TD 2005/D1 - Income tax: capital gains: if there is a change in the majority underlying interests in an asset owned by an entity, does the entity's ownership of the asset start from the change in majority underlying interests for the purpose of applying the tests in paragraphs 152-110(1)(b) and (c) of the Income Tax Assessment Act 1997?

This document has been finalised by TD 2005/13.

Draft Taxation Determination

Income tax: capital gains: if there is a change in the majority underlying interests in an asset owned by an entity, does the entity's ownership of the asset start from the change in majority underlying interests for the purpose of applying the tests in paragraphs 152-110(1)(b) and (c) of the *Income Tax Assessment Act 1997*?

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. No. For the purpose of the small business 15-year exemption in Subdivision 152-B of the *Income Tax Assessment Act 1997* (ITAA 1997), the period of ownership of the CGT asset does not start from the time of the change in majority underlying interests in the asset. The period starts from the time the asset was originally acquired by the entity.

Explanation

2. For a company or a trust to be eligible for the small business 15-year exemption the conditions in section 152-110 of the ITAA 1997 must be satisfied. In particular, the entity must have continuously owned the CGT asset for the 15-year period ending just before the CGT event (paragraph 152-110(1)(b) of the ITAA 1997). As well, at all times during the whole period for which the entity owned the asset, the entity must have had a controlling individual (even if it was not the same controlling individual): paragraph 152-110(1)(c) of the ITAA 1997.

3. Under subsection 149-30(1) of the ITAA 1997 an asset of a non-public entity stops being a pre-CGT asset if the majority underlying interests in the asset are '*not* had' by ultimate owners who had those interests immediately before 20 September 1985. In such a case the entity is taken to have acquired the asset when the change in majority underlying interests occurred.

4. Although section 149-30 deems that an entity's *acquisition* of the asset occurs at a later time, it does not change the entity's actual period of *ownership* of the asset. The entity has still owned the asset from the time it originally acquired it. As such, the entity's ownership of the asset prior to the change in majority underlying interests is relevant in determining whether the entity has met the tests in paragraphs 152-110(1)(b) and (c) of the ITAA 1997.

5. Accordingly, for the purposes of the 15-year continuous ownership test in paragraph 152-110(1)(b) of the ITAA 1997, the entity's ownership period starts when the entity actually acquired the asset (and does not restart at the time of the change in majority underlying interests in the asset). This means an entity that has a change in majority underlying interests is not disadvantaged in relation to its pre-CGT assets if it later seeks to apply the 15-year exemption.

6. Similarly, but this time not to the entity's advantage, for the purposes of the controlling individual test in paragraph 152-110(1)(c) of the ITAA 1997 the entity must have a controlling individual at all times during the period of the entity's actual ownership of the asset (and not just for the period following the change in majority underlying interests in the asset).

Example 1

7. *X Co acquired land and buildings in 1972 and operated a business from those premises from that time. X Co had 2 equal shareholders, A and B. All shares issued by X Co had the same rights. Accordingly, A and B were both controlling individuals of X Co under subsection 152-55(1) of the ITAA 1997.*

8. *On 30 March 2003, C and D acquired the shareholdings of A and B and held them in equal shares. As such, C and D became controlling individuals of X Co from that time. This also caused a change in the majority underlying interests in the business premises with the effect that the premises stopped being a pre-CGT asset of X Co under Division 149 of the ITAA 1997.*

9. *On 30 March 2005, X Co sold the business premises and made a capital gain. X Co has continuously owned the premises from 1972 to 30 March 2005 (more than 15 years) and accordingly satisfies paragraph 152-110(1)(b) of the ITAA 1997. X Co has also had at all times during the whole period it owned the premises at least one controlling individual (although not the same controlling individual throughout). Paragraph 152-110(1)(c) of the ITAA 1997 is therefore also satisfied.*

10. *Accordingly, the 15-year exemption will be available if the other conditions for the exemption are satisfied.*

11. *Note: If the relevant ownership period for the purpose of applying paragraphs 152-110(1)(b) and (c) of the ITAA 1997 did restart at the time of the change in majority underlying interests in the business premises, the 15-year exemption would not be available in this case because X Co would have continuously owned the premises for only 2 years (from 30 March 2003 to 30 March 2005).*

Example 2

12. *Y Co acquired land and buildings in 1980 and operated a business from those premises from that time. Y Co originally had 4 equal shareholders, A, B, C and D. All shares issued by Y Co had the same rights. Accordingly, Y Co did not have a controlling individual under subsection 152-55(1) of the ITAA 1997.*

