Private Business Tax Retreat

Tax Consolidation for SMEs

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1. Overview

The Tax Consolidation regime commenced on 1 July 2002 replacing many of the existing rules that applied for corporate groups, such as loss transfers. It is well known the regime has been underutilised in the SME market despite its many advantages. This is no surprise given the volume of legislation, rulings and workbooks produced over more than 20 years.

For a short list of the reasons the regime remains underutilised:

- Complexity of legislation from Division 700 to 721 ITAA 1997 coupled with numerous rulings. Although most of the complexity will be on entries and exit of members.
- Misconception that it remains complex once you are grouped.
- Fear of advisors making mistakes or knowing when to ask for assistance.
- Legislative drafting – Tax Consolidations is very much written in its own style and vocabulary.
- Professional advisor fees tend to remain the same overall. Although, in my experience the tax savings tend to outweigh this.

Unfortunately, for the above reasons, I do not see any rapid expansion in the use of the regime for SMEs without changes to the legislation. The last attempt to make any meaningful change occurred with the Board of Taxation Reviews of 2011 and 2013[1]. For SME's, there were attempts to simplify the entry process for ACA and losses, including where restructures occur to interpose holding companies[2]. Nothing came of these attempts and I am not aware of anything on the horizon.

I can make these comments as someone who provides training to accounting firms in the basics of Tax Consolidations through to in-depth training for those firms wanting to learn the intricacies.

Despite the complexity, in my experience a Tax Consolidated Group by its nature will confront less tax issues on a day-to-day basis than a group that is not. This is the feature that is missed by advisors as the intricacies of entity to entity taxation are avoided. That is, ensuring gains and losses are offset and requirements for entity to entity charges specifically to ensure deductibility.

I would ask readers to think of the benefits of Tax Consolidation more as one of "Business Efficiency". They are in my view one of the essential Tools in our tax toolkit.

The contents of this paper are expressly tailored for issues common to SME's and my experience of recent years. Features of recent years have seen a variety of accounting standard changes and the advent of covid from March 2020 leading to an expansion in deduction, with instant asset write-offs and entities with losses. This paper will deal with several of the issues faced in recent years along with practical suggestions in dealing with Tax Consolidated Groups.

[1] 2011 & 2013 Board of Taxation Reviews – Review of the Consolidation Rights to Future Income and Residual Tax Cost Setting Rules & Post-Implementation Reviews of the Consolidation Regime

[2] For example, Subdivision 122-A, 124-M & Division 615

2. Advantages & Disadvantages of Tax Consolidated Groups

Despite the known complexity of Tax Consolidated Groups, they are in many respects simpler than non-Tax Consolidated groups once in operation. Many ordinary issues we consider on a day to day basis become irrelevant, with many anti-avoidance measures also ceasing to operate within the group context. Like all structuring it requires us to contemplate future events.

No discussion on the advantages of Tax Consolidated Groups can occur without providing some background to the single entity rule and some understanding of how Tax Consolidated Groups operate on a day to day basis.

2.1 Day to day in a Tax Consolidated Group

On a day to day basis the accounting and operations of a group member should not change compared to a non-tax consolidated group. Legally each group member will still be subject to all the normal legal obligations on an entity by entity basis. From the perspective of the outside world the fact a company is a tax consolidated group member will not be of relevance to their dealings with any entity.

2.2 Advantages

Many of the advantages of a Tax Consolidated Group are the same for any type of Holding Company Group.

- **Standard Holding Company advantages:**
  - The ability to get all critical assets into the one holding vehicle for funding and capital raising purposes will often be the main reason a group exists in the first place. The use of subsidiaries will give the group the ability to protect different IP and assets all in the one vehicle. Some good examples are:
    - Start-Up's / Scale-Up's with separate IP and trading entities with holding company.

    - Aggregators and others looking to do M&A activity with expected sale events. A holding company group can easily package up a share sale often requiring minimal, if any, operational changes to a business on a day to day basis. In saying that there will be the normal legal change of control issues to take account of. For example, leases, contracts and banking requirements.

- **Advantages peculiar to Tax Consolidated Groups –** While we might all normally think of the below advantages as relating solely to "Tax", I would consider them essential "Business Efficiency" tools**:**
  - **One Tax Return** - All profits and losses are included in the one tax return of the head company. This is often the most important aspect of a Tax Consolidated Group. This takes away some of what I often call tax gymnastics required to minimise tax in non-

tax consolidated groups (and some annual advisor costs). Some good examples where this might be critical are:

  - Property Developers with each project in a different entity all at different stages of development, delivery and success. The GFC and recent Covid events make managing cashflow on tax payments critical.

  - Recent Instant Asset Write-off on depreciable assets affecting groups with separate plant and trading entities. These groups often found themselves in a situation where they were required to examine whether they met the conditions to tax consolidate to offset trading entity gains with plant owning entity losses.

- **Buying Company Shares** – When buying company shares all taxpayers are presented several problems where an ordinary discretionary trust is used:
  - Any debt funding will ordinarily require most taxpayers to pay dividends out of the acquired entity creating division 7A issues. From this will follow cashflow problems with top-up tax payments. Ordinarily this is not as much of an issue early on where interest expense might reduce the top up tax payments. But it will certainly become an issue as the debt is paid down, let alone if business conditions become difficult.

  - Interest deductions cannot be offset against business profits increasing cashflow problems.

  - The cost base of assets in the shares will only be of use in the future if there is a share sale. If there is never a share sale, then the return on investment hurdle is higher and the overall tax payable will be more.

- Tax Consolidations will improve the outcome by simply having a company buy those same shares (with its own discretionary trust shareholder) and then choosing to Tax Consolidate:
  - The interest deductions on debt funding will be offset against the groups other profits.

  - There are no top up tax or division 7A considerations to contemplate either on taking dividends out of the newly acquired entity or from related party funding if it comes from a related company.

  - The cost base in the shares will be pushed down for tax purposes across all the underlying assets subject to entry ACA calculations.

  - The only downside will be if there is a share sale, then the new holding company may not have any significant cost base. But this may still be resolved in part by splitting the funding between share capital in the new holding company and internal funding in the holding company.

- **Transactions between group members are ignored for "tax purposes":**
  - This is the case for both revenue and CGT assets. For example, land, plant and equipment and trading stock. Internal restructures will be much simpler. The larger a group or more entrepreneurial they are the more likely this benefit will be required.

    - Also of assistance, commercial debt forgiveness, share buy-backs and other corporate activities within the group are ignored.

    - FBT, GST and stamp duty will still need to be considered on each individual transaction. However, GST grouping will be the solution for a holding company group. In the case of stamp duty, Corporate Reconstruction relief may be available in Queensland.

  - **Franking Credits** – There is only one franking account for the head company. Following this it is clear the normal risks of wastage of franking credits between group members will not be an issue, nor is there a cost in maintaining the separate franking accounts.

2.3 Disadvantages

Many of the disadvantages of Tax Consolidated Groups are the same for any type of Holding Company Group:

- **Standard Holding Company disadvantages:**
  - **Small Business CGT Concessions**[3] will often be more difficult to pass in a holding company group whether consolidated or not:
    - The active asset test is rolled out on an entity-by-entity basis requiring tracing of individual entities for the 80% active asset test[4]. Inter-entity asset loans may cause issues for the group if they are regarded as non-active assets for these purposes. For this reason, care must be taken in how cash is moved around a holding company group. From this it is apparent the single entity rule noted below will provide no assistance.

    - The additional basic concessions introduced in 2018[5] requiring the company itself to be below the $6m test.

    - New modified active asset test introduced in addition to the already difficult to pass active asset test for shares[6].

