



New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002

Act No. 90 of 2002 as amended

This compilation was prepared on 17 July 2003

**[This Act was amended by Act No. 117 of 2002 and
Act Nos. 16 and 67 of 2003]**

Amendments from Act No. 117 of 2002

[Schedule 15 (items 2–4) amends Schedule 10

Schedule 15 (items 2 to 4) commenced on 24 October 2002]

Amendments from Act No. 16 of 2003

[Schedule 18 added item 11 to Schedule 10

Schedule 18 commenced on 24 October 2002]

Amendments from Act No. 67 of 2003

[Schedule 8 (item 1) amended Schedule 15 (item 1)

Schedule 8 (item 2) amended Schedule 15 (item 2)

Schedule 8 (items 1 and 2) commenced on 30 June 2003]

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Contents

| | | |
|---|--|-----------|
| 1 | Short title..... | 1 |
| 2 | Commencement..... | 1 |
| 3 | Schedule(s)..... | 2 |
| 4 | Amendment of income tax assessments | 2 |
| Schedule 1—Consolidation: membership rules | | 3 |
| | <i>Income Tax Assessment Act 1997</i> | 3 |
| Schedule 2—Consolidation: miscellaneous changes to asset cost provisions | | 4 |
| | <i>Income Tax Assessment Act 1997</i> | 4 |
| Schedule 3—Consolidation: new Subdivision 705-B (tax cost setting amount on group formation) | | 14 |
| | <i>Income Tax Assessment Act 1997</i> | 14 |
| Schedule 4—Consolidation: reset cost base assets held on revenue account | | 24 |
| | <i>Income Tax Assessment Act 1997</i> | 24 |
| Schedule 5—Consolidation: imputation | | 25 |
| | <i>Income Tax Assessment Act 1997</i> | 25 |
| Schedule 6—Consolidation: international tax | | 26 |
| | <i>Income Tax Assessment Act 1997</i> | 26 |
| Schedule 7—Consolidation: application and transitional asset cost provisions | | 42 |
| | <i>Income Tax (Transitional Provisions) Act 1997</i> | 42 |
| Schedule 8—Consolidation: amendment of transitional provisions for losses | | 56 |
| | <i>Income Tax (Transitional Provisions) Act 1997</i> | 56 |

| | |
|--|-------------------------------------|
| Schedule 9—Consolidation: transitional provisions for international tax | 58 |
| <i>Income Tax (Transitional Provisions) Act 1997</i> | 58 |
| Schedule 10—Consolidation: consequential provisions for international tax | 61 |
| <i>Income Tax Assessment Act 1936</i> | 61 |
| Schedule 11—Consolidation: amendment of transitional provision about limiting access to group concessions | 63 |
| <i>New Business Tax System (Consolidation) Act (No. 1) 2002</i> | 67 |
| Schedule 12—Consolidation: amendments of Dictionary | 68 |
| <i>Income Tax Assessment Act 1997</i> | 68 |
| Schedule 13—Exempting entities and former exempting entities | 69 |
| <i>Income Tax Assessment Act 1997</i> | 69 |
| Schedule 14—Loss integrity rules: global method of valuing assets | 121 |
| Part 1—Income Tax Assessment Act 1997 | 121 |
| Part 2—Income Tax (Transitional Provisions) Act 1997 | Error! Bookmark not defined. |
| Part 3—Dictionary amendments | Error! Bookmark not defined. |
| <i>Income Tax Assessment Act 1997</i> | 136 |
| Part 4—Application of amendments | Error! Bookmark not defined. |
| Schedule 15—Value shifting | 138 |
| Part 1—New Divisions inserted in the Income Tax Assessment Act 1997 | Error! Bookmark not defined. |
| Part 2—Amendment of the Income Tax (Transitional Provisions) Act 1997 | Error! Bookmark not defined. |

| | |
|---|-------------------------------------|
| Part 3—Consequential amendment of the Income Tax Assessment Act 1997 | Error! Bookmark not defined. |
| Division 1—Amendments | 256 |
| Division 2—Saving and transitional provisions | Error! Bookmark not defined. |
| Part 4—Consequential amendment of the Income Tax Assessment Act 1936 | Error! Bookmark not defined. |
| Part 5—Dictionary amendments | Error! Bookmark not defined. |
| <i>Income Tax Assessment Act 1997</i> | 260 |
| Schedule 16—Demerger relief | 276 |
| Part 1—CGT relief | Error! Bookmark not defined. |
| <i>Income Tax Assessment Act 1997</i> | 276 |
| Part 2—Dividend relief | Error! Bookmark not defined. |
| <i>Income Tax Assessment Act 1936</i> | 294 |
| Part 3—Consequential amendments | Error! Bookmark not defined. |
| <i>Income Tax Assessment Act 1997</i> | 302 |
| Part 4—Transitional | Error! Bookmark not defined. |
| Part 5—Application | Error! Bookmark not defined. |

An Act about income tax to implement a New Business Tax System, and for related purposes

[Assented to 24 October 2002]

The Parliament of Australia enacts:

1 Short title

This Act may be cited as the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*.

2 Commencement

- (1) Each provision of this Act specified in column 1 of the table commences, or is taken to have commenced, on the day or at the time specified in column 2 of the table.

| Commencement information | | |
|---|---|---------------------|
| Column 1 | Column 2 | Column 3 |
| Provision(s) | Commencement | Date/Details |
| 1. Sections 1 to 4 and anything in this Act not elsewhere covered by this table | The day on which this Act receives the Royal Assent | 24 October 2002 |
| 2. Schedules 1 to 12 | Immediately after the commencement of the <i>New Business Tax System (Consolidation) Act (No. 1) 2002</i> | 24 October 2002 |
| 3. Schedule 13 | Immediately after the commencement of the <i>New Business Tax System (Imputation) Act 2002</i> | 29 June 2002 |
| 4. Schedules 14 and 15 | Immediately after the commencement of the <i>New Business Tax System (Consolidation) Act (No. 1) 2002</i> | 24 October 2002 |
| 5. Schedule 16 | The day on which this Act receives the Royal Assent | 24 October 2002 |

Section 3

Note: This table relates only to the provisions of this Act as originally passed by the Parliament and assented to. It will not be expanded to deal with provisions inserted in this Act after assent.

- (2) Column 3 of the table is for additional information that is not part of this Act. This information may be included in any published version of this Act.

3 Schedule(s)

Each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

4 Amendment of income tax assessments

Section 170 of the *Income Tax Assessment Act 1936* does not prevent the amendment of an assessment made before the commencement of this section for the purposes of giving effect to this Act.

Schedule 1—Consolidation: membership rules

Income Tax Assessment Act 1997

1 Subsection 703-20(2) (table item 4)

Repeal the item.

Schedule 2—Consolidation: miscellaneous changes to asset cost provisions

Income Tax Assessment Act 1997

1 At the end of subsection 701-25(4)

Add:

Note: As a consequence of fixing the trading stock's value at the end of the income year under this subsection, no election would be available under section 70-45 to value the trading stock at that time.

Note: The heading to subsection 701-25(4) is altered by omitting “*cost*” and substituting “*value*”.

2 Subsection 701-35(4)

After “ends”, insert “, or, if section 701-30 applies, of the income year that is taken by subsection (3) of that section to end.”

Note: The heading to subsection 701-35(4) is altered by omitting “*cost*” and substituting “*value*”.

3 At the end of subsection 701-35(4)

Add:

Note: As a consequence of fixing the trading stock's value at the end of the income year under this subsection, no election would be available under section 70-45 to value the trading stock at that time.

4 Subsection 701-55(6)

After “above”, insert “is to apply in relation to the asset”.

5 Paragraph 701-70(3)(a)

Repeal the paragraph, substitute:

- (a) the following income year (the *joining adjustment year*):
 - (i) if the combining entity is the *head company and the joining time occurs at the start of an income year—the income year before that income year; or

- (ii) if the combining entity is the head company and subparagraph (i) does not apply—the income year in which the joining time occurs; or
- (iii) in any other case—the income year that ends, or, if section 701-30 applies, the income year that is taken by subsection (3) of that section to end, at the joining time; and

6 Paragraphs 701-70(3)(c) and (d)

Omit “income year”, substitute “adjustment year”.

7 Subsection 701-70(5)

Omit “income year and”, substitute “adjustment year and”.

8 Paragraphs 701-70(5)(a) and (b)

Omit “income year”, substitute “adjustment year”.

9 Subparagraph 701-70(7)(b)(ii)

After “started”, insert “, or, if section 701-30 applies, the income year that is taken by subsection (3) of that section to have started,”.

10 Paragraph 701-75(3)(a)

Repeal the paragraph, substitute:

- (a) the following income year (the *leaving adjustment year*):
 - (i) if the separating entity is the *head company—the income year in which the leaving time occurs; or
 - (ii) in any other case—the income year that starts, or, if section 701-30 applies, the income year that is taken by subsection (3) of that section to start, at the leaving time.

11 Subsection 701-75(5)

Omit “income year”, substitute “adjustment year”.

12 Paragraph 701-80(3)(a)

Repeal the paragraph, substitute:

- (a) the entity *acquired, at or before 11.45 am, by legal time in the Australian Capital Territory, on 21 September 1999, a

*depreciating asset to which Division 40 applies and held the asset continuously until the entity became a *subsidiary member of the group; and

13 Subsection 705-30(3)

After “*depreciating asset”, insert “to which Division 40 applies”.

14 Paragraph 705-45(a)

Repeal the paragraph, substitute:

- (a) the joining entity *acquired, at or before 11.45 am, by legal time in the Australian Capital Territory, on 21 September 1999, a *depreciating asset to which Division 40 applies and held the asset continuously until the joining time; and

15 After paragraph 705-50(2)(a)

Insert:

- (aa) subsection (5) does not apply to the asset; and

16 Paragraph 705-50(3)(a)

After “franked dividends”, insert “or distributions included in the step 4 amount mentioned in step 4 in the table in section 705-60”.

17 Paragraph 705-50(6)(a)

After “*depreciating asset”, insert “to which Division 40 applies”.

18 Subsection 705-65(3)

Omit “the *members of the joined group had, just before the joining time, *disposed of their *membership interests in the joining entity”, substitute “a *CGT event had happened just before the joining time in relation to the *membership interest”.

19 Subsection 705-65(3)

Omit “the membership interests” (twice occurring), substitute “the membership interest”.

20 After subsection 705-65(3)

Insert:

Reduction if section 165-115ZD could apply

(3A) If, on the assumption that:

- (a) the *members of the joined group had, just before the joining time, *disposed of their *membership interest in the joining entity; and
- (b) the consideration received by the members for the disposal were equal to the *market value of the membership interest at that time;

the *reduced cost base of the membership interest would have been reduced as a result of the operation of section 165-115ZD of this Act or the *Income Tax (Transitional Provisions) Act 1997*, then the reduced cost base of the membership interest that is to be used in subsection (1) of this section is reduced by the amount of that reduction.

21 Subsection 705-65(4)

After “subsection (3)”, insert “or (3A)”.

22 Subsection 705-65(4)

After “*CGT event”, insert “or a *realisation event”.

23 After subsection 705-65(5)

Insert:

Reduction in reduced cost base under subsection 165-115ZA(3) to be added back

(5A) If:

- (a) in working out the *reduced cost base of the *membership interest for the purposes of subsection (1), a reduction has taken place under subsection 165-115ZA(3) (about alterations in ownership or control of loss companies); and
- (b) the reduction is to some extent attributable to so much of an amount that was taken into account both in working out the amount of the reduction and in working out:
 - (i) the step 5 amount under section 705-100; or
 - (ii) the step 6 amount under section 705-110;

the reduced cost base is, to the extent mentioned in paragraph (b), increased by:

- (c) if subparagraph (b)(i) applies—the amount of that reduction;
or
- (d) if subparagraph (b)(ii) applies—the amount of that reduction multiplied by the *general company tax rate.

24 Subsection 705-70(1) (note)

Repeal the note.

25 After subsection 705-70(1)

Insert:

Where liability valued differently for joined group

- (1A) However, if, in accordance with those *accounting standards or statements, the amount of an accounting liability of the joining entity would be different when it became an accounting liability of the joined group, the different amount is treated as the amount of the liability.

Note: Liabilities that the joining entity owes to members of the joined group would not be excluded under subsection (1) or (1A) even though the standards or statements require that they be eliminated in consolidated accounts of a parent entity and its subsidiaries.

26 Subsection 705-75(3)

Omit “and (4)”, substitute “, (3) and (3A)”.

Note: The heading to subsection 705-75(3) is altered by omitting “and (4)” and substituting “, (3) and (3A)”.

27 At the end of section 705-75

Add:

Application of subsection 705-65(4)

- (4) Subsection 705-65(4) applies in relation to assets mentioned in subsection (2) of this section in a corresponding way to that in which it applies in relation to members’ *membership interests.

Reduction in reduced cost base under subsection 165-115ZA(3) to be added back

- (5) If:
- (a) in working out the *reduced cost base of a *member's asset for the purposes of subsection (2), a reduction has taken place under subsection 165-115ZA(3) (about alterations in ownership or control of loss companies); and
 - (b) the reduction is to some extent attributable to so much of an amount that was taken into account both in working out the amount of the reduction and in working out:
 - (i) the step 5 amount under section 705-100; or
 - (ii) the step 6 amount under section 705-110;the reduced cost base is, to the extent mentioned in paragraph (b), increased by:
 - (c) if subparagraph (b)(i) applies—the amount of that reduction; or
 - (d) if subparagraph (b)(ii) applies—the amount of that reduction multiplied by the *general company tax rate.

28 Section 705-90

Repeal the section, substitute:

705-90 Undistributed, frankable profits accruing to joined group before joining time—step 3 in working out allocable cost amount

- (1) For the purposes of step 3 in the table in section 705-60, the step 3 amount is worked out in accordance with this section.

Undistributed profits

- (2) First work out the undistributed profits of the joining entity at the joining time. These are the amounts that, in accordance with *accounting standards, or statements of accounting concepts made by the Australian Accounting Standards Board, are retained profits of the joining entity that could be recognised in the joining entity's statement of financial position if that statement were prepared as at the joining time.

Extent to which dividends paid out of undistributed profits would be frankable

- (3) Then work out the extent to which the undistributed profits, if they had been distributed as dividends at the joining time, could have been franked in accordance with section 160AQF of the *Income Tax Assessment Act 1936* on the assumptions in subsection (4) of this section.

Assumptions for purposes of subsection (3)

- (4) The assumptions are that the joining entity's franking account balance at the end of the income year that ends, or, if section 701-30 applies, of the income year that is taken by subsection (3) of that section to end, at the joining time had been adjusted to take account of franking credits or franking debits that would arise if the following were paid just before the joining time:
- (a) the income tax, or *refund of income tax, on the joining entity's taxable income for that income year; and
 - (b) any income tax, or refund of income tax, that has not yet been paid (regardless of whether it has become payable or due for payment) on the joining entity's taxable income for any earlier income year, other than one excluded by subsection (5).

Exclusion of certain income years where previous membership of a consolidated group

- (5) If the joining entity was previously a *subsidiary member of a *consolidated group, any income year earlier than the one that started, or, if section 701-30 applies, the one that is taken by subsection (3) of that section to have started, when the joining entity ceased to be a subsidiary member of that group is excluded for the purposes of paragraph (4)(b) of this section.

Undistributed profits must have accrued to joined group and not recouped losses

- (6) Next:
- (a) work out the extent to which the undistributed profits that, if they had been distributed as dividends at the joining time,

could have been so franked accrued to the joined group before the joining time (subsection (7) states what it means for a profit to accrue to the joined group before the joining time); and

- (b) then exclude those that recouped losses of any *sort that accrued to the joined group before the joining time (subsection (8) states what it means for a loss to accrue to the joined group before the joining time).

The result is the step 3 amount.

Profit accruing to the joined group before the joining time

- (7) A profit accrued to the joined group before the joining time if, on the following assumptions:
 - (a) that it was distributed to holders of *membership interests as it accrued; and
 - (b) that entities interposed between the *head company and the joining entity successively distributed any of it immediately after receiving it;

it would have been received by the entity that is the head company at the joining time, in respect of membership interests that it held continuously until that time either directly or indirectly through interposed entities.

Loss accruing to the joined group before the joining time

- (8) A loss accrued to the joined group before the joining time if and to the extent that, assuming that as it arose it were instead a profit that was accruing, a distribution of that profit would have been a distribution made to the joined group out of profits that accrued to the joined group before the joining time.

Use of reliable estimates

- (9) In working out:
 - (a) for the purposes of subsection (4), the amount of income tax, or *refund of income tax, on the joining entity's taxable income for a particular income year and the extent to which it has not yet been paid; or

- (b) for the purposes of subsection (7), the amount of a profit that accrued to the joined group during a particular period; or
 - (c) for the purposes of subsection (8), the amount of a loss that accrued to the joined group during a particular period;
- use the most reliable basis for estimation that is available.

29 Subparagraph 705-95(b)(i)

Omit “705-90(5)”, substitute “705-90(7)”.

30 Subparagraph 705-95(b)(ii)

Omit “705-90(4)”, substitute “705-90(8)”.

31 Paragraph 705-100(1)(b)

Omit “705-90(4)”, substitute “705-90(8)”.

32 Subsection 705-100(2)

Repeal the subsection, substitute:

- (2) However, a loss is not to be taken into account under subsection (1) to the extent that it reduced the undistributed profits comprising the step 3 amount in the table in section 705-60.

33 Paragraph 705-110(2)(b)

Omit “705-90(4)”, substitute “705-90(8)”.

