



ATO Technical Discussion Paper: Treatment of assets identified in relation to straddle contracts

This paper considers how the tax cost setting rules apply when an entity contracts to sell or buy a CGT asset and that contract is not completed at the time the entity joins or leaves a consolidated group (straddle contract). The tax consequences that arise on completion of the contract are also considered.

The paper should be read together with the views expressed in:

- Draft Taxation Determinations TD2008/D9, TD 2008/D10 and TD 2008/D11; and
- *Treatment of special classes of assets*, section C2-1-070 of the *Consolidation Reference Manual*.

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Scope of the paper

This paper applies when an entity contracts to sell or buy a CGT asset and that contract is not completed at the time the entity joins or leaves a consolidated group.

However, the paper does not apply if the CGT asset that is the subject of the straddle contract is a CGT asset of the same consolidated group at both the contract time and the time just after the contract is completed. That is, it does not apply if, after the contract has settled, the asset is still in the same consolidated group it was in when the contract was entered into. For example, this paper does not apply if a subsidiary member of a consolidated group contracts to sell a CGT asset to its head company (or any other member of the group), and the contract settles after the subsidiary has left the group. It also does not apply if an entity has contracted to buy a CGT asset from a member of a consolidated group and by the time the contract settles the entity has joined that group.

Sale cases

Identifying the relevant asset

1. If the entity has contracted to sell a CGT asset, the CGT asset that is the subject of the straddle contract is recognised as an asset of the entity at its joining or leaving time.
2. Generally, no other asset arising under the contractual arrangement would be recognised separately as an asset of the entity. See Draft Taxation Determination TD 2008/D11. See also the discussion on recognising contracts as assets in section C2-1-070 of the *Consolidation Reference Manual*.

Applying the tax cost setting rules

3. The CGT asset that is recognised as an asset of the entity is ordinarily a reset cost base asset for the purpose of allocating the group's allocable cost amount (ACA) for that entity in a joining case.
4. An exception applies where the CGT asset is a chose in action to receive a specified amount of Australian currency (see Taxation Ruling TR 2005/10), other than a right that is a marketable security within the meaning of section 70B of the *Income Tax Assessment Act 1936*. In this case, the asset will be a retained cost base asset for the purposes of allocating the group's ACA for the entity.
5. In a leaving case, the terminating value of the CGT asset is used in calculating the tax cost of the group's membership interests in the leaving entity. The rules for determining the terminating value vary according to the type of CGT asset. Generally, the terminating value would equal the cost base of the CGT asset to the head company at the entity's leaving time.

Completion of the contract

6. When the contract is completed upon the vendor transferring ownership of the CGT asset, there is a disposal for the purposes of CGT event A1 in section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997).
7. The calculation of the capital gain or loss made on the asset's disposal will depend on whether the entity entered into the straddle contract to sell the asset:
 - before joining a consolidated group (entry-sell), or
 - before leaving a consolidated group (exit-sell).

Entry-sell

8. In an entry-sell case, the joining entity is taken to have disposed of the CGT asset at the contract time for CGT purposes (see Draft Taxation Determination TD 2008/D9).
9. The capital gain or loss the joining entity makes on the disposal of the asset is calculated by using its cost base and reduced cost base for the CGT asset (not the group's tax cost for the asset set under Division 705 of the ITAA 1997).
10. Relevant costs and expenditure incurred by the entity after it joins the consolidated group are also added to the cost base and reduced cost base of the CGT asset in working out its capital gain or loss. The sale proceeds received on settlement are relevant in determining the entity's capital proceeds for the purpose of working out its capital gain or loss. This is taken into account in working out the joining entity's net capital gain or loss for the income year in which the CGT event is taken to have happened. This will relate to the entity's income tax return for the period before it joined the consolidated group: subsection 701-30(3) of the ITAA 1997.
11. Importantly, the CGT asset is not actually disposed of at the contract time – it is only once there has been a change of ownership of the CGT asset that the CGT provisions then take the asset's disposal to be back at the contract time for CGT purposes. There is, therefore, no need to recalculate the tax cost setting amounts for the assets held by the entity at its joining time having regard to the consideration received under the contract, instead of the CGT asset that is the subject of the contract.
12. As the joining entity is the relevant taxpayer assessed on the disposal of the CGT asset, no CGT event happens to the group's head company when the asset ceases to be an asset of the group.

Exit-sell

13. In an exit-sell case, the core consolidation rules operate to change the identity of the entity that is taken to have disposed of the asset. In this case, CGT event A1 is taken to have happened to the head company (not the subsidiary) of the consolidated group at the contract time (see Draft Taxation Determination TD 2008/D9).
14. Incidental costs of disposal incurred by the subsidiary after it has ceased to be a member of the group are included in the cost base and reduced cost base of the underlying CGT asset for the purposes of working out if there is a capital gain or capital loss for the event to the head company.
15. As discussed above, there is no recalculation of the tax cost setting amounts at the entity's leaving time using the consideration receivable under the contract, instead of the CGT asset the subject of the contract.

