Worked example

Pre-CGT membership interests in a leaving entity (with pre-CGT factor attached to assets)

Note:

The pre-CGT factor rules on leaving continue to apply where an entity in which pre-CGT membership interests were held joins a consolidated group before 10 February 2010 and the head company does not make a choice to apply the new pre-CGT proportion rules to that entity → 'Pre-CGT status of membership interests in a joining entity – pre-CGT proportion rules', C2-4-813.

Description

This example shows how a proportion of the membership interests in an entity leaving a consolidated group are treated as pre-CGT assets by reference to the pre-CGT factors of assets in the leaving entity.

Commentary

Where an entity joins a consolidated group before 10 February 2010 (and the head company does not make a choice to apply the pre-CGT proportion rules to that entity → 'Pre-CGT status of membership interests in a joining entity – pre-CGT proportion rules', C2-4-813), the pre-CGT status of membership interests in the joining entity is preserved by attaching a pre-CGT factor to its assets (other than current assets). → 'Pre-CGT factor for assets of a joining entity', C2-4-810

When an entity leaves a consolidated group with pre-CGT factors attached to some or all of its assets, a pre-CGT proportion of its membership interests is calculated as follows:

$$\frac{\sum \left(\text{Market value of each asset with a pre-CGT factor} \times \text{pre-CGT factor of asset} \right)}{\sum \text{ Market value of all assets of the leaving entity}}$$

→ subsection 711-65(5), *Income Tax Assessment Act 1997* (ITAA 1997)

The result is then multiplied by the number of membership interests in the leaving entity (100 shares in the example below), to give the number of pre-CGT membership interests (rounded down to the nearest whole number or zero if the number is less than 1). → subsections 711-65(3) and (4), ITAA 1997

Note: The amendments to section 711-65 contained in *Tax Laws Amendment (2010 Measures No. 1) Act 2010*, Schedule 5, Part 3 have no effect where an entity leaves a consolidated group and pre-CGT factors are attached to some or all of its assets. This will occur where pre-CGT factors were calculated for an entity (in which pre-CGT membership interests were held) that joined the consolidated group before 10 February 2010 and the head company did not make a choice to apply the new pre-CGT proportion rules to that entity.

(Section 711-65 as it stood before *Tax Laws Amendment (2010 Measures No. 1) Act 2010* took effect is reproduced at the end of this worked example.)

Example 1

Facts

Of ACo's 100 shares in BCo, 60 are pre-CGT membership interests. The financial positions on consolidation are shown in tables 1 and 2.

Table 1: ACo – financial position at 1 July 2003

Shares (100 in BCo)	$100	Equity	$100

Table 2: BCo – financial position at 1 July 2003

Land (MV $500)	$50	Equity	$100
Asset 2 (MV $100)	$50		
	$100		$100

Notes: MV = market value
Asset 2 is not a current asset

The pre-CGT factor attached to Asset 2 and Land is 0.6. → 'Pre-CGT factor for assets of a joining entity', C2-4-810

BCo leaves the group on 30 November 2003, and market values have not changed in the interim.

Calculation

Pre-CGT proportion of BCo's membership interests on leaving

a) Calculate the leaving entity's pre-CGT proportion – using s. 711-65(5) of the ITAA 1997 (as it stood at 30 November 2003)

Step 1

Multiply the market values of assets by their pre-CGT factors:

Land: $500 x 0.6 = $300

Asset 2: $100 x 0.6 = $60

Step 2

Add the results of step 1 to give a result of $360.

Step 3

Work out the market value of all assets that the head company holds in the leaving entity:

Asset 2 ($100) + Land ($500) = $600

Step 4

$360 (step 2) / $600 (step3) = 0.6

Therefore, the pre-CGT proportion of BCo leaving the group is 0.6.

b) Calculate the number of pre-CGT membership interests – using s. 711-65(4) of the ITAA 1997 (as it stood at 30 November 2003)

100 shares x 0.6 = 60 shares

c) Round down to nearest whole number of pre-CGT membership interests – s. 711-65(3) of the ITAA *(if applicable)*

In this example the result (60 shares) does not change.

Therefore, 60 of the 100 shares in BCo disposed of are treated as pre-CGT membership interests. The remaining 40 shares will be subject to the CGT provisions.

Example 2

Facts

A consolidated group holds all the shares in ACo. The financial position of ACo at the joining time is shown in table 3.

Table 3: ACo – financial position at 30 June 2003

Cash	$200	Equity	$1,000
Land (MV $2,000)	$1,300	Liabilities	$500
	$1,500		$1,500

The pre-CGT factor attached to Land is 0.51. → 'Pre-CGT factor for assets of a joining entity', C2-4-810

After the joining time, additional liabilities are transferred in and machinery is acquired. Then on 31 December 2003, the group decides to dispose of all its membership interests in ACo. The financial position of ACo is shown in table 4.

