


TD 2002/D12 - Income tax: is expenditure incurred by a head company in obtaining valuations in respect of the formation of a consolidated group or entities joining a consolidated group an allowable deduction?

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This document has been finalised by TD 2002/1.

Draft Taxation Determination

Income tax: is expenditure incurred by a head company in obtaining valuations in respect of the formation of a consolidated group or entities joining a consolidated group an allowable deduction?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office. DTDs should not be relied on; only final Taxation Determinations represent authoritative statements by the Australian Taxation Office.

1. Yes. Expenditure incurred by a head company in obtaining the market valuations required to comply with the income tax laws for forming a consolidated group or where entities join an existing consolidated group is deductible because it is a tax-related expense for the purposes of section 25-5 of the *Income Tax Assessment Act 1997* ('the Act'). A tax-related expense for the purposes of this Draft Taxation Determination refers to expenditure incurred by a head company to the extent that it is for (a) managing its tax affairs; or (b) complying with an obligation imposed on it by a Commonwealth law, insofar as that obligation relates to the tax affairs of an entity.
2. Market valuations are required under a number of provisions within the consolidation legislation. Where expenditure on such a valuation relates solely to complying with a legislative requirement under the consolidation regime it will be wholly deductible under section 25-5.
3. The expression 'You can deduct expenditure you incur to the extent that it is for...' in subsection 25-5(1) requires an apportionment of the valuation expenses between deductible amounts of tax-related expenses and amounts that are not deductible under section 25-5 in circumstances where the valuation is not obtained solely for the purpose of complying with the income tax requirements for forming or joining a consolidated group. The valuation could also be undertaken for other purposes such as to provide directors of companies with an independent valuation to assist their decision making on the acquisition or disposal of assets, to provide information to potential or existing lenders, or to provide a basis for the restructure of a corporate group prior to the formation of a consolidated group. To the extent that the valuation is undertaken for these non tax-related purposes the expenditure would not be an allowable deduction under section 25-5 but may satisfy the requirements for deductibility under another provision of the Act.
4. In these circumstances only an appropriate portion of the valuation expenses will be an allowable deduction under section 25-5. It is only this portion that can be said to have

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been incurred in respect of a tax-related matter. What is the appropriate portion will depend on the facts of each case. For example, with a valuation undertaken equally for the purposes of an entity joining the consolidated group and for valuing its assets for insurance purposes, we would say only half of the total cost of the valuation is an allowable deduction under section 25-5 with the remaining half being considered under section 8-1.

5. If the valuation is ordered solely for a tax-related purpose such as the formation of a consolidated group, the fact that it may subsequently be used for obtaining insurance, an accounting revaluation or any other purpose would not detract from its full deductibility under section 25-5. Likewise if the valuation is ordered for some other purpose the fact that it is subsequently able to be used in relation to the formation or joining of a consolidated group would not entitle the head company to a deduction under section 25-5.

6. Under section 25-5 of the Act, a head company can deduct expenditure incurred in managing its income tax affairs or complying with an obligation imposed on it by a Commonwealth law, insofar as that obligation relates to the income tax affairs of an entity. Where a consolidated group is formed the group is treated as a single entity for income tax purposes. Subsidiary members of the group are treated as parts of the head company rather than as separate income tax identities. A deduction will be allowed for a tax-related expense where the expenditure by the head company on obtaining the valuations is incurred after the formation of the consolidated group. A deduction will also be allowed where the tax-related expense on obtaining the valuations is incurred by the head company before the joining time or formation of the consolidated group even if the consolidation does not go ahead. A head company of a consolidated or consolidatable group that is an STS taxpayer will deduct tax-related valuation expenses only when they are paid (paragraph 328-105(1)(b) of the Act).

7. Capital expenditure is expressly excluded from being an allowable deduction under section 25-5. However, expenditure for this purpose is not necessarily characterised as being 'capital' merely because it relates to matters of a capital nature. Expenditure incurred by a head company in obtaining market valuations in respect of the formation of a consolidated group or entities joining a consolidated group is not capital in nature.

8. Although tax-related costs of this nature are not capital, they do not ordinarily satisfy the requirements of section 8-1 of the Act, as they are not incurred in the gaining or producing of assessable income (*Smith's Potato Estates Ltd v Bolland* (1948) AC 508; (1948) 2 All ER 367; *Cliffs International Inc v FC of T* (1985) 85 ATC 4374; 16 ATR 601; *FC of T v Ryder* 89 ATC 4250; 20 ATR 443).

Your comments

9. We invite you to comment on this draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date: 6 December 2002
Contact Officer: Mike Slattery
E-mail address: Mike.Slattery@ato.gov.au
Telephone: (02) 6246 9606
Facsimile: (02) 6246 9709
Address: 2 Constitution Ave, Canberra, ACT 2600

Commissioner of Taxation8 November 2002

Previous draft:

Not previously issued in draft form

Subject references:

- Tax-related expenses

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 25-5
- ITAA 1997 25-5(1)
- ITAA 1997 328-105(1)(b)

Case references:

- Smith's Potato Estates Ltd v Bolland (1948) AC 508; (1948) 2 All ER 367
- Cliffs International Inc v FC of T (1985) 85 ATC 4374; 16 ATR 601
- FC of T v Ryder 89 ATC 4250; 20 ATR 443

ATO references

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