34 Subsection 705-115(1) (paragraph (b) of the definition of *owned deductions*)

Omit “was earned”, substitute “accrued”.

35 Subsection 705-115(1) (paragraph (b) of the definition of *owned deductions*)

Omit “705-90(5)”, substitute “705-90(7)”.

36 Paragraph 705-115(2)(c)

Repeal the paragraph, substitute:

- (c) to the extent that the expenditure reduced the undistributed profits comprising the step 3 amount in the table in section 705-60.

37 Group heading before section 705-120

Repeal the heading.

38 Section 705-120

Repeal the section.

39 Section 711-20 (table items 5 and 6)

Repeal the items, substitute:

- 5 If the amount remaining after step 4 is positive, it is the old group's allocable cost amount for the leaving entity. Otherwise the old group's allocable cost amount is nil.

40 Subsection 711-20(1) (note)

Omit "step 5", substitute "step 4".

41 Subsection 711-35(1)

Omit "ltax rate", substitute "tax rate".

42 Subsection 711-45(5)

Omit "joined group", substitute "old group".

43 Section 711-50

Repeal the section.

44 Section 711-60

Repeal the section.

Schedule 3—Consolidation: new Subdivision 705-B (tax cost setting amount on group formation)

Income Tax Assessment Act 1997

1 Section 705-125

Repeal the link note.

2 After Subdivision 705-A

Insert:

Subdivision 705-B—Case of group formation

Guide to Subdivision 705-B

705-130 What this Subdivision is about

| |
|---|
| <p>When a consolidated group comes into existence, the tax cost setting amount for the assets of each entity that becomes a subsidiary member is worked out by modifying the rules in Subdivision 705-A, so that the amount reflects the cost to the group of acquiring the entity.</p> |
|---|

Table of sections

Application and object

705-135 Application and object of this Subdivision

Modified application of Subdivision 705-A

705-140 Subdivision 705-A has effect with modifications

705-145 Order in which tax cost setting amounts are to be worked out where subsidiary members have membership interests in other subsidiary members

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- 705-150 Adjustment to result of step 3 in working out allocable cost amount where pre-formation time roll-over from head company to member of wholly-owned group
- 705-155 Adjustment in working out step 4 of allocable cost amount for successive distributions through interposed entities
- 705-160 Adjustment to allocation of allocable cost amount to take account of owned losses of certain entities that become subsidiary members
- 705-165 Working out pre-CGT factors where subsidiary members have membership interests in other subsidiary members

[This is the end of the Guide.]

Application and object

705-135 Application and object of this Subdivision

Application

- (1) This Subdivision has effect for the head company core purposes set out in subsection 701-1(2) if one or more entities become *subsidiary members of a *consolidated group at the time (the ***formation time***) it comes into existence as a consolidated group.

Note: This is the first exception to Subdivision 705-A: see paragraph 705-15(a).

Object

- (2) The object of this Subdivision is to modify the rules in Subdivision 705-A (which basically determine the tax cost setting amount for assets of an entity joining an existing *consolidated group) so that they have effect, and take account of different circumstances that apply, when a consolidated group comes into existence.

Note: The main circumstance is where one of the entities has membership interests in another. In such a case, the order in which the rules in Subdivision 705-A are applied will affect the tax cost setting amounts for the assets of the entities.

Modified application of Subdivision 705-A

705-140 Subdivision 705-A has effect with modifications

- (1) Subdivision 705-A has effect in relation to each entity becoming a *subsidiary member of the *consolidated group at the formation time in the same way as that Subdivision has effect in relation to an entity becoming a subsidiary member of a consolidated group in circumstances covered by that Subdivision.
- (2) However, that effect of Subdivision 705-A is subject to modifications set out in this Subdivision.

705-145 Order in which tax cost setting amounts are to be worked out where subsidiary members have membership interests in other subsidiary members

Object

- (1) The object of this section is to ensure that where, on becoming *subsidiary members, entities hold assets consisting of *membership interests in other subsidiary members, the *head company's cost of becoming the holder of the assets of all of the entities that become subsidiary members correctly reflects the group's cost of acquiring the entities.

Tax cost setting amounts to be worked out from top down

- (2) If, on becoming *subsidiary members, entities hold *membership interests in any other entities that become subsidiary members, the *tax cost setting amounts for the assets of entities holding membership interests must be worked out before the tax cost setting amounts for the assets of the entities in which the membership interests are held.

Note: The tax cost setting amount in respect of assets of any subsidiary member in which the head company, but no other subsidiary member, holds membership interests can be worked out in any order in relation to the calculations for other subsidiary members.

Tax cost setting amount for higher entity's membership interests to be used in working out lower entity's tax cost setting amount

- (3) The tax cost setting amount worked out for assets of an entity mentioned in subsection (2) consisting of *membership interests in another such entity is to be used as the amount for those interests under subsection 705-65(1) (step 1 of allocable cost amount) in working out the tax cost setting amount for assets of that other entity.

Note 1: Subsection 705-65(1) adds together amounts worked out in accordance with section 705-65 representing the cost of the membership interests that each member of the group holds in the entity. If any of those membership interests is held by another subsidiary member, subsection (3) above will replace the amount otherwise applicable with the tax cost setting amount that will have been worked out for the interests in accordance with subsection (2) above.

Note 2: The tax cost setting amount worked out for the membership interests has no relevance other than for the purpose mentioned in subsection (3). This is because, under the single entity principle, intra group membership interests are ignored while entities are members of the group. If an entity ceases to be a member, section 701-15 and Division 711 set the tax cost of membership interests in the entity at that time.

Value shifting etc. provisions not to apply to later CGT events involving membership interests

- (4) However, despite subsection (3), subsection 705-65(4) (which prevents the later operation of value shifting etc. provisions) still applies to the *membership interests.

Rights and options to acquire membership interests

- (5) For the purposes of this section, if, on becoming a *subsidiary member, an entity holds a right or option (including a contingent right or option), created or issued by another entity that becomes a subsidiary member at the same time, to acquire a *membership interest in that other entity, that right or option is treated as if it were a membership interest in that other entity.

705-150 Adjustment to result of step 3 in working out allocable cost amount where pre-formation time roll-over from head company to member of wholly-owned group

Object

- (1) The object of this section is to ensure that, in working out the group's *allocable cost amount for certain entities that become *subsidiary members of the group at the formation time, an adjustment is made to take account of roll-overs under Subdivision 126-B or section 160ZZO of the *Income Tax Assessment Act 1936* before the formation time.

When section applies

- (2) This section applies if:
- (a) before the formation time, there was a roll-over under Subdivision 126-B or section 160ZZO of the *Income Tax Assessment Act 1936* in relation to a *CGT event (the **head company roll-over event**) that happened in relation to an asset (the **head company roll-over asset**), where:
 - (i) an entity (the **head company roll-over recipient**) that becomes a *subsidiary member of the group was the recipient company in relation to the roll-over; and
 - (ii) the originating company in relation to that roll-over was the entity that becomes the *head company of the group; and
 - (b) between the roll-over and the formation time, no other CGT event happened in relation to the head company roll-over asset:
 - (i) for which there was another roll-over satisfying the requirements of paragraph (a); or
 - (ii) for which there was not a roll-over under Subdivision 126-B or section 160ZZO of the *Income Tax Assessment Act 1936*; and
 - (c) the head company roll-over asset is not a *pre-CGT asset at the formation time; and
 - (d) the sum of the *cost bases of all of the *head company's *CGT assets just before the head company roll-over event

exceeded or was less than the sum of the cost bases of all of the head company's CGT assets just after the head company roll-over event (the excess or shortfall being the **head company roll-over adjustment amount**).

Adjustment to result of step 3 in allocable cost amount for head company roll-over recipient

- (3) For the purpose of working out the group's *allocable cost amount for the head company roll-over recipient, the result of step 3 in the table in section 705-60 is reduced (if the head company roll-over adjustment amount is an excess), or increased (if the head company roll-over adjustment amount is a shortfall), by the amount worked out as follows:

$$\frac{\text{*Market value of *head company's *membership interests in head company roll-over recipient}}{\text{Market value of all membership interests in head company roll-over recipient}} \times \text{Head company roll-over adjustment amount}$$

where:

market value of all membership interests in head company roll-over recipient means the *market value, at the formation time, of all *membership interests in the head company roll-over recipient that are held by entities that become *members of the group at that time.

Adjustment to result of step 3 in allocable cost amount for interposed entity

- (4) Also, if this section applies, for the purpose of working out the group's *allocable cost amount for any entity (the **target entity**) that:
- (a) becomes a *subsidiary member of the group at the formation time; and
 - (b) is interposed at that time between the *head company and the head company roll-over recipient; and
 - (c) is the first or only such interposed entity;

the result of step 3 in the table in section 705-60 is reduced (if the head company roll-over adjustment amount is an excess), or increased (if the head company roll-over adjustment amount is a shortfall), by the amount worked out as follows:

$$\frac{\text{Market value of head company's indirect membership interests in head company roll-over recipient}}{\text{Market value of all membership interests in head company roll-over recipient}} \times \text{Head company roll-over adjustment amount}$$

where:

market value of all membership interests in head company roll-over recipient has the same meaning as in subsection (3).

market value of head company's indirect membership interests in head company roll-over recipient means so much of the *market value, at the formation time, of the *head company's *membership interests in the target entity as is attributable to membership interests that the entity holds directly, or indirectly through other interposed entities that become *subsidiary members of the group at the formation time, in the head company roll-over recipient.

Note: If under subsection (3) or (4) the amount by which the result of step 3 is to be reduced exceeds that result, the excess is treated as a capital gain of the head company.

705-155 Adjustment in working out step 4 of allocable cost amount for successive distributions through interposed entities

Object

- (1) The object of this section is to ensure that, in working out the group's *allocable cost amount for entities that become *subsidiary members of the group at the formation time, there is only one reduction under step 4 in the table in section 705-60 (about pre-formation time distributions out of certain profits) for distributions of the same profits.

When section applies

- (2) This section applies if, apart from this section:
-

-
- (a) in working out the group's *allocable cost amount for an entity that becomes a *subsidiary member of the group at the formation time, there would be a reduction under step 4 in the table in section 705-60 for a distribution (the *first distribution*) made by the entity; and
 - (b) in working out the group's *allocable cost amount for a second entity that becomes a *subsidiary member of the group at that time, there would also be a reduction under that step for any of the first distribution that the second entity successively distributed as mentioned in paragraph 705-95(a).

No step 4 reduction in respect of successive distribution of amount for which there has already been a step 4 reduction

- (3) If this section applies, there is no reduction as mentioned in paragraph (2)(b).

705-160 Adjustment to allocation of allocable cost amount to take account of owned losses of certain entities that become subsidiary members

Object

- (1) The object of this section is to prevent a distortion under section 705-35 in the allocation of *allocable cost amount to an entity that becomes a *subsidiary member of the group where that entity has *membership interests in another entity that has certain tax losses when it becomes a subsidiary member.

Adjustment to allocation of allocable cost amount

- (2) If:
 - (a) an entity becomes a *subsidiary member of the group at the formation time; and
 - (b) the entity has *membership interests in a second entity that becomes a subsidiary member of the group at that time; and
 - (c) in working out the group's *allocable cost amount for the second entity an amount is required to be subtracted (the *loss subtraction amount*) under step 5 in the table in

section 705-60 (about losses accruing before becoming a subsidiary member of the group);

then, for the purposes of working out under section 705-35 the *tax cost setting amount for the assets of the first entity, the *market value of the first entity's membership interests in the second entity is increased by the first entity's interest in the loss subtraction amount (see subsection (3)).

First entity's interest in loss subtraction amount

- (3) The first entity's interest in the loss subtraction amount is worked out using the formula:

$$\frac{\text{*Market value of first entity's * membership interests in second entity}}{\text{Market value of all membership interests in second entity}} \times \text{Loss subtraction amount}$$

705-165 Working out pre-CGT factors where subsidiary members have membership interests in other subsidiary members

Object

- (1) The object of this section is to ensure that where, on becoming *subsidiary members, entities hold *membership interests in other subsidiary members, the pre-CGT status of membership interests held by the *head company, and not the pre-CGT status of membership interests held by other entities, is used to work out the *pre-CGT factor under section 705-125 for assets of the other subsidiary members.

Pre-CGT factor to be worked out from top down

- (2) If, on becoming *subsidiary members, entities hold *membership interests in any other entities that become subsidiary members, the *pre-CGT factor for the assets of entities holding membership interests must be worked out before the pre-CGT factor for the assets of the entities in which the membership interests are held.

[The next Division is Division 707.]

Schedule 4—Consolidation: reset cost base assets held on revenue account

Income Tax Assessment Act 1997

1 Section 705-40

Repeal the section, substitute:

705-40 Tax cost setting amount for reset cost base assets held on revenue account

- (1) The *tax cost setting amount for a reset cost base asset that is *trading stock, a *depreciating asset or a *revenue asset must not exceed the greater of:
 - (a) the asset's *market value; and
 - (b) the joining entity's *terminating value for the asset.
- (2) If subsection (1) *reduces* the asset's *tax cost setting amount, the amount of the reduction is allocated among the other reset cost base assets (including other *trading stock, *depreciating assets and *revenue assets) other than excluded assets, so as to *increase* their tax cost setting amounts, in accordance with the principles set out in subsection (3).

Note: If any of the amount of the reduction cannot be allocated, it is instead treated as a capital loss of the head company.

- (3) These are the principles:
 - (a) the allocation is to be in proportion to the *market values of the assets;
 - (b) the amount allocated to an item of *trading stock, to a *depreciating asset or to a *revenue asset must not cause its *tax cost setting amount to contravene subsection (1);
 - (c) any of the amount that cannot be allocated is to be reallocated, to the maximum extent possible, among the remaining reset cost base assets (other than excluded assets) by applying this subsection a further one or more times.

Schedule 5—Consolidation: imputation

Income Tax Assessment Act 1997

1 Paragraph 709-60(3)(c)

Omit “item 6 of the table in section 160-115”, substitute “item 5 of the table in section 205-15”.

2 Subsection 709-70(2) (note)

Omit “section 160-115”, substitute “section 205-15”.

3 Subsection 709-75(2) (note)

Omit “section 160-130”, substitute “section 205-30”.

Schedule 6—Consolidation: international tax

Income Tax Assessment Act 1997

1 Section 711-70 (link note)

Repeal the link note, substitute:

[The next Division is Division 717.]

2 After Division 711

Insert:

Division 717—International tax rules

Table of Subdivisions

- 717-A Foreign tax credits
- 717-D Attributable income: entry rules
- 717-E Attributable income: exit rules

Subdivision 717-A—Foreign tax credits

Guide to Subdivision 717-A

717-1 What this Subdivision is about

If an entity becomes a subsidiary member of a consolidated group, its excess foreign tax credits are transferred to the head company of the group, for use in later income years. The head company receives any foreign tax credits that arise because the entity pays foreign tax while it is a subsidiary member of the group.

Table of sections

Objects

717-5 Objects of this Subdivision

Foreign tax on amounts in head company's assessable income

717-10 Head company taken to be liable for subsidiary member's foreign tax

Foreign tax on amounts not in head company's assessable income

717-15 Transferring subsidiary member's excess foreign tax credits from earlier years to head company

717-20 Where entity not subsidiary member for whole of income year

[This is the end of the Guide.]

Objects**717-5 Objects of this Subdivision**

- (1) The main objects of this Subdivision are set out in subsections (2), (3) and (4).
- (2) The first of those objects is to allow the *head company of a *consolidated group to get the benefit of foreign tax paid in respect of foreign income (within the meaning of the *Income Tax Assessment Act 1936*) included in the head company's assessable income because another entity is or was a *subsidiary member of the group.
- (3) The second of those objects is to allow the *head company of a *consolidated group to apply, in relation to an income year, *excess foreign tax credits of an entity (the *joining entity*) that becomes a *subsidiary member of the group at a time (the *joining time*) if:
 - (a) the income year starts after the joining time; and
 - (b) those excess foreign tax credits are from an income year ending before the joining time.
- (4) The third of those objects is to prevent an entity (other than the *head company of the group) from applying *excess foreign tax credits mentioned in paragraph (3)(b) to increase its own credits in respect of foreign tax.

Foreign tax on amounts in head company's assessable income

717-10 Head company taken to be liable for subsidiary member's foreign tax

- (1) This section operates if:
 - (a) an entity was a *subsidiary member of a *consolidated group for all or part of an income year; and
 - (b) the assessable income of the *head company of the group for that income year included foreign income (within the meaning of the *Income Tax Assessment Act 1936*); and
 - (c) the entity paid, and was personally liable for, foreign tax (within the meaning of that Act) in respect of that foreign income (whether or not the entity was a subsidiary member of the group at the time of payment).
- (2) Section 160AF of the *Income Tax Assessment Act 1936* operates as if:
 - (a) the *head company had paid and been personally liable for the foreign tax; and
 - (b) the entity had not paid and had not been personally liable for the foreign tax.

Note: Section 160AF of the *Income Tax Assessment Act 1936* provides a foreign tax credit (which is a tax offset) of an amount that depends on:

 - (a) foreign tax that an entity paid, and was personally liable for, in respect of foreign income included in the entity's assessable income; and
 - (b) the amount of Australian tax payable (worked out as described in that section) in respect of the foreign income.
- (3) This section does not limit the operation of section 160AF of the *Income Tax Assessment Act 1936*.