    - If a new holding company is interposed the shares will be refreshed for the purposes of the active asset test[7] period. This is unlike the deeming relating to the 50% cgt discount where the earlier period of ownership is taken account of. This may or may not be a detriment depending on whether the original shares were active in the first instance or could benefit from the small business 15 year exemption.

  - **Early Stage Tax Incentive ("ESIC")[8]** – These rules were never crafted with holding company groups in mind where the holding company does nothing more than act as a

[3] Division 152 ITAA 1997
[4] s152-40(3) -(3B) ITAA 1997
[5] Treasury Laws Amendment (Tax Integrity and Other Measures) Bill 2018
[6] s152-10(2) -(2B) ITAA 1997
[7] s152-35 ITAA 1997
[8] Division 360-A and s360-40 & s360-45

holding company. Due to this a company hoping to qualify for ESIC will normally need to start as a standalone company and plan how it will move to a tax consolidated group after the brief ESIC window expires.

- **Disadvantages peculiar to only Tax Consolidated Groups:**
  - **Entry & Exit ACA** – This is realistically the bug bear of the SME advisor market for several reasons:
    - Complexity and nuance of the calculations.
    - Lack of accounts available with sufficient accounting standards used.
    - Unexpected tax outcomes on entry or exit.
    - The need to ensure most dealings in shares only occur at the holding company level.
  - Step one in examining any non-tax consolidated group is normally whether you can tax consolidate without creating a tax liability, reduction in revenue assets or lose losses.
  - Thankfully once you are in a group, it is in my view simpler on a day to day basis from a tax perspective.
  - **Single Entity Rule** – While I am a disciple of the benefits of Tax Consolidation, I do appreciate the complexity of upskilling in the area and understanding the nuances of some of the day to day questions that will arise.
  - When does the single entity rule apply or not apply. For example, while you may cease lodging individual tax returns, a subsidiary will still have its own division 7A distributable surplus – this is not at the group level[9]. Family Trust Election and Interposed entity elections will also operate on an entity by entity basis. How these operate is not always straight forward and is the subject of various rulings.
  - Preparing consolidated accounts, even if only in spreadsheet form. This will also require a good understanding of what each member in the group does and how it interacts with other group members from an operational and accounting perspective.
  - **One in, all in approach** – All 100% owned entities are automatically included in the group, which may not always be beneficial. The easy answer to this, is to ensure you always do draft entry calculations first. If for some reason you do not want the entity to join the group then you can ensure the entity is not 100% owned.
  - **Joint & several liability for Tax** - All members are jointly and severally liable for tax liabilities of the group unless you have in place a Tax Sharing Agreement ("TSA"). There is then the ongoing requirement to manage both TSA and Tax Funding Agreements ("TFA") within a group as members are added or removed.
  - **Losses on Entry** – For larger corporates this is more likely to be an advantage as SBT losses may be refreshed to COT losses within the group. In the SME market this is

[9] TD 2004/68, TD 2015/18,

often a detriment as losses are either lost or the available fraction is too low to be of any use. If anything, it shows the importance of tax consolidating SME groups at the first available opportunity.

- **Tax Deferments -** As the group is treated as one tax entity there can be no deferments or arbitrage of tax liabilities, whether intended or otherwise. For example, a service entity incurring all costs before on-charging them to other group members.

- **Costs of entering Tax Consolidated Groups** – In my experience this is a perception issue and is not a real disadvantage once you consider the benefits of tax consolidating, which can normally be expressed in real dollar terms. It is more the fear factor of tax consolidated groups and talking to the client about the benefits to them.

- **Professional advisors** – There is a lack of professional advisors available in the SME market to support SME firms. Realistically it is hard to see this number growing keeping in mind the only period we have completed entry and exit calculations on a day to day basis was between 2000 and 2006. Not a dissimilar problem to GST where younger accountants will not have the day to day experience in the nitty gritty of the legislation.

- **Lazy Accounting** - Taxpayers and their CFO’s no longer feel as though they need advice and start to operate the group as though the single entity rule applies to everything. I have seen numerous examples of taxpayers ceasing to do normal accounting entries through on an entity by entity basis, nor necessarily reflecting what has legally and factually occurred. This can cause everything from Corporations Act issues, through to GST and stamp duty problems.

3. Single Entity Rule

The single entity rule as it is called is fundamental to the understanding of how entities within a tax consolidated group will operate. Just as often it is said the entities within a group cease to exist while tax consolidated. This is not strictly correct with the single entity rule only operating in a clearly defined and restricted way as set out below:

ITAA 1997 701-1 Single entity rule

(1) *If an entity is a * subsidiary member of a * consolidated group for any period, it and any other subsidiary member of the group are taken for the purposes covered by subsections (2) and (3) to be parts of the * head company of the group, rather than separate entities, during that period.*

Head company core purposes

(2) *The purposes covered by this subsection (the head company core purposes) are:*

- ***(a)*** *working out the amount of the * head company's liability (if any) for income tax calculated by reference to any income year in which any of the period occurs or any later income year; and*
- ***(b)*** *working out the amount of the head company's loss (if any) of a particular * sort for any such income year.*

Note: *The single entity rule would affect the head company's income tax liability calculated by reference to income years after the entity ceased to be a member of the group if, for example, assets that the entity held when it became a subsidiary member remained with the head company after the entity ceased to be a subsidiary member.*

Entity core purposes

(3) *The purposes covered by this subsection (the entity core purposes) are:*

- ***(a)*** *working out the amount of the entity's liability (if any) for income tax calculated by reference to any income year in which any of the period occurs or any later income year; and*
- ***(b)*** *working out the amount of the entity's loss (if any) of a particular * sort for any such income year.*

Note: *An assessment of the entity's liability calculated by reference to income tax for a period when it was not a subsidiary member of the group may be made, and that tax recovered from it, even while it is a subsidiary member.*

As a summary of the effect of s701-1 ITAA 1997:

- It is only relevant to members of the group and no other entity.
- This is only for the period of membership (it is a deeming rule). For the purposes of outsiders of the group, including related entities, there should be no difference to the normal tax outcomes for them. That is, interposed entity elections and shareholders of a tax consolidated group. Family trust distributions tax could only be assessed to an individual member, not the head company.
- For the period of membership they are treated as “parts” of the head company, rather than separate entities. This is often called the divisional approach where each member is treated as a division of the head company’s business.
- The core purposes of the single entity rule are limited to:
  - Working out the tax liability or taxable income of the group

  - Working out the amount of losses of a group

  As FBT and GST are neither of these core purposes they will operate in the normal way.

- Following the above for group members:
  - All inter entity transactions will still legally occur but have no tax effect on the group.
  - The membership interests, for example, shares and units also cease to have any relevance as they are already part of the one entity.
  - The head company holds all assets and liabilities for this purpose alone.
  - The actions of subsidiary entities are deemed to be those of the head company – divisional approach.
  - The business of the group must be assessed holistically as though the groups were simply divisions of the one entity.

The depth and breadth of the single entity rule has been explored briefly in existing case law. The last case of significance being Channel Pastoral Holdings Pty Ltd v FCT (2015) FCAFC 57[10] heard by the Full Federal Court. While this case was a win to the Commissioner it did call into question the ordinary breadth of the single entity rule. For the moment the Commissioner has advised their interpretation of the single entity rule will remain as it is expressed in TR 2004/11[11].

For those interested in a more detailed explanation of the depth and breadth of the single entity rule I would recommend the Tax Specialist Article of AH Slater QC and Peter Murray KPMG[12].

Based on former precedents with Tax Consolidations, if the Courts were to find the single entity rule does not apply in the way the Commissioner has outlined, we can expect the government to provide legislation backdated to 1 July 2002.

