TD 2004/D69 - Income tax: consolidation: capital gains: does the deregistration of a subsidiary member of a consolidated group cause a 'new event' to happen under paragraph 170-275(1)(a) of the Income Tax Assessment Act 1997 if, before it joined that group, a transfer of shares in the subsidiary was a 'deferral event' under section 170-255 and group's head company is the 'originating company' for the deferral event?

This document has been finalised by TD 2004/81.

Draft Taxation Determination

Income tax: consolidation: capital gains: does the deregistration of a subsidiary member of a consolidated group cause a 'new event' to happen under paragraph 170-275(1)(a) of the *Income Tax Assessment Act 1997* if, before it joined that group, a transfer of shares in the subsidiary was a 'deferral event' under section 170-255 and group's head company is the 'originating company' for the deferral event?

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.

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 a CGT asset to another member of that 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 that linked group. These events are referred to as 'new events'.

3. In particular, a new event happens if the CGT asset that gave rise to the deferral event ceases to exist: paragraph 170-275(1)(a) of the ITAA 1997. In the case where the CGT asset is a share in a company, a new event would happen if the company were deregistered pursuant to the *Corporations Act 2001*. This is because a deregistered company ceases to exist as do the shares in that company (see Taxation Determination TD 2000/7).

4. When the subsidiary member of the consolidated group is deregistered, the interaction between the loss deferral provisions in Subdivision 170-D and the single entity rule in section 701-1 of the ITAA 1997 must be considered. Under the single entity rule, the subsidiary members of a consolidated group are treated as parts of the head company (and not separate entities) for the group's income tax purposes.

5. It has been argued that the effect of the single entity rule is that no new event can happen on deregistration of a subsidiary member because there is no point in time while the shares exist that they are not covered by the single entity rule (that is, they are not recognised for income tax purposes during the period they are held within the group). As a consequence, for the head company there is no CGT asset that ceases to exist under paragraph 170-275(1)(a) of the ITAA 1997. This would mean that the deferred loss could never be realised. We do not agree with this view.

6. The single entity rule does not apply to defeat a clearly intended outcome under provisions outside the consolidation rules (such as Part 3-5 of the ITAA 1997). In such cases, intra-group interests, or legal entities that are part of a single entity for consolidation purposes, require a level of recognition in applying provisions that have regard to such interests and entities. Paragraphs 8(c) and 26 to 28 of Taxation Ruling TR 2004/11 explain the Commissioner's view that reading the Act as a whole achieves this outcome (and without the need to resort to section 701-85 of the ITAA 1997).

7. In our view, the single entity rule does not prevent the recognition of shares held in the subsidiary member for the purpose of identifying if a new event happens under paragraph 170-275(1)(a) of the ITAA 1997. In applying this provision, the shares in the subsidiary member are recognised as CGT assets which cease to exist on deregistration. The deferred loss can therefore be recognised, consistent with the policy underlying Subdivision 170-D of the ITAA 1997 which provides for loss deferral, not loss denial.

8. Because the head company is the originating company for the deferral event, it will be taken to have made the loss. The head company will be the originating company if it acquired this status from a subsidiary that joined the consolidated group (see Example 1 and Draft Taxation Determination TD 2004/D68) or was the actual originating company for the deferral event (see Example 2).

9. In both cases, the head company will be taken to have made the loss just before the subsidiary member is deregistered: subsection 170-275(1) of the ITAA 1997. The loss amount will be equal to the loss deferred under section 170-270 of the ITAA 1997, subject to the operation of Subdivision 715-D of the ITAA 1997 if the deferred loss is in a loss denial pool at the time the new event happens.

