

TD 2004/D72 - Income tax: consolidation: capital gains: to which entity does a CGT event happen, and when, if a contract to sell a CGT asset entered into by an entity before it joins a consolidated group as a subsidiary member settles after joining?

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Draft Taxation Determination

Income tax: consolidation: capital gains: to which entity does a CGT event happen, and when, if a contract to sell a CGT asset entered into by an entity *before* it joins a consolidated group as a subsidiary member settles *after* joining?

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 IVA of the **Taxation Administration Act 1953**. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. CGT event A1 in section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997) happens to the subsidiary at the time the subsidiary entered into the contract.
2. The disposal of the asset on settlement of the contract after the subsidiary has joined the consolidated group is not attributed to the head company under the single entity rule in section 701-1 of the ITAA 1997. Likewise, the head company does not inherit, under the entry history rule in section 701-5, the subsidiary's history in relation to the signing of the contract. Those rules do not apply to cause a CGT event to happen to the head company prior to the subsidiary becoming a member of the group.
3. An alternative view is that the single entity and entry history rules do apply in respect of the transaction and CGT event A1 therefore happens to the head company at the contract time. However, those rules only apply for the income tax purposes of the head company and subsidiary in respect of a period during which the subsidiary is a member of the group (or a later income year).

Working out the capital gain or loss

4. Because the CGT event happens to the subsidiary before it joins the consolidated group, any resulting capital gain or loss is taken into account in working out the subsidiary's net capital gain or loss for the subsidiary's income year in which the CGT event happened. Generally, it will relate to the subsidiary's final income tax return before the joining time.

5. In working out its capital gain or loss, the subsidiary uses the asset's historical cost base and reduced cost base, rather than any tax cost set under the tax cost setting rules. This is because the event happens to the subsidiary before it joins the group. The tax cost setting rules are therefore not relevant in working out the capital gain or loss as their object is limited to recognising the tax cost of assets to the head company: subsection 701-10(3) of the ITAA 1997.

6. Relevant costs and expenditure incurred by the subsidiary after it joins the group may be added to the subsidiary's cost base and reduced cost base for the asset used in working out the subsidiary's capital gain or loss. These costs and expenditure are not attributable to the head company under the single entity rule because they are relevant to the subsidiary's income tax liability or loss in relation to a period before it joins the group.

7. On that same basis, the sale proceeds received by the subsidiary on settlement form part of the subsidiary's capital proceeds for the purpose of working out its capital gain or loss.

Application

8. This Determination does not apply if the subsidiary is a member of a consolidated group at the contract time. For example, one consolidated group (the target) is acquired by another group and, at the acquisition time, a subsidiary member of the target group is a party to an uncompleted sale contract. Further consideration is being given to these matters.

Example

9. *On 16 June 2004, X Co enters into a contract to sell a block of land for \$200k. The land has a cost base of \$100k and a market value of \$200k.*

10. *On 10 July 2004, Head Co acquires all of the shares in X Co which causes X Co to become a member of Head Co's consolidated group.*

11. *On 30 July 2004, the contract settles and X Co ceases to be the legal owner of the land.*

12. *CGT event A1 happens to X Co on 16 July 2004 when it entered into the contract. X Co makes a capital gain of \$100k.*

Date of Effect

13. 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

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

15. We are developing our views on the tax cost setting issues arising in the above scenario. They include the relevant asset or assets (see Taxation Ruling TR 2004/13 about assets) and the application of the tax cost setting steps in Division 705 of the ITAA 1997. We are also considering the potential application of CGT events in Subdivision 104-L of the ITAA 1997. Therefore, any comments and submissions on these and other related issues are also welcome.

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Previous draft:
Not previously issued in draft form

- net capital loss
- single entity rule
- subsidiary member

Related Rulings/Determinations:
TR 92/20; TR 2004/13

Legislative references:

Subject references:

- capital gains
- CGT event A1
- consolidated group
- entry history rule
- head company
- membership interest
- net capital gain

- TAA 1953 Pt IVAAA
- ITAA 1997 104-10
- ITAA 1997 Subdiv 104-L
- ITAA 1997 701-1
- ITAA 1997 701-5
- ITAA 1997 701-10(3)
- ITAA 1997 Div 705

ATO references
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