Worked example

Events that trigger pooling in a MEC group

Description

This example explains that the cost setting amount (cost) for certain membership interests held in an eligible tier-1 company by an entity outside the MEC group – called 'pooled' interests – is recalculated each time one or both of two 'trigger events' happen to the membership interest.

Broadly, these trigger events are:

- when an eligible tier-1 company leaves the group
- when a CGT event happens to one or more pooled interests in the company

Note

This example does not consider the effect that the value shifting or loss integrity measures in Divisions 727 and 715 and Subdivision 719-T may have on resetting the cost of membership interests. Examples of the effect those provisions can have on membership interests are considered in:

- 'Effect of Subdivision 165-CC where an entity leaves a consolidated group', C2-5-120
- 'Effect of Subdivision 165-CD for consolidated groups', C2-6-130
- 'General value shifting regime (GVSR)', C2-6-170
- 'All assets in head company's loss denial pool become assets of leaving entity', C2-6-540.

Commentary

A membership interest in an eligible tier-1 company held by an entity outside the MEC group is a pooled interest, provided it is not:

- an employee share scheme interest, or
- held only as a nominee for members of the MEC group.

Each time a membership interest that is a pooled interest undergoes one of the events that trigger the pooling rules, the cost of the pooled interest is recalculated (reset) using the pooling rules in Subdivision 719-K of the *Income Tax Assessment Act 1997* (provided the market value of the pooled interests as a whole – including the market value of synergies arising from the combination of those interests – is more than nil just before the trigger time). The recalculation takes place just before the trigger time (the time a trigger event happens) using the formulas in that Subdivision. The resulting amount, the reset amount, is the cost of the pooled interests for tax purposes.

For more details about how the pooling rules and formulas are applied:

→ 'Pooling of external membership interests', C10-2-420.

Events that trigger pooling

The cost of all the pooled interests in all of the eligible tier-1 companies in a MEC group is reset where either or both of the following things happen:

- an eligible tier-1 company leaves the group ('trigger event 1')
- a CGT event happens in relation to one or more pooled interests in the company ('trigger event 2'),

(providing the market value of the reset interests as a whole – including the market value of synergies arising from the combination of those interests – is more than nil just before trigger time).

The eligible tier-1 company that undergoes the trigger event is referred to as a trigger company. Not all the eligible tier-1 companies in a MEC group are necessarily trigger companies when a trigger event happens. However, both trigger companies and non-trigger companies have the cost of their pooled interests reset when an event that triggers pooling happens.

The pooling method is used to reset the cost of pooled interests to facilitate the tax-free transfer of assets within a MEC group.

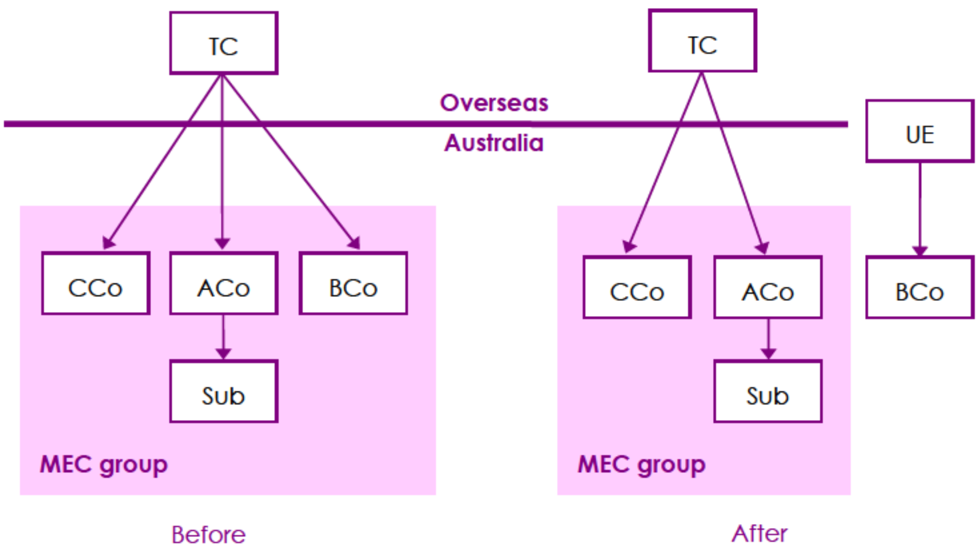
Example: Trigger event 1

An eligible tier-1 company ceases to be a member of the MEC group

When, after formation of a MEC group, shares in BCo are issued to UE (i.e. an unrelated entity outside the group), trigger event 1 happens. Even though there is no CGT event, BCo ceases to be eligible to be a member of the group. The pooling calculation in Subdivision 719-K ensures that the pooled interests have an appropriate cost. The difference between the selling price and cost of the reset interest (calculated using the pooling rules in Subdivision 719-K) is the capital (or revenue) gain or loss to TC.