Foreign tax on amounts not in head company's assessable income

717-15 Transferring subsidiary member's excess foreign tax credits from earlier years to head company

- (1) This section operates for the purposes of section 160AFE of the *Income Tax Assessment Act 1936* in relation to an income year if:
 - (a) an entity (the *joining entity*) becomes a *subsidiary member of a *consolidated group at a time (the *joining time*); and
 - (b) the joining time is:
 - (i) before the start of that income year; and
 - (ii) after the start of an earlier income year (the *earlier year*); and
 - (c) the joining entity has *excess foreign tax credits (the *transfer credits*) from the earlier year.
- (2) For those purposes:
 - (a) the *head company of the group is taken to have the transfer credits; and
 - (b) the joining entity is taken *not* to have the transfer credits; and
 - (c) if, apart from paragraph (a), the head company has *excess foreign tax credits from the earlier year—the transfer credits are taken to be included in those excess foreign tax credits.
- (3) Subsection (2) also has effect for the purposes of a subsequent operation of this section.

Example: An entity becomes a subsidiary member of a consolidated group in an income year. This section operates in relation to a later income year so that the entity no longer has the transfer credits mentioned in paragraph (1)(c) (see paragraph (2)(b)). The entity later leaves the group and becomes a subsidiary member of a second consolidated group. In a subsequent operation of this section in relation to the head company of the second group, the entity will not have those transfer credits, because of the previous operation of paragraph (2)(b).
- (4) This section operates separately in relation to each class of foreign income (within the meaning of the *Income Tax Assessment Act 1936*) identified in subsection 160AF(7) of that Act, as if:

- (a) the *head company's foreign income of that class for an income year were the whole of the head company's foreign income for that year; and
- (b) the joining entity's foreign income of that class for an income year were the whole of the joining entity's foreign income for that year.

717-20 Where entity not subsidiary member for whole of income year

- (1) This section operates if:
 - (a) an entity (the *joining entity*) is a *subsidiary member of a *consolidated group for some but not all of an income year (the *joining year*); and
 - (b) there are one or more periods in the joining year (each of which is a *non-membership period*) during which the entity is not a subsidiary member of any *consolidated group.

Note: Section 701-30 treats each non-membership period as a separate income year for some purposes.

- (2) Subsection (3) has effect for the purposes of section 701-30 in relation to the joining entity.
- (3) In working out amounts for the joining entity under subsection 701-30(3) in relation to each non-membership period, make these assumptions:
 - (a) if the joining year starts at the same time as the earliest of those non-membership periods:
 - (i) subsection 160AFE(2) of the *Income Tax Assessment Act 1936* operates in relation to the joining entity for that non-membership period; and
 - (ii) subsection 160AFE(2) of that Act does *not* operate in relation to the joining entity for the later non-membership periods (if any);
 - (b) otherwise—subsection 160AFE(2) of that Act does *not* operate in relation to the joining entity for any of the non-membership periods.

-
- (4) Subsection (5) has effect for the purposes of section 717-15 in relation to the *head company of the *consolidated group for a later income year.
- (5) In working out the amount (if any) of the joining entity's transfer credits (within the meaning of paragraph 717-15(1)(c)) from the joining year, do not include the amount of the joining entity's *excess foreign tax credits from a non-membership period (if any) that ends at the same time the joining year ends.

[The next Subdivision is Subdivision 717-D.]

Subdivision 717-D—Attributable income: entry rules

Guide to Subdivision 717-D

717-200 What this Subdivision is about

Each attribution surplus, attributed tax account surplus, FIF attribution surplus and FIF attributed tax account surplus relating to a company that becomes a subsidiary member of a consolidated group is transferred to the head company of the group.

Table of sections

Object

717-205 Object of this Subdivision

Transfers

717-210 Attribution surpluses
 717-215 Attributed tax account surpluses
 717-220 FIF attribution surpluses
 717-225 FIF attributed tax account surpluses
 717-230 Calculating FIF income where a company joins the group

[This is the end of the Guide.]

Object

717-205 Object of this Subdivision

The main object of this Subdivision is to avoid double taxation by transferring from a company (the *joining company*) that becomes a *subsidiary member of a *consolidated group at a time (the *joining time*) to the *head company of the group the benefit of each of these:

- (a) the attribution surplus (if any) for an attribution account entity (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in relation to the joining company just before the joining time;
- (b) the attributed tax account surplus (if any) for an attribution account entity (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in relation to the joining company just before the joining time;
- (c) the FIF attribution surplus (if any) for a FIF attribution account entity (within the meaning of Part XI of the *Income Tax Assessment Act 1936*) in relation to the joining company just before the joining time;
- (d) the FIF attributed tax account surplus (if any) for a *FIF (within the meaning of Part XI of the *Income Tax Assessment Act 1936*) in relation to the joining company just before the joining time.

Transfers

717-210 Attribution surpluses

- (1) This section operates for the purposes of Part X of the *Income Tax Assessment Act 1936* if:
 - (a) a company (the *joining company*) becomes a *subsidiary member of a *consolidated group at a time (the *joining time*); and
 - (b) just before the joining time there was an attribution surplus for an attribution account entity in relation to the joining company for the purposes of that Part; and

- (c) just before the joining time the joining company's attribution account percentage in relation to the attribution account entity for the purposes of that Part was more than nil.

Credit in relation to the head company

- (2) An attribution credit arises at the joining time for the attribution account entity in relation to the *head company of the group. The credit is equal to the attribution surplus.

Debit in relation to the joining company

- (3) An attribution debit arises at the joining time for the attribution account entity in relation to the joining company. The debit is equal to the attribution surplus.

717-215 Attributed tax account surpluses

Section 717-210 also operates as described in the table:

| Transfer of attributed tax account surpluses by section 717-210 | | |
|--|--|--|
| Item | Section 717-210 operates in relation to this thing (within the meaning of Part X of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
| 1 | Attributed tax account surplus | Attribution surplus |
| 2 | Attributed tax account credit | Attribution credit |
| 3 | Attributed tax account debit | Attribution debit |

717-220 FIF attribution surpluses

Section 717-210 also operates for the purposes of Part XI of the *Income Tax Assessment Act 1936* as described in the table:

Transfer of FIF attribution surpluses by section 717-210

| Item | Section 717-210 operates in relation to this thing (within the meaning of Part XI of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
|-------------|---|--|
| 1 | FIF attribution surplus | Attribution surplus |
| 2 | FIF attribution account entity | Attribution account entity |
| 3 | FIF attribution account percentage | Attribution account percentage |
| 4 | FIF attribution credit | Attribution credit |
| 5 | FIF attribution debit | Attribution debit |

Note: Section 717-230 may affect the calculation of the FIF attribution surplus for the FIF attribution account entity in relation to the joining company just before the joining time.

717-225 FIF attributed tax account surpluses

Section 717-210 also operates for the purposes of Part XI of the *Income Tax Assessment Act 1936* as described in the table:

Transfer of FIF attributed tax account surpluses by section 717-210

| Item | Section 717-210 operates in relation to this thing (within the meaning of Part XI of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
|-------------|---|--|
| 1 | FIF attributed tax account surplus | Attribution surplus |
| 2 | *FIF | Attribution account entity |
| 3 | FIF attribution account percentage | Attribution account percentage |
| 4 | FIF attributed tax account credit | Attribution credit |
| 5 | FIF attributed tax account debit | Attribution debit |

Note: Section 717-230 may affect the calculation of the FIF attributed tax account surplus for the FIF in relation to the joining company just before the joining time.

717-230 Calculating FIF income where a company joins the group

- (1) This section modifies the operation of Part XI of the *Income Tax Assessment Act 1936* if:

-
- (a) a company (the *joining company*) becomes a *subsidiary member of a *consolidated group at a time (the *joining time*); and
 - (b) for the purposes of that Part, the FIF attribution account percentage of the joining company in relation to a FIF attribution account entity that is a *FIF is more than nil at the time (the *surplus time*) just before the joining time.
- (2) That Part operates in relation to the joining company as if a notional accounting period of the *FIF in relation to the joining company ended at the time (the *credit/debit time*) just before the surplus time.
 - (3) That Part operates in relation to the joining company as if subsection 485(3) of that Act provided that the operative provision applied to the joining company in relation to the *FIF in respect of the notional accounting period of that FIF that ended in the year of income that included the credit/debit time.
 - (4) Paragraph 538(2)(d) of that Act operates in relation to the *head company of the *consolidated group in relation to the *FIF in respect of the notional accounting period of that FIF that included the joining time as if:
 - (a) the head company had acquired the interest or interests mentioned in that paragraph during that period (so far as those interests are held by the head company because the joining company became a *subsidiary member of the group); and
 - (b) the amount or value of the consideration paid or given by the head company in respect of the acquisition was equal to the amount worked out under paragraph 538(2)(a) of that Act in relation to the joining company in relation to the FIF in respect of the notional accounting period mentioned in subsection (2) of this section.

Note: The modifications made by this section:

- (a) apply if a company joins a consolidated group during a notional accounting period of a FIF in which the company has an interest; and
- (b) allow the appropriate calculation of amounts attributed under FIF rules to the head company and joining company before and after the joining time; and

- (c) mean that foreign investment fund income that accrued to the joining company from the FIF will be included in the joining company's assessable income and will give rise to a FIF attribution credit, and may also give rise to a FIF attribution debit, in relation to the joining company; and
- (d) mean that the FIF attribution surplus and the FIF attributed tax account surplus for the FIF attribution account entity in relation to the joining company at the surplus time will take account of credits and debits arising at the credit/debit time and earlier.

Subdivision 717-E—Attributable income: exit rules

Guide to Subdivision 717-E

717-235 What this Subdivision is about

Each attribution surplus, attributed tax account surplus, FIF attribution surplus and FIF attributed tax account surplus relating to a company that ceases to be a subsidiary member of a consolidated group is transferred to that company from the head company of the group.

Table of sections

Object

717-240 Object of this Subdivision

Transfer of Part X surpluses

717-245 Attribution surpluses

717-250 Attributed tax account surpluses

Transfer of Part XI surpluses

717-255 FIF attribution surpluses

717-260 FIF attributed tax account surpluses

717-265 Calculating FIF income where a company leaves the group

[This is the end of the Guide.]

Object

717-240 Object of this Subdivision

The main object of this Subdivision is to avoid double taxation by transferring from the *head company of a *consolidated group to a company (the **leaving company**) that ceases to be a *subsidiary member of the group at a time (the **leaving time**) the benefit of each of these surpluses (to the extent that each surplus can be attributed to the leaving company):

- (a) the attribution surplus (if any) for an attribution account entity (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in relation to the head company just before the leaving time;
- (b) the attributed tax account surplus (if any) for an attribution account entity (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in relation to the head company just before the leaving time;
- (c) the FIF attribution surplus (if any) for a FIF attribution account entity (within the meaning of Part XI of the *Income Tax Assessment Act 1936*) in relation to the head company just before the leaving time;
- (d) the FIF attributed tax account surplus (if any) for a *FIF (within the meaning of Part XI of the *Income Tax Assessment Act 1936*) in relation to the head company just before the leaving time.

Transfer of Part X surpluses

717-245 Attribution surpluses

- (1) This section operates for the purposes of Part X of the *Income Tax Assessment Act 1936* if:
 - (a) a company (the **leaving company**) ceases to be a *subsidiary member of a *consolidated group at a time (the **leaving time**); and
 - (b) just before the leaving time there was, for the purposes of that Part, an attribution surplus for an attribution account entity in relation to the *head company of the group; and
-

- (c) at the leaving time the leaving company's attribution account percentage in relation to the attribution account entity for the purposes of that Part is more than nil.

Credit in relation to leaving company

- (2) An attribution credit arises at the leaving time for the attribution account entity in relation to the leaving company. The credit is the amount worked out under subsection (4).

Debit in relation to head company

- (3) An attribution debit arises at the leaving time for the attribution account entity in relation to the company that was the *head company of the group just before the leaving time. The debit is the amount worked out under subsection (4).

Amount of credit and debit

- (4) The amount of the credit and debit is worked out using the formula:

$$\frac{\text{Leaving company's attribution account percentage in relation to the attribution account entity at the leaving time}}{\text{*Head company's attribution account percentage in relation to the attribution account entity just before the leaving time}} \times \text{Attribution surplus for the attribution account entity in relation to the *head company just before the leaving time}$$

717-250 Attributed tax account surpluses

Section 717-245 also operates as described in the table:

| Transfer of attributed tax account surpluses by section 717-245 | | |
|--|--|--|
| Item | Section 717-245 operates in relation to this thing (within the meaning of Part X of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
| 1 | Attributed tax account surplus | Attribution surplus |
| 2 | Attributed tax account credit | Attribution credit |
| 3 | Attributed tax account debit | Attribution debit |

Transfer of Part XI surpluses

717-255 FIF attribution surpluses

Section 717-245 also operates for the purposes of Part XI of the *Income Tax Assessment Act 1936* as described in the table:

| Transfer of FIF attribution surpluses by section 717-245 | | |
|---|---|--|
| Item | Section 717-245 operates in relation to this thing (within the meaning of Part XI of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
| 1 | FIF attribution surplus | Attribution surplus |
| 2 | FIF attribution account entity | Attribution account entity |
| 3 | FIF attribution account percentage | Attribution account percentage |
| 4 | FIF attribution credit | Attribution credit |
| 5 | FIF attribution debit | Attribution debit |

Note: Section 717-265 may affect the calculation of the FIF attribution surplus for the FIF attribution account entity in relation to the head company just before the leaving time.

717-260 FIF attributed tax account surpluses

Section 717-245 also operates for the purposes of Part XI of the *Income Tax Assessment Act 1936* as described in the table:

| Transfer of FIF attributed tax account surpluses by section 717-245 | | |
|--|---|--|
| Item | Section 717-245 operates in relation to this thing (within the meaning of Part XI of the <i>Income Tax Assessment Act 1936</i>): | In the same way as it operates in relation to this thing: |
| 1 | FIF attributed tax account surplus | Attribution surplus |
| 2 | *FIF | Attribution account entity |
| 3 | FIF attribution account percentage | Attribution account percentage |
| 4 | FIF attributed tax account credit | Attribution credit |
| 5 | FIF attributed tax account debit | Attribution debit |

Note: Section 717-265 may affect the calculation of the FIF attributed tax account surplus for the FIF in relation to the head company just before the leaving time.

717-265 Calculating FIF income where a company leaves the group

- (1) This section modifies the operation of Part XI of the *Income Tax Assessment Act 1936* in relation to a company (the **transferor company**) if:
 - (a) the transferor company is the *head company of a *consolidated group at a time (the **surplus time**); and
 - (b) for the purposes of that Part, the FIF attribution account percentage of the transferor company in relation to a FIF attribution account entity that is a *FIF is more than nil at the surplus time; and
 - (c) another company (the **leaving company**) ceases to be a *subsidiary member of the group at the time (the **leaving time**) just after the surplus time; and
 - (d) for the purposes of that Part, the leaving company's FIF attribution account percentage in relation to that FIF attribution account entity is more than nil at the leaving time.
- (2) That Part operates in relation to the transferor company as if a notional accounting period of the *FIF in relation to the transferor company ended at the time (the **credit/debit time**) just before the surplus time.
- (3) That Part operates in relation to the transferor company as if the next notional accounting period of the *FIF in relation to the transferor company started at the surplus time and continued until whichever of these times occurs first:
 - (a) the time when a notional accounting period of the FIF in relation to the transferor company would have ended apart from this section;
 - (b) the time when the period ends because of another application of this section.
- (4) That Part operates in relation to the transferor company as if subsection 485(3) of that Act provided that the operative provision applied to the transferor company in relation to the *FIF in respect

of the notional accounting period of that FIF that ended in the year of income that included the credit/debit time.

- (5) Paragraph 538(2)(d) of that Act operates in relation to the leaving company in relation to the *FIF in respect of the notional accounting period of that FIF that included the leaving time as if:
- (a) the leaving company had acquired the interest or interests mentioned in that paragraph during that period (so far as those interests are held by the leaving company because it ceased to be a *subsidiary member of the group); and
 - (b) the amount or value of the consideration paid or given by the leaving company in respect of the acquisition was equal to the amount worked out under paragraph 538(2)(a) of that Act in relation to the transferor company in relation to the FIF in respect of the notional accounting period mentioned in subsection (2) of this section.

Note: The modifications made by this section:

- (a) apply if a company leaves a consolidated group during a notional accounting period of a FIF in which the company has an interest; and
- (b) allow the appropriate calculation of amounts attributed under FIF rules to the transferor company and leaving company before and after the leaving time; and
- (c) mean that foreign investment fund income that accrued to the transferor company from the FIF will be included in the transferor company's assessable income and will give rise to a FIF attribution credit, and may also give rise to a FIF attribution debit, in relation to the transferor company; and
- (d) mean that the FIF attribution surplus and the FIF attributed tax account surplus for the FIF attribution account entity in relation to the transferor company at the surplus time will take account of credits and debits arising at the credit/debit time and earlier.

[The next Division is Division 719.]

Schedule 7—Consolidation: application and transitional asset cost provisions

Income Tax (Transitional Provisions) Act 1997

1 Section 700-1

Repeal the section, substitute:

700-1 Application of Part 3-90 of *Income Tax Assessment Act 1997*

Part 3-90 of the *Income Tax Assessment Act 1997*, as inserted by the *New Business Tax System (Consolidation) Bill (No. 1) 2002* and amended by the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*, applies on and after 1 July 2002.

