarie Dictionary* defines an error as a ‘deviation from accuracy or correctness; a mistake, as in action, speech, etc.’ In the context of Subdivision 705-E, there is an error in working out a TCSA when there is a deviation from accuracy or correctness in the result of the calculation of the TCSA.

50. However, it is not expected that an error would arise for the purposes of Subdivision 705-E of the ITAA 1997 where a TCSA is incorrect due to the adoption of a position that is not reasonably arguable.

When it is not reasonable to require calculations to correct the errors

51. The four factors listed in subsection 705-315(4) of the ITAA 1997 (see paragraph 42(c) of this Ruling) that one must have regard to when determining whether or not it is reasonable to require recalculation of the amounts involved are discussed below. The relative importance of each of the factors will vary from case to case. In forming an objective judgment on the reasonableness or otherwise of requiring a recalculation of the amounts involved, the factors are to be evaluated in the context of the compliance costs that such recalculation would involve.

The net size of the errors compared to the size of the ACA

52. ‘Net size of the errors’ is not a defined term. The Commissioner considers that the term is equivalent to what would be the ‘net overstated amount’ or ‘net understated amount’ as defined in subsection 104-525(3) of the ITAA 1997 (see the second dot point of paragraph 39 of this Ruling) assuming that the conditions in subsection 705-315 of the ITAA 1997 (see paragraphs 42 and 43 of this Ruling) were satisfied.¹⁰

¹⁰ There is an alternative view of the meaning of ‘net size of the errors’ – see Appendix 2 at paragraph 61 of this Ruling.

53. Where the net size of the errors represents only a small fraction of the ACA, it would be less reasonable to require the TCSAs to be recalculated.

The number of TCSAs that would have to be recalculated and the difficulty of doing so

54. The more TCSAs that would have to be recalculated and the more difficult the recalculations become, the less reasonable it would be to require the recalculations. However, the availability of computers and suitable software enables the recalculations of even large numbers of TCSAs to be readily made. In such cases, the weighting given to this factor would be reduced accordingly.

The number of adjustments in assessments that could be amended and in future income tax returns that would be necessary to correct the errors

55. As the number of adjustments becomes larger, it would become less reasonable to have to recalculate the amounts involved. The time limit for amending assessments that would generally apply under section 170 of the ITAA 1936 restricts the number of assessments that could be amended. (The reference in paragraph 705-315(4)(c) of the ITAA 1997 to adjustments in future income tax returns may be interpreted as a reference to adjustments to presently existing information that would be necessary for the preparation of future tax returns.)

Difficulty in obtaining the necessary information

56. The greater the difficulty in obtaining the information necessary to perform the recalculations and make the adjustments, the less reasonable it would be to require those recalculations and adjustments to be carried out. It may be very time consuming to locate the relevant records or they may have been destroyed by a fire or natural catastrophe.

57. It should be noted that the record keeping requirements in Division 121 of the ITAA 1997 require records to be kept of every act, transaction, event or circumstance that can reasonably be expected to be relevant to working out whether a capital gain or capital loss arises from a CGT event (including CGT event L6), whether that event has happened or may happen in the future. These records must be retained until the end of 5 years after it becomes certain that no subsequent CGT event can happen such that the records could reasonably be expected to be relevant to working out whether there is a capital gain or capital loss from the event.¹¹

¹¹ There are limited exceptions to this requirement – see subsection 121-25(4) and section 121-30 of the ITAA 1997.

Whether the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen

58. Subsection 705-320(1) of the ITAA 1997 states:

For the purposes of this Act (other than this Subdivision) and for the purposes of the *Taxation Administration Act 1953*, any tax cost setting amounts that were worked out by the head company, so far as they were due to the errors, are taken to have been correct if the conditions in section 705-315 are satisfied.

59. Subsection 104-525(1) of the ITAA 1997 states:

CGT event L6 happens if:

- (a) you are the head company of a consolidated group or a MEC group; and
- (b) the conditions in section 705-315 (about errors in tax cost setting amounts) are satisfied for a subsidiary member of the group; and
- (c) you have a net overstated amount or a net understated amount for the subsidiary member.

