TD 2010/D6 - Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, after the member leaves the group?

This cover sheet is provided for information only. It does not form part of *TD 2010/D6 - Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the Income Tax Assessment Act 1997 prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, after the member leaves the group?*

This document has been finalised by TD 2011/10.

There is a Compendium for this document: **TD 2011/8EC; TD 2011/9EC; TD 2011/10EC** .

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Draft Taxation Determination

Income tax: consolidation: capital gains: does paragraph 40-880(5)(f) of the *Income Tax Assessment Act 1997* prevent the deduction, under section 40-880 of that Act, of incidental costs described in subsection 110-35(2) of that Act that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, after the member leaves the group?

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Ruling

1. Yes. Paragraph 40-880(5)(f) of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] does prevent the deduction, under section 40-880, of incidental costs described in subsection 110-35(2) that the head company of a consolidated group or MEC group incurs, in disposing of shares in a subsidiary member to a non-group entity, after the member leaves the group (that is, ceases to be a member of the group).

Application

2. This draft Determination does not apply to the extent (if any) that the incidental costs mentioned in paragraph 1 of this draft Determination are remuneration to a member of the group.

[1] All legislative references are to the ITAA 1997 unless otherwise indicated.

Example

3. *H Co is the head company of a consolidated group of which another company, Sub Co, is a subsidiary member. H Co's shareholding in Sub Co consists of 2,000 shares, all of the same class.*

4. *H Co sells 500 of the Sub Co shares to a non-group entity for $175,000 ($350 per share). As a result, Sub Co leaves the group.*

5. *Just before the leaving time, H Co calculates the tax cost setting amount for each of the group's membership interests in Sub Co in accordance with section 711-15. The tax cost setting amount for each of H Co's shares in Sub Co is $220 and this amount forms the cost base or reduced cost base of each of the membership interests for CGT purposes just before the leaving time.*

6. *After Sub Co leaves the group, H Co incurs a liability to pay legal fees of $5,000 to an entity outside the group in relation to the sale of the shares.*

7. *The legal fees are incidental costs as described in subsection 110-35(2). The legal fees form part of the second element of the cost base of the shares disposed of and therefore could be taken into account in working out the amount of the capital gain from the CGT event A1 that happens on the sale of these shares. After including the incidental costs, the cost base of each share sold is $230.*

8. *As the legal fees could be taken into account in working out the amount of the capital gain on the sale of the shares, paragraph 40-880(5)(f) prevents any deduction for the fees that would otherwise be available under section 40-880.*

Date of effect

9. 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 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
17 November 2010

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

10. Section 40-880 allows certain business capital expenditure to be deducted in equal proportions over five income years. However, paragraph 40-880(5)(f) prevents an amount of expenditure from being deductible under section 40-880 to the extent the expenditure could be taken into account in working out the amount of a capital gain or capital loss from a CGT event.

11. Under the single entity rule (SER) in subsection 701-1(1), an entity that is a subsidiary member of a consolidated group or MEC group for any period is taken to be part of the head company, and as a result the shares in the subsidiary member held by the group are not recognised. If a subsidiary member leaves the group the head company recognises the shares just before the leaving time

12. Where some or all of the shares in a subsidiary member of a consolidated group are disposed of to an entity outside the group, CGT event A1[2] happens and the subsidiary member leaves the group.[3] Just before the subsidiary member leaves the group, subsection 701-15(3) sets the tax costs of the shares (and any other membership interests) held by the head company in the leaving entity to their tax cost setting amounts as determined under Division 711.

13. Under subsection 701-55(5), the cost base or reduced cost base of each of the shares (or other membership interests) is set to its tax cost setting amount just before the leaving time for CGT purposes.[4]

14. Incidental costs are defined in section 110-35. The incidental costs described by subsection 110-35(2) that a taxpayer incurs that relate to a CGT event are included in the second element of the cost base or reduced cost base of the CGT asset under subsections 110-25(3) or 110-55(2) respectively.

15. While the cost base or reduced cost base of each of the membership interests held by the head company in a leaving entity is established just before the leaving time as described in paragraphs 12 to 13 of this draft Determination, this does not prevent an amount of incidental costs being included in the second element of that cost base or reduced cost base where the expenditure is incurred after the member has left the group.

16. Therefore, the incidental costs the head company incurred in disposing of its shares in the subsidiary member to a non-group entity after the subsidiary member left the group could be taken into account in working out the amount of any capital gain or capital loss from a CGT event, and paragraph 40-880(5)(f) prevents any deduction for the incidental costs that would otherwise be available under section 40-880.

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[2] Section 104-10

[3] The subsidiary member ceases to be a member because it no longer meets the requirement, in subsection 703-15(2), to be a wholly-owned subsidiary of the head company.

[4] See *Handbury Holdings Pty Ltd v. Federal Commissioner of Taxation* (2009) 179 FCR 569; [2009] FCAFC 141; 2009 ATC 20-136 at paragraphs 17 and 45.

Appendix 2 – Your comments

17. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

18. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Australian Taxation Office website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **17 December 2010**

Contact officer: **Shirley Cooper-Dixon**

Email address: **shirley.cooper-dixon@ato.gov.au**

Telephone: **(08) 9268 6535**

Facsimile: **(08) 9268 5250**

Address: **Australian Taxation Office**
GPO Box 9977
Northbridge WA 6848

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10
TD 2010/1

Subject references:

- blackhole expenditure
- capital expenditure
- capital gains tax
- CGT cost base
- consolidation
- cost setting rules
- leaving entity
- membership interest in an entity
- single entity rule
- tax cost setting rules

Legislative references:

- ITAA 1997
- ITAA 1997 40-880
- ITAA 1997 40-880(5)(f)
- ITAA 1997 104-10
- ITAA 1997 110-25(3)
- ITAA 1997 110-35
- ITAA 1997 110-35(2)
- ITAA 1997 110-55(2)
- ITAA 1997 701-1(1)
- ITAA 1997 701-15(3)
- ITAA 1997 701-55(5)
- ITAA 1997 703-15(2)
- ITAA 1997 Div 711
- ITAA 1997 711-15

Case references:

- Handbury Holdings Pty Ltd v. Federal Commissioner of Taxation (2009) 179 FCR 569; [2009] FCAFC 141; 2009 ATC 20-136

ATO references

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