

TD 2008/31EC - Compendium



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Ruling Compendium – TD 2008/31

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D11 – Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*, is the CGT asset that an entity has contracted to sell to another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Entity/ies commenting	Issue raised	Tax Office Response/Action taken
1	1	Recognising assets under the contract A separate asset, being a right under a contractual agreement, should also be recognised. In Example 1 of the draft Determination, if a separate asset is not recognised (being a right under the contractual arrangement) then it is likely that the shares in B Co will have little or limited value at the time of entry. The vendor may have no or limited rights over the shares in B Co as they are subject to the rights of the purchaser. If the shares in B Co have no or limited value, then upon allocation of X Co's ACA, other assets may have greater ACA inappropriately allocated – on the basis that ACA is allocated to reset cost base assets proportionately based on market value. Recognition of a separate asset would also mitigate the potential double tax issues in an exit-sell case.	Paragraphs 2 and 21 of the final Determination have been changed to clarify the circumstances in which an asset arising under the contractual arrangement can be recognised as an asset of the joining or leaving entity, in addition to the CGT asset that is the subject of the contract. Where such an asset is recognised as an asset of the joining entity in an entry-sell case, the group's ACA for that entity will be allocated to the asset according to its market value relative to that of other reset cost base assets. The market value of an asset is a question of fact. However, the Tax Office does not consider the market value of the shares in B Co to be impeded in the circumstances described. The task of establishing the market value of an asset for consolidation purposes is to be approached according to the typical definition adopted by business valuers: The price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length. Further guidance on determining the market value of an asset for tax cost setting purposes is available in Part C4-1 of the <i>Consolidation Reference Manual</i> .

2	2	<p><i>Entry-sell: market value changes of the CGT asset</i></p> <p>The entry-sell scenario causes uncertainty where the market value of the CGT asset at the time the joining entity entered into the contract differs from the market value of the asset when the subsidiary joined the consolidated group.</p> <p>The tax cost calculated for each reset cost base asset will be distorted in these cases because the head company will only receive the consideration agreed under the contract. For example, if the CGT asset's market value had increased between the contract time and the joining time, more ACA would be allocated to the CGT asset, away from other reset cost base assets.</p> <p>A solution to this would be to allow the head company to adopt the market value of the asset at the time of entry into the contract as its market value for tax cost setting purposes.</p>	<p>In the case where the market value of the CGT asset being sold under the straddle contract is greater at the contract time than at the entity's joining or leaving time, paragraph 21 of the Determination has been changed to include this as an example of when it may be possible to recognise an asset arising under the contractual arrangement as an asset of the entity.</p> <p>In an entry-sell case, this will mean ACA is allocated more appropriately across the joining entity's assets.</p> <p>However, accounting standards may not permit the recognition of a liability for cost setting purposes in circumstances where the value of the CGT asset that is the subject of the contract has increased in value as at the joining or leaving time. These situations will need to be considered on a case by case basis.</p> <p>The Tax Office does not consider that the suggested solution is available under the law.</p>
3	3	<p><i>Tax effect accounting and ACA</i></p> <p>Has the Tax Office considered the implications of tax effect accounting on the joining or exit ACA calculations?</p> <p>Assuming accounting principles recognise the timing of the asset's sale at the change of beneficial ownership:</p> <ul style="list-style-type: none">• The entity selling the CGT asset is likely to recognise a current tax liability to reflect that a capital gain will arise at the contract time. In an exit-sell case, this liability might be reflected as an inter-company liability under a tax funding agreement (and a 'clear-exit' payment extinguishing the liability might be made prior to exit under a tax sharing agreement).	<p>The Determination does not address tax effect accounting and so does not attempt to map the various scenarios this issue raises.</p>

		<ul style="list-style-type: none">• The entity selling the asset would book a deferred tax asset to reflect that the current tax liability is a temporary difference that will reverse when the sale is recognised for accounting purposes.	
4		Further exclusion from the TD's scope	Paragraph 3 of TD 2008/31 clarifies that the acquisition or disposal of assets through the use of finance leases are not within the scope of the Determinations. Such situations raise a different set of issues to those addressed in the Determinations. The Tax Office will give further consideration to the way the law operates in these cases.
5	4	The Tax Office's view on the interaction of the consolidation provisions and straddle contracts are in 3 draft Determinations, a Discussion Paper and section C2-1-070 of the <i>Consolidation Reference Manual</i> which makes it difficult for taxpayers to form a comprehensive view of the income tax consequences for straddle contracts. We ask that the Tax Office give some consideration to how these documents interact and provide textual linkages between the documents.	The Tax Office acknowledges the comment. To further assist taxpayers, worked examples setting out the income tax consequences for straddle contracts will be included in the <i>Consolidation Reference Manual</i> .