TD 2004/D18 - Income tax: consolidation: capital gains: for the purposes of Subdivision 125-C of the Income Tax Assessment Act 1997, can the head company of a consolidated group meet the requirements of a demerging entity in subsection 125-70(7) where, under a demerger, the shares held in a subsidiary member of a group are transferred to the head company's shareholders?

This cover sheet is provided for information only. It does not form part of *TD 2004/D18 - Income tax: consolidation: capital gains: for the purposes of Subdivision 125-C of the Income Tax Assessment Act 1997, can the head company of a consolidated group meet the requirements of a demerging entity in subsection 125-70(7) where, under a demerger, the shares held in a subsidiary member of a group are transferred to the head company's shareholders?*

This document has been finalised by TD 2004/48.

Draft Taxation Determination

Income tax: consolidation: capital gains: for the purposes of Subdivision 125-C of the *Income Tax Assessment Act 1997*, can the head company of a consolidated group meet the requirements of a *demerging entity* in subsection 125-70(7) where, under a demerger, the shares held in a subsidiary member of a group are transferred to the head company's shareholders?

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. The head company of the consolidated group can satisfy the requirements of a *demerging entity* in subsection 125-70(7) of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. Section 125-155 of the ITAA 1997 disregards any capital gains or capital losses made by demerging entities when certain CGT events happen to their ownership interests in the entity being demerged (the 'demerged entity').

3. To be a demerging entity, an entity must satisfy the requirements contained in subsection 125-70(7) of the ITAA 1997. One of the conditions is that the entity is a member of a demerger group *just before (emphasis added)* the relevant CGT event happens to its ownership interests in the demerged entity. Under subsection 125-65(1) of the ITAA 1997, the membership of a demerger group is made up of a head entity and one or more demerger subsidiaries.

4. When the entity being demerged is a member of a consolidated group, there is an issue regarding the interaction of the demerger provisions with the single entity rule in section 701-1 of the ITAA 1997. Under the single entity rule, the subsidiary members of a consolidated group are treated as parts of the head company, rather than separate entities, for income tax purposes.

5. It has been argued that the operation of the single entity rule would effectively deny CGT relief where a demerger occurs within a consolidated group. This is on the basis that the single entity rule prevents the recognition of any demerger subsidiaries and therefore the demerger group. We do not agree.

6. In our view, the single entity rule does not prevent recognition of the group's membership interest in the demerged subsidiary just before the relevant CGT event happens. The head company can meet the requirements of a demerging entity in subsection 125-70(7) of the ITAA 1997. It should be noted that the single entity rule has no application in determining the eligibility of *non-group members* (for example, shareholders of the head company) for demerger relief.

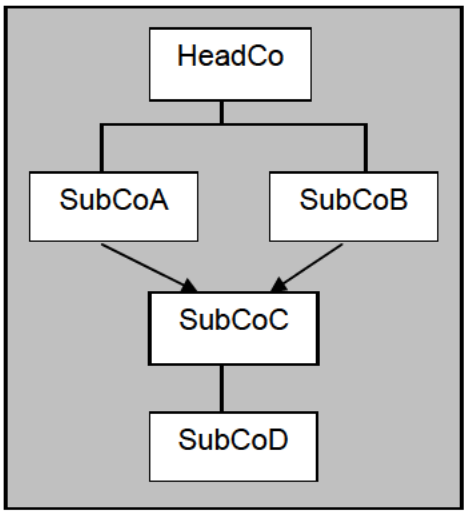
Example

7. *HeadCo is the head company of a consolidated group. The subsidiary members of the consolidated group include two Australian resident companies, SubCoA and SubCoB, each of which is wholly-owned by HeadCo. SubCoA and SubCoB also own, in equal proportions, all of the shares in SubCoC. SubCoC owns all of the ownership interests in SubCoD.*

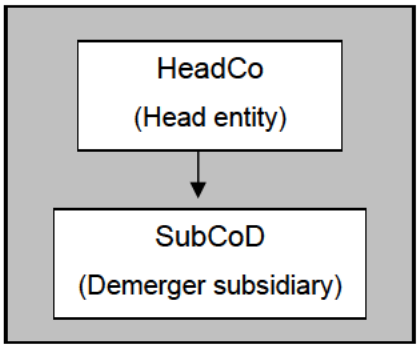
8. *In December 2003, SubCoC demerges all of its interests in SubCoD. Under the restructure, SubCoC's ownership interests in SubCoD are transferred to HeadCo's shareholders, in proportion to their existing shareholding in the head company.*

9. *The relevant consolidated group and demerger group is shown below:*

Consolidated group



Demerger group



10. *In this example, there is a demerger group consisting of HeadCo and SubCoD. HeadCo is the head entity as no other member of the demerger group owns ownership interests in it: subsection 125-65(3) of the ITAA 1997. SubCoD is a demerger subsidiary because, by virtue of the single entity rule applying to the other subsidiary members, HeadCo has the right to receive more than 20% of any distribution of income or capital by SubCoD: subsection 125-65(6) of the ITAA 1997.*

11. *HeadCo would also meet the requirements of a demerging entity under subsection 125-70(7) of the ITAA 1997 as:*

- *it is a member of a demerger group just before the relevant CGT event happens to the ownership interest in SubCoD; and*
- *by virtue of the single entity rule, HeadCo is taken to have disposed of at least 80% of its ownership interests in SubCoD to its own shareholders under the demerger.*

12. *As HeadCo is a demerging entity, and the restructure of SubCoD satisfies the requirements of a demerger, a capital gain or capital loss made by HeadCo from CGT event A1 happening on the transfer of interests held in SubCoD is disregarded under section 125-155 of the ITAA 1997.*

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.

Due date: **30 July 2004**

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Commissioner of Taxation
30 June 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20

Subject references:

- capital gains tax
- CGT exemptions
- consolidation
- consolidation – capital gains tax
- demerger
- demerger group
- demerger subsidiary
- head entity
- single entity rule

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 125-65(1)
- ITAA 1997 125-65(3)
- ITAA 1997 125-65(6)
- ITAA 1997 125-70(7)
- ITAA 1997 Subdiv 125-C
- ITAA 1997 125-155
- ITAA 1997 701-1

ATO references
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