3.1 Examples of the Single Entity Rule in operation

Some examples of the single entity rule and how it would change the expected outcomes or requires you to examine the situation more carefully:

- **Premises used by the business but held in a separate subsidiary with lease agreement in place** - On a standalone basis the property is a rental property with assessable income and deductions claimed against the rental income. When tax consolidated the property is treated as though it is owned by the head company, which cannot charge itself rent on its own property. Accordingly, deductions will be necessarily incurred in relation to the business income. While the tax outcome is likely to achieve the same result the basis upon which deductions are claimed is different.

- **Pre and Post settlement capital costs when acquiring a group member** – Ordinarily these costs will form part of the cost base of the acquired assets when not tax consolidated. In a tax consolidated group they will form part of Step 1 of entry ACA up until settlement. However,

[10] See para 119 to 127 Pagone in Channel Pastoral Holdings
[11] See also para 42A to 42M of TR 2004/11 re Channel Pastoral
[12] The Tax Specialist Volume 7 No 4 April 2004

costs incurred after this date cannot form part of Step 1 ACA as the share cost base is already absorbed into step 1 ACA[13]. The costs are incurred by the head company in relation to its business, which will result in black hole treatment[14] in most cases. A good example will be a sales type commission or success fee only incurred if settlement occurs.

- **Division 7A** – If a trust is a member of a Tax Consolidated Group there will be no division 7A tax consequences in dealing with group members[15]. This is due to those inter-entity transactions having no tax effect.

- **Wages as Revenue or Capital** – When a group is not tax consolidated it is a more straight forward process to examine what is revenue or capital on an entity by entity basis. However, when in a tax consolidated group this will take a more holistic view of expenditure. A good example will be a Tax Consolidated Group where a subsidiary is constructing a capital asset, but various costs and labour may be going through another entity or entities in the group. As the group will be considered the one entity you will need to take a wider view of how the taxpayer allocates expenditure in the accounts and what it is for – see also TR 2023/2 Income tax: application of paragraph 8-1(2)(a) of the *Income Tax Assessment Act 1997* to labour costs related to the construction or creation of capital assets.

- **768-G ITAA 1997 CGT Active Foreign Company Exemption** – Unlike the 768-A dividend exemption, which may be available through a chain of trusts distributing to a company, the 768-G exemption will only apply to company to company shareholdings. However, where a group tax consolidates and has a trust member owning shares in a foreign company the position will change. It is the head company, which is treated as the owners of those shares. Following this under the single entity rule the 768-G exemption would be available.

[13] TD 2011/8, TD 2011/9, TD 2010/1 & TD 2011/10
[14] 40-880 ITAA 1997
[15] TD 2004/69

4. Membership of a Tax Consolidated Group

Another fundamental part of the Tax Consolidation measures is understanding who can and cannot be a member of a group[16]. Once the election to Tax Consolidate has occurred all 100% owned entities will automatically be part of group. As a general rule an entity will be eligible to be a member of a group where all membership interests are held within a tax consolidated group.

It also goes without saying that a group must have a "Head Company" in order to Tax Consolidate. We would normally refer to this as a holding company. There are some exceptions to who can be a head company, such as certain types of Public Trading Trusts. However, they will rarely be relevant in an SME context.

Understanding these rules is important as I have seen many circumstances where a group member has been inadvertently exited. This normally comes from taxpayers or their advisors not realising a small amount of equity being issued outside the group, will exit an entity in full. Similarly, if the ACA entry calculations have a detrimental effect, thought should be given to ensuring a small amount of equity is held outside the group.

4.1 Can you elect to Tax Consolidate?

Step 1 will always be identifying whether you have a group in the first instance. This requires an ultimate head company with an all membership interests in at least one subsidiary member[17]. If this ever ceases a group will automatically de-consolidate.

There is an exception to the general rule where an entity may qualify, which has a less than 1% interest held by employee's[18] issued under an Employee Share Scheme. In practice this would be extremely rare in an SME context.

For a standalone company incorporating either its first subsidiary or interposing a holding company this will be the first time where a group will come into existence, which could be tax consolidated referred to as a "Consolidatable Group".

4.2 Who can or cannot be a member of a Tax Consolidated Group?

The membership of a group will be wider than most taxpayers contemplate and can include partnerships, unit trusts and discretionary trusts[19]. For trusts this will require all beneficiaries to be solely members of the tax consolidated group. If all member interests are held within the group, an entity will be eligible.

A membership interest will not include a debt interest for tax purposes such as redeemable preference ("RPS") shares[20]. If the RPS are issued external to the group as an equity instrument then you cannot tax consolidate. This may mean a subsidiary with RPS (which are debt) issued outside of the group may still qualify as a member until the RPS are converted.

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[16] Divion 703 ITAA 1997
[17] s703-10 ITAA 1997
[18] s703-35 ITAA 1997
[19] s703-15 ITAA 1997
[20] s960-135 ITAA 1997

It should be noted however, that where an equity interest such as a convertible note is held (not being a membership interest) these can be ignored for this purpose. Following this a subsidiary member with a convertible note to an outsider can be a member of the group. This will only change when the note is converted in the subsidiary member.

For completeness, options and other instruments, which may eventually be issued are not membership interests for these purposes.

Trust and non-fixed trusts[21] may also be included but this will require all of their beneficiaries / objects to be members of the group. For fixed trusts, ie, unit trusts, this will normally be a straightforward process as the unit holders are more readily identifiable. Non-fixed trusts as a rule will have beneficiaries, including defaults outside of the group and so will rarely qualify[22]. It does not matter that the deed may allow the nomination of new beneficiaries outside of the group, only that there are no current potential beneficiaries of the trust at the time it is a group member.

Other than entities where all members interests are not held, non-resident entities will also be excluded from being group members.

4.3 Electing to Tax Consolidate

The choice to Tax Consolidate has several key features:

- **Irrevocable** - The choice is irrevocable[23] from the day elected and cannot be amended. Only the head company can make the choice with subsidiaries in effect being passengers to the decision. The group will only cease to exist if the membership requirements of the head company cease to exist.

- It was not unusual when tax consolidations was introduced for companies to lodge their tax returns extremely late as they considered carefully whether or not to make an election.

- **Hindsight** - This also allows the benefit of hindsight as an SME might make an unexpected loss or the legislation evolves over a year. For example, instant asset write-off legislation throughout the Covid period.

- **Due Date** - The choice is not subject to the due date of the head company or subsidiaries tax return lodgement date[24]. However, the election must occur prior to the lodgement of those tax returns.

- **Form** - The election to tax consolidate must be notified to the Commissioner in the approved form[25] before lodgement of the company tax return.

- **One in all in** - Once the choice is made all entities eligible to be members automatically join the group. It will not matter whether the taxpayer has formally notified the

[21] s703-15, 703-40 ITAA 1997
[22] s960-130 ITAA 1997
[23] s703-50(1) ITAA 1997
[24] s703-50(3) ITAA 1997
[25] s703-58 ITAA 1997 & NAT 6781

Commissioner of any additional members on the required forms after the initial election. Same goes for a future group members exiting.

Practically speaking the choice to Tax Consolidate will often be done either on 1 July of a year or at the end of a month where accounting records might more easily facilitate ACA calculations. However, this can be difficult to manage in M&A transactions where dates might keep moving and be outside of your control.

It should also be noted that a subsidiary entity will prepare tax returns as standalone entities for the part of the year where not a group member.

5. Entry to a Tax Consolidated Group

When establishing a Tax Consolidated Group this will normally be the most complex and costly part of the process. Draft calculations are required prior to entry to ensure no unintended consequences will occur. If there are and a group is required, then restructuring of balance sheets and group members may be required.

Another must, is doing some type of reconciliation or proofing of what the end result should be. I have seen many errors caused by drafters of ACA calculations failing to consider what the result should or is likely to be. In an ordinary acquisition example, the result should as a guide look like the AASB 3 business combination allocation noted below. For other unexpected results, whether on entry or exit you can expect the internal accounting teams will require a logical explanation, long before the taxpayer receives the news.