Buy cases

Identifying the relevant asset

16. In the case of a straddle contract to buy a CGT asset, that asset is not recognised as an asset of the purchasing entity at the time it joins or leaves a consolidated group.
17. The only asset that may be recognised as an asset of the joining or leaving entity is one that arises out of the contractual arrangement. Whether such an asset can be recognised will depend on whether, consistent with the views expressed in TR 2004/13, it is something that would be recognised in commerce and business as having economic value to the entity at the joining or leaving time for which a purchaser of its membership interests would be willing to pay. See Draft Taxation Determination TD 2008/D11. See also the discussion on recognising contracts as assets in section C2-1-070 of the *Consolidation Reference Manual*.

Applying the tax cost setting rules

18. In a joining case (entry-buy), any asset of the entity recognised in relation to the contractual arrangement would be a reset cost base asset for the purposes of allocating the group's ACA for the entity.
19. In a leaving case (exit-buy), the terminating value of the asset would be used in calculating the tax cost of the group's membership interests in the leaving entity. Depending on the asset recognised, the terminating value could include, for example, any deposit or purchase price paid and any incidental costs incurred (before the leaving time) by the group to non-group entities to acquire the underlying CGT asset. The amounts forming part of the terminating value may have been paid or incurred by the leaving entity, or another member of the consolidated group. This is because the transactions would be taken to be that of the head company under the single entity rule.

Completion of the contract

20. When the contract is completed upon the vendor transferring ownership of the CGT asset, the CGT provisions would ordinarily apply to only give tax recognition to the acquisition of the CGT asset and not, for example, the ending of the rights under the contract. This is consistent with the 'look through' approach described in Taxation Ruling TR 95/35.
21. But in the case of uncompleted contracts straddling an entity's joining or leaving time, an asset arising from the contractual arrangements may, in accordance with the views expressed in Draft Taxation Determination TD 2008/D10, be assigned a tax cost under the consolidation regime.

22. In the case of a contract to buy a CGT asset, there is a continuum of events, from the time of the contract to the time of settlement, which comprises the complete acquisition of the CGT asset. Any asset of the purchaser that arises from the contractual arrangements is effectively transformed into the new asset. There would be no CGT event in respect of that transformation.
23. In accordance with section 109-5 of the ITAA 1997, the CGT asset that is the subject of the contract would be taken to be acquired at the time of entering into the contract. Importantly, the CGT asset is not actually acquired on entering into the contract – it is only once there has been a change of ownership of the CGT asset that the CGT provisions then *take* the asset's acquisition to be back at the contract time for tax purposes. There is, therefore, no need to recalculate the tax cost setting amounts at the entity's joining or leaving time using the CGT asset, instead of the asset arising from the contract.
24. The cost base and reduced cost base of the CGT asset acquired under the contract would include the terminating value of the asset recognised under the contract on joining or leaving just before the change, together with any additional amounts incurred in respect of the CGT asset's acquisition.

Commissioner of Taxation

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References

Legislation

Income Tax Assessment Act 1936, section 70B

Income Tax Assessment Act 1997, section 104-10

Income Tax Assessment Act 1997, section 109-5

Income Tax Assessment Act 1997, subsection 701-30(3)

Income Tax Assessment Act 1997, Division 705

Tax Rulings

TR 95/35 – Income Tax: capital gains: treatment of compensation receipts

TR 2004/13 – Income Tax: the meaning of an asset for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*

TR 2005/10 - Income tax: consolidation: retained cost base assets consisting of Australian currency or a right to receive a specified amount of such currency

Draft Taxation Determinations

Draft Taxation Determination TD 2008/D9 - Income tax: consolidation: capital gains: do the core consolidation rules in Division 701 of the *Income Tax Assessment Act 1997* modify the effect of the CGT contract rules if an entity

contracts to buy or sell a CGT asset and the contract settles after the entity becomes, or ceases to be, a member of a consolidated group?

Draft Taxation Determination TD 2008/D10 - Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*, is the CGT asset that an entity has contracted to buy from another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

Draft Taxation Determination TD 2008/D11 - Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*, is the CGT asset that an entity has contracted to sell to another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

Precedential ATO view documents

Treatment of special classes of assets”, section C2-1-070 of the *Consolidation Reference Manual*.

Comments

We invite you to comment on this paper and on the material at section C2-1-070 of the *Consolidation Reference Manual* to the extent that it discusses the recognition of contracts as assets for consolidation purposes.

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