Worked example

Pre-CGT factor for assets where subsidiary has membership interests in another member – formation

Description

This example shows how on formation the pre-CGT status of membership interests held directly and indirectly by the head company is preserved by attaching a pre-CGT factor to assets (other than current assets) held by subsidiary members of the group.

Commentary

The pre-CGT status of membership interests held directly by the head company (that is, in the first subsidiary) is preserved by attaching a pre-CGT factor to the assets (other than current assets) of the first subsidiary at the formation time.

If, on formation, the first subsidiary holds membership interests in another subsidiary member (the second subsidiary), the pre-CGT factor must first be worked out for the first subsidiary's assets before any pre-CGT factor can be worked out for the second subsidiary's assets. The market value of each membership interest owned by the first subsidiary in the second subsidiary is multiplied by the pre-CGT factor that was worked out and attached to the first subsidiary's assets.

This provision allows a proportion of the membership interests in a leaving entity to be treated as pre-CGT assets by reference to the pre-CGT factors of assets in the leaving entity. → Worked example: 'Pre-CGT membership interests in a leaving entity', C2-5-710

Example

Facts

ACo, the future head company, was incorporated in 1983 with its sole asset being $300 in cash. On 1 July 1985, ACo paid $60 for 60% of BCo, which had been incorporated 1 July 1984 with a cash asset of $200.

On 30 January 1985, BCo paid $160 for an 80% interest in CCo, with the other 20% being owned by a third party. (CCo had assets of Cash $100 and Land $100.) In 1999 CCo bought Asset 1 at a cost of $10.

Table 1: ACo – financial position at 1 July 1985

Cash	$240	Contributed capital	$300
Shares BCo	$60		
Total	$300	Total	$300

Table 2: BCo – financial position at 1 July 1985

Cash	$40	Contributed capital	$200
Shares CCo	$160		
Total	$200	Total	$200

Table 3: CCo – financial position at 1 July 1985

Cash	$100	Contributed capital	$200
Land (MV $100)	$100		
Total	$200	Total	$200

Note: MV = market value

On 1 July 2002, ACo acquires the 40% balance of BCo for $99.20. BCo acquires the 20% balance of the shares in CCo for $52 after borrowing $12 from an external source.

On 1 July 2002, ACo forms a consolidated group with the other companies.

Figure 1: Group structure at formation time

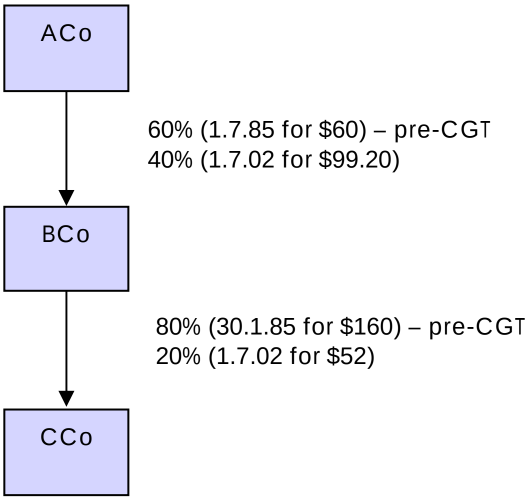

Table 4: ACo – financial position at 1 July 2002

Cash	$140.80	Contributed capital	$300
Shares BCo (MV $248)	$159.20		
Total	$300	Total	$300

Table 5: BCo – financial position at 1 July 2002

Shares CCo (MV $260)	$212	Contributed capital	$200
		Liability - bank loan	$12
Total	$212	Total	$212

Table 6: CCo – financial position at 1 July 2002

Cash	$90	Contributed capital	$200
Land (MV $150)	$100		
Asset 1 (MV $20)	$10		
Total	$200	Total	$200

Calculation

Pre-CGT factor For BCo's assets (other than current assets)

Step 1

Work out the market value of the pre-CGT membership interests (which are pre-CGT assets) that the head company ACo holds in BCo at formation time.

Market value of shares in BCo is $248 (MV of Shares in CCo, $260, less Liability of $12).

x 60% = $148.80

Step 2

Work out the market value of all of BCo's assets (other than current assets), at the formation time:

MV of Shares in CCo is $260.

Step 3

Work out the pre-CGT factor:

$148.80 (step 1) / $260 (step 2) = 0.5723076

Therefore, the pre-CGT factor to be attached to all assets, other than current assets, (shares held by BCo in CCo) is 0.5723076.

Pre-CGT factor for CCo's assets (other than current assets)

Step 1

Multiply the market values of the membership interests held by BCo in CCo by their pre-CGT factors (worked out above):

Market value of Shares in CCo ($260) x 0.5723076 = $148.80

Step 2

Work out the market value of all of CCo's assets (other than current assets) at the formation time:

Land ($150) + Asset 1 ($20) = $170

Step 3

Work out the pre-CGT factor:

$148.80 (step 1) / $170 (step 2) = 0.8752941

Therefore, the pre-CGT factor to be attached to CCo's assets, other than current assets, (Land and Asset 1) is 0.8752941.

References

Income Tax Assessment Act 1997, section 705-165; as amended by *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* (No. 90 of 2002), Schedule 3.

Explanatory Memorandum to the New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Bill 2002, paragraphs 1.72-1.73.