In an SME context you will normally be aiming to do this in the way that has the least amount of ACA calculations or simply making the choice at the earliest opportunity to avoid issues with entry ACA or losses.

It goes without saying, if a group is established from day one with a subsidiary, the tax consolidation process is as simple as filling in the election to consolidate at incorporation date of the first subsidiary when there is nothing more than share capital. Avoiding the election at the earliest opportunity may lead to costly entry calculations with lost tax benefits in the future.

Before we get into the technicalities of ACA, we should appreciate what ACA is trying to achieve. In many ways this reflects the business combination standard under AASB 3 where for consolidated accounting you need to allocate the shares over the underlying assets.

For example:

Balance Sheet of Subsidiary	**Actual**	**AASB 3**	
Assets	**$**	**$**	
Cash	100,000	100,000	
Debtors	1,000,000	1,000,000	
Goodwill	-	1,050,000	
Plant & Equipment	100,000	150,000	
Liabilities			
Employee entitlements	100,000	100,000	
Loan	200,000	200,000	
Net Assets	**900,000**	**2,000,000**	*

** Purchase price of subsidiary shares $2 million*

5.1 The Entry Process

The entry process for tax consolidations is well developed and has undergone change since 1 July 2002. This is compared to the exit process, with far less rulings and guidance and a minimal amount of legislation. Most of these changes occurred to deal with anomalies or unintended tax consequences caused by accounting standard changes.

For most SME's only steps 1, 2 and 7 will normally be relevant before allocating ACA to assets. In the case of a head company, there are no changes to cost bases of its own assets.

The Entry Process can be summarised as follows:

Step 1 Calculate Entry ACA over 7 steps[26]

This establishes the total amount available to be attributed to the underlying assets of the subsidiary or subsidiaries[27] and can be found in a table in the act at s705-60 ITAA 1997, which then reference other sections relating to each step.

Step 2 Allocate step 1 ACA over all assets of the subsidiary

This will require an understanding of the market value of different assets held by the company.

Step 3 Calculate losses available to the head company along with available fractions[28]

Step 3.1 Can the losses transfer to the head company at all.

Step 3.2 If transferring, can the losses be utilised or potentially added to the cost base of assets.

Step 3.3 What is the rate at which the losses can be used – "Available Fraction".

Losses in themselves are not the focus of this paper keeping in mind SME groups will rarely be acquiring loss entities and should already be tax consolidated.

Step 4 Transfer Franking accounts to the head company[29]

The franking accounts of subsidiaries cease to operate and are transferred to the head company.

5.2 The entry process in detail

In many respects most SME's issues will occur in the allocation over different assets, not necessarily in the seven steps. Although as noted in Neil Brydges earlier paper there are some substantial issues with consolidating a group where certain rollovers have occurred. For example, 122-A (one shareholder interposed company), 124-M (scrip for scrip) and 615 Rollover (two shareholder interposed company).

[26] Division 705 ITAA 1997
[27] Subdivision 705-B & 705-D ITAA 1997
[28] Division 707 ITAA 1997
[29] Subdivision 709-A to 709-C ITAA 1997

Step 1 - A summary of those seven steps is as follows:

Step 1.1 Cost of Membership Interests[30]

This will normally be the cost base for tax purposes in the shares. For an acquired entity this will normally reflect the current market value of the shares unless not consolidating at the earliest opportunity.

For rollovers in the SME market using 122-A rollover and 124-M this step will not reflect the market value of the shares exchanged as the shareholder is simply receiving the original tax cost base. Notably the cost base rules under a 615 rollover differs with more of an asset less liability approach. On this point I should distinguish between a 122-A rollover of shares and rollover of business assets with the latter achieving some degree of cost base.

Step 1.2 Add Liabilities less adjustment for liabilities that create future deductions[31]

This includes all accounting liabilities of an entity and will require some thought as to recognising liabilities that may not be in special purpose accounts. For example, employee entitlements and other provisions.

The adjustment to reduce liabilities is an internal adjustment within this step and will include employee entitlements, superannuation payable and other provisions.

This adjustment step in an SME context is often problematic and will require some strategising for larger SME's when first consolidating after being established for some time. This is due to the likelihood of making a capital gain and/or reduction in cost bases of assets.

Step 1.3 Add undistributed frankable profits accrued to the group[32]

These are the retained earnings frankable to the subsidiary while part of the group, whether electing to consolidate or not. You will only have an amount in this step if the company has been in the group but you did not choose to consolidate when first able to. For example, a subsidiary purchased on 1 July 2022 but not consolidated until 1 July 2023.

For an SME group coming into existence by 122-A, 124-M and 615 rollover the amount at this step will be $nil. This is due to the deeming of the 50% cgt discount period not extending to other areas such as Tax Consolidations. Very simply there is no group membership of the interposed company until the date of the rollover.

Step 1.4 Less distributions of profits not accruing to the group and those accruing to the group that recouped losses[33]

This step is only relevant if you have paid a dividend out of acquired profits. For example, a subsidiary acquired on 1 July 2022 with $1m of retained profits from which you pay a $0.5m dividend out by 30 June 2023. If you elect to tax consolidate on 1 July 2023 the Step 4 amount would be $0.5m.

[30] s705-65 ITAA 1997
[31] s705-75 ITAA 1997
[32] s705-90 ITAA 1997
[33] s705-95 ITAA 1997

Step 1.5 Less unused tax losses accrued to the group except those reducing step 3 profits[34]

This step is only relevant if the subsidiary has losses and those losses were incurred at a point where part of the group, whether consolidated or not. For example, a subsidiary acquired on 1 July 2022 makes a loss of $100,000 to 30 June 2023 and elects to tax consolidate on 1 July 2023. The amount of $100,000 will be reduced at Step 5.

Unlike step 6 acquired losses, there is no ability to cancel the losses and avoid a reduction in ACA.

Step 1.6 Less an amount equal to transferred losses that did not accrue to the group, multiplied by the company tax rate[35]

If the subsidiary you acquire has losses that are transferred to the head company, then you will have a Step 6 amount. This only relates to losses incurred by a subsidiary while not owned within the group. For example, you acquire a subsidiary on 1 July 2023 with $100,000 of losses at joining time, which are transferred to the head company. You will have a step 6 amount of $30,000.

It is possible with this step to cancel a transferred loss to avoid any reduction in ACA.

Step 1.7 Less certain inherited deductions to avoid duplication of benefit[36]

This step will involve items such as borrowing costs and black hole expenditure and will be divided between:

Owned deductions – costs incurred while part of the group, which are adjusted by the company tax rate.

Inherited deductions – costs incurred prior to joining the group on acquisition without any tax adjustment.

= Entry ACA

Positive ACA – Cost base for allocation over assets

Negative ACA – Nil cost base

Step 2 - Allocation of ACA to Assets

Step 2.1 Allocate to "Retained" cost base assets[37]

These will ordinarily be the assets such as cash at bank, debtors and prepayments. No change to these assets cost base will occur.

If after allocation you have:

Negative ACA - CGT event L3[38] will occur with a capital gain to the head company

[34] s705-100 ITAA 1997
[35] s705-110 ITAA 1997
[36] s705-115 ITAA 1997
[37] s705-25 ITAA 1997
[38] s104-510 ITAA 1997

Positive ACA – further allocation is required to the remaining assets in step 2.1

Step 2.2 Allocated to "Reset" cost base assets[39]

These will ordinarily be stock on hand, plant and equipment and other capital assets, such as goodwill and other intangibles. The remaining ACA is allocated across these assets in proportion to their market value subject to limitations.

This step has always been problematic as both revenue asset and capital assets are grouped together in this step. This brings with it the danger revenue asset cost base will move into a capital asset bringing forward tax payable. This is often referred to as "Skew".

