

Worked example

## Calculating pre-CGT membership interests in a multiple exit case

**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.

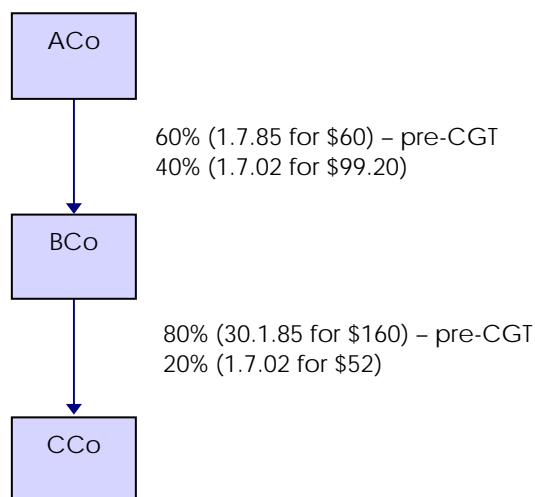
In the following example, subsections 711-65(3) to (6) of the *Income Tax Assessment Act 1997* (ITAA 1997) are first applied to work out the number of pre-CGT membership interests that BCo holds in CCo (the first entity). These pre-CGT assets of BCo will be assigned a pre-CGT factor of one for the purpose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

## Example

Facts At 30 June 2003 ACo sells 20% of its holding in BCo.

Figure 1: Group structure at formation time



**Note:** In this example CCo is the first entity.

The financial positions of ACo, BCo and CCo are as follows:

Table 1: ACo – financial position at 30 June 2003

Cash	\$140.80	Contributed capital	\$300
Shares in BCo (MV \$248)	\$159.20		
	<u>\$300</u>	Total	<u>\$300</u>

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	<u>\$212</u>	Total	<u>\$212</u>

Table 3: CCo – financial position at 30 June 2003

Cash	\$90	Contributed capital	\$200
Land (MV \$150)	\$100		
Asset 1 (MV \$20)	\$10		
Total	<u>\$200</u>	Total	<u>\$200</u>

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Calculation **Number of pre-CGT membership interests that BCo holds in CCo**

**(a) Calculate leaving entity's pre-CGT proportion – subsection 711-65(5)**

*Step 1*

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

$$\begin{aligned}\text{Land:} & \quad \$150 \times 0.8752941 = \$131.29 \\ \text{Asset 1:} & \quad \$20 \times 0.8752941 = \$17.51\end{aligned}$$

*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:

$$\text{Land } (\$150) + \text{Asset 1 } (\$20) + \text{Cash } (\$90) = \$260$$

*Step 4*

$$\$148.80 \text{ (step 2)} / \$260 \text{ (step 3)} = 0.572307692$$

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

**(b) Calculate number of pre-CGT membership interests – subsection 711-65(4)**

$$100 \text{ shares} \times 0.572307692 = 57.2307692 \text{ shares}$$

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

$$= 57$$

**Number of pre-CGT membership interests that ACo holds in BCo**

**(a) Calculate leaving entity's pre-CGT proportion – subsection 711-65(5)**

*Step 1*

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

$$\text{Pre-CGT shares in CCo: } 57 \text{ shares} \times \$2.60 \text{ (MV)} \times 1 = \$148.20$$

**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) of the

ITAA 1997

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*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*

$\$148.20 \text{ (step 2)} / \$260 \text{ (step 3)} = 0.57$

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 – subsection 711-65(4)**

$100 \text{ shares} \times 0.57 = 57 \text{ shares}$

**(c) Round down to nearest whole number of pre-CGT membership interests – subsection 711-65(3) (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 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), paragraph 5.153.