2 After Division 700

Insert:

Division 701—Modified application of provisions of *Income Tax Assessment Act 1997* for certain consolidated groups formed in 2002-3 and 2003-4 financial years

Table of Subdivisions

| | |
|-------|------------------------------------|
| 701-A | Preliminary |
| 701-B | Modified application of provisions |

Subdivision 701-A—Preliminary

Table of sections

| | |
|-------|--|
| 701-1 | Transitional group and transitional entity |
| 701-5 | Chosen transitional entity |

701-10 Interpretation

701-1 Transitional group and transitional entity

Group formed on 1 July 2002

- (1) If a consolidated group came into existence on 1 July 2002:
- (a) the group is a **transitional group**; and
 - (b) each entity that became a subsidiary member of the group on the day it came into existence is a **transitional entity**.

Group formed after 1 July 2002 but before 1 July 2003

- (2) If a consolidated group came into existence after 1 July 2002 but before 1 July 2003:
- (a) the group is a **transitional group** if at least one entity that became a subsidiary member of the group on the day the group came into existence is a **transitional entity**; and
 - (b) an entity is a transitional entity if:
 - (i) at no time after 1 July 2002 and before the group came into existence was the entity a wholly-owned subsidiary of the entity (the **future head company**) that became the head company of the group; or
 - (ii) at some time during that period, the entity was a wholly-owned subsidiary of the future head company and it remained such from the earliest time after 1 July 2002 when it was a wholly-owned subsidiary of the future head company until the group came into existence.

Group formed during financial year starting on 1 July 2003

- (3) If a consolidated group came into existence during the financial year starting on 1 July 2003:
- (a) the group is a **transitional group** if at least one entity that became a subsidiary member of the group on the day the group came into existence is a transitional entity; and
 - (b) an entity is a **transitional entity** if:
 - (i) just before 1 July 2003, it was a wholly-owned subsidiary of the future head company; and

- (ii) it remained such from the earliest time after 1 July 2002 when it was a wholly-owned subsidiary of the future head company until the group came into existence.

701-5 Chosen transitional entity

- (1) If a group is a transitional group, its head company may choose that the group's transitional entity is a *chosen transitional entity*, or one or more of the group's transitional entities are *chosen transitional entities*.

Period for making choice

- (2) The choice must be made by the end of the period described in subsection 703-50(3) for giving the Commissioner the choice under section 703-50 that the group is taken to be consolidated.

Choice is irrevocable

- (3) The choice cannot be revoked.

701-10 Interpretation

A reference in this Division to:

- (a) a provision of the *Income Tax Assessment Act 1997*; or
 - (b) a consolidated group's allocable cost amount for an entity;
- is a reference to that provision as it applies to the group, or to the allocable cost amount as it is worked out for the entity, in accordance with Subdivision 705-B of that Act and with this Division.

Subdivision 701-B—Modified application of provisions

Table of sections

| | |
|--------|---|
| 701-15 | Tax cost and trading stock value not set for assets of chosen transitional entities |
| 701-20 | Working out allocable cost amount on formation for subsidiary members other than chosen transitional entities |
| 701-25 | No operation of value shifting and loss transfer provisions to membership interests in chosen transitional entities |

- 701-30 Undistributed, unfrankable pre-formation profits of non-chosen transitional entities—adjustment to allocable cost amount and tax cost setting amount reduction for over-depreciated assets
- 701-35 CGT event for pre-formation roll-over after 16 May 2002 to be disregarded if cost base etc. would be different
- 701-40 When entity leaves transitional group, head company may choose, for purposes of transitional group's allocable cost amount, to increase terminating values of over-depreciated assets
- 701-45 When entity leaves transitional group, head company may choose, for purposes of transitional group's allocable cost amount, to use formation time market values, instead of terminating values, for certain pre-CGT assets

701-15 Tax cost and trading stock value not set for assets of chosen transitional entities

Section 701-10 (cost to head company of assets that entity brings into group) and subsection 701-35(4) (setting value of trading stock at tax-neutral amount) do not apply to the assets of a chosen transitional entity.

Note: The fact that the head company inherits the entity's history under section 701-5 when the entity becomes a subsidiary member of the group means that the entity's assets would be treated as having the same cost as they would for the entity at that time.

701-20 Working out allocable cost amount on formation for subsidiary members other than chosen transitional entities

When section applies

- (1) This section applies if any of the transitional entities in the transitional group is a chosen transitional entity.

Allocable cost amount to be worked out in special way

- (2) If this section applies, the group's allocable cost amount for each of the entities, other than a chosen transitional entity, that become subsidiary members when the group comes into existence (each of which is a *non-chosen subsidiary*) is worked out in a special way.

How to work out allocable cost amount

- (3) The allocable cost amount for each non-chosen subsidiary is the sum of:
- (a) the head company adjusted allocable amount for the non-chosen subsidiary (see subsection (4)); and
 - (b) for each sub-group (see subsection (6)) that exists in relation to the non-chosen subsidiary—the sub-group’s notional allocable cost amount (see subsection(5)) for the non-chosen subsidiary.

Head company adjusted allocable amount

- (4) The **head company adjusted allocable amount** for the non-chosen subsidiary is the amount that would be the transitional group’s allocable cost amount for that entity if;
- (a) the holding of all sub-group membership interests were disregarded; and
 - (b) only the following proportion of each of the step 2 to step 7 amounts in the table in section 705-60 was taken into account:

$$\frac{\text{Market value of head company's direct and indirect membership interests in non - chosen subsidiary}}{\text{Market value of all membership interests in non - chosen subsidiary}}$$

where:

market value of all membership interests in non-chosen subsidiary means the market value, at the time the group comes into existence, of all membership interests in the non-chosen subsidiary that are held by entities that become members of the group at that time.

market value of head company’s direct and indirect membership interests in non-chosen subsidiary means the market value, at the time the group comes into existence, of all membership interests in the non-chosen subsidiary that the head company holds directly or indirectly through interposed entities that become subsidiary members of the group at that time and are not included in any sub-group in relation to the non-chosen subsidiary.

Sub-group's notional allocable cost amount

- (5) For each sub-group that exists in relation to the non-chosen subsidiary, there is a ***sub-group's notional allocable cost amount***. That amount is the amount that would be a consolidated group's allocable cost amount for the non-chosen subsidiary if:
- (a) the consolidated group came into existence at the same time as the transitional group and consisted only of the non-chosen subsidiary and the entities comprising the sub-group; and
 - (b) the chosen transitional entity in the sub-group were the head company of the consolidated group; and
 - (c) the only membership interests that any entity in the sub-group held in any other member of the consolidated group were the sub-group membership interests (see subsection (6)) in relation to the sub-group; and
 - (d) only the following proportion of each of the step 2 to step 7 amounts in the table in section 705-60 was taken into account:

$$\frac{\text{Market value of chosen transitional entity's direct and indirect membership interests in non - chosen subsidiary}}{\text{Market value of all membership interests in non - chosen subsidiary}}$$

where:

market value of all membership interests in non-chosen subsidiary means the market value, at the time the group comes into existence, of all membership interests in the non-chosen subsidiary that are held by entities that become members of the group at that time.

market value of chosen transitional entity's direct and indirect membership interests in non-chosen subsidiary means the market value, at the time the group comes into existence, of all membership interests in the non-chosen subsidiary that the chosen transitional entity holds directly or indirectly through interposed entities that are included in the sub-group.

Sub-group and sub-group membership interests

- (6) If a chosen transitional entity holds membership interests in a non-chosen subsidiary, either directly or indirectly through one or more other entities, each of which is a non-chosen subsidiary:
- (a) the chosen transitional entity and each interposed non-chosen subsidiary comprise a ***sub-group*** in relation to the non-chosen subsidiary (unless the non-chosen subsidiary is included in a sub-group in relation to another non-chosen subsidiary); and
 - (b) the following membership interests are the ***sub-group membership interests*** in relation to the sub-group:
 - (i) the membership interests that the chosen transitional entity holds directly in the non-chosen subsidiary or in any of the interposed non-chosen subsidiaries;
 - (ii) the membership interests that each interposed non-chosen subsidiary holds directly in the non-chosen subsidiary or in any of the other interposed non-chosen subsidiaries.

701-25 No operation of value shifting and loss transfer provisions to membership interests in chosen transitional entities

If any provision of this Act would, because of events that happened before the time the transitional group came into existence, apply to a CGT event that happens after that time to change the cost base or reduced cost base of the members' membership interests in a chosen transitional entity, the provision does not so apply.

Note: For example, such a provision could otherwise apply where a loss transfer or value shift involving the entity has occurred.

701-30 Undistributed, unfrankable pre-formation profits of non-chosen transitional entities—adjustment to allocable cost amount and tax cost setting amount reduction for over-depreciated assets

Application of section to non-chosen transitional entities where transitional group formed before 1 July 2003

- (1) This section applies if the transitional group comes into existence before 1 July 2003. It applies to each transitional entity in the transitional group, other than a chosen transitional entity. This is so even if there are no chosen transitional entities at all.

Increase in step 3 of allocable cost amount on group formation

- (2) The amount to be added under section 705-90 (step 3 of allocable cost amount) of the *Income Tax Assessment Act 1997* in working out the transitional group's allocable cost amount for the transitional entity is increased by the additional undistributed profits (the **step 3 unfrankable profits increase**) that would form part of the step 3 amount under that section if:
- (a) subsections (3) and (4), and paragraph (6)(b), of that section were disregarded; and
 - (b) it were a requirement of that section that, if any additional undistributed profits resulting from paragraph (a) of this subsection were distributed as dividends just before the group came into existence, the head company and each other transitional entity interposed between the head company and the transitional entity would be entitled to a rebate of income tax under section 46 or 46A of the *Income Tax Assessment Act 1936* on the dividends.

Increase in tax deferral amount in relation to over-depreciated assets

- (3) The tax deferral amount for the purposes of applying section 705-50 (reduction in tax cost setting amount for over-depreciated assets) of the *Income Tax Assessment Act 1997* in relation to an asset of the transitional entity that becomes that of the head company under subsection 701-1(1) (the single entity rule) of that Act when the transitional group comes into existence

is increased by the amount worked out under subsection (4) of this section.

Amount of increase in tax deferral amount

- (4) The increase is equal to the amount that would have been the step 3 unfrankable profits increase if the undistributed profits constituting that increase were also required to satisfy the following requirements:
- (a) the profits were not subject to income tax because of deductions for the asset's decline in value;
 - (b) the decline in value represented the over-depreciation of the asset;
 - (c) the deductions for the decline in value do not form part of a tax loss covered by the step 5 amount mentioned in step 5 in the table in section 705-60 of the *Income Tax Assessment Act 1997* in working out the transitional group's allocable cost amount for the transitional entity.

701-35 CGT event for pre-formation roll-over after 16 May 2002 to be disregarded if cost base etc. would be different

If:

- (a) after 16 May 2002 and before the transitional group came into existence, a CGT event happened in relation to an asset for which there was:
 - (i) a roll-over under Subdivision 126-B of the *Income Tax Assessment Act 1997*; or
 - (ii) roll-over relief under section 40-340 of that Act in a case covered by item 4 of the table in subsection (1) of that section; and
- (b) the cost base or reduced cost base of that asset or any other asset that:
 - (i) became an asset of the head company when the transitional group came into existence because subsection 701-1(1) (the single entity rule) of that Act applies; or
 - (ii) was otherwise an asset of the head company at that time;

differs at that time from what it would have been if the roll-over had not occurred or there had been no such roll-over relief;

then Part 3-90 of the *Income Tax Assessment 1997* applies as if the CGT event had not happened.

701-40 When entity leaves transitional group, head company may choose, for purposes of transitional group's allocable cost amount, to increase terminating values of over-depreciated assets

- (1) This section applies if an entity ceases to be a subsidiary member of the transitional group and the requirements of subsections (2) to (5) are satisfied.

Asset held at leaving time

- (2) Just before the entity ceases to be a subsidiary member, it must, disregarding subsection 701-1(1) (the single entity rule) of the *Income Tax Assessment Act 1997*, hold an asset.

Reduction of asset's tax cost setting amount for over-depreciation

- (3) When the transitional group came into existence:
- (a) the asset must have become that of the head company of the transitional group because subsection 701-1(1) of that Act applied in relation to a transitional entity; and
 - (b) section 705-50 of that Act must have reduced by an amount (the **reduction amount**) the tax cost setting amount for the asset.

Asset held continuously within group

- (4) The asset must, disregarding subsection 701-1(1) of that Act, have been held at all times by the head company or a subsidiary member of the transitional group from when the transitional group came into existence until the entity ceases to be a subsidiary member of the transitional group.

Head company's advice to leaving entity

- (5) Before the entity ceases to be a subsidiary member of the transitional group, the head company must have advised the entity of the amount that the head company proposes to choose under subsection (6) of this section in relation to the asset.

Note: This information would need to be known by the entity if it later becomes a subsidiary member of another consolidated group and still holds the asset. This is because subsection 705-50(5) of the *Income Tax Assessment Act 1997* requires a reduction in the tax cost setting amount for the asset on joining that other group and the amount chosen by the head company under this section is relevant to working out that reduction.

Head company's choice

- (6) If this section applies, the head company may, in relation to the entity's ceasing to be a subsidiary member, choose that the terminating value for the asset, that is to be used in applying step 1 of the table in section 711-20 of the *Income Tax Assessment Act 1997*, is increased by so much of the reduction amount as the head company chooses.

701-45 When entity leaves transitional group, head company may choose, for purposes of transitional group's allocable cost amount, to use formation time market values, instead of terminating values, for certain pre-CGT assets

- (1) This section applies if:
- (a) an entity ceases to be a subsidiary member of the transitional group; and
 - (b) just before the transitional group came into existence, the entity that became the head company held a pre-CGT asset; and
 - (c) that holding of the asset did not occur as a result of a CGT event:
 - (i) for which there was a roll-over under Subdivision 126-B of the *Income Tax Assessment Act 1997*; and
 - (ii) that occurred after 11.45 am by legal time in the Australian Capital Territory on 21 September 1999; and

- (d) just before the entity ceases to be a subsidiary member of the group, the asset is still a pre-CGT asset and is held by the head company only because the entity is taken by subsection 701-1(1) (the single entity rule) of the *Income Tax Assessment Act 1997* to be a part of the head company.
- (2) If this section applies, the head company may, in relation to the entity's ceasing to be a subsidiary member, choose that the terminating value for the asset, that is to be used in applying step 1 of the table in section 711-20 of the *Income Tax Assessment Act 1997*, is equal to its market value just before the transitional group came into existence.

Division 702—Modified application of this Act to assets that an entity brings into a consolidated group

Table of sections

| | |
|-------|---|
| 702-1 | Modified application of section 40-77 of this Act to assets that an entity brings into a consolidated group |
| 702-5 | Modified application of subsection 40-285(6) of this Act after entity brings assets into consolidated group |

702-1 Modified application of section 40-77 of this Act to assets that an entity brings into a consolidated group

- (1) This section applies if:
 - (a) an entity becomes a subsidiary member of a consolidated group; and
 - (b) just before it does so, section 40-77 of this Act applies to an asset that it holds.
- (2) For so long as the asset continues to be:
 - (a) an asset of the head company because subsection 701-1(1) (the single entity rule) of the *Income Tax Assessment Act 1997* applies; or
 - (b) an asset of another entity, where it became such an asset as a result of that subsection ceasing to apply on the entity ceasing to be a subsidiary member of the group;

then, despite certain provisions of that Act applying, in accordance with subsection 701-55(2) of that Act, as if the asset were acquired for a payment equal to its tax cost setting amount:

- (c) subsection 40-77(1) continues to apply to the asset; and

Note: This means that Division 40 of the *Income Tax Assessment Act 1997* continues not to apply to an asset that is a mining, quarrying or prospecting right.

- (d) subsection 40-77(2) continues to apply to the asset, but applies as if the reference in that subsection to the cost of the asset were a reference to the cost worked out on the basis that the asset were acquired for a payment equal to its tax cost setting amount; and
- (e) subsection 40-77(3) continues to apply to the asset, but applies as if the reference in that subsection to the amount included in assessable income under subsection 40-285(1) of that Act were a reference to the amount so worked out on the basis that the asset were acquired for a payment equal to its tax cost setting amount.

702-5 Modified application of subsection 40-285(6) of this Act after entity brings assets into consolidated group

If:

- (a) an entity becomes a subsidiary member of a consolidated group; and
- (b) because subsection 701-1(1) (the single entity rule) of the *Income Tax Assessment Act 1997* applies, an asset of the entity becomes an asset of the head company of the group; and
- (c) a balancing adjustment event happens in relation to the asset while it is an asset of the head company;

subsection 40-285(6) of this Act (about reducing the amount included in assessable income for a balancing adjustment event) applies as if the cost of the asset were equal to the tax cost setting amount applicable in relation to the asset for the purposes of having its tax cost set by section 701-10 (cost to head company of assets that entity brings into group) of the *Income Tax Assessment Act 1997*.

Note: The tax cost setting amount applicable in relation to the asset for that purpose is worked out in accordance with Division 705 of the *Income Tax Assessment Act 1997*.

Schedule 8—Consolidation: amendment of transitional provisions for losses

Income Tax (Transitional Provisions) Act 1997

1 Paragraph 707-325(1)(a)

Omit “increase”, substitute “work out”.

2 Subsection 707-325(3) (heading)

Repeal the heading, substitute:

Adding to the modified market value of the real loss-maker

3 Subsection 707-325(3)

Omit “the modified market value of the real loss-maker at the initial transfer time were increased by”, substitute “there were added to the modified market value of the real loss-maker at the initial transfer time”.

4 At the end of subsection 707-325(3)

Add:

Note: The amount worked out using the formula will be nil if the value donor’s modified market value at the initial transfer time is nil. Even if the amount is nil, section 707-327 may treat losses transferred by the value donor to the transferee as if they were included in the bundle of losses transferred by the real loss-maker to the transferee.