Revenue assets such as trading stock and depreciable assets then have some further limitations[40]:

- Their reset cost base is limited to their market value. Any excess is allocated proportionately to capital assets.

- Depreciable assets are further limited where some of the up-front deductions relating to Covid reliefs were applied. For example, temporary full expensing TFE, backing business investment BBI and instant asset write-offs IAWO[41]. In the case of these types of assets they will still be allocated ACA but will get no uplift in cost base regardless of whether the acquirer was a related party or not. This is problematic in M&A transactions where an unrelated buyer may require some adjustment to the purchase price.

As a rule there should be no ACA left after this step.

Step 3 Calculate losses available to the head company along with available fractions[42]

How losses operate in a tax consolidated group is one of the more misunderstood areas of tax consolidation. The important thing to remember in the SME market is that once a group is established all profits and losses are absorbed into the one tax return without any restrictions on use of those losses (except for the normal COT and SBT considerations).

Whereas for an SME group that could tax consolidate but chooses not to there are restrictions on how losses can be utilised in the group if electing later. Many of the steps are identical to buying an unrelated subsidiary with losses.

Step 3.1 Will the losses transfer to the head company

The head company and subsidiary members will test losses under a modified COT and SBT as to whether the losses can be used by the group moving forward[43]. If they can, the group will have "transferred" losses. For an SME group you will normally find the modified COT passed.

Step 3.2 If the losses will transfer they can either be utilised or potentially added to the cost base of assets

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[39] s705-35 ITAA 1997
[40] s705-40 ITAA 1997
[41] LCR 2021/3 Para 100 to 124
[42] Division 707 ITAA 1997
[43] s707-120 to 707-140 ITAA 1997

For an acquired entity you can choose to cancel a loss and increase your ACA under step 5 of the entry process[44]. For an existing entity already within a group this is not available.

Step 3.3 What is the rate at which the losses can be used – "Available Fraction"[45]

This step is normally the problem for SME's in holding off on tax consolidating. While the loss might easily transfer there are restrictions on how quickly the losses can be utilised for each transferred members losses – "loss bundles"[46]. This will normally come as a surprise. This restriction is caused by the "Available Fraction" rules.

While the head company is not subject to ACA entry steps as it already owns the assets, its losses can be restricted by its available fraction.

The available fraction is a percentage calculated for each member of the group, including the head company based on the market value of each entity[47]. For example:

Company	Market Value $	Available Fraction	Losses $
Head Co	900,000	45%	-
Plant Co	200,000	10%	500,000
Trade Co	900,000	45%	-
Total	**2,000,000**	**100%**	**500,000**

The available fraction is normally referred to as a proxy for determining how much of the groups ongoing taxable income relates to the former loss-making subsidiary.

Example

Using this example with 10% available fraction on $500,000 "transferred" revenue loss and assuming $1 million of taxable income in the first year post consolidation:

- $100,000 maximum amount of loss able to be utilised = $1m group taxable income x 10% available fraction

- $900,000 group taxable income ($1m less $100,000 max loss) – This is the taxable income recorded in the first year Consolidated Tax Return.

- $400,000 "transferred" losses carried forward ($500,000 transferred less $100,000 losses utilised)

- Any "group" losses made by the head company must always be used before "transferred" losses of Plant Co. Group losses are not subject to rules with available fractions and can be used in the ordinary way.

[44] s707-145 ITAA 1997
[45] s707-135 ITAA 1997
[46] s707-315 ITAA 1997
[47] s707-320 ITAA 1997

Step 4 Transfer of Franking Credits[48]

The franking regime on entering a consolidated group is one of the more straight forward areas with the following key features:

- The franking account of each subsidiary is transferred to the head company on the joining date. More of a debiting and crediting process in pre-existing franking accounts per s709-60 ITAA 1997 with s709-65 ITAA 1997 ensuring the account is not active during this time.

- If the franking account is in debit at joining time, franking deficits tax is payable by the subsidiary member[49].

- Any PAYG instalments paid by subsidiaries after date of joining or other tax payments or refunds will be franking debits and credits of the head company[50].

It is easy to see from the above calculations why you might prepare draft calculations in advance to deal with client expectations. That is, from either unexpected capital gains or loss of cost base in revenue assets.

Some other points of interest:

Multiple Subsidiaries - Allocating to other downstream subsidiaries in a group will require a top-down approach with multiple seven step calculations. This is due to the requirement to start the consolidation steps from the head company and steadily push this down over all underlying assets.

Creeping Acquisitions – Where a subsidiary is acquired over more than one year. For example, 50% in year one and then the remaining 50% in year two, several steps will require an adjustment. Step 3 and 4 would only involve you taking up 50% of undistributed profits.

Depreciable Assets – As alluded to in allocating ACA to various covid relief depreciable assets this will require all entities to examine how depreciable assets have been claimed. In an M&A context, an acquirer who cannot revalue these assets will either request a discount or undertake an asset purchase.

Consolidated Groups acquiring other consolidated groups – Where a consolidated group acquires another consolidated group no de-consolidation event occurs with the acquired group[51]. This is despite the acquired head company no longer meeting the member requirements. This is important as it avoids the potential negative consequences of calculating exit ACA prior to doing another entry ACA on an entity-by-entity basis[52].

5.3 Other practical issues on Entry

Entry History Rule[53] – Much of the tax history of subsidiary members is “inherited” on entry. For example, division 43 building allowance, bad debts, etc despite the ACA process occurring.

[48] Subdivision 709-A to 709-C ITAA 1997
[49] s709-70 ITAA 1997
[50] s709-70 to 709-75 ITAA 1997
[51] s705-175 ITAA 1997
[52] Subdivision 705-C ITAA 1997
[53] s701-5 ITAA 1997

Accounts & Workpapers – The cost setting process will mean that what might ordinarily be cost base in shares and straight forward is now allocated across a variety of different assets, including intangibles. This may mean accounts will not reflect the real cost base of assets for tax purposes requiring maintenance of new workpapers, including updating tax depreciation schedules. Doing consolidated accounting will not solve all these problems.

Dividends & Franking – Each subsidiary in effect has no franking account during the period of group membership and consequently no franking account statement is required. However, each subsidiary will still need to pay its dividends while meeting Corporations Act requirements.

Notification - On entry to a group the head company will need to notify the Commissioner of the entry using the form "Notification of members joining and/or leaving an income tax consolidated group" NAT 6782.

Tax Returns – On entry a subsidiary member will have a part year tax return to lodge up until the joining date. For example, a subsidiary entering on 1 February 2024 will need to lodge a tax return for the period 1 July 2023 to 31 January 2024. Following this example, if using an end of financial year as the entry date 1 July should be chosen and not 30 June. This avoids a 1 day period where the group is not tax consolidated.

5.4 Checklist of key issues on Entries

The following issues need to be contemplated on any entry event:

- For an SME they can be succinctly summarised as follows:
    - What is the advantage you are looking for in Tax Consolidating
    - Can you get there without entry ACA, loss or franking issues
    - If you can do the benefits outweigh the costs, entry calculations, valuations, etc. It may be that future benefits will outweigh advisor and tax costs on entry

- Draft calculations in advance are a must – Preparation for Entry.

- Do the draft calculations make sense compared to the business combinations standard.

- If you have unusual assets or liabilities based on tax rules or accounting standards go looking for special rules affecting calculations.

- If you are doing any type of rollovers or interposed company rollovers expect problems and plan in advance, to avoid them if possible, eg, capital gains, lost cost base.

- Ensure the joining entity does not have a franking deficit at time of joining.

- Plan ahead if exit events are likely for subsidiaries.

