


***TD 2004/73 - Income tax: consolidation: where the head company and a chosen transitional entity in a consolidated group hold separate membership interests in a non-chosen subsidiary, how does the group calculate the allocable cost amount for the non-chosen subsidiary?***

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## Taxation Determination

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Income tax: consolidation: where the head company and a chosen transitional entity in a consolidated group hold separate membership interests in a non-chosen subsidiary, how does the group calculate the allocable cost amount for the non-chosen subsidiary?

### **Preamble**

*The number, subject heading, date of effect and paragraph 1 to paragraph 4 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.*

1. When working out the allocable cost amount (ACA) for a non-chosen subsidiary,<sup>1</sup> the group is required to do separate ACA-like calculations using the membership interests the head company has in the non-chosen subsidiary and the membership interests the chosen transitional entity<sup>2</sup> (or each chosen transitional entity) has in the non-chosen subsidiary.
2. The calculation for the head company is done on the basis that the only membership interests that existed in the non-chosen subsidiary were those interests that were not held (directly or indirectly) by any chosen transitional entity. However, any amounts at steps 2 to 7 of the calculation<sup>3</sup> are multiplied by the fraction determined under paragraph 701-20(4)(b) of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997).
3. Similarly, the calculation for a chosen transitional entity is done on the basis that the membership interests it has in the non-chosen subsidiary were the only interests that existed in that non-chosen subsidiary. In doing this calculation, any amounts at steps 2 to 7 are multiplied by the fraction determined under paragraph 701-20(5)(d) of the IT(TP)A 1997.
4. The results of the separate calculations are added together to produce the group's ACA for the non-chosen subsidiary under subsection 701-20(3) of the IT(TP)A 1997.

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<sup>1</sup> Every member of the consolidated group, other than the head company and the chosen transitional entities, is a non-chosen subsidiary – subsection 701-20(2) of the *Income Tax (Transitional Provisions) Act 1997*.

<sup>2</sup> A chosen transitional entity is a subsidiary member for which the head company has chosen the transitional option of retaining the existing tax costs for its assets instead of applying the cost setting rules: sections 701-5 and 701-15 of the *Income Tax (Transitional Provisions) Act 1997*.

<sup>3</sup> Steps 2 to 7 are set out in the table in section 705-60 of the *Income Tax Assessment Act 1997*.

**Explanation**

5. Section 701-20 of the IT(TP)A 1997 applies on formation of a consolidated group where the group is a transitional group under section 701-1 of the IT(TP)A 1997, and included in the subsidiary members of the group are at least one chosen transitional entity and one or more non-chosen subsidiaries. The ACA for the non-chosen subsidiaries in the group is calculated under section 701-20 by dividing the consolidated group into sub-groups.

6. Under subsection 701-20(6) of the IT(TP)A 1997, a sub-group consists of the chosen transitional entity and each non-chosen subsidiary through which it holds membership interests in the non-chosen subsidiary for which the ACA is to be calculated ('the subject NCS'). A non-chosen subsidiary cannot be included in more than one sub-group.

7. For the ACA calculation, each chosen transitional entity that has direct or indirect interests (other than wholly through another chosen transitional entity) in the subject NCS is treated as if it were the head company of a consolidated group, the consolidated group being made up of the chosen transitional entity's sub-group and the subject NCS. If the head company of the transitional group, apart from the interests it has through the sub-groups, also holds membership interests in the subject NCS directly, or through one or more other non-chosen subsidiaries that are not included in any sub-group, these interests are taken into account separately in the ACA calculation.

8. Under section 701-20 of the IT(TP)A 1997, firstly, if the head company holds membership interests in the subject NCS directly or through one or more non-chosen subsidiaries that are not included in any sub-group, the group calculates an ACA for the subject NCS based only on those membership interests. This is the 'head company adjusted allocable amount'. It is calculated disregarding all membership interests that any sub-group holds in the subject NCS [paragraph 701-20(4)(a)]. That is, it is calculated as if the membership interests the sub-group holds did not exist and the other membership interests that are held independently of any sub-group were the entire membership interests in the subject NCS.

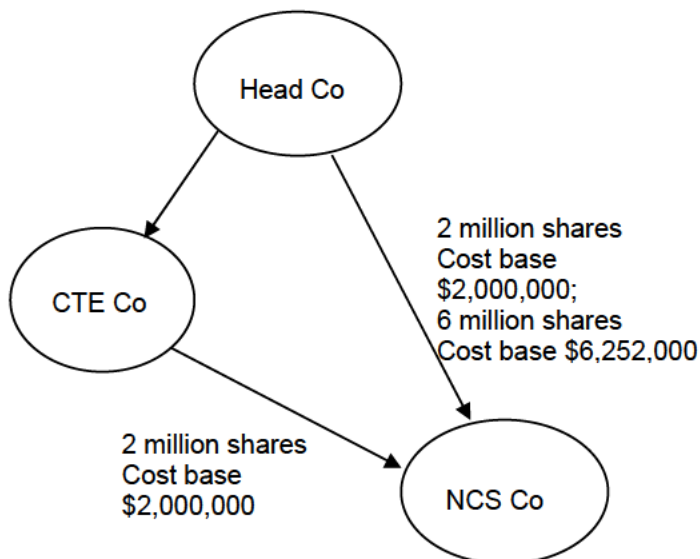
9. Secondly, section 701-20 of the IT(TP)A 1997 requires the group to work out an ACA for the subject NCS on a similar basis for the membership interests each sub-group holds in the subject NCS. This is the 'sub-group's notional allocable cost amount'. It is calculated as if the membership interests the sub-group holds were the only membership interests in the subject NCS.