60. Therefore, where there are both overstated amounts and understated amounts for a subsidiary member for the purposes of subsection 705-315(3) of the ITAA 1997 and they net off to zero, CGT event L6 does not happen because there is no net overstated amount or net understated amount for the subsidiary member for the purposes of subsection 104-525(1) of the ITAA 1997. However, as long as the conditions in section 705-315 of the ITAA 1997 are satisfied, the erroneous TCSAs will nevertheless be taken to be correct under section 705-320 of the ITAA 1997.

Appendix 2 – Alternative views

1 *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

Meaning of ‘net size of the errors’

61. An alternative to the view expressed in paragraphs 24 and 52 of this Ruling is that ‘net size of the errors’ in subsection 705-315(4) of the ITAA 1997 (see paragraph 42(c) of this Ruling) is a reference to the net impact of one or more errors insofar as it causes the TCSA of a *single* reset cost base asset to deviate from its correct amount.

62. It is said in support of this view that the wording adopted in subsections 705-315(2) and (3) of the ITAA 1997 (see paragraphs 42(a) and (b) of this Ruling) indicates that section 705-315 as a whole is concerned with the ultimate impact of one or more errors on the TCSA of a single reset cost base asset.

63. On this view, this net impact of the errors on the TCSA of the single asset is then compared to the size of the ACA for the joining entity to constitute the first of the four factors in subsection 705-315(4) of the ITAA 1997 for assessing the reasonableness or otherwise of requiring recalculations. The subsequent factors then consider the wider impact of the errors, that is, the number of TCSAs of reset cost base assets that have to be recalculated and the number of consequential adjustments needed in assessments that could be amended.

64. The Commissioner agrees that subsections 705-315(2) and (3) of the ITAA 1997 concern themselves with the TCSA of one reset cost base asset at a time. However, it may be argued that the question of whether ‘net size of the errors’ is in relation to one, or alternatively all, of the TCSAs should be decided by reference to the wording in the remaining three factors listed in subsection 705-315(4) of the ITAA 1997 (see paragraph 42(c)(ii)-(iv) of this Ruling). These refer to a plurality of TCSAs and adjustments to assessments, etc. which would suggest that subsection 705-315(4) is concerned with the errors in *all* of the incorrect TCSAs.

65. In Example 5.1 in the Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No.2) 2002 (the EM), the ACA of a joining entity is worked out to be \$6.2 million when in fact it should have been \$6.5 million. The error of \$300,000 is described in the example as being ‘only a small fraction of the ACA’. In Example 5.2 in the EM, which continues Example 5.1, it is stated that the error in the ACA leads to a net understated amount of \$300,000 in the TCSAs of the joining entity’s reset cost base assets. So it is the net impact of the error on the TCSAs of *all* the affected reset cost base assets that is referred to as a small fraction of the ACA in these examples.

Appendix 3 – Your comments

66. We invite you to comment on this draft Taxation Ruling. Please forward your comments to the contact officer by the due date. (Note: the Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

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Appendix 4 – Detailed contents list

67. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Ruling	5
The meaning of ‘in purported compliance with’	5
What is considered to be an error in working out a TCSA	7
<i>Example 1</i>	11
<i>Example 2</i>	13
<i>Example 3</i>	15
When it is not reasonable to require calculations to correct the errors	20
<i>Example 4</i>	26
<i>Example 5</i>	29
Whether the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen	32
<i>Example 6</i>	34
Date of effect	38
Appendix 1 – Explanation	39
Background	39
The meaning of ‘in purported compliance with’	47
What is considered to be an error in working out a TCSA	49
When it is not reasonable to require calculations to correct the errors	51
<i>The net size of the errors compared to the size of the ACA</i>	52
<i>The number of TCSAs that would have to be recalculated and the difficulty of doing so</i>	54
<i>The number of adjustments in assessments that could be amended and in future income tax returns that would be necessary to correct the errors</i>	55
<i>Difficulty in obtaining the necessary information</i>	56
Whether the erroneous TCSAs are taken to be correct under section 705-320 of the ITAA 1997 where all the conditions in section 705-315 of the ITAA 1997 are satisfied, even if CGT event L6 does not happen	58
Appendix 2 – Alternative views	61

Meaning of ‘net size of the errors’	61
Appendix 3 – Your comments	66
Appendix 4 – Detailed contents list	67

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains tax
- CGT events
- CGT events L1-L8 - consolidated and MEC groups
- consolidation
- consolidation - assets
- consolidation - joining
- cost setting rules
- tax cost setting rules

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