5.5 Example of an Entry Calculation

The following example shows the difference between an SME acquirer choosing to utilise a tax consolidated structure or simply buying the shares with their trust. The comparison should be read in conjunction with the advantages and disadvantages of tax consolidated groups earlier in this paper.

Key facts in this scenario:

- The stamp duty savings on the $4m purchase were considerable and a share purchase settled on 1 July 2023.

- The taxpayer on your advice established a new holding company with shares owned by discretionary trust to acquire the shares.

- In this example I have assumed no Covid relief depreciation claims. However, that will rarely be the case.

Acquirer Co	**Accounts**	**Market Value**
Assets	**$**	**$**
Cash	100,000	100,000
Debtors	1,000,000	1,000,000
Goodwill	-	3,050,000
Plant & Equipment	100,000	150,000
Liabilities		
Employee entitlements	100,000	100,000
Loan	200,000	200,000
Net Assets	**900,000**	**4,000,000**

Step 1: Cost base of membership interests	
	$
Share cost base	4,000,000

Step 2: Add liabilities less adjustment for liabilities that create future deductions	
Loan	200,000
Employee entitlements	100,000
less Employee entitlements	-100,000
ENTRY ACA	**4,200,000**

Allocation to "Retained" Cost base assets	
Cash / Debtors	1,100,000
Remaining ACA	3,100,000

Allocation to "Retained" Cost l	**Mkt Value**	**%**	**New Cost Base**
Goodwill	3,050,000	95%	2,954,688
Plant & Equipment	150,000	5%	145,313
Total	**3,200,000**	**100%**	**3,100,000**

ACA remaining	**$Nil**

The benefits of going down a tax consolidated path in this example will involve the following:

- The having a cost base available on goodwill

- Some tax depreciation up-lift

- All debt deductions within the one tax group

- If for some reason a share sale was to occur the new head company could look to sell the shares in its subsidiary and go through a de-consolidation process to re-attribute cost base to those shares. It is only the discretionary trust shareholder, which has a low cost base.

- Depending on the circumstances the taxpayer will in fact have three options:
  1. Sale of shares by discretionary trust shareholder
  2. Sale of shares by the head company in its subsidiary
  3. Asset sale by the subsidiary

6. Exit of a Tax Consolidated Group

A member of a tax consolidated group will exit when any membership interest is not held by a group member. There are very few exceptions to this rule.

When a group member exits[54] it is necessary to again calculate the cost base of the shares in the entity.

This normally makes it vital to ensure any changes in shareholding occur only in the head company, unless you are specifically divesting a subsidiary. For example, ESOP, convertible notes and redeemable preference shares along with debt-to-equity conversions.

The other important feature of an exit event is the full exit of a group member. It is often mistakenly believed that a very small change. For example, 1% in member interest will not pose any significant tax issues. This is not correct.

Ensuring draft calculations are prepared ahead of any exit event is essential.

6.1 The Cost Setting Process on Exit

The exit process is much simpler than the entry process. Some might say underdeveloped and left alone since 1 July 2002. In saying this there are several issues advisors need to be aware of any exits causing issues for the unwary.

The Exit Process can be summarised as follows[55]:

Step 1 Calculate Exit ACA

This is the cost base of all shares in the exiting member, which have not been previously recognised within the Tax Consolidated Group.

Step 2 Allocate step 1 ACA over all shares

This allocates the cost base over each membership interests (ie, individual shares). If there is more than one class of share you will need to work out the market value of different classes of shares before proportionately allocating ACA.

Step 3 Calculate the capital gain or loss on the shares sold

Proceeds on shares less cost base of shares sold.

6.2 Calculating Exit ACA & allocation to cost base of member interests

Step 1 Calculation of ACA is where most of the complexity will occur as this involves a number of steps, not dissimilar to the entry ACA process. At this point it is worth noting there are only four steps in this process, unlike the seven steps involved in entry ACA. To some extent the attention of government has rarely been on the exit process as much as the entry process.

[54] Division 711 ITAA 1997
[55] s711-15 ITAA 1997

A summary of those four steps is as follows[56]:

Step 1.1 Add the tax values of the exiting subsidiaries assets on the exit date

This will be the settlement date and not contract date as is normally used for CGT events. This step is often expressed as "add the terminating value of the leaving entities assets just before leaving time".

Step 1.2 Add inherited deductions not reflected in the tax value of exiting subsidiary assets

Two examples would be borrowing costs and black hole costs and reflects step 7 of entry ACA.

Step 1.3 Add group liabilities owed to the exiting subsidiary

This step will bring to account asset loans of the exiting subsidiary with other group members, which have not been recognised for tax purposes until exit.

Step 4 Less the market value of liabilities owed by the exiting subsidiary

This step reflects step 2 of entry ACA with similar adjustments.

As detailed under entry ACA, liabilities for these purposes are "Accounting" liabilities and not present legal obligations or any other term.

Liabilities at this step are further reduced by the tax benefit of any liabilities to be deducted in the future. For example, annual leave, long service leave, superannuation and other provisions are adjusted by the corporate tax rate at the exit date, 25% or 30%.

= Exit ACA

Positive ACA – Cost base for allocation over shares

Negative ACA - CGT Event L5[57] will occur with a capital gain made. It will also be the case that you will have no cost base on the shares for any future sale event.

The above is a short summary of the steps. Each step has various exceptions to the general rules and adjustments. Where anything unusual is present care should be taken to review the legislation.

Negative ACA - Negative ACA issues are not uncommon and will normally occur in an exiting subsidiary with a deficit or where there are large discrepancies in the tax value of assets versus liabilities. This could occur through internal restructures within a tax consolidated group. This is a reminder again of the importance of doing draft calculations as a capital gain occurring on a subsidiary exiting with only a small percentage divested, may come as something of a shock.

Losses and Franking Credits - It is important to note that losses and franking credits will not exit with a subsidiary member. This is distinctly different to the situation on entry where both losses and franking credits are contributed to the head company. For this reason, where you are only partially divesting a subsidiary member, you might ordinarily aim for the balance sheet to have neither retained profits, nor a deficit.

Liquidation – On wind up of a subsidiary there will always be an exit ACA calculation and you must normally ensure inter-entity group assets and liabilities are dealt with prior to final liquidation. For

[56] s711-20 ITAA 1997
[57] s104-520 ITAA 1997

example, a liability owed by the subsidiary being liquidated to another group member should be forgiven prior to final liquidation. As the group is still tax consolidated there is no tax event.

6.3 Other practical issues on Exit

Exit History Rule – As outlined at step 2 much of the tax history[58] of subsidiary members is "inherited" on exit.

Interestingly there may on occasion be items the legislation is silent on for both entries and exit. For example, notional franking debits resulting from refunds of income tax from R&D claims. These are neither mentioned on entry, nor exit. On this basis the likely outcome would be the head company does not inherit the notional franking debits on entry, but on exit the subsidiaries notional franking debits become operational again.

Notification - On exit from a group the head company will need to notify the Commissioner of the exit using the form "Notification of members joining and/or leaving an income tax consolidated group" NAT 6782. The form itself is nothing more than a notification, once any membership interest is held outside the group a subsidiary member is divested.

Tax Returns - From the exit date the subsidiary will have its own tax identity again unless it has joined another tax consolidated group. A subsidiary exiting on 31 January 2024 will need to lodge a tax return for the period 1 February 2024 to 30 June 2024.

6.4 Examples of Exit Calculations

The following example shows the different outcomes and significant issues that can occur without forward planning.

Key facts in this scenario:

- The head company of a group has divested one of its internal business units into a subsidiary with the intention of selling 10% of the shares to an Executive who operates this business unit.

- The internally generated business unit has goodwill with a cost base of $nil but market value of $1 million.

- As the group was tax consolidated there is no initial tax issue on the divestment to a subsidiary. Accordingly, the company can be more liberal with its accounting entries and process.

