TD 2004/D42 - Income tax: consolidation and capital gains tax: Does CGT event A1 in section 104-10 of the Income Tax Assessment Act 1997 happen to the head company of a consolidated group when a subsidiary member transfers a licence, granted to it by another member, to a non-group entity for no capital proceeds?

This cover sheet is provided for information only. It does not form part of *TD 2004/D42 - Income tax: consolidation and capital gains tax: Does CGT event A1 in section 104-10 of the Income Tax Assessment Act 1997 happen to the head company of a consolidated group when a subsidiary member transfers a licence, granted to it by another member, to a non-group entity for no capital proceeds?*

This document has been finalised by TD 2004/35.

Draft Taxation Determination

Income tax: consolidation and capital gains tax: Does CGT event A1 in section 104-10 *of the Income Tax Assessment Act 1997* happen to the head company of a consolidated group when a subsidiary member transfers a licence, granted to it by another member, to a non-group entity for no capital proceeds?

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes, section 104-10 (CGT event A1 about the disposal of a CGT asset) of the *Income Tax Assessment Act 1997* (ITAA 1997) happens to the head company. The capital proceeds are deemed to be the market value of the licence at the time of the event under the market value substitution rule in section 116-30 of the ITAA 1997.

2. When a subsidiary member of a consolidated group is granted a licence by another member, there are no income tax consequences for the head company because of the single entity rule (SER) in section 701-1 of the ITAA 1997.

3. However, when the licence is transferred from the group to a non-group entity for no capital proceeds, CGT event A1 happens to the head company because of the change of ownership that occurs from the consolidated group to the non-group entity.

4. That is, whilst the disposal of the licence is by a subsidiary member of the group the SER takes the disposal to have been by the head company. From the group's perspective it is disposing of an asset and there is no need, in this case, to look at the transaction as other than a transfer of ownership of the licence from the group (that is, the head company) to the third party.

5. The application of the SER doesn't necessarily mean that intra-group assets, such as a licence, are taken not to have existed prior to their disposal by the consolidated group. CGT event A1 happens 'if ***you*** dispose of a CGT asset'. In this case '***you***' is taken to be the head company and the CGT asset is the licence. Clearly, from the third party's perspective, it is acquiring an existing asset.

6. The cost base of a CGT asset consists of 5 elements (see subsection 110-25(1)). Those elements are the various amounts of money or property '***you***' paid, gave, incurred or are required to pay or give. Again, in this case, '***you***' is the head company of the group. As inter-group expenditures and transfers are taken to be the actions of the head company during the period of consolidation and are not recognised for income tax purposes they cannot be included in an element of cost base. Only consideration from within the group to non-group entities can be an element of the cost base of a CGT asset.

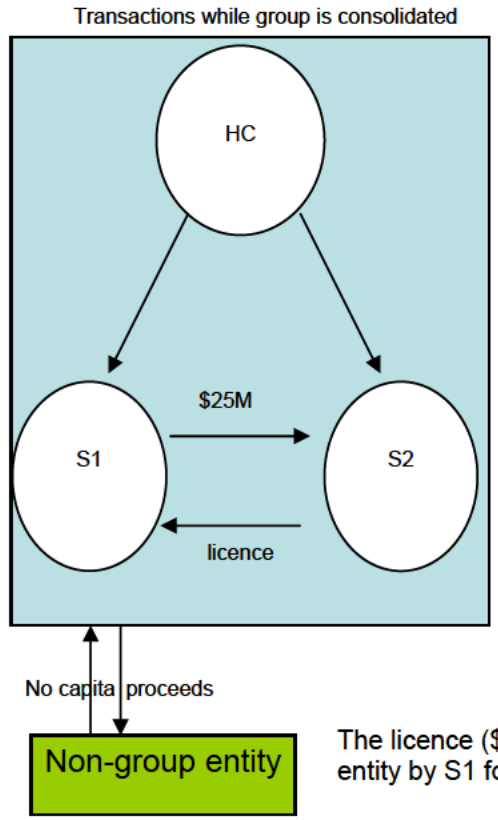
7. The legal character of the transaction matches the economic character of the transaction and appropriately, like all CGT events of this kind, the group (that is, the head company) is to be assessed on the market value of the licence (see section 116-30) less the elements of cost base that involved payments to non-group entities, such as the incidental costs in respect of the disposal, and the third party is taken to have paid the market value of the licence (see section 112-20) to the group (that is, the head company).

8. Of course, transfers of valuable property for no consideration are usually between related parties not dealing at arm's length so again, in this case, the appropriate tax outcome is achieved by a limited or straight forward application of the SER in the context of the CGT provisions.

Example

9. *HC is the head company of a consolidated group with S1 and S2 being subsidiary members of the consolidated group. While consolidated, S1 pays $25 million to S2 for the grant of a licence. S1 subsequently assigns the licence to a non-group entity for no capital proceeds even though it has a market value of $25 million. S1 incurs incidental costs of $10,000. The incidental costs are in respect of legal services provided by a third party.*

10. *The diagram below shows the above transactions.*



The licence ($25 million market value) is assigned to the non-group entity by S1 for no capital proceeds incurring incidental costs of $10,000.

11. *In the above example, there are no income tax consequences from S2 creating a licence in S1 for $25 million.*

12. *CGT event A1 applies to HC because the SER treats the change of ownership of the licence from S1 to the non-group entity as a change of ownership from HC to that entity.*

13. *Equally the SER will treat HC as having received capital proceeds of $25 million for the licence under the market value substitution rule. HC is also taken to have a cost base being incidental costs of $10,000. This results in the HC making a capital gain of a $24,990,000.*

14. *An incorrect outcome would arise if the SER treated HC as having created the licence in the non-group member for the purposes of CGT event D1 (in section 104-35 of the ITAA 1997). The market value substitution rule in section 116-30 of the ITAA 1997 would not apply. However the non-group member would have a market value cost base under section 112-20 of the ITAA 1997.*

Date of Effect

15. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Your comments

16. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

Due date: **27 August 2004**

Contact officer: **Peter Van De Maele**

E-mail address: **Peter.VanDeMaele@ato.gov.au**

Telephone: **02 6216 1943**

Facsimile: **02 6216 2738**

Address: **PO BOX 900**
CIVIC SQUARE ACT 2608

Commissioner of Taxation
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Previous draft:
Not previously issued in draft form

Related Rulings/Determinations:
TR 92/20

Legislative references:
- TAA 1953 Pt IVAAA
- ITAA 1997 104-10
- ITAA 1997 104-35
- ITAA 1997 110-25(1)
- ITAA 1997 112-20
- ITAA 1997 116-30
- ITAA 1997 701-1

ATO references
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