Tax Consolidation Report

C.E. Bartlett Pty Ltd

Bartlett Tank Liners Pty Ltd

21 November 2018

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1 Background & Instructions

1.1 BACKGROUND

By way of relevant background, we understand the following:

C.E. Bartlett Pty Ltd (CEB) is considering whether to elect to form an income tax consolidated group which would comprise the following members:

- CEB – Head Company
- Bartlett Tank Liners Pty Ltd (BTL) - Subsidiary

BTL was incorporated on 21 September 2007. The original company name was “Bluescope Bartlett Liners Pty Ltd” to reflect a joint ownership interest with BHP / BlueScope Steel.

Our understanding is that 50% of the issued shares were acquired by CEB on incorporation of BTL for the shares par value of $1 each. The remaining 50% holding was acquired directly from Bluescope in June 2015 for a negotiated price. Based on the information provided to us, the total acquisition cost of shares in BTL (paid by CEB) is as follows:

Purchase Date	Qty	Cost
21 September 2007	2,624,355	2,624,355
12 June 2015	2,624,355	1,075,184
Total	**5,248,710**	**3,699,539**

For the purposes of this advice, it will be assumed that the “joining time” (i.e. the start date of the tax consolidated group) is **1 July 2017**, since this is the earliest time that an election to form a tax consolidated group could theoretically now be made.

We have assumed that goodwill represented at cost of $3,712,638 in the financial statements is representative of business goodwill market value as at 1 July 2017.

We have also assumed that the value of plant & equipment is consistent with its current market value.

1.2 INSTRUCTIONS

We have been instructed to prepare preliminary advice to consider the taxation consequences of the formation of a tax consolidated group.

The specific scope of this preliminary advice is to:

1. Provide a high-level overview of the taxation consequences of BTL becoming a member of the CEB income tax consolidated group, such as the effects on any franking credit balances, the tax costs of assets and on transactions within the group;
2. Prepare the “allocable cost amount” (ACA) and “tax cost setting” calculations in order to reset the tax cost of assets held by each subsidiary member upon joining the group on 1 July 2017.

Should CEB proceed with making a tax consolidation election, it will be necessary to have accurate valuations of plant and equipment, inventory and goodwill. For the purposes of these preliminary calculations, we have relied on the information provided to us in this regard although we note that in the event CEB proceeds to consolidate, the ATO generally prefer external professional valuations to support tax consolidation calculations.

1.3 INFORMATION & MATERIALS RELIED ON

1.3.1 In attending to our work, and particularly the ACA calculations and asset tax cost setting amounts for each subsidiary, we have relied upon the following information provided to us:

- Audited financial statements for BTL for the year ended 30 June 2017;
- Audited financial statements for CEB for the year ended 30 June 2017;
- Information provided by Andrew McMaster about the nature of the acquisition of shares in BTL from Bluescope.

1.3.2 In addition, we have relied on various other materials and representations provided to us, as we have noted where appropriate in this report and in the accompanying work papers we have prepared.

2 Executive Summary

The key outcomes of the ACA calculations and tax cost setting process upon CEB electing to form an income tax consolidated group on 1 July 2017 are:

- If CEB elects to form a tax consolidated group, the choice is irrevocable and the earliest date that consolidation can be applied from is 1 July 2017.
- Upon formation of a tax consolidated group, the cost base of all assets owned by BTL will be reset based on the amount of ACA that can be allocated to its assets. Broadly, the ACA represents the economic cost of CEB's equity interest in BTL which is pushed down into the assets of BTL according to a prescribed methodology.
- Due to the acquisition of 50% of the shares in BTL from Bluescope for a discount to BTL's book value, there is currently a deficiency of ACA of $2,055,804 as at 30 June 2017. The deficiency of ACA will directly affect the cost base of plant and equipment, inventory and goodwill, reducing them in total by $2,055,804.
- Our modelling indicates that if a consolidation election took effect from 1 July 2017:
  - Inventories will be written down by $450,649, resulting in an additional amount of $450,649 being included in assessable income during the 2018 income year, because the cost base of the inventory will be lower by this amount. This is likely to result in additional income tax payable in the 2018 income year of around $123,928 (i.e. $450,649 x 27.5%).
  - The tax carrying value of plant and equipment would be required to be reduced by around $63,589. This would reduce the 2018 tax depreciation claim for the group.
  - Further, the cost base of the goodwill acquired by BTL for $3,712,638 will be permanently reduced to $2,171,072. The consequence of this is if the BTL business were to ever be sold, BTL would only be able to claim a cost base of $2,171,072, notwithstanding it has historically paid an amount of $3,712,638 for the goodwill.
- There is no impact on any carry forward losses, because the group does not have any.
- The franking credits of $270,305 in BTL as at 30 June 2017 will be transferred to CEB and fully available for distribution to its shareholders. Any subsequent tax payments made with respect to BTL's pre-joining income tax liabilities will be treated as having be made on behalf of CEB and included in its franking account.
- There will not be any capital gain or loss arising on formation of the tax consolidated group.

Recommendation

We recommend that you do not consolidate CEB and BTL for tax purposes, as there will be detrimental tax consequences as outlined above, without any real benefits.

3 Tax consolidation overview

General

3.1 The tax consolidation rules were introduced with effect from 1 July 2002, and provide the opportunity for the activities of wholly-owned groups of Australian companies to be combined for income tax purposes, including the requirement to lodge a single income tax return. One key feature of the tax consolidation rules is that transactions between entities who are members of the same tax consolidated group are effectively disregarded for tax purposes. Another key feature is consolidation effectively allows for tax losses made by one entity to be automatically offset against taxable income of other entities within the same consolidated group.

3.2 A tax consolidated group is formed by the Australian holding company making an irrevocable election to form the group from a nominated date. The entities that are 100% owned, both directly by the holding company and indirectly via other entities, automatically join the consolidated group. Furthermore, any entities which become wholly-owned after the consolidated group is formed will automatically join the group at that later point.

Taxation consequences of formation of the income tax consolidated group

3.7 The table below provides an overview of the taxation consequences upon an entity becoming a subsidiary member of an income tax consolidated group.

Tax consequences	Detail comments if an entity becomes a subsidiary member of a tax consolidated group
Transactions within the group	Under the single entity rule transactions between members of a tax consolidated group are ignored for tax purposes.
Tax Returns	The head company (i.e. CEB) lodges a single income tax return for the tax consolidated group.
Tax losses	Tax losses made by entities within the group are automatically offset against the income of other entities in the group. Upon each subsidiary member joining the income tax consolidated group any losses the subsidiary or parent company make whilst part of the income tax consolidated group are automatically offset against the income of other entities in the group.

Tax consequences	Detail comments if an entity becomes a subsidiary member of a tax consolidated group
Franking account	The head company of a tax consolidated group is required to maintain a single franking account for the tax consolidated group. The franking account balances of any subsidiaries joining the group are added to the head company's balance. The subsidiary members franking account balance as at the date of joining is transferred to CEB's franking account. Any other tax payments made after the joining date that relate to pre-joining tax liabilities of the subsidiary are taken on in the parents franking account.
Fringe Benefits Tax	Formation of a consolidated group will have no impact on any of the entities current FBT obligations. Each entity in the group that is currently required to lodge a separate FBT return will continue to have that obligation, even after joining the income tax consolidated group.
Goods and Services Tax	The formation of a tax consolidated group does not impact the GST liabilities of entities in any manner. For simplicity, the ATO does allow taxpayers to apply to form a GST consolidated group if certain criteria are met.
Tax costs of assets	Upon a subsidiary joining a tax consolidated group, the tax costs of its assets are reset based on the ACA calculations.
Notification required to the ATO	Upon formation of an income tax consolidated group a notification is required to be submitted to the ATO. The notification must be submitted within 28 days after the formation of the income tax consolidated group. However, the ATO does allow taxpayers to delay notification until the due date for lodgment of the head company's income tax return for the year in which consolidation occurs.