5 Subsection 707-325(5) (heading)

Repeal the heading, substitute:

Choice to work out available fraction using this section

6 Subsection 707-325(5)

Omit “increase”, substitute “work out”.

7 Paragraph 707-327(1)(a)

Repeal the paragraph, substitute:

- (a) the available fraction for a bundle of other losses is worked out, because of section 707-325, as if there were added to the modified market value of the real loss-maker of the other losses an amount worked out under that section by reference to the value donor's modified market value; and

8 At the end of subsection 707-327(1)

Add:

- Note: This section has effect even if the amount added to the real loss-maker's modified market value under section 707-325 is nil because the value donor's modified market value is nil.

9 Paragraph 707-327(2)(b)

Repeal the paragraph, substitute:

- (b) each other company (if any) for which it is the case that the available fraction for the bundle is worked out, because of another application of section 707-325, as if there were added to the real loss-maker's modified market value an amount worked out by reference to the company.

10 Subsection 707-327(6) (note)

Omit "working out an increased available fraction for a bundle of losses under section 707-325", substitute "section 707-325 to apply in relation to the working out of the available fraction for a bundle of losses".

Schedule 9—Consolidation: transitional provisions for international tax

Income Tax (Transitional Provisions) Act 1997

1 Section 707-405 (link note)

Repeal the link note, substitute:

[The next Division is Division 717.]

2 At the end of Part 3-90

Add:

Division 717—International tax rules

717-15 Head company's accelerated access to joining entity's excess foreign tax credits from earlier years

- (1) This section operates in relation to an income year if:
 - (a) a consolidated group came into existence during an income year (the *current year*); and
 - (b) the current year ended before 1 July 2004; and
 - (c) section 160AFE of the *Income Tax Assessment Act 1936* as amended by the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* applies in relation to the head company of the consolidated group for the current year; and
 - (d) an entity (the *joining entity*) became a subsidiary member of a consolidated group at a time (the *joining time*) during the current year; and
 - (e) the condition in subsection (2) is satisfied.
- (2) The condition is that the joining entity and the head company of the group were members of the same wholly-owned group:

- (a) if the joining time was the start of the current year or the time the joining entity came into existence—at the joining time; or
 - (b) otherwise—throughout the period:
 - (i) beginning at the start of the current year, or the time the joining entity came into existence (whichever is later); and
 - (ii) ending at the joining time.
- (3) For the purposes of section 717-15 of the *Income Tax Assessment Act 1997* in relation to the current year, the reference in subparagraph 717-15(1)(b)(i) of that Act to the start of that income year is taken to be a reference to the end of that income year.

717-20 Head company's accelerated access to joining entity's excess foreign tax credits from joining year

- (1) This section operates if:
- (a) a consolidated group came into existence during an income year (the *current year*); and
 - (b) the current year ended before 1 July 2004; and
 - (c) section 160AFE of the *Income Tax Assessment Act 1936* as amended by the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* applies in relation to the head company of the consolidated group for the current year; and
 - (d) an entity (the *joining entity*) became a subsidiary member of the consolidated group at a time (the *joining time*) during the current year; and
 - (e) the condition in subsection (2) is satisfied; and
 - (f) the joining entity had excess foreign tax credits from the earliest non-membership period (under section 701-30 of the *Income Tax Assessment Act 1997*) in the current year.
- (2) The condition is that the joining entity and the head company of the consolidated group were members of the same wholly-owned group:
- (a) if the joining time was the start of the current year or the time the joining entity came into existence—at the joining time; or
 - (b) otherwise—throughout the period:
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- (i) beginning at the start of the current year, or the time the joining entity came into existence (whichever is later); and
 - (ii) ending at the joining time.
- (3) Section 160AFE of the *Income Tax Assessment Act 1936* operates in relation to the head company of the consolidated group for the current year as if:
- (a) subsection 160AFE(4) of that Act provided that the amount of the excess foreign tax credits mentioned in paragraph (1)(f) of this section was the amount of the head company's excess foreign tax credits from an earlier year of income (the *notional year*); and
 - (b) paragraphs 160AFE(3)(a) and (b) of that Act provided that the excess foreign tax credits from the notional year should be applied before the other credits mentioned in those paragraphs.

717-25 No double counting of foreign tax

To avoid doubt, sections 717-15 and 717-20 do not operate so as to result in an amount of foreign tax (within the meaning of the *Income Tax Assessment Act 1936*) being counted twice for the purposes of section 160AF of that Act.

[The next Division is Division 820.]

Schedule 10—Consolidation: consequential provisions for international tax

Income Tax Assessment Act 1936

1 Section 160AFE

Repeal the section, substitute:

160AFE Carrying forward excess foreign tax credits

- (1) This section operates if the amount (the ***current foreign tax amount***) worked out under paragraph 160AF(1)(c) for a taxpayer for a year of income (the ***current year***) falls short of the amount worked out under paragraph 160AF(1)(d) for the taxpayer for the current year.
- (2) The taxpayer's excess foreign tax credits from earlier years of income (see subsection (4)) are applied in accordance with subsection (3) to increase the current foreign tax amount.
- (3) Apply those credits according to the following rules:
 - (a) only apply credits from the most recent 5 years of income ending before the current year;
 - (b) apply credits from an earlier year of income before applying credits for a later year of income;
 - (c) do not apply credits beyond the extent of the shortfall mentioned in subsection (1);
 - (d) do not apply credits to the extent that the credits have already been applied under a previous operation of this section.
- (4) The taxpayer has ***excess foreign tax credits*** from an earlier year of income (the ***earlier year***) if the amount worked out under paragraph 160AF(1)(c) for the taxpayer for the earlier year exceeds the amount worked out under paragraph 160AF(1)(d) for the taxpayer for the earlier year. The amount of the credits equals the excess.

- (5) This section operates separately in relation to each class of foreign income identified in subsection 160AF(7), as if the taxpayer's foreign income of that class for a year of income were the whole of the taxpayer's foreign income for that year.

2 Basic rule about application of section 160AFE

- (1) Section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule applies in relation to a taxpayer for each of its:
- (a) income years starting after 30 June 2003; and
 - (b) non-membership periods (if any) under section 701-30 of the *Income Tax Assessment Act 1997* starting after 30 June 2003.
- (2) This item does not apply in relation to a taxpayer to which item 3 applies.

Note: If you have a substituted accounting period, item 5 or 7 may apply instead of this item.

3 Different application for members of certain groups

- (1) This item applies to a taxpayer if:
- (a) the taxpayer becomes a member of a consolidated group or MEC group on the day (the *consolidation day*) the group comes into existence; and
 - (b) the consolidation day either is before 1 July 2003 or is both:
 - (i) the first day of the first income year starting after 30 June 2003 of the group's head company (for a consolidated group) or provisional head company (for a MEC group) on the consolidation day; and
 - (ii) before 1 July 2004; and
 - (c) the taxpayer was not a member of a consolidated group or MEC group before the consolidation day.
- (2) Section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule applies in relation to the taxpayer for each of its:
- (a) income years starting on or after the consolidation day; and
 - (b) non-membership periods (if any) under section 701-30 of the *Income Tax Assessment Act 1997* starting on or after the consolidation day.

Note: If you become the head company of a consolidated group on or after 1 July 2002 and before 1 July 2003 on a day that is not the start of your income year, item 6 will apply instead of this item.

4 Transitional provision for section 160AFE

For the purposes of paragraph 160AFE(3)(d) of the *Income Tax Assessment Act 1936* as in force immediately after the commencement of this Schedule, take account of an amount utilised or applied under section 160AFE of that Act as in force either before or after that commencement for a year of income ending before or after that commencement.

5 Modification of basic rule

- (1) This item applies to a taxpayer instead of item 2 if the taxpayer:
 - (a) has a substituted accounting period; and
 - (b) is not a member of a consolidated group or a MEC group.
- (2) Section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule applies to the taxpayer from 1 July 2003. That section applies from 1 July 2003 until the start of the taxpayer's next income year as if that period were an income year.
- (3) Section 160AFE of the *Income Tax Assessment Act 1936* as in force just before the commencement of this Schedule (the *old section 160AFE*) applies to the taxpayer from the start of the taxpayer's income year in which 1 July 2003 occurs until the end of 30 June 2003 as if that period were an income year.

6 Consolidation day on or after 1 July 2002 and before 1 July 2003

- (1) This item applies to a taxpayer instead of item 3 if:
 - (a) the taxpayer becomes the head company of a consolidated group or MEC group on the day (also the *consolidation day*) the group comes into existence; and
 - (b) the consolidation day is on or after 1 July 2002 and before 1 July 2003 and is not the start of an income year (whether or not the taxpayer has a substituted accounting period).
 - (2) Section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule applies to the taxpayer from the consolidation day. That
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section applies from the consolidation day until the end of the taxpayer's income year in which that day occurs as if that period were an income year.

- (3) If:
- (a) the consolidation day is after 1 July 2002; and
 - (b) the taxpayer does not have a substituted accounting period;
- the old section 160AFE applies to the taxpayer from 1 July 2002 until just before the consolidation day. If the taxpayer so chooses, it applies as if that period were an income year.
- (4) If the taxpayer has a substituted accounting period, the old section 160AFE applies to the taxpayer from the start of the taxpayer's income year in which the consolidation day occurred until just before the consolidation day. If the taxpayer so chooses, it applies as if that period were an income year.

7 Consolidation day on or after 1 July 2003

- (1) This item applies to a taxpayer instead of item 2 if:
- (a) the taxpayer has a substituted accounting period; and
 - (b) the taxpayer becomes the head company of a consolidated group or MEC group on the day (also the *consolidation day*) the group comes into existence; and
 - (c) the consolidation day is on or after 1 July 2003 and is not the start of the taxpayer's next income year.
- (2) Section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule applies to the taxpayer from 1 July 2003. That section applies from 1 July 2003 until the start of the taxpayer's next income year as if that period were an income year.
- (3) The old section 160AFE applies to the taxpayer from the start of the taxpayer's income year in which 1 July 2003 occurs until the end of 30 June 2003. If the taxpayer so chooses, it applies as if that period were an income year.

8 Applying old section 160AFE to part years

- (1) Subitem (2) has effect for the purposes of applying the old section 160AFE:
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- (a) to a taxpayer as mentioned in item 5, 6 or 7; and
 - (b) for a period that is shorter than an income year.
- (2) The requirement in paragraph (1D)(b) of that section that the income company be a group company in relation to the credit company in relation to the current year of income has effect as if it were a requirement that the income company be a group company in relation to the credit company:
 - (a) continuously for a period of at least 12 months ending on the day before the day on which section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule starts to apply to the taxpayer; or
 - (b) from the time when the income company and the credit company were both in existence, if that period is shorter.

9 Applying old section 160AFE to non-membership periods

- (1) Subitem (2) has effect for the purposes of applying the old section 160AFE to a taxpayer that:
 - (a) becomes a subsidiary member of a consolidated group or MEC group; and
 - (b) has a period referred to in section 701-30 as a non-membership period.
- (2) The requirement in paragraph (1D)(b) of the old section 160AFE that the income company be a group company in relation to the credit company in relation to the current year of income has effect as if it were a requirement that the income company be a group company in relation to the credit company:
 - (a) continuously for a period of at least 12 months ending on the last day of the non-membership period; or
 - (b) from the time when the income company and the credit company were both in existence, if that period is shorter.

10 Parts of income years not earlier income years

Any period that is shorter than an income year and that is treated as if it were an income year for the purposes of item 5, 6 or 7 of this Schedule is taken not to be an earlier income year for the purposes of section 160AFE of the *Income Tax Assessment Act 1936* as amended by this Schedule.

11 Transitional provision for section 160AF

- (1) This item applies if:
 - (a) because of item 5, 6 or 7, old section 160AFE applies to a taxpayer as if a period were an income year (the *notional income year*); and
 - (b) the taxpayer has an initial excess credit (within the meaning of old section 160AFE) in relation to the notional income year; and
 - (c) the taxpayer transfers all or part (the extent of the transfer being the *transfer amount*) of that initial excess credit under old section 160AFE for utilisation by another company in the notional income year.
- (2) Section 160AF of the *Income Tax Assessment Act 1936* applies to the taxpayer for the year of income in which the notional income year ends as if the amount of foreign tax paid by the taxpayer mentioned in paragraph 160AF(1)(b) of that Act were reduced by the transfer amount.
- (3) This item operates separately in relation to each class of foreign income identified in subsection 160AF(7) of the *Income Tax Assessment Act 1936*, as if the taxpayer's foreign income of that class for a year of income were the whole of the taxpayer's foreign income for that year.

**Schedule 11—Consolidation: amendment of
transitional provision about limiting
access to group concessions**

New Business Tax System (Consolidation) Act (No. 1) 2002

1 Subitem 39(9) of Schedule 3

Omit “in the same way as they apply in relation to”, substitute “as if it were”.

Schedule 12—Consolidation: amendments of Dictionary

Income Tax Assessment Act 1997

1 Subsection 995-1(1)

Insert:

excess foreign tax credits has the meaning given by subsection 160AFE(4) of the *Income Tax Assessment Act 1936*.

Schedule 13—Exempting entities and former exempting entities

Income Tax Assessment Act 1997

1 Paragraph 204-30(3)(b)

Repeal the paragraph, substitute:

- (b) that a specified *exempting debit arises in the *exempting account of the entity, for a specified *distribution or other benefit to a disadvantaged member;
- (c) that no *imputation benefit is to arise in respect of a distribution that is made to a favoured member and specified in the determination.

2 Subsection 204-30(4)

Repeal the subsection, substitute:

- (4) The Commissioner may:
 - (a) specify the *franking debit under paragraph (3)(a) by specifying the *franking percentage to be used in working out the amount of the debit; and
 - (b) specify the *exempting debit under paragraph (3)(b) by specifying the *exempting percentage to be used in working out the amount of the debit.

3 Subsection 204-30(5)

Omit “or (b)”, substitute “, (b) or (c)”.

4 Paragraph 204-30(6)(d)

Repeal the paragraph, substitute:

- (d) an *exempting credit would arise in the *exempting account of the member as a result of the distribution; or
- (e) the member would not be liable to pay *withholding tax on the distribution, because of the operation of paragraph 128B(3)(ga) of the *Income Tax Assessment Act 1936*.

5 At the end of subsection 204-30(8)

Add:

; (f) the other member is an *exempting entity.

6 At the end of section 204-30

Add:

- (9) A *member of an entity derives a *greater benefit from franking credits* than another member of the entity if any of the following circumstances exist in relation to the first member in the income year in which the *distribution giving rise to the benefit is made, and not in relation to the other member:
- (a) a *franking credit arises for the first member under item 5, 6 or 7 of the table in section 208-130 (distributions by *exempting entities to exempting entities);
 - (b) a franking credit or *exempting credit arises for the first member because the distribution is *franked with an exempting credit;
 - (c) the first member is entitled to a *tax offset because:
 - (i) the distribution is a *franked distribution made by an exempting entity; or
 - (ii) the distribution is *franked with an exempting credit.

7 At the end of section 204-35

Add:

- (2) If the Commissioner makes a determination giving rise to an *exempting debit in the *exempting account of an entity under paragraph 204-30(3)(b), the debit arises in the exempting account of the entity on the day on which the notice of determination is given to the entity in accordance with section 204-50.

8 After section 204-40

Insert:

204-41 Amount of the exempting debit

The amount of the *exempting debit arising because of a determination by the Commissioner under paragraph 204-30(3)(b) must not exceed:

- (a) if the specified *distribution has been *franked with an exempting credit—the difference between the amount of the *exempting credit on the distribution and an amount worked out by multiplying the amount of the distribution by the highest *exempting percentage at which a distribution to a favoured member is franked; or
- (b) if the specified distribution, although *frankable, has not been franked with an exempting credit—an amount worked out by multiplying the amount of the distribution by the highest exempting percentage at which a distribution to a favoured member is franked; or
- (c) if the specified distribution is *unfrankable—an amount worked out by multiplying the amount of the distribution by the highest exempting percentage at which a distribution to a favoured member is franked; or
- (d) if the specified benefit is the issue of bonus shares from a share premium account—an amount worked out by multiplying the amount debited to the share premium account in respect of the bonus shares by the highest exempting percentage at which a distribution to a favoured member is franked; or
- (e) if some other benefit is specified—an amount worked out by multiplying the value of the benefit by the highest exempting percentage at which a distribution to a favoured member is franked.

9 Section 204-45

Omit “paragraph 204-30(3)(b)”, substitute “paragraph 204-30(3)(c)”.

10 Paragraph 204-50(2)(b)

Repeal the paragraph, substitute:

- (b) in a case where the Commissioner determines that an *exempting debit is to arise in the *exempting account of an entity under paragraph 204-30(3)(b)—to the entity; and

(c) in a case where a favoured member is denied an *imputation benefit under paragraph 204-30(3)(c)—to the favoured member.

11 Subsection 204-50(3)

Omit “paragraph 204-30(3)(b)”, substitute “paragraph 204-30(3)(c)”.

12 Section 205-25

Omit “specified in the table in section 205-15 or 205-30”, substitute “specified in a relevant table”.

13 At the end of section 205-25

Add:

(2) The tables in sections 205-15 and 205-30 are relevant for the purposes of subsection (1).

14 Section 207-75

Omit “*franked distribution”, substitute “*distribution”.