10. If, in calculating the head company adjusted allocable amount or a sub-group's notional allocable cost amount, there are amounts at any of steps 2 to 7, the steps 2 to 7 amounts are reduced by multiplying them by a fraction. The fractions reflect the head company's and chosen transitional entity's proportionate interests in the value of the subject NCS. This reduction is necessary to avoid double-counting, since the calculations have been done on the basis that the membership interests that the entity concerned held in the subject NCS were the only membership interests that group members held in the subject NCS.

11. For the head company adjusted allocable amount, the fraction is determined under paragraph 701-20(4)(b) of the IT(TP)A 1997; for the sub-group's notional allocable cost amount, the fraction is determined under paragraph 701-20(5)(d).

12. Having calculated the head company adjusted allocable amount and each sub-group's notional allocable cost amount using the fractions provided to reduce the steps 2 to 7 amounts, the group adds the results together to produce its total ACA for the subject NCS.

**Example**



13. *Head Co and its wholly-owned subsidiary CTE Co each acquired a 20% interest (2 million shares) in NCS Co for \$2,000,000 on 1 July 2001. In the 2001-2002 income year NCS Co derived profits of \$600,000 and paid tax of \$180,000 on those profits. At the end of the income year the total market value of all membership interests in NCS Co was \$10,420,000 (representing \$1.042 per share).*

14. *On 30 June 2002 Head Co acquired the remaining 6 million shares in NCS Co for \$6,252,000. Head Co chooses that the group consisting of itself, CTE Co and NCS Co become a consolidated group from 1 July 2002. Head Co also chooses that CTE Co be a chosen transitional entity. NCS Co is a non-chosen subsidiary.*

15. *In calculating the ACA for NCS Co the group calculates a head company adjusted allocable amount and a sub-group's notional allocable cost amount. For this purpose, CTE Co is a sub-group in relation to NCS Co.*

**Head company adjusted allocable amount**

16. *Head Co's total acquisition cost for the shares in NCS Co, \$8,252,000, is taken into account at step 1 of the ACA calculation for the head company adjusted allocable amount.*

17. *There were also undistributed taxed profits in NCS Co when the group became a consolidated group. The group must determine how much of those profits accrued to the shares Head Co held in NCS Co. Disregarding the 2 million shares CTE Co held in NCS Co, the 2 million shares Head Co held when the profits accrued would be taken to have been a 25% interest; that is, 2 million of a total 8 million shares. On that basis, 25% of the \$420,000 undistributed taxed profits, being \$105,000, would have accrued to Head Co. This amount is relevant to step 3.*

18. To calculate the step 3 amount, multiply \$105,000 by:

	Market value of head company's direct and indirect membership interests in non-chosen subsidiary	
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	Market value of all membership interests in non-chosen subsidiary	
	\$8,336,000 (ie 8 million shares @ \$1.042 per share)	4
=	-----	--
	\$10,420,000 (ie 10 million shares @ \$1.042 per share)	5

The step 3 amount for the head company adjusted allocable amount is \$84,000. Assume no other step is relevant in the ACA calculation.

19. The head company adjusted allocable amount is therefore:

$$\$8,252,000 + \$84,000 = \$8,336,000.$$

### **Sub-group's notional allocable cost amount**

20. The group also calculates a sub-group's notional allocable cost amount. The amount CTE Co paid for its 2 million shares in NCS Co, \$2,000,000, is taken into account at step 1 of the calculation. There is also a step 3 amount, first calculated on the basis that the 2 million shares CTE Co held when the group became a consolidated group were the only shares in NCS Co. On this basis the entire \$420,000 undistributed taxed profits is relevant to step 3.

21. This amount is multiplied by:

	Market value of chosen transitional entity's direct and indirect membership interests in non-chosen subsidiary	
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	Market value of all membership interests in non-chosen subsidiary	
	\$2,084,000 (ie 2 million shares @ \$1.042 per share)	1
=	-----	--
	\$10,420,000 (ie 10 million shares @ \$1.042 per share)	5

The step 3 amount for the sub-group's notional allocable cost amount is \$84,000 (that is, \$420,000 divided by 5).

22. The sub-group's notional allocable cost amount is therefore:

$$\$2,000,000 + \$84,000 = \$2,084,000.$$

23. Adding together the head company adjusted allocable amount and the sub-group's notional allocable cost amount, the group's ACA for NCS Co is \$10,420,000.

### **Date of effect**

24. 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).

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**Commissioner of Taxation**8 December 2004

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*Previous draft:*

TD 2004/D58

*Related Rulings/Determinations:*

TR 92/20

*Subject references:*

- allocable cost amount
- calculation of the allocable cost amount
- chosen transitional entity
- non-chosen subsidiary
- sub-group

*Legislative references:*

- ITAA 1997 705-60
- IT(TP)A 1997 701-1
- IT(TP)A 1997 701-5
- IT(TP)A 1997 701-15
- IT(TP)A 1997 701-20
- IT(TP)A 1997 701-20(2)
- IT(TP)A 1997 701-20(3)
- IT(TP)A 1997 701-20(4)(a)
- IT(TP)A 1997 701-20(4)(b)
- IT(TP)A 1997 701-20(5)(d)
- IT(TP)A 1997 701-20(6)
- TAA 1953 Pt IVAAA

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ATO references

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