[58] s701-40 ITAA 1997

From a book entry point of view the balance sheet could look like the following:

	Option 1	Option 2	Option 3	
Balance Sheet of Subsidiary	**$**	**$**	**$**	
Assets				
Goodwill	1,000,000	-	1,000,000	*
Loan - Head Co		100,002		
Liabilities				
Employee entitlements	100,000	100,000	100,000	
Loan - Head Co	899,998			
Net Assets	**2**	**2**	**900,000**	
Shares	2	2	900,000	
Retained Profits	-			
Total Equity	**2**	**2**	**900,000**	
Market Value of Subsidiary	**2**	**1,000,002**	**900,000**	
Sale of 10% to Executive	**0.20**	**100,000**	**90,000**	

** Market value of Goodwill $1,000,000, Tax Cost base $nil*

	Option 1	Option 2	Option 3
Step 1: Terminating value (to the head company) of assets to be taken by the subsidiary			
Goodwill	0	0	0
Step 3: Add market value of intra-group liabilties owed TO the leaving entity			
Loan - Head Co	0	100,002	0
Step 4: Less market value of liabilties owed BY the leaving entity			
Employee entitlements	100,000	100,000	100,000
Tax adjustment	- 25,000	- 25,000	- 25,000
Loans - Head Co	899,998	0	0
EXIT ACA	**- 974,998**	**25,002**	**- 75,000**
Negative ACA CGT Event L5	**974,998**	**0**	**75,000**
Cost base on subsidiary sh's	**0**	**25,002**	**0**
Proceeds 10% to Executive	0.20	100,000	90,000
less			
Cost base on 10% subsidiary sh's	0	2,500	-
Capital gain on sale of 10% sh's	**0.20**	**97,500**	**90,000**
Total Capital gain on 10% sale			
CGT Event L5	974,998	0	75,000
Sale of 10% shares	0.20	97,500	90,000
Total Capital gain A1 / L5	**974,998**	**97,500**	**165,000**

As shown here negative ACA can occur very easily with a restructure without forward planning. In option 1 the head company is owed $899,998 and so it is easier to see the logic behind the calculations. In this example I have used goodwill, but the result would be the same with depreciable assets where instant asset write-off has already been claimed.

In option 2 the accounting followed the tax value of the assets leaving a more logical result for the head company. In option 3 the head company is still likely to be surprised by having a capital gain of more than the proceeds it is receiving.

6.5 Checklist of key issues on Exits

The following issues need to be contemplated on any exit event:

- Draft calculations in advance are a must – Preparation for Exit.
- Do the draft calculations make sense. If you were selling the assets and dealing with liabilities directly what would the tax result be versus your draft calculations.
- If you have assets or liabilities you are intending to deal with, this should occur prior to the exit event as inter-company transactions prior to exit have no tax effect. For example, member debt forgiveness. Beware events only crystallising at settlement[59].
- If the exiting entity has any retained profits they will be unfranked, is this intended.
- If the exiting entity has a deficit on exit you are likely to make a capital gain under CGT Event L5 with or without any proceeds changing hands.
- If the exiting entity has assets with tax values much lower than their accounting costs in the accounts you are likely to make a capital gain under CGT Event L5.
- Beware unintended exit events from unexpected share issues to key people in subsidiaries, debt to equity conversions and convertible notes.

[59] Hanbury Holdings Pty Ltd v FCT (2008) FCA 1787

7. Examples of where SME's will find Tax Consolidations useful in practice

For SME's Tax Consolidating will often be the solution to what can sometimes prove to be an insoluble problem. For example, and with reference to advantages in this paper at 2.2:

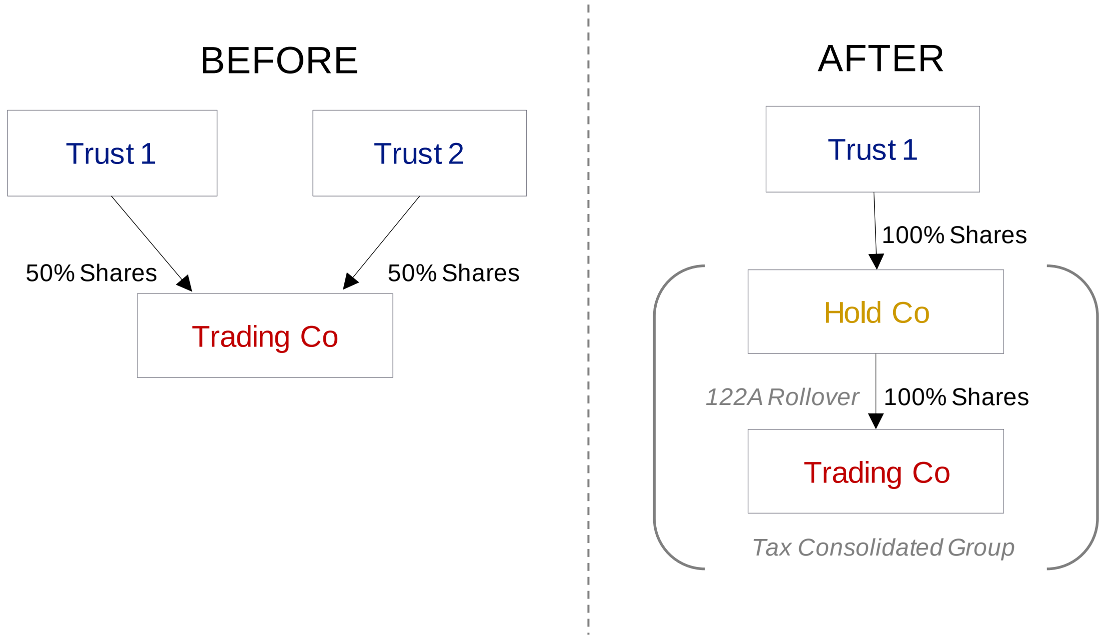
- Significant cost base on shares, which might never be utilised leaving the taxpayer company with a large capital gain in the company.
- Top up tax on paying out dividends to reduce debt of the shareholder.
- Offsetting of shareholder interest deductions with business profits made by the company.

In each case thought should be given to Part IVA considerations with all examples and the peculiarities of any rollovers mentioned.

7.1 Buying out a business partner in a company

In an SME context one of the age-old problems is unused cost base and division 7A issues when buying out the shares or units of a fellow business partner. The division 7A issues are sometimes solved by having a company buy the remaining interest, rather than an existing discretionary trust shareholder. However, this will still create deduction offset issues as a company will only expect to receive franked dividends and has nothing to offset interest deductions against. While a unit holder will not have this issue, its ability to utilise cost base will depend upon it ability to wind up the unit trust in the same year as any capital gain.

A solution to this may involve the use of a 122-A rollover if we use the example of a company. The discretionary trust shareholder engages in a 122-A rollover prior to the acquisition of their partners remaining 50%. It is the new 122-A rollover company, which acquires the remaining 50% before electing to tax consolidate.



Key facts in this scenario:

- Both partners have discretionary trusts holding their 50% share each.
- The remaining partner has only a nominal cost base on its 50% of shares.
- The acquisition price for the 50% of shares is $2m (total market value being $4m for all assets).
- A pre-sale dividend will be paid out prior to settlement of $500,000 and before the 122-A rollover.