15 After Division 207

Insert:

Division 208—Exempting entities and former exempting entities

Table of Subdivisions

Guide to Division 208

- 208-A What are exempting entities and former exempting entities?
- 208-B Franking with an exempting credit
- 208-C Amount of the exempting credit on a distribution
- 208-D Distribution statements
- 208-E Distributions to be franked with exempting credits to the same extent
- 208-F Exempting accounts and franking accounts of exempting entities and former exempting entities
- 208-G Tax effects of distributions by exempting entities
- 208-H Tax effect of a distribution franked with an exempting credit

Guide to Division 208**Table of sections**

- 208-5 What is an exempting entity?
- 208-10 Former exempting entities
- 208-15 Distributions by exempting entities and former exempting entities

208-5 What is an exempting entity?

- (1) An exempting entity is a corporate tax entity that is effectively owned by entities that, either because they are not Australian residents or because they receive distributions as exempt income, would not be able to fully utilise franking credits on distributions by the corporate tax entity.
- (2) In deciding whether a corporate tax entity is effectively owned by such entities, these rules:
 - (a) look at the membership interests in the entity that involve the holder of the interest in bearing the risks and accruing the opportunities of ownership of the entity; and
 - (b) ask whether at least 95% of those membership interests, and 95% of any interests in those membership interests, are held

by Australian residents or entities that receive distributions as exempt income.

208-10 Former exempting entities

When an entity ceases to be an exempting entity, it becomes a former exempting entity.

208-15 Distributions by exempting entities and former exempting entities

To ensure that franking credits accumulated by an exempting entity are not the target of franking credit trading, these rules:

- (a) limit the circumstances in which a distribution franked with those credits can give rise to benefits under the imputation system; and
- (b) quarantine those credits by moving them into a separate account, called the exempting account, when the entity ceases to be an exempting entity; and
- (c) deny a recipient of a distribution franked with a credit from that account any benefit under the imputation system as a result of that distribution, unless the recipient was a member of the entity immediately before it became a former exempting entity.

Subdivision 208-A—What are exempting entities and former exempting entities?

Table of sections

| | |
|--------|---|
| 208-20 | Exempting entities |
| 208-25 | Effective ownership of entity by prescribed persons |
| 208-30 | Accountable membership interests |
| 208-35 | Accountable partial interests |
| 208-40 | Prescribed persons |
| 208-45 | Persons who are taken to be prescribed persons |
| 208-50 | Former exempting companies |

208-20 Exempting entities

A *corporate tax entity is an *exempting entity* at a particular time if, at that time, the entity is effectively owned by prescribed persons.

Note: Prescribed persons are identified in sections 208-40 and 208-45.

208-25 Effective ownership of entity by prescribed persons

- (1) An entity is *effectively owned by prescribed persons* at a particular time if:
 - (a) at that time:
 - (i) not less than 95% of the *accountable membership interests in the entity; or
 - (ii) not less than 95% of the *accountable partial interests in the entity;
are held by, or held indirectly for the benefit of, prescribed persons; or
 - (b) paragraph (a) does not apply but it would nevertheless be reasonable to conclude that, at that time, the risks involved in, and the opportunities resulting from, holding accountable membership interests, or accountable partial interests, in the entity that are not held by, or directly or indirectly for the benefit of, prescribed persons are substantially borne by, or substantially accrue to, prescribed persons.
- (2) In deciding whether it would be reasonable to conclude as mentioned in paragraph (1)(b):
 - (a) have regard to any *arrangement in respect of *membership interests (including unissued membership interests), or in respect of *partial interests, in the entity (including any derivatives held or issued in connection with those membership interests or partial interests) of which the entity is aware; but
 - (b) do not have regard to risks involved in the ownership of membership interests, or partial interests, in the entity that are substantially borne by any person in the person's capacity as a secured creditor.

- (3) An entity has a *partial interest* in a *corporate tax entity if it has an interest in a *membership interest in the corporate tax entity.

208-30 Accountable membership interests

- (1) The purpose of this section is to identify which *membership interests in an entity are relevant in determining whether the entity is effectively owned by prescribed persons.
- (2) A *membership interest in an entity is an *accountable membership interest* if it is not an excluded membership interest.
- (3) A *membership interest in an entity is an *excluded membership interest* if, having regard to:
- (a) the purposes for which the membership interest was issued; and
 - (b) any special or limited rights connected with, arising from, or attached to:
 - (i) the membership interest; or
 - (ii) other membership interests in the entity held by the holder of the membership interest; or
 - (iii) membership interests in the entity held by persons other than the holder of the membership interest; or
 - (iv) interests in any of the above; including rights that are conferred or exercisable only if the holder of the membership interest or interests concerned is, or is not, a prescribed person; and
 - (c) the extent to which any such special or limited rights are similar to or differ from the rights that are normally attached to the ownership of *ordinary membership interests in *corporate tax entities; and
 - (d) the relationship between the value of the membership interest and the value of the entity; and
 - (e) any relationship or connection (whether of a personal or business nature) between holders of membership interests in the entity of which the entity is aware; and
 - (f) any *arrangement in respect of membership interests (including unissued membership interests) in the entity, or

interests in membership interests in the entity, of which the entity is aware;

it would be reasonable to conclude that the membership interest is not relevant in determining whether the entity is effectively owned by prescribed persons because holding the membership interest does not involve the holder bearing the risks, or result in the accrual to the holder of the opportunities, of ownership of the entity that ordinarily arise from, or are ordinarily attached to, the holding of ordinary membership interests in an entity.

- (4) In applying subsection (3), the fact that a person is a trustee is to be disregarded.
- (5) Without limiting subsection (3), a *membership interest in an entity held by a person who is not a prescribed person is an ***excluded membership interest*** if:
 - (a) it is a finance membership interest; or
 - (b) it is a distribution access membership interest; or
 - (c) it does not carry the right to receive distributions; or
 - (d) it was issued, transferred or acquired for a purpose (other than an incidental purpose) of ensuring that the entity is not effectively owned by prescribed persons.
- (6) A *membership interest is a ***finance membership interest*** if:
 - (a) the membership interest is a *non-equity share in the entity; or
 - (b) having regard to the rights attached to the membership interest and to any *arrangement with respect to the membership interest of which the entity is aware, the membership interest is equivalent to a debt owed by the entity to the holder of the membership interest.
- (7) A *membership interest to which subsection (6) does not apply is a ***finance membership interest*** if:
 - (a) the manner in which the *distributions payable in respect of the membership interest are calculated, and the conditions applying to the payment of such distributions, indicate that the distributions paid are equivalent to the receipt by the person to whom they are paid of interest or an amount in the nature of or similar to interest; or

- (b) the capital invested by the holder of the membership interest will be redeemed or, because of an *arrangement between the holder and the entity or an *associate of the entity, it is reasonable for the holder to expect that the capital will be redeemed, for an amount that is not less than, or for property (including other membership interests in the entity) the value of which is not less than, the amount paid for the membership interest; or
 - (c) the membership interest is redeemable by the entity by payment of a lump sum or by the transfer of property, or the membership interest has a preferred right to a repayment of capital on a winding up, where the amount of the lump sum or the value of the property, or the amount of the capital to be repaid, as the case may be, is to be calculated by reference to an implicit interest rate.
- (8) A *membership interest in an entity is a ***distribution access membership interest*** if, having regard to:
- (a) the terms of the issue of the membership interest, including any guarantee of payment of distributions; and
 - (b) the amounts of the *distributions paid on the membership interest relative to the issue price of the membership interest; and
 - (c) whether there is any guaranteed rate at which *franked distributions are to be paid on the membership interest; and
 - (d) the duration of the period within which the membership interest was issued; and
 - (e) the rights attached to other membership interests in the entity; and
 - (f) any other relevant matters;
- it could be concluded that the membership interest was issued only for the purpose of paying distributions to the holder of the membership interest.

208-35 Accountable partial interests

- (1) The purpose of this section is to identify which *partial interests in an entity are relevant in determining whether the entity is effectively owned by prescribed persons.
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- (2) A *partial interest in an entity is an *accountable partial interest* if it is not an excluded partial interest.
- (3) A *partial interest in an entity is an *excluded partial interest* if, having regard to:
- (a) the purposes for which the interest was granted; and
 - (b) the nature of the interest; and
 - (c) any special or limited rights connected with or arising from:
 - (i) the interest; or
 - (ii) other *membership interests, or partial interests, in the entity held by the holder of the interest; or
 - (iii) membership interests, or partial interests, in the entity held by persons other than the holder of the interest; including rights that are conferred or exercisable only if the holder of the membership interests or partial interests concerned is, or is not, a prescribed person; and
 - (d) the extent to which the interest is similar to or differs from beneficial ownership; and
 - (e) the relationship between the value of the interest and the value of the entity; and
 - (f) any relationship or connection (whether of a personal or business nature) between holders of partial interests in the entity, and the holders of membership interests in the entity, of which the entity is aware; and
 - (g) any *arrangement in respect of membership interests (including unissued membership interests) in the entity, or partial interests in the entity, of which the entity is aware;
- it would be reasonable to conclude that the partial interest is not relevant in determining whether the entity is effectively owned by prescribed persons because holding the membership interest to which the partial interest relates does not involve the holder bearing the risks, or result in the accrual to the holder of the opportunities, of ownership of the entity that ordinarily arise from, or are ordinarily attached to, the holding of *ordinary membership interests in an entity.
- (4) In applying subsection (3), the fact that a person is a trustee is to be disregarded.

- (5) Without limiting subsection (3), a *partial interest in an entity is also an *excluded partial interest* if it was granted or otherwise created, or was transferred or acquired, for a purpose (other than an incidental purpose) of ensuring that the entity is not effectively owned by prescribed persons.

208-40 Prescribed persons

- (1) A company is a *prescribed person* in relation to another *corporate tax entity if:
- (a) the company is not an *Australian resident; or
 - (b) were the company to receive a *distribution made by the other corporate tax entity, the distribution would be *exempt income of the company.
- (2) A trustee is a *prescribed person* in relation to a *corporate tax entity if:
- (a) all the beneficiaries in the trust are prescribed persons under other provisions of this section; or
 - (b) were the trustee to receive a *distribution made by the corporate tax entity, the distribution would be *exempt income of the trust estate.
- (3) A *partnership is a *prescribed person* in relation to a *corporate tax entity if:
- (a) all the partners are prescribed persons under other provisions of this section; or
 - (b) were the partnership to receive a *distribution made by the corporate tax entity, the distribution would be *exempt income of the partnership.
- (4) An individual (other than a trustee) is a prescribed person in relation to a *corporate tax entity if:
- (a) he or she is not an *Australian resident; or
 - (b) were he or she to receive a *distribution made by the corporate tax entity, the distribution would be *exempt income of the individual.

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- (5) The Commonwealth, each of the States, the Australian Capital Territory, the Northern Territory and Norfolk Island are prescribed persons in relation to any *corporate tax entity.

208-45 Persons who are taken to be prescribed persons

- (1) This section applies to a person that:
- (a) is a *company, a trustee, or a *partnership, that holds *membership interests (whether *accountable membership interests or excluded membership interests), or *partial interests (whether *accountable partial interests or excluded partial interests), in a *corporate tax entity (the *relevant entity*); and
 - (b) is not a prescribed person under section 208-40.
- (2) A *company that holds *membership interests, or *partial interests, in the relevant entity is taken to be a *prescribed person* in relation to the relevant entity if the risks involved in, and the opportunities resulting from, holding the membership interests or partial interests are substantially borne by, or substantially accrue to, as the case may be, one or more prescribed persons.
- (3) A trustee of a trust who holds *membership interests, or *partial interests, in the relevant entity is taken to be a *prescribed person* in relation to the relevant entity if the risks involved in, and the opportunities resulting from, holding the membership interests or partial interests are substantially borne by, or substantially accrue to, as the case may be, one or more prescribed persons.
- (4) A trustee of a trust who holds *membership interests, or *partial interests, in the relevant entity is taken to be a *prescribed person* in relation to the relevant entity if:
- (a) unless subsection (7) applies, the trust is controlled by one or more persons who are prescribed persons; or
 - (b) all the beneficiaries who are presently entitled to, or during the relevant year of income become presently entitled to, income from the trust are prescribed persons.
- (5) In determining whether subsection (3) or (4) applies in respect of a trust that is controlled by a person, have regard to the way in which

the person, or any *associate of the person, exercises powers in relation to the trust.

- (6) A person ***controls a trust*** if:
- (a) the person has the power, either directly, or indirectly through one or more interposed entities, to control the application of the income, or the distribution of the property, of the trust; or
 - (b) the person has the power, either directly, or indirectly through one or more entities, to appoint or remove the trustee of the trust; or
 - (c) the person has the power, either directly, or indirectly through one or more entities, to appoint or remove beneficiaries of the trust; or
 - (d) the trustee of the trust is accustomed or under an obligation, whether formal or informal, to act according to the directions, instructions or wishes of the person or of an *associate of the person.
- (7) Paragraph (4)(a) does not apply in relation to a trust if some of the beneficiaries receiving income from the trust are not prescribed persons and the Commissioner considers that it is reasonable to conclude that the risks involved in, and the opportunities resulting from, holding the *membership interests or *partial interests in the relevant entity are substantially borne by, or substantially accrue to, as the case may be, one or more persons who are not prescribed persons.
- (8) A *partnership that holds *membership interests, or *partial interests, in the relevant entity is taken to be a ***prescribed person*** in relation to the relevant entity if the risks involved in, and the opportunities resulting from, holding the membership interests or partial interests are substantially borne by, or substantially accrue to, as the case may be, one or more prescribed persons.
- (9) If any of the prescribed persons referred to in subsection (2), (3), (4) or (8) is a *corporate tax entity, that subsection applies even if the risks involved in, and the opportunities resulting from, holding any of the *membership interests, or *partial interests, in that entity are substantially borne by, or substantially accrue to, as the case may be, one or more persons who are not prescribed persons.
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208-50 Former exempting companies

- (1) Subject to subsection (2), a *corporate tax entity is a **former exempting entity** if it has, at any time, ceased to be an *exempting entity and is not again an exempting entity.
- (2) If an entity that, at any time, becomes effectively owned by prescribed persons ceases to be so effectively owned within 12 months after that time, the entity is not taken, by so ceasing, to become a former exempting entity.

Subdivision 208-B—Franking with an exempting credit

Guide to Subdivision 208-B

208-55 What this Subdivision is about

If a former exempting entity makes a distribution in circumstances where it could be franked, the entity can frank the distribution with an exempting credit.

Table of sections

Operative provisions

208-60 Franking with an exempting credit

[This is the end of the Guide.]

Operative provisions

208-60 Franking with an exempting credit

An entity **franks** a *distribution **with an exempting credit** if:

- (a) the entity is a *former exempting entity when the distribution is made; and
- (b) the entity is a *franking entity that satisfies the *residency requirement when the distribution is made; and
- (c) the distribution is a *frankable distribution; and

(d) the entity allocates an *exempting credit to the distribution.

Note: The residency requirement for an entity making a distribution is set out in section 202-20.

Subdivision 208-C—Amount of the exempting credit on a distribution

Guide to Subdivision 208-C

208-65 What this Subdivision is about

The amount of the exempting credit on a distribution is that stated in the distribution statement, unless the amount stated exceeds the maximum franking credit for the distribution. In that case, it is nil.

Table of sections

Operative provisions

208-70 Amount of the exempting credit on a distribution

[This is the end of the Guide.]

Operative provisions

208-70 Amount of the exempting credit on a distribution

- (1) Subject to subsection (2), the amount of the *exempting credit on a *distribution is that stated in the *distribution statement for the distribution.
- (2) If the sum of the *franking credit and the *exempting credit stated in the *distribution statement for a *distribution exceeds the *maximum franking credit for the distribution, the amount of the exempting credit on the distribution is taken to be nil.

Note: If the franking credit stated in the distribution statement exceeds the maximum franking credit for the distribution, the amount of the franking credit on the distribution is taken to equal that maximum under section 202-65.

Subdivision 208-D—Distribution statements

Guide to Subdivision 208-D

208-75 Guide to Subdivision 208-D

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| Former exempting entities and exempting entities that make certain distributions must provide additional information in the distribution statement given to the recipient. |
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Table of sections

Operative provisions

208-80 Additional information to be included by a former exempting entity or exempting entity

[This is the end of the Guide.]

Operative provisions

208-80 Additional information to be included by a former exempting entity or exempting entity

- (1) A *former exempting entity that makes a *distribution *franked with an exempting credit must include in the *distribution statement given to the recipient, a statement that there is an *exempting credit of a specified amount on the distribution.
- (2) An *exempting entity that makes a *frankable distribution to a *member must include in the *distribution statement given to the member, a statement to the effect that members who are *Australian residents are not entitled to a *tax offset or *franking credit as a result of the distribution, except for certain *corporate tax entities, and employees who receive the distribution in connection with certain *employee share schemes.

- (3) If, under subsection (1) or (2), a statement must be included in a *distribution statement, the distribution statement is taken not to have been given unless the statement is included.

Subdivision 208-E—Distributions to be franked with exempting credits to the same extent

Guide to Subdivision 208-E

208-85 What this Subdivision is about

All frankable distributions made within a franking period must be franked to the same extent with an exempting credit.

Table of sections

Operative provisions

- 208-90 All frankable distributions made within a franking period must be franked to the same extent with an exempting credit
- 208-95 Exempting percentage
- 208-100 Consequences of breaching the rule in section 208-90

[This is the end of the Guide.]

Operative provisions

208-90 All frankable distributions made within a franking period must be franked to the same extent with an exempting credit

- (1) If an entity *franks a *distribution with an exempting credit, it must frank each other *frankable distribution made within the same *franking period with an exempting credit worked out at the same *exempting percentage.
- (2) If an entity is not a *former exempting entity for the whole of a *franking period (the *longer period*), then, for the purposes of subsection (1), each period within that longer period during which

the entity is a former exempting entity is taken to be a *franking period*.