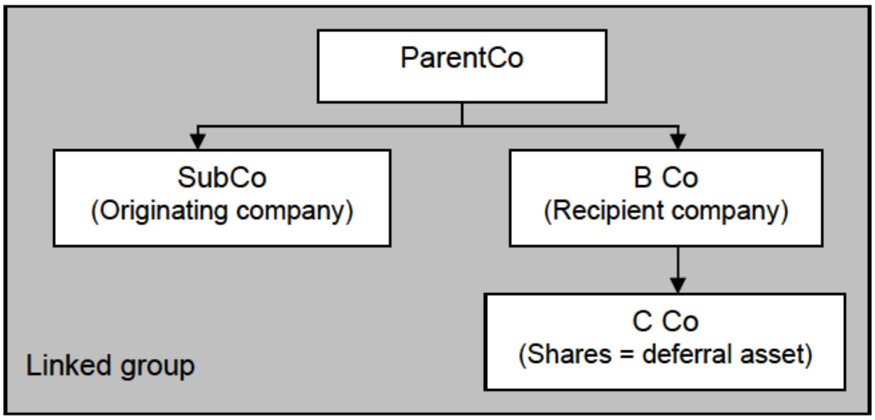
Note 1: We would take the same view if the shares in the subsidiary member ceased to exist in some other way, such as a cancellation. However, as in the case of deregistration, the shares in the subsidiary member would only be recognised where, and to the extent, the shares were the subject of a deferral event under section 170-255 of the ITAA 1997. That is, it is only for the purposes of allowing the capital loss or deduction under section 170-275 of the ITAA 1997 that the shares in the subsidiary are recognised.

Note 2: This Determination applies if the head company is the originating company. If the head company is *not* the originating company because the originating company for the deferral event never became a member of the consolidated group (but remains a member of the linked group) there is no issue. That is, the entity entitled to recognise the deferred loss is not a member of the consolidated group and so the single entity rule is not relevant. The single entity rule does not affect the application of the income tax laws to an entity outside the group. (See Example 3.)

Example 1

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

11. *In November 1999, SubCo disposed of all its shares in C 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. SubCo is the originating company in respect of this deferral event. This is what the linked group looks like just after the deferral event:*



12. *ParentCo chooses to form a consolidated group with effect from 1 July 2002. The group comprises all of the above companies. SubCo's full history in respect of the deferral event, including its status as the originating company, is inherited by ParentCo by operation of the entry history rule (see Draft Taxation Determination 2004/D68).*

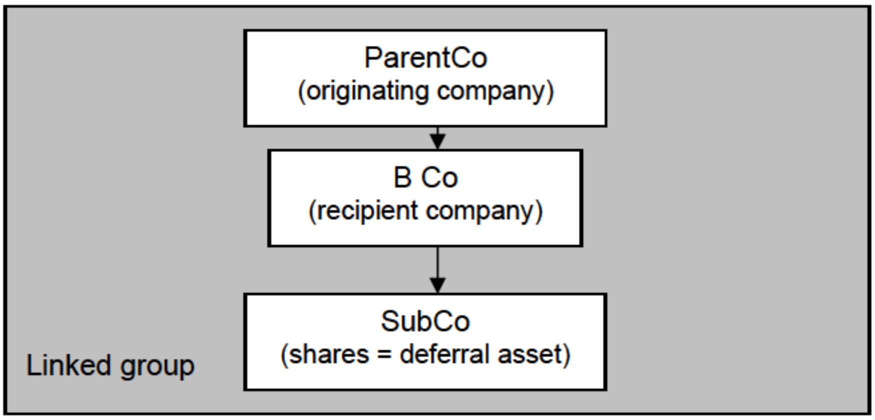
13. *In May 2004, C Co is deregistered. The shares in C Co are recognised as CGT assets for the purpose of applying subsection 170-275(1) of the ITAA 1997 (ParentCo would be the 'other entity' that acquired C Co's shares under paragraph 170-255(1)(a) by operation of the single entity and entry history rules). On deregistration, the shares in C Co will cease to exist and a new event happens under paragraph 170-275(1)(a) of the ITAA 1997. ParentCo, as the originating company, will therefore be taken to have made a capital loss just before C Co is deregistered, for an amount equal to the original deferred capital loss on each share.*

Example 2

14. *ParentCo and its wholly-owned subsidiaries SubCo and B Co are members of a linked group within the meaning of section 170-260 of the ITAA 1997. ParentCo owns all the shares in SubCo and B Co. All of these entities are Australian resident companies.*