	Accounts	Market Value	
Buy out of 50% JV Partner Shares	**$**	**$**	
Assets			
Cash	500,000	-	
Debtors	500,000	500,000	
Goodwill	-	3,650,000	
Plant & Equipment	100,000	150,000	
Liabilities			
Employee entitlements	100,000	100,000	
Loan	200,000	200,000	
Net Assets	**800,000**	**4,000,000**	*

** 50% of shares $2m on buy out of JV partner*

	$
Step 1: Cost base of membership interests	
Share cost base	2,000,002

Step 2: Add liabilities less adjustment for liabilities that create future deductions	
Loan	200,000
Employee entitlements	100,000
less Employee entitlements	- 100,000
ENTRY ACA	**2,200,002**

Allocation to "Retained" Cost base assets	
Debtors	500,000
Remaining ACA	1,700,002

Allocation to "Retained" Cost base assets	**Mkt Value**	**%**	**New Cost Base**
Goodwill	3,650,000	96%	1,632,897
Plant & Equipment	150,000	4%	67,105
Total	**3,800,000**	**100%**	**1,700,002**

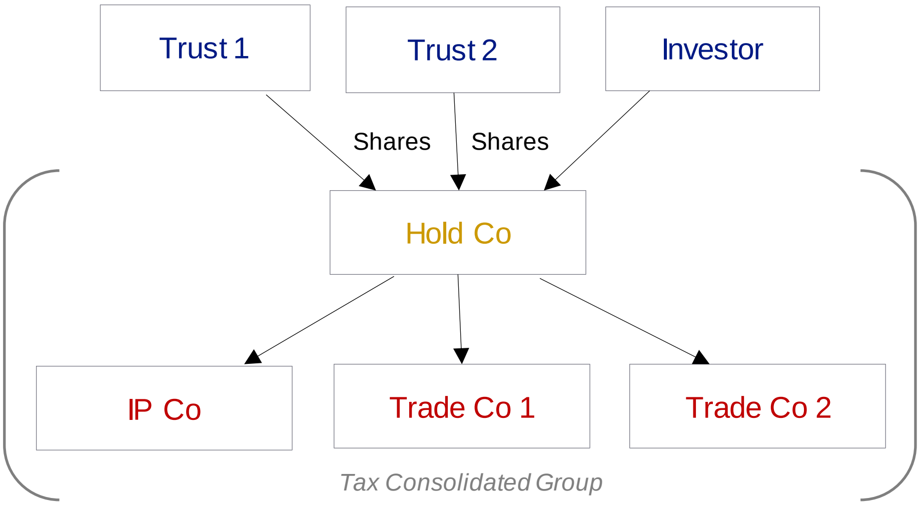
ACA remaining	**$Nil**

* In this example a small loss of depreciable assets has occurred by way of the reduction from $100,000 of tax cost base to $67,105 both by virtue of the 122-A rollover and skew.

The use of a 122-A rollover in this instance comes with all the problems already noted for the 122-A rollover. That is, no credit allowed for the franked retained profits not already distributed. Whether or not this outcome is acceptable will often come down to how much of the retained profits are left in the company after settlement. The less the better noting no credit is given in any of the steps for these retained profits except on the 50% portion reflected in the purchase price.

7.2 Start-Ups & Scale-Ups

In my experience Start-ups and Scale-ups will often find a Tax Consolidated Group to be a must.



There are numerous reasons for this:

- Capital raising activities require a company and all assets in the one group.
- It is standard to have different business units in different entities, as well as IP and sometimes IP development. This will require the offsetting of gains and losses in an efficient way for cashflow purposes.
- A tax consolidated group will facilitate everything from simplicity of R&D claims by the head company to efficient offsetting of losses.
- If expanding internationally then the use of the 768-A and 768-G dividend and capital gain exemptions are likely to be preferred in a holding company type group. This is due to the group only being focussed on growth and not what the after tax return is after payment of dividends.

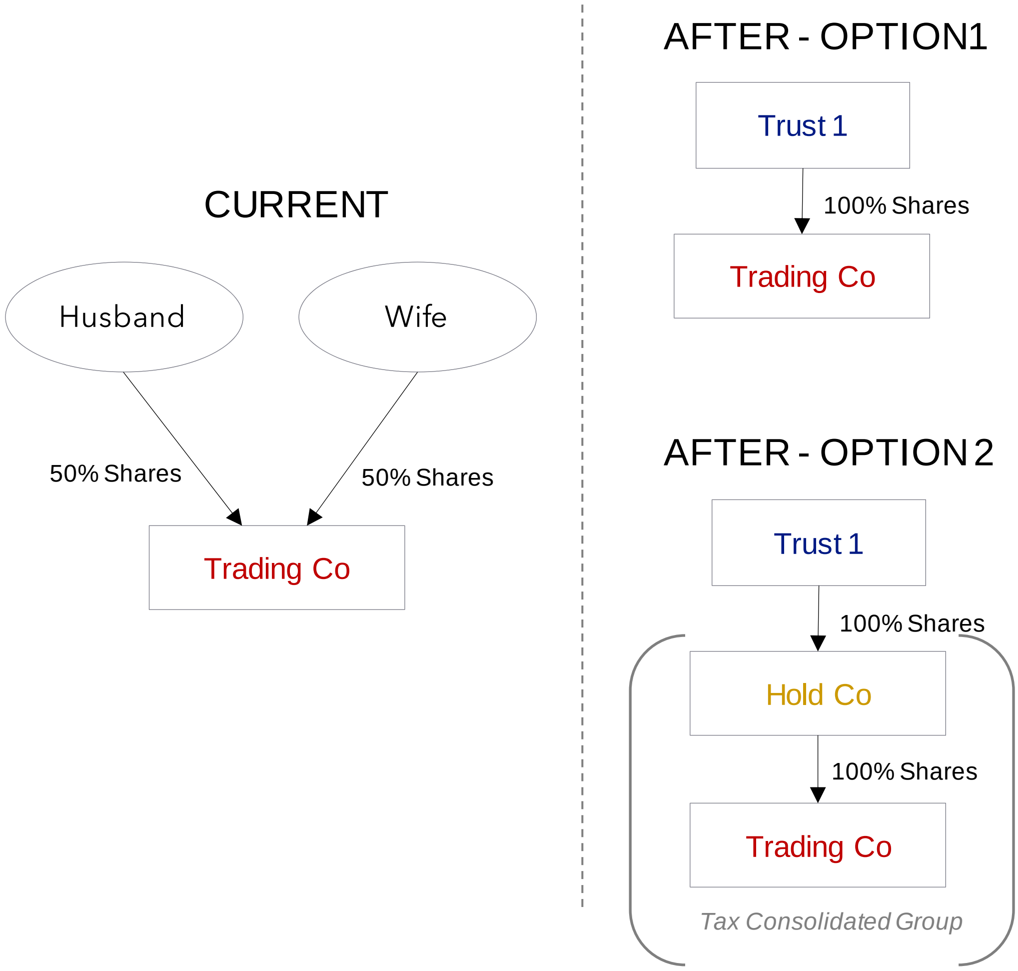
Like it or not, in this area you will be in a complex structure. The question will be whether the structure is tax efficient or not. In my experience a tax consolidated structure will be more cost and tax effective than a non-consolidated holding company group.

7.3 Small Business Concession Restructures

Restructuring a Mum and Dad shareholding into a discretionary trust shareholding using the Small Business Concessions is not an unusual way to improve a taxpayers asset protection and long-term flexibility with their structure.

In the ordinary course we would normally expect the trust would buy the shares. However, this would leave all cost base in shares that might never be utilised. A different way to structure this would be to have a new holding company set-up with the same discretionary trust owning those shares. The company would then normally tax consolidate at the earliest opportunity.

While I have not set out a calculation all the issues will be the same as with a normal unrelated acquirer with same advantages – see 5.5.



8. Concluding comments

While it is hard to disagree with the conclusion that the Tax Consolidation rules are complex it is also the case they are the only solution to a variety of problems besetting SME's. In some cases, such as Start-ups and Scale Up's they may be the only viable solution. It is important to think differently about how we approach structures utilising Tax Consolidated Groups. In my view they are an essential part of the SME accountants tool kit.