208-95 Exempting percentage

The *exempting percentage* for a *frankable distribution is worked out using the formula:

$$\frac{\text{Amount of the *exempting credit on the distribution}}{\text{*Maximum franking credit for the distribution}} \times 100$$

208-100 Consequences of breaching the rule in section 208-90

If an entity *franks a *distribution with an exempting credit in breach of section 208-90:

- (a) that distribution is taken not to have been franked with an exempting credit; and
- (b) each other *frankable distribution made by the entity within the relevant *franking period is taken not to have been franked with an exempting credit.

Subdivision 208-F—Exempting accounts and franking accounts of exempting entities and former exempting entities

Guide to Subdivision 208-F

208-105 What this Subdivision is about

This Subdivision:

- creates an exempting account for each former exempting entity; and
- identifies when exempting credits and debits arise in those accounts and the amount of those credits and debits; and

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- identifies when there is an exempting surplus or deficit in the account; and
 - identifies when franking credits and debits arise in the franking account of an entity because it is an exempting entity, or former exempting entity.

Table of sections

Operative provisions

- 208-110 Exempting account
- 208-115 Exempting credits
- 208-120 Exempting debits
- 208-125 Exempting surplus and deficit
- 208-130 Franking credits arising because of status as exempting entity or former exempting entity
- 208-135 Relationships that will give rise to a franking credit under item 5 of the table in section 208-130
- 208-140 Membership of the same effectively wholly-owned group
- 208-145 Franking debits arising because of status as exempting entity or former exempting entity
- 208-150 Residency requirement
- 208-155 Eligible continuing substantial member
- 208-160 Distributions that are affected by a manipulation of the imputation system
- 208-165 Amount of the exempting credit or franking credit arising because of a distribution franked with an exempting credit
- 208-170 Where a determination under paragraph 177EA(5)(b) of the *Income Tax Assessment Act 1936* affects part of the distribution
- 208-175 When does a distribution franked with an exempting credit flow indirectly to an entity?
- 208-180 What is an entity's share of the exempting credit on a distribution?
- 208-185 Minister may convert exempting surplus to franking credit of former exempting entity previously owned by the Commonwealth

[This is the end of the Guide.]

Operative provisions

208-110 Exempting account

Each *former exempting entity has an *exempting account*.

208-115 Exempting credits

The following table sets out when a credit arises in the *exempting account of a *former exempting entity. A credit in the former exempting entity's account is called an *exempting credit*.

| Exempting Credits | | | |
|--------------------------|---|--|----------------------------------|
| Item | If: | A credit of: | Arises: |
| 1 | the entity had a *franking surplus at the time it became a *former exempting entity (at the time of its <i>transition</i>) | an amount equal to: (a) in a case not covered by paragraph (b)—the franking surplus; or (b) if the entity has been a former exempting entity at any time within a period of 12 months before its transition—so much of the franking surplus as would have been the entity's *exempting surplus had it remained a former exempting entity throughout the period | immediately after its transition |

Schedule 13 Exempting entities and former exempting entities

| Exempting Credits | | | |
|--------------------------|--|--|--|
| Item | If: | A credit of: | Arises: |
| 2 | the entity receives a *distribution *franked with an exempting credit; and the entity satisfies the *residency requirement for the income year in which the distribution is made and at the time the distribution is made; and the distribution is not wholly *exempt income of the entity; and the entity is an *eligible continuing substantial member in relation to the distribution; and the distribution is not affected by a manipulation of the imputation system mentioned in section 208-160 | an amount worked out under section 208-165 | on the day on which the distribution is made |

Exempting Credits

| Item | If: | A credit of: | Arises: |
|-------------|---|---|---|
| 3 | <p>the entity receives a *distribution *franked with an exempting credit; and</p> <p>the entity satisfies the *residency requirement for the income year in which the distribution is made and at the time the distribution is made; and</p> <p>the distribution is not wholly *exempt income of the entity; and</p> <p>the entity is an *eligible continuing substantial member in relation to the distribution; and</p> <p>the Commissioner has made a determination under paragraph 177EA(5)(b) of the <i>Income Tax Assessment Act 1936</i> that no franking credit benefit (within the meaning of that section) is to arise in respect of a specified part of the distribution</p> | <p>an amount worked out under section 208-170</p> | <p>on the day on which the distribution is made</p> |

Schedule 13 Exempting entities and former exempting entities

| Exempting Credits | | | |
|--------------------------|---|--|--|
| Item | If: | A credit of: | Arises: |
| 4 | a *distribution *franked with an exempting credit *flows indirectly to the entity (the <i>ultimate recipient</i>); and the recipient of the distribution is an *eligible continuing substantial member in relation to the distribution; and except for the fact that the ultimate recipient is not an eligible continuing substantial member in relation to the distribution, it would have been entitled to an *exempting credit because of the distribution had the distribution been made to the ultimate recipient | an amount equal to the exempting credit that would have arisen for the ultimate recipient if: (a) the ultimate recipient had been an eligible continuing substantial member in relation to the distribution; and (b) the distribution had been made to the ultimate recipient; and (c) the distribution had been franked with an exempting credit equal to the ultimate recipient's *share of the actual exempting credit | on the day on which the distribution is made |
| 5 | the entity *pays a *PAYG instalment; and the entity satisfies the *residency requirement for the income year in relation to which the PAYG instalment is paid; and the entity was an *exempting entity for the whole or part of the relevant *PAYG instalment period | an amount equal to that part of the payment that is attributable to the period during which the entity was an exempting entity | on the day on which the payment is made |

| Exempting Credits | | | |
|--------------------------|---|--|--|
| Item | If: | A credit of: | Arises: |
| 6 | the entity *pays income tax; and the entity satisfies the *residency requirement for the income year for which the tax is paid; and the entity was an *exempting entity for the whole or part of that income year | an amount equal to that part of the payment that is attributable to the period during which the entity was an exempting entity | on the day on which the payment is made |
| 7 | the *exempting account of the entity would, apart from this item, be in *deficit immediately before the end of an income year | an amount equal to the deficit | immediately before the end of the income year |
| 8 | the entity becomes an *exempting entity; and the entity has an *exempting deficit at the time it becomes an exempting entity | an amount equal to the exempting deficit | immediately after the entity becomes an exempting entity |

208-120 Exempting debits

The following table sets out when a debit arises in the *exempting account of the *former exempting entity. A debit in the *former exempting entity's exempting account is called an *exempting debit*.

Schedule 13 Exempting entities and former exempting entities

| Exempting debits | | | |
|-------------------------|---|--|--|
| Item | If: | A debit of: | Arises: |
| 1 | the entity had a *franking deficit at the time it became a *former exempting entity (at the time of its <i>transition</i>) | an amount equal to: (a) in a case not covered by paragraph (b)—the franking deficit; or (b) if the entity has been a former exempting entity at any time within a period of 12 months before its transition—so much of the franking deficit as would have been the entity's *exempting deficit had it remained a former exempting entity throughout the period | immediately after its transition |
| 2 | the entity makes a *distribution *franked with an exempting credit | an amount equal to the *exempting credit on the distribution | on the day on which the distribution is made |
| 3 | the entity *receives a refund of income tax; and the entity was an *exempting entity during all or part of the income year to which the refund relates; and the entity satisfies the *residency requirement for the income year to which the refund relates | an amount equal to that part of the refund that is attributable to the period during which the entity is an exempting entity | on the day on which the refund is received |
| 4 | the Commissioner makes a determination under paragraph 204-30(3)(b) giving rise to an *exempting debit for the entity (streaming distributions) | the amount specified in the determination | on the day specified in section 204-35 |

| Exempting debits | | | |
|-------------------------|---|---|--|
| Item | If: | A debit of: | Arises: |
| 5 | a *franking debit arises for the entity under section 204-15 (linked distributions), 204-25 (substituting tax-exempt bonus shares for franked distributions) or a determination made under paragraph 204-30(3)(a) (streaming distributions); and the entity was an *exempting entity for the whole or part of the period to which the franking debit relates | an amount equal to that part of the franking debit that relates to the period during which the entity was an exempting entity | when the franking debit arises |
| 6 | the Minister makes a determination under paragraph 208-185(4)(a) giving rise to an *exempting debit for the entity | the amount specified in the determination | on the day specified in the determination |
| 7 | the entity becomes an *exempting entity; and the entity has an *exempting surplus at the time it becomes an exempting entity | an amount equal to the exempting surplus | immediately after the entity becomes an exempting entity |

208-125 Exempting surplus and deficit

- (1) An entity's *exempting account is in *surplus* at a particular time if, at that time, the sum of the *exempting credits in the account exceeds the sum of the *exempting debits in the account. The amount of the *exempting surplus* is the amount of the excess.
- (2) An entity's *exempting account is in *deficit* at a particular time if, at that time, the sum of the *exempting debits in the account exceeds the sum of the *exempting credits in the account. The amount of the *exempting deficit* is the amount of the excess.

208-130 Franking credits arising because of status as exempting entity or former exempting entity

The following table sets out when a credit arises in the *franking account of an entity because of its status as an *exempting entity or *former exempting entity.

| Franking credits arising because of status as an exempting entity or former exempting entity | | | |
|---|---|--|--|
| Item | If: | A credit of: | Arises: |
| 1 | an entity becomes a *former exempting entity; and the entity has a *franking deficit at the time it becomes a former exempting entity | an amount equal to the franking deficit | immediately after the entity becomes a former exempting entity |
| 2 | an entity receives a *distribution *franked with an exempting credit; and the entity is an *exempting entity at the time the distribution is made; and the entity satisfies the *residency requirement for the income year in which the distribution is made and at the time the distribution is made; and the distribution is not wholly *exempt income of the entity; and the entity is an *eligible continuing substantial member in relation to the distribution; and the distribution is not affected by a manipulation of the imputation system mentioned in section 208-160 | an amount worked out under section 208-165 | on the day on which the distribution is made |

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|---|---|---|
| 3 | <p>the entity receives a *distribution *franked with an exempting credit; and</p> <p>the entity is an *exempting entity at the time the distribution is made; and</p> <p>the entity satisfies the *residency requirement for the income year in which the distribution is made and at the time the distribution is made; and</p> <p>the distribution is not wholly *exempt income of the entity; and</p> <p>the entity is an *eligible continuing substantial member in relation to the distribution; and</p> <p>the Commissioner has made a determination under paragraph 177EA(5)(b) of the <i>Income Tax Assessment Act 1936</i> that no franking credit benefit (within the meaning of that section) is to arise in respect of a specified part of the distribution</p> | <p>an amount worked out under section 208-170</p> | <p>on the day on which the distribution is made</p> |

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|---|---|---|
| 4 | <p>a *distribution *franked with an exempting credit *flows indirectly to the entity (the <i>ultimate recipient</i>); and the recipient of the distribution is an *eligible continuing substantial member in relation to the distribution; and except for the fact that the ultimate recipient is not an eligible continuing substantial member in relation to the distribution, it would have been entitled to a *franking credit because of the distribution had the distribution been made to the ultimate recipient</p> | <p>an amount equal to the franking credit that would have arisen for the ultimate recipient if:</p> <p>(a) the ultimate recipient had been an eligible continuing substantial member in relation to the distribution; and</p> <p>(b) the distribution had been made to the ultimate recipient; and</p> <p>(c) the distribution had been franked with a franking credit equal to the ultimate recipient's *share of the actual franking credit</p> | <p>on the day on which the distribution is made</p> |

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|--|--|---|
| 5 | <p>an *exempting entity makes a *franked distribution to the entity (the <i>recipient</i>); and at the time the distribution is made:</p> <p>(a) the recipient is an exempting entity; and</p> <p>(b) the recipient satisfies the *residency requirement; and</p> <p>(c) the relationship between the entities is of the type mentioned in section 208-135; and</p> <p>the recipient satisfies the residency requirement for the income year in which the distribution is made; and</p> <p>the distribution is not wholly *exempt income of the recipient; and</p> <p>the distribution is not affected by a manipulation of the imputation system mentioned in section 208-160</p> | <p>an amount worked out using the formula in section 208-165</p> | <p>on the day on which the distribution is made</p> |

Schedule 13 Exempting entities and former exempting entities

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|--|--|---|
| 6 | <p>an *exempting entity makes a *franked distribution to the entity (the <i>recipient</i>); and at the time the distribution is made:</p> <p>(a) the recipient is an exempting entity; and</p> <p>(b) the recipient satisfies the *residency requirement; and</p> <p>(c) the relationship between the entities is of the type mentioned in section 208-135; and</p> <p>the recipient satisfies the residency requirement for the income year in which the distribution is made; and</p> <p>the distribution is not wholly *exempt income of the recipient; and</p> <p>the Commissioner has made a determination under paragraph 177EA(5)(b) of the <i>Income Tax Assessment Act 1936</i> that no franking credit benefit (within the meaning of that section) is to arise in respect of a specified part of the distribution</p> | <p>an amount worked out using the formula in section 208-170</p> | <p>on the day on which the distribution is made</p> |

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|--|--|--|
| 7 | a *distribution made by an *exempting entity *flows indirectly to the entity (the <i>ultimate recipient</i>); and the recipient of the distribution is an *eligible continuing substantial member in relation to the distribution; and except for the fact that the ultimate recipient is not an eligible continuing substantial member in relation to the distribution, it would have been entitled to a *franking credit because of the distribution had the distribution been made to the ultimate recipient | an amount equal to the franking credit that would have arisen for the ultimate recipient if: (a) the ultimate recipient had been an eligible continuing substantial member in relation to the distribution; and (b) the distribution had been made to the ultimate recipient; and (c) the distribution had been franked with a franking credit equal to the ultimate recipient's *share of the actual franking credit | on the day on which the distribution is made |
| 8 | the Minister makes a determination under paragraph 208-185(4)(b) giving rise to a *franking credit for the entity | the amount of the credit specified in the determination | on the day specified in the determination |
| 9 | an *exempting debit arises for the entity under item 3 or 5 of the table in section 208-120 | an amount equal to the exempting debit | when the exempting debit arises |

Franking credits arising because of status as an exempting entity or former exempting entity

| Item | If: | A credit of: | Arises: |
|-------------|---|---|--|
| 10 | a *former exempting entity becomes an *exempting entity; and the entity has an *exempting surplus at the time it becomes an *exempting entity | an amount equal to the *exempting surplus | immediately after it becomes an exempting entity |

Note: Item 9 is designed to reverse out franking debits that arise in relation to a period during which the entity is an exempting entity. The entity will receive an exempting debit instead.

208-135 Relationships that will give rise to a franking credit under item 5 of the table in section 208-130

- (1) A relationship between an entity making a *franked distribution and the recipient of the distribution is of a type that gives rise to a *franking credit under item 5 or 6 of the table in section 208-130 if either:
 - (a) both entities are members of the same effectively wholly-owned group; or
 - (b) the recipient holds more than 5% of the *membership interests in the entity making the distribution (other than finance membership interests or distribution access membership interests within the meaning of section 208-30 or membership interests that do not carry the right to receive distributions) and it would be reasonable to conclude that the risks involved in, and the opportunities resulting from, holding those membership interests are substantially borne by, or substantially accrue to, the recipient.
 - (2) In deciding whether it would be reasonable to make the conclusion mentioned in paragraph (1)(b):
 - (a) have regard to any *arrangement in respect of the *membership interests (including unissued membership interests) in the entity making the distribution (including derivatives held or issued in connection with those membership interests); and
-

- (b) do not have regard to risks involved in the ownership of membership interests in the entity making the distribution that are substantially borne by any person in the person's capacity as a secured creditor.

208-140 Membership of the same effectively wholly-owned group

- (1) Two *corporate tax entities are members of the *same effectively wholly-owned group of entities* on a particular day if:
 - (a) throughout that day, not less than 95% of the *accountable membership interests in each of the entities, and not less than 95% of the *accountable partial interests in each of the entities, are held by, or are held indirectly for the benefit of, the same persons; or
 - (b) paragraph (a) does not apply but it would nevertheless be reasonable to conclude, having regard to the matters mentioned in subsection (2), that, throughout that day, the risks involved in, and the opportunities resulting from, holding accountable membership interests, or accountable partial interests, in each of the entities are substantially borne by, or substantially accrue to, the same persons.
- (2) The matters to which regard is to be had as mentioned in paragraph (1)(b) are:
 - (a) any special or limited rights attaching to *accountable membership interests, or *accountable partial interests, in each of the entities held by persons other than the persons mentioned in paragraph (1)(b) or their *associates; and
 - (b) any special rights attaching only to accountable membership interests, or accountable partial interests, in each of the entities held by the persons mentioned in paragraph (1)(b) or their associates; and
 - (c) the respective proportions:
 - (i) that accountable membership interests in each of the entities held by the persons mentioned in paragraph (1)(b) or their associates, and other accountable membership interests in the entity concerned, bear to all the accountable membership interests in that entity; and

- (ii) that accountable partial interests in each of the entities held by the persons mentioned in paragraph (1)(b) or their associates, and other accountable partial interests in the entity concerned, bear to all the accountable partial interests in that entity; and
- (d) the respective proportions that:
 - (i) the total value of accountable membership interests in each of the entities held by the persons mentioned in paragraph (1)(b) or their associates, and the total value of other accountable membership interests in the entity concerned, bear to the total value of all the accountable membership interests in that entity; and
 - (ii) the total value of accountable partial interests in each of the entities held by the persons mentioned in paragraph (1)(b) or their associates, and the total value of other accountable partial interests in the entity concerned, bear to the total value of all the accountable partial interests in that entity; and
- (e) the purposes for which accountable membership interests, or accountable partial interests, in each of the entities were issued or granted to persons other than the persons mentioned in paragraph (1)(b) or their associates; and
- (f) any *arrangement in respect of accountable membership interests, or accountable partial interests, in each of the entities held by persons other than the persons mentioned in paragraph (1)(b) or their associates (including any derivatives held or issued in connection with those membership interests or interests) of which the entity concerned is aware.