It is important to be aware that any CGT event that happens to a pooled interest (reset interest) in an eligible tier-1 company and anything that happens to cause the eligible tier-1 company to leave the group, will trigger the pooling provisions.

Figure 1: An eligible tier-1 company leaves the group



Example: Trigger event 2

A CGT event happens to a pooled interest in an eligible tier-1 company

The top company (TC) sells 40% of the membership interests in BCo to ACo but BCo continues to be a member of the MEC group. When the trigger event happens, pooling will ensure that the reset interests will have an appropriate cost just before the time the trigger event happens in relation to the membership interests in BCo. This reset cost is used to determine any capital (or revenue) gain/loss that TC makes on disposal of 40% of the membership interests in BCo.

Figure 2: CGT event

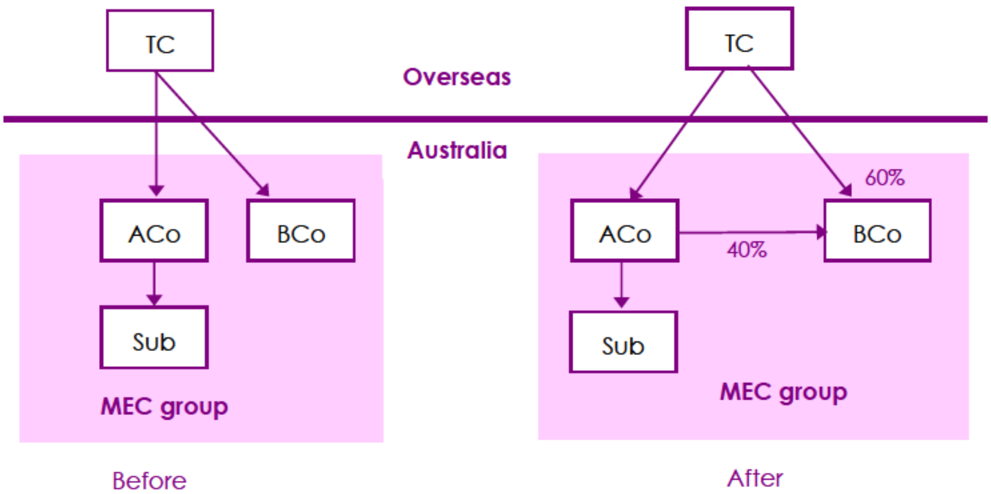


Table 1: Examples of CGT events that will trigger pooling

CGT event	Brief description
A1 section 104-5, ITTA 1997	Disposal of a pooled interest
G1 section 104-135, ITTA 1997	A company makes a capital payment in relation to a pooled interest
G3 section 104-145, ITTA 1997	Liquidator declares the pooled interests worthless
I1 section 104-160, ITTA 1997	Australian residency ends

It is also important to recognise that a company may leave the group and trigger the pooling provisions without a CGT event happening.

Events that are not CGT events that will trigger pooling

- An eligible tier-1 company issues shares to entities outside the foreign wholly-owned group. The eligible tier-1 company ceases to be wholly-owned by the top company of the MEC group and leaves the group.
- An eligible tier-1 company fails the membership eligibility rules after joining or formation time. In this instance the eligible tier-1 company ceases to be eligible to be a member of the MEC group.

References

Income Tax Assessment Act 1997, Subdivision 719-K; as amended by *New Business Tax System (Consolidation and Other Measures) Act (No. 1) 2002* (No. 117 of 2002), Schedule 8

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 1) 2002, paragraphs 3.53 to 3.57

Income Tax Assessment Act 1997, Division 104

Income Tax Assessment Act 1997, Subdivision 719-T; as amended by *New Business Tax System (Consolidation and Other Measures) Act 2003* (No. 16 of 2003)

Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No. 2) 2002, Chapter 11