CONSOLIDATION: COST SETTING RULES FOR PARTNERS AND PARTNERSHIPS LEAVING A CONSOLIDATED GROUP

PURPOSE

1. This paper sets out the proposed cost setting rules that will apply where a partner or a partnership ceases to be a member of a consolidated group.

BACKGROUND

2. The modifications to the general cost setting rules for setting the tax cost for assets of a partner or a partnership that joins a consolidated group are contained in Subdivision 713-E of the *Income Tax Assessment Act 1997* (ITAA 1997). Under these rules, partnerships are not treated as a joining entity for the purposes of Division 705 of the ITAA 1997 (the cost setting rules). Instead, an allocable cost amount (ACA) is worked out for a partner in the partnership and a tax cost is set for the partner’s interest in the assets of the partnership. Where a partnership becomes a member of a consolidated group, the ‘underlying’ assets of the partnership have their tax cost reset.

3. There are currently no rules for setting the tax cost of assets where a partner or a partnership ceases to be a member of a consolidated group. The changes that are proposed to deal with the different circumstances in which a consolidated group disposes of an interest in a partnership are set out in paragraphs 4 to 16 below. The different circumstances that are dealt with are:

- where there is a disposal of an interest in a partnership and the partnership is not a subsidiary member of a consolidated group;

- where there is a disposal of an interest in a partnership and the partnership was a subsidiary member of a consolidated group (and the partnership ceases to be eligible to be a member of the group, but not because a partner leaves the consolidated group);

1 For ease, the term ‘consolidated group’ includes a multiple entry consolidated group unless there is an intention to the contrary.

The principles outlined in this paper are supported by Government. However, they are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.
where a partner leaves a consolidated group (but the consolidated group retains some interests in the partnership); and

where a partner leaves a consolidated group (such that the consolidated group no longer has any interest in the partnership).

**REQUIRED CHANGES**

**Disposal of an interest in a partnership where the partnership is not a subsidiary member of a consolidated group**

4. No additional rules are required. The disposal of an interest in a partnership to an outsider by the group would ordinarily entail each partner making a part disposal of each of their fractional interests in the partnership assets. Consequently, this disposal would give rise to a capital gains tax (CGT) event consistent with paragraph 106-5(4)(b) of the ITAA 1997.

5. This scenario is illustrated by the following diagram, in which A Co. sells its fractional interest in the partnership assets (i.e. its partnership cost setting interests) to an entity outside the group.
6. It is proposed that Division 711 of the ITAA 1997 (which sets the tax cost for membership interests in an entity that leaves a consolidated group) will *not* be applied to the partnership. Consequently, the partnership will not be a leaving entity for the purposes of Division 711.

7. It is proposed that the head company will cease to recognise the underlying assets of the partnership and instead recognise partnership cost setting interests in the partnership. The disposal of a partnership cost setting interest in the partnership would then be determined under the existing CGT provisions (in the same manner as if the partnership were not a subsidiary member). The CGT consequences will be based on the proportion of partnership cost setting interests that have been disposed.

8. This scenario is illustrated by the following diagram, in which A Co. sells its partnership cost setting interests in the assets of the partnership to an entity outside the group. Prior to A Co. disposing of its partnership cost setting interests, the partnership was a member of the consolidated group and the underlying assets of the partnership would have been recognised by Head Co.

![Diagram showing the disposal of an interest in a partnership where the partnership was a subsidiary member of a consolidated group.](image-url)
When a partner leaves a consolidated group (but the consolidated group retains some interests in the partnership)

9. It is proposed that Division 711 will be applied in working out the cost of the membership interests in the entity that leaves the consolidated group (being the entity that is the partner in a partnership). The assets of the leaving entity for Division 711 purposes will include the partnership cost setting interests in the partnership that are held by the partner.

10. For other non-consolidation purposes, the entity that leaves the consolidated group will apply the ordinary income tax law to determine what interest it has (for income tax purposes) in the partnership.

11. The consolidated group will no longer recognise the underlying assets of the partnership but will instead recognise the partnership cost setting interests in the partnership.

12. This scenario is illustrated by the following diagram, in which Head Co. sells all of its interests in A Co., resulting in both A Co. and the partnership exiting the group (A Co. is treated as the leaving entity). However, the group retains some interest in the partnership, via B Co. Prior to Head Co. disposing of its interest in A Co., the partnership was a member of the consolidated group and the underlying assets of the partnership would have been recognised by Head Co.
When a partner leaves a consolidated group (such that the consolidated group no longer has any interest in the partnership)

13. It is proposed that Division 711 will be applied in working out the cost of the membership interests in the entity leaving the consolidated group (being the partner). The assets of the leaving entity for the purposes of Division 711 will include its partnership cost setting interests in the underlying assets of the partnership.

14. For other non-consolidation purposes, the entity that leaves the consolidated group will apply the ordinary income tax law to determine what interest it has (for income tax purposes) in the partnership.

15. As the consolidated group has no remaining interest in the partnership, it would no longer recognise any partnership cost setting interests in the partnership.

16. This scenario is illustrated by the following diagram, in which Head Co. sells all of its interests in A Co., resulting in A Co. exiting the consolidated group. Prior to Head Co. disposing of its interest in A Co., the partnership was not a member of the consolidated group (as it was not wholly owned) and the underlying assets of the partnership would not have been recognised by Head Co.
Application of Division 711 to leaving entity that is a partner in a partnership

17. It is proposed that amendments will be made to ensure that Steps 2, 3 and 4 of calculating a leaving entity’s ACA apply appropriately where the leaving entity is a partner in a partnership and Division 711 applies to the leaving entity. The proposed amendments will ensure that a leaving entity’s ACA will include the following amounts at Steps 2, 3 and 4 respectively:

- the leaving entity’s share of future deductions of the partnership;
- the leaving entity’s share of partnership assets that represent liabilities owed by the old group to the partnership; and
- the leaving entity’s share of the liabilities of the partnership.

APPLICATION

18. The date of effect of any amendment would be 1 July 2002, consistent with the commencement date of the consolidation regime. This would provide maximum certainty and minimise the risk of arbitrary outcomes from a later commencement date.