13. *On 30 March 1988, A and B acquired the shareholdings of C and D. This resulted in A and B each increasing their shareholdings in Y Co from 25% to 50% and each becoming a controlling individual of Y Co from that time. It also resulted in a change in the majority underlying interests in the business premises with the effect that the premises stopped being a pre-CGT asset of Y Co under Division 149 of the ITAA 1997.*

14. *On 30 March 2005, Y Co sold the business premises and made a capital gain. Y Co has continuously owned the premises from 1980 to 30 March 2005 (more than 15 years) and accordingly satisfies paragraph 152-110(1)(b) of the ITAA 1997. However, Y Co did not have a controlling individual at all times during the whole period it owned the premises. In particular, it did not have a controlling individual from when it first acquired the premises to when there was a change in the majority underlying interests in the premises (that is, from 1980 to 30 March 1988).*

15. *Paragraph 152-110(1)(c) of the ITAA 1997 is therefore not satisfied and the 15-year exemption is not available.*

16. *Note: If the relevant ownership period for the purpose of applying paragraphs 152-110(1)(b) and (c) of the ITAA 1997 did restart at the time of the change in majority underlying interests in the business premises, the 15-year exemption would have been available in this case. This is because Y Co would have continuously owned the premises for at least 15 years (that is, from 30 March 1988 to 30 March 2005) and would have had a controlling individual at all times during the whole period it owned the premises (again from 30 March 1988 to 30 March 2005).*

Example 3

17. *Z Co acquired land and buildings in 1982 and operated a business from those premises from that time. Z Co originally had 3 equal shareholders, A, B, and C. All shares issued by Z Co had the same rights. Accordingly, Z Co did not have a controlling individual under subsection 152-55(1) of the ITAA 1997.*

18. *On 30 March 2002, D and E acquired the shareholdings of A, B and C. This resulted in D and E each acquiring a 50% shareholding in Z Co and each becoming a controlling individual of Z Co from that time. It also resulted in a change in the majority underlying interests in the business premises with the effect that the premises stopped being a pre-CGT asset of Z Co under Division 149 of the ITAA 1997.*

19. *On 30 March 2005, Z Co sold the business premises and made a capital gain. Z Co has continuously owned the premises from 1982 to 30 March 2005 (more than 15 years) and accordingly satisfies paragraph 152-110(1)(b) of the ITAA 1997. However, Z Co did not have a controlling individual at all times during the whole period it owned the premises. In particular, it did not have a controlling individual from when it first acquired the premises to when there was a change in the majority underlying interests in the premises (that is, from 1982 to 30 March 2002).*

20. *Paragraph 152-110(1)(c) of the ITAA 1997 is therefore not satisfied and the 15-year exemption is not available.*

21. *Note: If the relevant ownership period for the purpose of applying paragraphs 152-110(1)(b) and (c) of the ITAA 1997 did restart at the time of the change in majority underlying interests in the business premises, the 15-year exemption would not be available in this case. This is because Z Co would have continuously owned the premises for only 3 years (from 30 March 2002 to 30 March 2005) even though it would have had a controlling individual at all times during the whole period it owned the premises.*

Date of Effect

22. The Tax Office previously expressed the view at the June 2001 NTLG CGT Subcommittee meeting that if a change in the majority underlying interests in an asset happens, the relevant ownership period for paragraph 152-110(1)(c) purposes restarts. The Tax Office has now revised its view as set out in this Draft Determination.

23. Accordingly, it is proposed to apply the view in this Determination only to CGT events that happen on or after the date of issue of the final Determination. For CGT events happening before the date of issue of the final Determination, taxpayers may choose whichever view is more favourable to them but must adopt the same view for both paragraph 152-110(1)(b) and paragraph 152-110(1)(c) purposes.

24. The change was foreshadowed by the Tax Office at the June 2004 NTLG CGT Subcommittee meeting.

Your comments

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

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Commissioner of Taxation
12 January 2005

Previous draft:
Not previously issued in draft form

Subject references:
- capital gains
- capital gains tax
- CGT asset
- controlling individual
- majority underlying interests
- pre-CGT asset
- small business 15-year exemption
- small business relief
- ultimate owners

Legislative references:
- ITAA 1997 Div 149
- ITAA 1997 149-30
- ITAA 1997 149-30(1)
- ITAA 1997 152-55(1)

- ITAA 1997 Subdiv 152-B
- ITAA 1997 152-110
- ITAA 1997 152-110(1)(b)
- ITAA 1997 152-110(1)(c)
- TAA 1953 Pt IVAAA

ATO references

NO: 2004/15001
ISSN: 1038-8982