15. *In November 1999, ParentCo disposed of all its shares in SubCo 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. ParentCo is the originating company in respect of this deferral event. This is what the linked group looks like just after the deferral event:



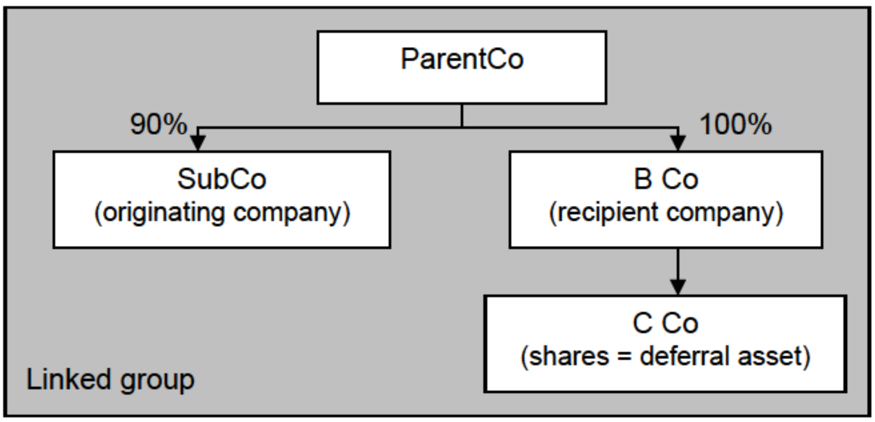
16. *ParentCo chooses to form a consolidated group with effect from 1 July 2002. The group comprises all of the above companies.*

17. *In May 2004, SubCo is deregistered and, as a result, a new event happens under paragraph 170-275(1)(a) of the ITAA 1997. ParentCo, as the actual originating company for the deferral event, will therefore be taken to have made a capital loss just before SubCo is deregistered, for an amount equal to the original deferred capital loss on each share.*

Example 3

18. *ParentCo owns all the shares in B Co. It also owns 90% of the shares in SubCo which has a wholly owned subsidiary, C Co. All of these entities are Australian resident companies.*

19. *In November 2000, SubCo disposed of all its shares in C 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. SubCo is the originating company in respect of this deferral event. This is what the linked group looks like just after the deferral event:*



20. *ParentCo chooses to form a consolidated group with effect from 1 July 2002. The consolidated group comprises only ParentCo, B Co and C Co. The originating company, SubCo, does not become a member of the consolidated group but remains a member of the linked group.*

21. *In May 2004, C Co is deregistered and a new event happens under paragraph 170-275(1)(a) of the ITAA 1997. In this example, the entity entitled to recognise the deferred loss (SubCo) is not a member of the consolidated group. Therefore, neither the single entity rule nor this Determination apply. But SubCo will be taken to have made a capital loss just before C Co is deregistered, for an amount equal to the original deferred capital loss on each share.*

Date of Effect

22. 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

23. 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**
Contact officer:	**Angela Jankovic**
E-mail address:	**angela.jankovic@ato.gov.au**
Telephone:	**(07) 3213 5822**
Facsimile:	**(07) 3213 5971**
Address:	**GPO Box 9990**
	Brisbane Qld 4000

Commissioner of Taxation
6 October 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20; TR 2004/11; TD 2000/7; TD 2004/D68

Subject references:

- capital gains tax
- capital losses
- consolidation
- deferral event
- deferred capital losses and deductions
- disregarded capital loss
- linked group
- new event
- originating company
- relevant CGT asset
- single entity rule

Legislative references:

- TAA 1953 Pt IVAAA

- ITAA 1997 Pt 3-5
- ITAA 1997 Subdiv 170-D
- ITAA 1997 170-255
- ITAA 1997 170-255(1)(a)
- ITAA 1997 170-260
- ITAA 1997 170-270
- ITAA 1997 170-270(1)
- ITAA 1997 170-275
- ITAA 1997 170-275(1)
- ITAA 1997 170-275(1)(a)
- ITAA 1997 701-1
- ITAA 1997 701-85
- ITAA 1997 Subdiv 715-D
- Corporations Act 2001

ATO references

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