Table 4: ACo – financial position at 31 December 2003

Machinery (MV $600)	$600	Equity (100 shares)	$1,000
Land (MV $3,000)	$1,300	Liabilities	$900
	$1,900		$1,900

Calculation

Pre-CGT proportion of ACo's membership interests on leaving

a) Calculate the leaving entity's pre-CGT proportion – using s. 711-65(5) of the ITAA 1997 (as it stood at 31 December 2003)

Step 1

Multiply the market value of Land by its pre-CGT factor:

$3,000 x 0.51 = $1,530

Note: The pre-CGT factor is attached to each of the joining entity's assets at the joining time (other than current assets). Machinery is an asset that has been acquired after the joining time and is therefore not included in step 1 because it does not have any pre-CGT factor attached.

Step 2

Add the results of step 1 to give a result of $1,530.

Step 3

Work out the market value of all assets that the head company holds in the leaving entity:

Land ($3,000) + Machinery $600) = $3,600

Step 4

$1,530 (step 2) / $3,600 (step 3) = 0.425

Therefore, the pre-CGT proportion of ACo leaving the group is 0.425.

b) Calculate the number of pre-CGT membership interests – using s. 711-65(4) of the ITAA 1997 (as it stood at 31 December 2003)

100 shares x 0.425 = 42.5 shares

c) Round down to nearest whole number of pre-CGT membership interests – s. 711-65(3) of the ITAA 1997 *(if applicable)*

= 42

Therefore, 42 of the 100 shares in ACo that are disposed of will be treated as pre-CGT membership interests.

The gain or loss on disposal of these 42 shares is treated as the sale of pre-CGT assets. Consideration would need to be given to the possible application of CGT event K6, where the post-CGT assets of the leaving entity are equal to or greater than 75% of the net value of the entity. The remaining 58 shares will be subject to the CGT provisions.

References

Income Tax Assessment Act 1997, section 711-65; as inserted by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1, and amended by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* (No. 56 of 2010), Schedule 5, Part 3

Explanatory Memorandum to New Business Tax System (Consolidation) Bill 2002 (No. 1), paragraphs 5.147–153

Explanatory Memorandum to Tax Laws Amendment (2010 Measures No. 1) Bill 2010, paragraphs 5.111 to 5.142

Revision history

Section C2-5-710 first published (excluding drafts) 2 December 2002.

Further revisions are described below.

Date	Amendment	Reason
6.5.11	Significant revisions to reflect changes to the method of working out the proportion of the pre-CGT membership interests in a joining entity.	Legislative amendments.

Section 711-65 as it stood before *Taxation Laws Amendment (2010 Measures No. 1) Act 2010*

711-65 Membership interests treated as having been acquired before 20 September 1985 – simple case

When this section applies

(1) This section applies if:

(a) any of the assets (a *pre-CGT factor asset*), that the *head company of the old group holds at the leaving time because the leaving entity is taken by subsection 701-(1) to be a part of the head company, has a *pre-CGT factor under section 705-125; and

(b) section 711-70 (about the multiple exit of *subsidiary members) does not apply; and

(c) the leaving entity does not cease to be a subsidiary member of the old group where Subdivision 705-C (about the old group joining another consolidated group) applies.

Interests treated as if purchased before 20 September 1985

(2) If this section applies, a number of the *membership interests in the leaving entity that *members of the old group hold are taken to have been acquired before 20 September 1985.

Note: Because of the deemed acquisition of the membership interests, this section is the only basis on which any of these interests can be pre-CGT assets.

Number of pre-CGT membership interests

(3) The number is the result of the formula in subsection (4), rounded down to:

(a) the nearest whole number if the result is not already a whole number; or

(b) zero if the result is a number more than zero but less than one.

Formula

(4) The formula is:

$$\text{Number of *membership interests in leaving entity held by *members of old group} \times \text{Leaving entity's pre-CGT proportion}$$

where:

leaving entity's pre-CGT proportion is the amount worked out under subsection (5).

Pre-CGT proportion

(5) Work out the leaving entity's pre-CGT proportion in this way:

Leaving entity's pre-CGT proportion

Step 1. For each *pre-CGT factor asset, multiply its *market value before the leaving time by its *pre-CGT factor.

Step 2. Add up all the results of step 1.

Step 3. Add up the *market values of all the assets that the *head company holds at the leaving time because the leaving entity is taken by section 701-1 to be a part of the head company.

Step 4. Divide the result of step 2 by the result of step 3.

Dealing with classes of membership interests

(6) If there are 2 or more classes of *membership interests in the leaving entity, this section operates separately in relation to each class as if the interests in that class were all the interests in the entity.

Allocation of the number to particular membership interests

(7) The *head company must choose which particular *membership interests comprise the number worked out under subsection (2).

Modification if leaving entity is a trust

(8) If the leaving entity is a trust, a *membership interest in it is not taken into account under this section unless the membership interest is either a unit or an interest in the trust.