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4 General outline of tax consolidation calculations

4.1 A core principle of the tax consolidation rules is that shareholdings of the parent company in the subsidiary members of the group are disregarded, and that the underlying assets and liabilities of each subsidiary are brought into the consolidated group. The determination of the appropriate starting tax costs for those assets is therefore critical.

4.2 The tax cost setting process broadly attempts to align the tax costs of underlying assets of the subsidiary with the cost of acquiring the shares in that subsidiary.

4.3 The required process for each subsidiary that joins a tax consolidated group is broadly as follows:

i. Determine the economic cost of the head entity acquiring its interests in each of its subsidiaries and “spread” this over the assets of each subsidiary respectively. The economic cost amount is called the Allocable Cost Amount (“ACA”) and it is calculated by way of an 8-step formula set out in the tax consolidation provisions of the tax legislation. It is principally comprised of the tax cost base of the shares of the joining subsidiary the head entity, plus the liabilities of the subsidiary, plus or minus a number of other adjustments.

ii. Firstly, apply that ACA to the “retained cost base” assets of the subsidiary, and then apportion the remaining ACA to other assets referred to as “reset cost base assets” (refer below).

4.4 The consolidation tax cost resetting process may result in uplift or downgrade to the tax cost base of assets brought into the group by the joining entities.

4.5 The 8 steps in the determination of the ACA for a subsidiary member joining a tax consolidated group are broadly:

Step	Description
1	Start with the tax cost of membership interests in the joining entity
2	Add the value of the joining entity’s liabilities, as adjusted for certain amounts, such as liabilities that shall be deductible in the future
3	Add undistributed frankable profits which accrued to the group prior to the joining time
3A	Adjust for certain pre-joining time roll-overs from foreign companies
4	Subtract distributions of profits not accruing to the group, and those accruing to the group that recouped losses
5	Subtract unused tax losses which accrued to the group, except those which reduced step 3 profits

Step	Description
6	Subtract an amount equal to transferred tax losses that did not accrue to the group, multiplied by the general company tax rate
7	Subtract certain tax deduction entitlements inherited from the subsidiary
8	The ACA is the remaining amount

4.6 Depending upon the specific facts and circumstances, aside from steps 1 and 2, not all of the steps are likely to be relevant to a particular joining entity.

4.7 The ACA amount is then allocated firstly to the “retained cost base” assets of the subsidiary member. A “retained cost base asset” is broadly an asset that retains its cost base on entry into the consolidated group (i.e. certain assets whose market value does not differ from its book value). Retained cost base assets are generally limited to cash at bank, cash equivalents, prepayments and trade debtors.

4.8 The ACA balance remaining is then apportioned across all the “reset cost base assets” based on their respective market values. A reset cost base asset is any asset that is not a retained cost base asset, but is limited to Capital Gains Tax (“CGT”) assets (including goodwill), depreciating assets, trading stock, other revenue assets, and assets in the form of financial arrangements.

4.9 The legislation places a ceiling on the amount that can be pushed down to “revenue type” reset cost base assets (such as depreciable assets and trading stock). This is the greater of market value and the termination value of the “revenue type” reset cost base asset. Where the allocated amount to a “revenue type” reset cost base asset exceeds the assets market value or termination value the allocated amount is reduced by the excess. The excess is then re-allocated to other reset cost base assets in accordance with their market values, but not exceeding the ceiling limit for any “revenue type” assets.

4.10 Where the tax cost resetting amounts exceed the joining ACA, then deemed capital gains may arise for the head company of the tax consolidated group.

5 Allocable Cost Amount calculations

5.2 The table below notes the key matters considered, and any assumptions made, at each step in undertaking these ACA calculations:

Step		Detail comments in relation to consolidation of BTL
1. Tax cost of shares	**$3,699,539**	Our understanding is that 50% of the issued shares were acquired by CEB on incorporation for face value of $1 each, and the remaining 50% were acquired directly from Bluescope.
2. Liabilities	**$1,128,612**	Previously, all liabilities for accounting purposes were recognised under Step 2 in the ACA calculation. However, recent changes impose restrictions on amounts that can be included at Step 2. The changes obtained royal assent on 28 March 2018. Under the new laws, liabilities which give rise to future income tax deductions are ignored from Step 2. The most common scenario where this is likely to occur is with employee provisions, such as accrued annual leave or long service leave, which give rise to future income tax deductions when they are eventually paid out. We have calculated the Step 2 amount on the assumption it does not include any future deductible liabilities, on the assumption the liability represents trade creditors and payments to suppliers, which are deductible when incurred, not when paid and therefore are not reduced in the Step 2 calculation. To the extent the liabilities recognized in the financial statements include amounts that give rise to future tax deductions, such as provisions for employee entitlements, these will need to be factored into the ACA calculation.
3. Undistributed frankable profits	**$712,627**	The undistributed franked profits of BTL at the joining time includes amounts that, in accordance with the joining entity's accounting principles for tax cost setting, are retained profits BTL. Based on the audited 2017 financial statements, undistributed profits are $1,219,259. The franking account as at 30 June 2017 is $270,307. Pursuant to s.705-90(4) of the *Income Tax Assessment Act 1997* (Cth), any outstanding PAYG instalments or income tax liabilities that existing at the joining time can

Step		Detail comments in relation to consolidation of BTL
		be taken into consideration when calculating the joining entities' franking account balance. For simplicity of the calculation, we have not taken these additional tax payments into account and have adopted a franking balance of $270,307. When the formula prescribed by the legislation is applied, the undistributed profits is $270,307 x 72.5 / 27.5 = $712,627.
3A. Pre-joining time roll-overs	**Nil**	Not applicable
4. Distributions of pre-joining time profits	**Nil**	Under step 4, it is assumed that there were no distributions of pre-joining time profits. Based on retained earnings of $703 at 30 June 2015.
5. "Owned" tax losses	**Nil**	Not applicable as BTL has no tax losses.
6. "Acquired" tax losses	**Nil**	Not applicable as BTL has no tax losses.
7. Inherited deductions	**Nil**	We understand that there are no inherited deductions.
8. ACA result	**$5,540,778**	The result of steps 1 to 7 equals the "ACA" amount for BTL

6 Tax Cost Resetting Modelling

We enclose our tax cost resetting modelling calculations in **Appendix A**.

The calculations are based on the tax consolidation election taking effect from **1 July 2017**.

The modelling applies the calculated ACA amount of $5,540,778 to the retained cost base assets and reset cost base assets of the BTL as per the audited accounts as at that day in the manner prescribed in the tax legislation.

In summary, the outcomes of this tax cost resetting modelling are as follows:

	Asset	Tax Carrying Value - pre consolidation election $	Tax Carrying Value – post consolidation election $	Uplift / (Downgrade) in tax carrying value $
1	Cash and cash equivalents	634,657	634,657	Nil
2	Trade and other receivables	2,010,818	2,010,818	Nil
3	Inventories	1,085,323	634,674	(450,649)
4	Property, Plant & Equipment	153,146	89,557	(63,589)
5	Goodwill	3,712,638	2,171,072	(1,541,566)
	TOTALS	**7,596,582**	**5,540,778**	**2,055,804**

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7 Disclaimer & Approvals

7.1 DISCLAIMER

The above comments and advice have been made specifically in response to your request for advice on behalf of C.E. Bartlett Pty Ltd (**"the Client"**). Accordingly, neither Crowe Horwath (the firm) or any member or employee of the firm undertakes any responsibility in any way whatsoever to any person or company other than the Client for any errors or omissions in the advice given, however caused.

The above advice has been prepared on the basis of taxation law as at **20 November 2018**. We have not been engaged by the Client to update the contents of this advice to reflect legislative or judicial amendment to law occurring after that date. Therefore the firm can accept no responsibility for any outcomes that differ to the above arising from a change to the legislation. For this reason, it is strongly recommended that no party proceed with any of the transactions contemplated in this advice without first seeking professional advice in light of the then current legislation and practices.

7.2 APPROVAL

This advice has been approved and authorised for release to C.E. Bartlett Pty Ltd.

Alex Duonis | Principal

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Date: 20 November 2018