Worked example

Pre-CGT membership interests in a leaving entity

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

When an entity joins a consolidated group, 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). When an entity leaves a consolidated group, 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)

Example 1

Facts

60 out of ACo's 100 shares in BCo are pre-CGT membership interests. On consolidation the financial positions are:

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. → Worked example: 'Pre-CGT factor for assets of a joining entity', C2-4-810

BCo leaves the group shortly after joining, 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 – s. 711-65(5)

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 – s. 711-65(4)

100 shares x 0.6 = 60 shares

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

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.

Example 2

Facts

A consolidated group holds all the shares in ACo. The financial position of ACo at the joining time is as follows:

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. → Worked example: '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 30 December 2003, the group decides to dispose of all its membership interests in ACo. The financial position of ACo is as follows:

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 – s. 711-65(5)

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 – s. 711-65(4)

100 shares x 0.425 = 42.5 shares

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

= 42

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

The gain or loss on disposal of these 42 shares are 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 amended by *New Business Tax System (Consolidation) Act (No. 1) 2002* (No. 68 of 2002), Schedule 1

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