Worked example

Calculating pre-CGT membership interests in a multiple exit case (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 joined a consolidated group before 10 February 2010 and the head company has not made 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 to calculate the number of membership interests in multiple exit entities held by

- members of the old group, or
- other multiple exit entities,

that are taken to have been acquired before 20 September 1985 for CGT purposes.

Commentary

When two or more entities (multiple exit entities) leave a consolidated group, the number of membership interests that are deemed to be pre-CGT assets are worked out on a 'bottom up' basis.

In the following example, subsections 711-65(3) to (6) of the *Income Tax Assessment Act 1997* (ITAA 1997) are first applied to work out the number of pre-CGT membership interests that BCo holds in CCo (the first entity). These pre-CGT assets of BCo will be assigned a pre-CGT factor of one for the purpose of working out the number of pre-CGT membership interests that ACo holds in BCo. → section 711-70, ITAA 1997

Where more than one entity holds membership interests in the first entity, the head company can choose which of the membership interests in the first entity will be pre-CGT assets, up to the maximum allowed under the formula in section 711-70 of the ITAA 1997.

Note: The amendments to section 711-65 and section 711-70 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 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.

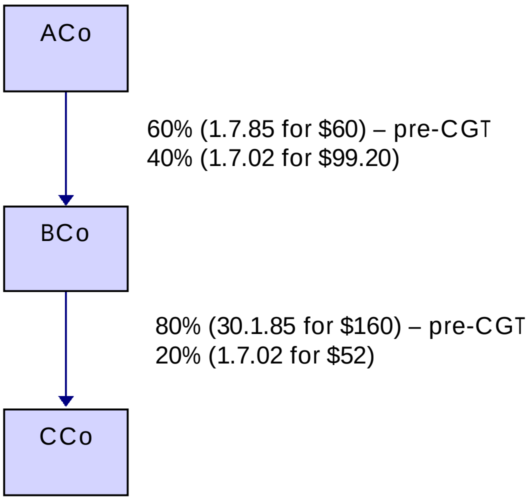
(Sections 711-65 and 711-70 as they stood before *Tax Laws Amendment (2010 Measures No. 1) Act 2010* took effect are reproduced at the end of this worked example.)

Example

Facts

On 1 July 2002, ACo forms a consolidated group with BCo and CCo as its subsidiaries. Total shareholding in both BCo and CCo is 100 shares each. The group structure at formation time, including the cost of membership interests, is shown in figure 1.

Figure 1: Group structure at formation time



Note: In this example CCo is the first entity.

On 30 June 2003, ACo sells 20% of its holding in BCo. The financial positions of ACo, BCo and CCo at this time are shown in tables 1, 2 and 3.

Table 1: ACo – financial position at 30 June 2003

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

MV = market value

Table 2: BCo – financial position at 30 June 2003

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

Table 3: CCo – financial position at 30 June 2003

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

Calculation

1. Work out the number of pre-CGT membership interests BCo holds in CCo

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

Step 1

Multiply the market values of CCo's non-current assets by their pre-CGT factors. → 'Pre-CGT status of membership interests where subsidiary has membership interests in another member – formation', C2-4-820

Land:	$150 x 0.8752941	=	$131.29
Asset 1:	$20 x 0.8752941	=	$17.51

Step 2

Add the results of step 1 to give a result of $148.80.

Step 3

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

Land ($150) + Asset 1 ($20) + Cash ($90) = $260

Step 4

$148.80 (step 2) / $260 (step 3) = 0.572307692

Therefore, the pre-CGT proportion of CCo leaving the group is 0.57.

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

100 shares x 0.572307692 = 57.2307692 shares

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

= 57

Therefore, of the 100 shares in CCo (a multiple exit entity), 57 are treated as pre-CGT.

2. Work out the number of pre-CGT membership interests ACo holds in BCo

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

Step 1

Multiply the market value of the pre-CGT assets by the assigned factor of 1:

Pre-CGT shares in CCo: 57 shares x $2.60 (MV) x 1 = $148.20

Note: A pre-CGT factor of one is assigned to the asset (membership interests in CCo that were determined to be pre-CGT assets). The balance of the asset (post-CGT shares in CCo) is not included. → paragraphs 711-70(4)(b) and (c), ITAA 1997 (as those paragraphs stood at 30 June 2003)

Step 2

Add the results of step 1 to give a result of $148.20.

Step 3

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

Shares in CCo = $260

Step 4

$148.20 (step 2) / $260 (step 3) = 0.57

Therefore the pre-CGT proportion of membership interests in BCo on leaving the group is 0.57.

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

100 shares x 0.57 = 57 shares

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

= 57

Therefore, of the 100 shares in BCo (a multiple exit entity), 57 are treated as pre-CGT.

References

Income Tax Assessment Act 1997, sections 711-65 and 711-70; 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), paragraph 5.153

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

Revision history

Section C2-5-715 first published 28 May 2003.

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 prior to *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.

Section 711-70 as it stood before *Taxation Laws Amendment (2010 Measures No. 1) Act 2010*

711-70 Membership interests treated as having been acquired before 20 September 1985 – multiple exit case

(1) If 2 or more entities (multiple exit entities) cease to be *subsidiary members of the old group at the same time because of an event happening in relation to one of them (other than where Subdivision 705-C applies), a number of the *membership interests (*subject interests*) held in any multiple exit entity by:

(a) *members of the old group; or

(b) other multiple exit entities; or

(c) any combination of paragraphs (a) and (b);

are taken to have been acquired before 20 September 1985.

Numbers to be worked out first for bottom entities

(2) Numbers are to be worked out first for subject interests in multiple exit entities that do not themselves hold any of the subject interests in other multiple exit entities.

Numbers to be worked out progressively up to those subject interests held only by members of the old group

(3) If the holders of other subject interests are or include multiple exit entities, numbers must be worked out for the former subject interests before both the latter and any subject interests whose holders consist entirely of *members of the old group.

How to work out the numbers

(4) The number for subject interests in a particular multiple exit entity that is required to be worked out under subsection (2) or (3) is worked out by applying subsections 711-65(3) to (6) as if:

(a) a reference in those subsections to *membership interests that members of the old group hold in the leaving entity were a reference to the subject interests; and

(b) assets (previously numbered assets) of the multiple exit entity consisting of other subject interests for which a number has been worked out as required by subsection (2) or (3) of this section were assets that the *head company holds at the leaving time because the entity is taken by section 701-1 to be a part of the *head company; and

(c) each previously numbered asset were treated as having a *pre-CGT factor of 1.

Example: Companies A, B, C, D and E are all subsidiary members that leave the old group at the same time. Just before the leaving time, company A owned shares in company B and company C, and company B owned shares in companies D and E.

First, work out company A's number for membership interests in company C and company B's number for membership interests in companies D and E.

Next, work out company A's number for membership interests in company B, taking into account the number just worked out for company B's assets consisting of shares in companies D and E.

Finally, work out the old group's number for membership interests in company A, taking into account the numbers worked out for its assets consisting of shares in companies B and C.

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

Allocation of the number to particular membership interests

(5) The *head company must:

(a) choose which particular *membership interests comprise any number worked out under this section; and

(b) if any *membership interest that is so chosen is held by a multiple exit entity—inform that entity of the fact.

Modification if leaving entity is a trust

(6) A *membership interest in a trust that is one of the multiple exit entities is not taken into account under this section unless the membership interest is either a unit or an interest in the trust.