

TD 2004/D26 - Income tax: consolidation: capital gains: does section 104-530 (CGT event L7) of the Income Tax Assessment Act 1997 apply to amounts of a liability that accrue after the time that the entity with the liability joins a consolidated group?

 This cover sheet is provided for information only. It does not form part of *TD 2004/D26 - Income tax: consolidation: capital gains: does section 104-530 (CGT event L7) of the Income Tax Assessment Act 1997 apply to amounts of a liability that accrue after the time that the entity with the liability joins a consolidated group?*

This document has been finalised by TD 2004/64.



Draft Taxation Determination

Income tax: consolidation: capital gains: does section 104-530 (CGT event L7) of the *Income Tax Assessment Act 1997* apply to amounts of a liability that accrue after the time that the entity with the liability joins a consolidated group?

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. Section 104-530 (CGT event L7) of the *Income Tax Assessment Act 1997* (ITAA 1997) does not apply to amounts of a liability that accrue after the time the relevant entity joins a consolidated group.
2. Under CGT event L7, if a liability taken into account in working out the allocable cost amount (ACA) for an entity that joins a consolidated group is later discharged for a different amount (realised amount), the head company may make a capital gain or loss. A capital gain will arise if the ACA would have been smaller had the realised amount been taken into account in working out the ACA. Alternatively, a capital loss will arise if the ACA would have been greater had the realised amount been taken into account in working out the ACA.
3. One of the conditions that must be satisfied in order for CGT event L7 to happen is that the liability was taken into account in working out the ACA for an entity that became a subsidiary member of the consolidated group. It is only the amount of the liability that accrued up to the joining time that can be 'taken into account' in working out the ACA.
4. According to paragraph 5.36 of the Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No.2) 2002, CGT event L7 accounts for 'any difference that using the eventual amount of the liability would have made to the ACA'. In the absence of such an adjustment mechanism, permanent differences may be embedded in the cost base and other tax costs of assets by the cost setting process (Division 705 of the ITAA 1997).

5. The amount of an accounting liability of an entity at the time it joins a consolidated group is generally included in the ACA for that entity. The ACA for the entity is used in determining the tax cost setting amounts for assets of the joining entity (see sections 701-10, 701-60 and 701-55 of the ITAA 1997). It is through this process that an amount in respect of the liability is embedded in the cost bases and other tax costs of the joining entity's assets. CGT event L7 compensates for the tax effect of embedding what turns out to be an incorrect tax cost setting amount albeit one that was accurately calculated at the joining time. In effect, it prevents under-taxation and over-taxation from the tax cost setting process.

6. An amount of a liability that accrues after the joining time (for example new liabilities or increases that accumulate to a liability that existed at the joining time) does not factor into the ACA calculation or the cost base or other tax costs of the joining entity's assets. Consequently there is no need for CGT event L7 to apply to such amounts.

7. The reference in paragraph 104-530(3)(b) of the ITAA 1997 to the discharge of *the* liability for a different amount is to be construed as a reference to *the* liability that was in existence at the joining time and not to the discharge of amounts that have accrued to that liability from that point in time.

8. Whether or not an amount of a liability accrued after the joining time or was taken into account in working out the ACA for a subsidiary member are questions of fact and the outcomes of which depend on the circumstances of each case.

Example

9. Subco has a liability of \$50,000.00 for the provision of long service leave at the joining time. This amount is taken into account in working out the ACA for Subco. One year later the liability is discharged by Headco for \$55,000.00. The additional \$5,000.00 was due to extra employment services undertaken by the employees of Subco during that year.

10. As the additional \$5,000.00 is an amount that 'accrued' after the joining time as a consequence of additional employment services that were undertaken after that point in time, CGT event L7 does not apply.

Date of Effect

11. 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

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

Due date: **13 August 2004**

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Commissioner of Taxation
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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20

Subject references:

- accounting liabilities
- CGT event
- CGT event L7
- consolidation
- consolidation – capital gains tax
- discharge of liabilities
- liabilities

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 104-530
- ITAA 1997 104-530(3)(b)
- ITAA 1997 Div 705
- ITAA 1997 701-10
- ITAA 1997 701-55
- ITAA 1997 701-60

Other references:

- Explanatory Memorandum to the New Business Tax System (Consolidation and Other Measures) Bill (No.2) 2002
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ATO references

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