TD 2004/D68 - Income tax: consolidation: capital gains: does an entity permanently lose its status as an 'originating company', in respect of a deferral event in subsection 170-255(1) of the Income Tax Assessment Act 1997 , when the entity becomes a subsidiary member of a consolidated group?

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This document has been finalised by TD 2004/80.

Draft Taxation Determination

Income tax: consolidation: capital gains: does an entity permanently lose its status as an 'originating company', in respect of a deferral event in subsection 170-255(1) of the *Income Tax Assessment Act 1997*, when the entity becomes a subsidiary member of a consolidated group?

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. When the entity becomes a subsidiary member of a consolidated group, its status as the originating company for the deferral event is inherited by the head company of the group by the operation of the entry history rule in section 701-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). Further, the head company retains the originating company status after the subsidiary member leaves the group.

2. Subdivision 170-D of the ITAA 1997 disregards a capital loss or deduction that arises if a company (the 'originating company') that is a member of a 'linked group' disposes of an asset to another member of the group. A disposal in these circumstances is referred to as a 'deferral event'. The disregarded loss or deduction (the 'deferred loss') may be recognised subsequently as a loss of the originating company if either the asset, or the originating company, leaves the linked group. These events are referred to as 'new events': section 170-275 of the ITAA 1997.

3. The entry history rule in section 701-5 of the ITAA 1997 provides that, for the head company's income tax purposes, everything that happened in relation to an entity before it became a subsidiary member of the consolidated group is taken to have happened in relation to the head company. Section 715-355 of the ITAA 1997 makes it clear that the entry history rule operates in respect of Subdivision 170-D deferred losses. It is therefore considered that the head company inherits the full history of the entity in respect of the deferral event, including its status as the originating company, when it becomes a subsidiary member of the consolidated group.

4. Further, the head company retains this status as the originating company for the deferral event after the subsidiary member leaves the consolidated group, including where it leaves with the CGT asset whose disposal or creation gave rise to the deferral event.

5. It has been suggested that the operation of the exit history rule in section 701-40 of the ITAA 1997 allows the subsidiary member to reacquire its status as the originating company when it leaves the consolidated group. We do not agree.

6. In our view, the exit history rule confers on a leaving entity only that history in relation to the matters listed in subsection 701-40(2) (that is, assets, liabilities, business and research and development registration). An entity's status for the purpose of recognising a deferred loss is not one of the matters listed, nor does the deferred loss form part of the history of the CGT asset that was the subject of the deferral event.

7. Implications of the views expressed in this Determination include:

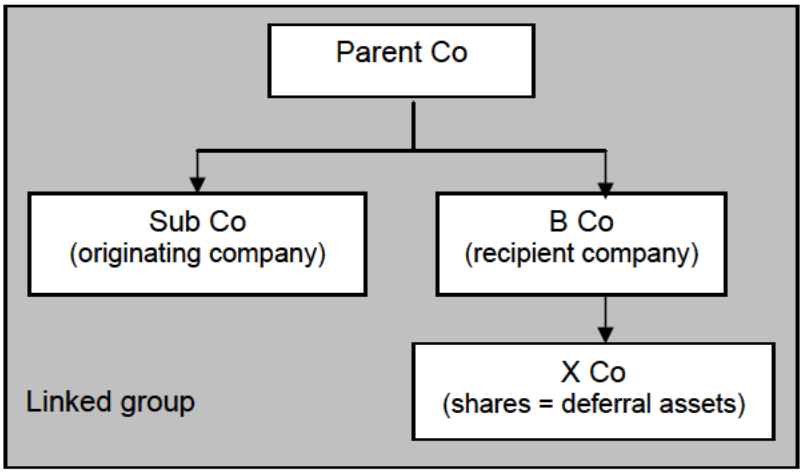
- no new event happens when the subsidiary member, which was the originating company before it became a member of the consolidated group, ceases to be a member of both the consolidated and linked group – for example, if the subsidiary is liquidated or shares equating to a controlling interest in it are sold to entities outside the linked group. The requirement for a new event in paragraph 170-275(1)(d) of the ITAA 1997 would not be met because the head company of the consolidated group is (now) the originating company for that deferred loss; and
- if a new event happens under section 170-275 of the ITAA 1997 – for example, the CGT asset that gave rise to the deferral event ceases to exist or leaves the linked group – the head company, as the originating company, will be taken to have made a capital loss immediately before that event happens. The loss amount is equal to the amount of the deferred loss, reduced to the extent of any loss denial balance if the deferred loss is in a loss denial pool at the time of the new event: sections 170-275 and 715-365 of the ITAA 1997.

Note: Where Subdivision 170-D of the ITAA 1997 defers a loss made by an entity and no new event happens before it becomes a subsidiary member of a consolidated group, the deferred loss is not a pre-joining time loss able to be transferred to the head company under Division 707 of the ITAA 1997. Accordingly, when a new event happens so that the head company makes a loss under section 170-275 of the ITAA 1997, its use is not limited by reference to any 'available fraction'.

Example 1

8. *Parent Co and its wholly-owned subsidiaries Sub Co, B Co and X Co are members of a linked group within the meaning of section 170-260 of the ITAA 1997. Parent Co owns all the shares in Sub Co and B Co. Also, Sub Co owned all the shares in X Co. All of these entities are Australian resident companies.*

9. *In November 1999, Sub Co disposed of all its shares in X Co to B Co. Because the entities were members of the same linked group, the capital loss that would otherwise have arisen as a result of this disposal is disregarded under subsection 170-270(1) of the ITAA 1997. Sub Co is the originating company in respect of this deferral event. This is what the linked group looks like just after the deferral event:*



10. *Parent Co chose to form a consolidated group with effect from 1 July 2002. The group comprised all of the above companies.*

11. *In May 2004, Sub Co is liquidated which results in Sub Co no longer being a member of both the consolidated and linked group. Because Parent Co is now regarded as the originating company and has not left the linked group, Sub Co's exit from the linked group does not trigger a 'new event' for the purposes of section 170-275 of the ITAA 1997.*

Example 2

12. *Following from the facts in Example 1 assume that, in October 2004, more than 50% of the shares in X Co are sold to an entity that is not a member of either the consolidated or linked group (and is not a connected entity of Parent Co, or an associate of a connected entity). In respect of each X Co share sold, a new event would happen pursuant to paragraph 170-275(1)(b) of the ITAA 1997.*

13. *Parent Co, as the originating company, will therefore be taken to have made a loss just before the sale of each X Co share in October 2004. The loss amount for each X Co share sold is equal to the loss deferred under Subdivision 170-D on each share.*

Date of Effect

14. 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

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

Due date: **5 November 2004**

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Commissioner of Taxation
6 October 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20

Subject references:

- capital gains tax
- capital losses
- consolidation
- deferral event
- deferred capital losses and deductions
- disregarded capital loss
- head company
- inherited history rules
- linked group
- new event
- originating company
- relevant CGT asset
- single entity rule
- subsidiary member of a consolidated group

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Subdiv 170-D
- ITAA 1997 170-255
- ITAA 1997 170-255(1)
- ITAA 1997 170-260
- ITAA 1997 170-270(1)
- ITAA 1997 170-275
- ITAA 1997 170-275(1)(b)
- ITAA 1997 170-275(1)(d)
- ITAA 1997 701-5
- ITAA 1997 701-40
- ITAA 1997 701-40(2)
- ITAA 1997 Div 707
- ITAA 1997 715-355
- ITAA 1997 715-365

ATO references
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