208-145 Franking debits arising because of status as exempting entity or former exempting entity

The following table sets out when a debit arises in the *franking account of an entity because of its status as an *exempting entity or *former exempting entity.

Franking debits arising because of status as an exempting entity or former exempting entity

| Item | If: | A debit of: | Arises: |
|-------------|--|--|--|
| 1 | an entity becomes a *former exempting entity; and the entity has a *franking surplus at the time it becomes a former exempting entity | the amount of the franking surplus | immediately after the entity becomes a former exempting entity |
| 2 | the *exempting account of a *former exempting entity would, apart from this item, be in *deficit immediately before the end of an income year | an amount equal to the deficit | immediately before the end of the income year |
| 3 | an *exempting credit arises in the *exempting account of the entity under item 5 or 6 of the table in section 208-115 | an amount equal to the exempting credit | when the exempting credit arises |
| 4 | a *former exempting entity becomes an *exempting entity; and the entity has an *exempting deficit at the time it becomes an *exempting entity | an amount equal to the exempting deficit | immediately after it becomes an exempting entity |

Franking debits arising because of status as an exempting entity or former exempting entity

| Item | If: | A debit of: | Arises: |
|-------------|---|--|---------------------------------|
| 5 | a *franking credit arises in the *franking account of an entity under item 3 or 4 of the table in section 205-15 because a *distribution is made by an *exempting entity to the entity, or a distribution made by an exempting entity *flows indirectly to the entity | an amount equal to the amount of the franking credit | when the franking credit arises |

Note 1: Item 3 of the table is designed to reverse out franking credits that arise in relation to a period during which the entity is an exempting entity. The entity will receive an exempting credit instead.

Note 2: Item 5 of the table is designed to reverse out franking credits that arise under the core rules because an entity receives a franked distribution from an exempting entity. Only a recipient who is itself an exempting entity is entitled to a franking credit in these circumstances.

208-150 Residency requirement

The tables in sections 208-115, 208-120, 208-130 and 208-145 are relevant for the purposes of subsection 205-25(1).

Note 1: Subsection 205-25(1) sets out the residency requirement for an income year in which, or in relation to which, an event specified in one of the tables occurs.

Note 2: Section 207-75 sets out the residency requirement that must be satisfied by the entity receiving a distribution when the distribution is made.

208-155 Eligible continuing substantial member

- (1) A *member of a *former exempting entity is an ***eligible continuing substantial member*** in relation to a *distribution made by the entity if the following provisions apply.

-
- (2) At both the time when the *distribution was made, and the time immediately before the entity ceased to be an *exempting entity, the *member was entitled to not less than 5% of:
- (a) where the entity is a *company:
 - (i) if the voting shares (as defined in the *Corporations Act 2001*) in the relevant former exempting entity are not divided into classes—those voting shares; or
 - (ii) if the voting shares (as so defined) in the relevant former exempting entity are divided into 2 or more classes—the shares in one of those classes; and
 - (b) where the entity is a *corporate unit trust or *public trading trust—the units in the trust; and
 - (c) where the entity is a *corporate limited partnership—the income of the partnership.
- (3) At both the time when the *distribution was made, and the time immediately before the entity ceased to be an *exempting entity, the *member was a person referred to in one or more of the following paragraphs:
- (a) a person who is not an *Australian resident;
 - (b) a *life insurance company;
 - (c) an exempting entity;
 - (d) a *former exempting entity;
 - (e) a trustee of a trust in which an interest was held by a person referred to in any of paragraphs (a) to (d);
 - (f) a *partnership in which an interest was held by a person referred to in any of paragraphs (a) to (d).
- (4) If the assumptions set out in subsection (5) are made:
- (a) if the *member was a person referred to in any of paragraphs (3)(a) to (d)—the member; or
 - (b) if the member was a trustee of a trust or a *partnership, being a trust or partnership in which a person referred to in any of those paragraphs held an interest—the holder of the interest; would (if not an *Australian resident) be exempt from *withholding tax on the distribution or (if an Australian resident) be entitled to a *franking credit or a *tax offset in respect of the distribution.
- (5) The assumptions referred to in subsection (4) are that:
-

- (a) the relevant former exempting entity was an *exempting entity at the time it made the *distribution; and
 - (b) the distribution was a *franked distribution made to the member; and
 - (c) if the *member was a *former exempting entity—the member was an exempting entity; and
 - (d) if the member was a trustee of a trust or *partnership in which a former exempting entity had an interest—the former exempting entity was an exempting entity.
- (6) A person is taken to hold an interest in a trust, for the purposes of paragraph (3)(e), if:
- (a) the person is a beneficiary under the trust; or
 - (b) the person derives, or will derive, income indirectly, through interposed trusts or *partnerships, from *distributions received by the trustee.
- (7) A person is taken to hold an interest in a *partnership, for the purposes of paragraph (3)(f), if:
- (a) the person is a partner in the partnership; or
 - (b) the person derives, or will derive, income indirectly, through interposed trusts or partnerships, from *distributions received by the partnership.

208-160 Distributions that are affected by a manipulation of the imputation system

For the purposes of item 2 of the table in section 208-115 and items 2 and 5 of the table in section 208-130, a *distribution to an entity is affected by a manipulation of the imputation system if:

- (a) the Commissioner has made a determination under paragraph 204-30(3)(c) that no *imputation benefit is to arise for the entity in respect of the distribution; or
- (b) the Commissioner has made a determination under paragraph 177EA(5)(b) of the *Income Tax Assessment Act 1936* that no franking credit benefit (within the meaning of that section) is to arise in respect of the distribution to the entity; or
- (c) the distribution is part of a *dividend stripping operation.

208-165 Amount of the exempting credit or franking credit arising because of a distribution franked with an exempting credit

Use the following formula to work out:

- (a) the amount of an *exempting credit arising under item 2 of the table in section 208-115 because a *former exempting entity receives a *distribution *franked with an exempting credit; or
- (b) the amount of a *franking credit arising under item 2 or 5 of the table in section 208-130 because an *exempting entity receives a distribution franked with an exempting credit;

$$\text{*Exempting credit on the *distribution} \times \frac{\text{Amount of the distribution that is not *exempt income of the recipient}}{\text{Amount of the distribution}}$$

208-170 Where a determination under paragraph 177EA(5)(b) of the Income Tax Assessment Act 1936 affects part of the distribution

Use the following formula to work out:

- (a) the amount of an *exempting credit arising under item 3 of the table in section 208-115 because a *former exempting entity receives a *distribution *franked with an exempting credit; or
- (b) the amount of a *franking credit arising under item 3 or 6 of the table in section 208-130 because an *exempting entity receives a distribution franked with an exempting credit;

$$\text{*Exempting credit on the *distribution} \times \frac{\text{Amount of the distribution that is not *exempt income}}{\text{Amount of the distribution}} \times \frac{\text{Amount of the distribution} - \text{Specified part of the distribution}}{\text{Amount of the distribution}}$$

208-175 When does a distribution franked with an exempting credit flow indirectly to an entity?

A *distribution *franked with an exempting credit is taken to *flow indirectly* to an entity if, had it been a *franked distribution, it would have been taken to have flowed indirectly to the entity under section 207-35.

208-180 What is an entity's share of the exempting credit on a distribution?

To work out an entity's *share* of the *exempting credit on a *distribution *franked with that credit, use section 207-55 to work out what the entity's share of the credit would be if it were a *franking credit on a *franked distribution. The entity's share of the exempting credit is equal to that amount.

208-185 Minister may convert exempting surplus to franking credit of former exempting entity previously owned by the Commonwealth

- (1) The Minister may make a determination or determinations under this section if:
 - (a) at a particular time, a *corporate tax entity is an *exempting entity; and
 - (b) at that time all of the *membership interests in the entity are owned by the Commonwealth; and
 - (c) the Commonwealth has offered for sale or sold, or proposes to offer for sale, some or all of the membership interests; and
 - (d) the Minister is satisfied, having regard to the matters mentioned in subsection (2), that it is desirable to make a determination or determinations under this section in relation to the entity.
- (2) The matters to which the Minister must have regard under paragraph (1)(d) are:
 - (a) whether the making of the determination or determinations is necessary to enable the entity to make *distributions *franked at a *franking percentage of 100% after the sale; and

- (b) the extent to which the success of the sale or proposed sale depended or will depend upon the ability of the entity to make *franked distributions; and
 - (c) the extent to which the reduction in receipts of income tax resulting from the making of the determination or determinations would be offset by the receipt of increased proceeds from the sale; and
 - (d) any other matters that the Minister thinks relevant.
- (3) The following provisions of this section apply after the *exempting entity becomes a *former exempting entity.
- (4) If the *former exempting entity would, apart from this section, have an *exempting surplus at the end of an income year, the Minister may, in writing, determine that:
 - (a) an *exempting debit of the entity (not exceeding the exempting surplus) specified in the determination is taken to have arisen immediately before the end of that income year; and
 - (b) a *franking credit of the entity equal to the amount of the exempting debit is taken to have arisen immediately before the end of that income year.
- (5) A determination under this section may be expressed to be subject to compliance by the *former exempting entity with such conditions as are specified in the determination.
- (6) If a condition specified in a determination is not complied with, the Minister may revoke the determination and, if the Minister thinks it appropriate, make a further determination under subsection (4).
- (7) A determination, unless it is revoked, has effect according to its terms.

Subdivision 208-G—Tax effects of distributions by exempting entities

Guide to Subdivision 208-G

208-190 What this Subdivision is about

Generally, a franked distribution from an exempting entity will only generate a tax effect for the recipient under Division 207 if the recipient is also an exempting entity.

A concession is made to employees of the entity who receive a franked distribution because they hold shares under an eligible employee share scheme.

Table of sections

Operative provisions

- 208-195 Division 207 does not generally apply
- 208-200 Distributions to exempting entities
- 208-205 Distributions to employees acquiring shares under an eligible employee share scheme
- 208-210 Subsidiaries
- 208-215 Eligible employee share scheme

[This is the end of the Guide.]

Operative provisions

208-195 Division 207 does not generally apply

Division 207 does not apply to a *distribution by an *exempting entity, unless expressly applied under this Subdivision.

208-200 Distributions to exempting entities

- (1) Division 207 applies to a *franked distribution made by an *exempting entity to another exempting entity if the distribution

gives rise to a *franking credit for the other exempting entity under item 5 or 6 of the table in section 208-130.

- (2) Division 207 applies to a *franked distribution that is made by an *exempting entity and *flows indirectly to another exempting entity if the distribution gives rise to a *franking credit for that other entity under item 7 of the table in section 208-130.

208-205 Distributions to employees acquiring shares under an eligible employee share scheme

Division 207 also applies to a *franked distribution made by an *exempting entity if:

- (a) the distribution is made to a person who is an employee of the exempting entity, or of a *company that is a *subsidiary of the exempting entity, at the time the distribution is made; and
- (b) the recipient acquired the *share on which the distribution is made under an *employee share scheme in circumstances specified as relevant in section 208-215; and
- (c) the recipient does not hold that share as a trustee.

208-210 Subsidiaries

The question whether a company is a *subsidiary* of another company is to be determined in the same way as the question whether a corporation is a subsidiary of another corporation is determined under the *Corporations Act 2001*.

208-215 Eligible employee share scheme

A *share in a *company is acquired by a person under an *employee share scheme in circumstances that are relevant for the purposes of paragraph 208-205(b) and 208-235(b) if:

- (a) the share is acquired by the person in respect of, or for or in relation directly or indirectly to, any employment of the person by the entity or by an entity that is a *subsidiary of the company; and
- (b) all the shares available for acquisition under the scheme are ordinary shares or are preference shares to which are attached

substantially the same rights as are attached to ordinary shares; and

- (c) immediately after the acquisition of the shares:
 - (i) the person does not hold a legal or beneficial interest in more than 5% of the shares in the company; and
 - (ii) the person is not in a position to control, or control the casting of, more than 5% of the maximum number of votes that might be cast at a general meeting of the company; and
- (d) the share is not a *non-equity share.

Subdivision 208-H—Tax effect of a distribution franked with an exempting credit

Guide to Subdivision 208-H

208-220 What this Subdivision is about

Generally, a distribution franked with an exempting credit will only generate a tax effect for the recipient under Division 207 if a tax effect would have been generated for the recipient had the recipient received a franked distribution when the distributing entity was an exempting entity.

Table of sections

Operative provisions

- 208-225 Division 207 does not generally apply
- 208-230 Distributions to exempting entities and former exempting entities
- 208-235 Distributions to employees acquiring shares under an eligible employee share scheme
- 208-240 Distributions to certain individuals

[This is the end of the Guide.]

Operative provisions

208-225 Division 207 does not generally apply

Division 207 does not apply to a *distribution *franked with an exempting credit, unless the Division is expressly applied to the distribution under this Subdivision.

208-230 Distributions to exempting entities and former exempting entities

Division 207 applies to a *distribution *franked with an exempting credit by a *former exempting entity as if it were a *franked distribution if:

- (a) the recipient of the distribution is a former exempting entity and the distribution gives rise to an *exempting credit for the recipient; or
- (b) the recipient of the distribution is an *exempting entity and the distribution gives rise to a *franking credit for the recipient; or
- (c) the distribution *flows indirectly to a former exempting entity and gives rise to an exempting credit for that entity; or
- (d) the distribution flows indirectly to an exempting entity and gives rise to a franking credit for that entity.

208-235 Distributions to employees acquiring shares under an eligible employee share scheme

Division 207 also applies to a *distribution *franked with an exempting credit made by a *former exempting entity as if it were a *franked distribution if:

- (a) the distribution is made to a person who is an employee of the former exempting entity, or of a *company that is a *subsidiary of the former exempting entity, at the time the distribution is made; and
- (b) the recipient acquired the *share on which the distribution is made under an *employee share scheme in circumstances specified as relevant in section 208-215; and
- (c) the recipient does not hold that share as a trustee.

208-240 Distributions to certain individuals

Division 207 also applies to a *distribution *franked with an exempting credit made by a *former exempting entity as if it were a *franked distribution if:

- (a) a *corporate tax entity other than a former exempting entity became an *exempting entity; and
- (b) immediately before the entity became an exempting entity all the accountable membership interests and accountable partial interests were beneficially owned (whether directly or indirectly) by natural persons who were *Australian residents; and
- (c) the entity became an exempting entity because some or all of the persons mentioned in paragraph (b) ceased to be Australian residents; and
- (d) the entity becomes a former exempting entity because all of the persons mentioned in paragraph (b) are or have become Australian residents; and
- (e) an amount attributable to a distribution *franked with an exempting credit made by the entity is included in the assessable income of such a person; and
- (f) all the accountable membership interests or accountable partial interests in the entity were, throughout the period beginning when the entity became an exempting entity and ending when the amount was received by the person, beneficially owned (directly or indirectly) by the person mentioned in paragraph (b); and
- (g) the person is an eligible continuing substantial member in relation to the distribution.

16 After section 960-135

Insert:

960-140 Ordinary membership interest

A *membership interest in a *corporate tax entity is an *ordinary membership interest* if:

- (a) in the case of a membership interest in a *company—it is an ordinary share; and

- (b) in the case of a membership interest in a *corporate limited partnership—it is an interest in the income of the partnership; and
- (c) in the case of a membership interest in a *corporate unit trust or *public trading trust—it is a unit in the trust.

17 Subsection 995-1(1)

Insert:

accountable membership interest has the meaning given by section 208-30.

18 Subsection 995-1(1)

Insert:

accountable partial interest has the meaning given by section 208-35.

19 Subsection 995-1(1) (definition of deficit)

Repeal the definition, substitute:

deficit:

- (a) section 205-40 sets out when a *franking account is in deficit; and
- (b) section 208-125 sets out when an *exempting account is in deficit.

20 Subsection 995-1(1)

Insert:

eligible continuing substantial member of a *former exempting entity has the meaning given by section 208-155.

21 Subsection 995-1(1)

Insert:

exempting account means an account that arises under section 208-110.

22 Subsection 995-1(1)

Insert:

exempting credit has the meaning given by section 208-115.

23 Subsection 995-1(1)

Insert:

exempting debit has the meaning given by section 208-120.

24 Subsection 995-1(1)

Insert:

exempting deficit has the meaning given by subsection 208-125(2).

25 Subsection 995-1(1)

Insert:

exempting entity has the meaning given by section 208-20.

26 Subsection 995-1(1)

exempting percentage has the meaning given by section 208-95.

27 Subsection 995-1(1)

exempting surplus has the meaning given by subsection 208-125(1).

28 Subsection 995-1(1) (at the end of the definition of flows indirectly)

Add:

; and (c) section 208-175 sets out the circumstances in which a *distribution *franked with an exempting credit flows indirectly to an entity.

29 Subsection 995-1(1)

Insert:

former exempting entity has the meaning given by section 208-50.

30 Subsection 995-1(1)

Insert:

franks with an exempting credit has the meaning given by section 208-60.

31 Subsection 995-1(1)

Insert:

partial interest in a *corporate tax entity has the meaning given by subsection 208-25(3).

32 Subsection 995-1(1) (paragraphs (a), (b) and (c) of the definition of residency requirement)

Repeal the paragraphs, substitute:

- (a) for an entity making a *distribution—has the meaning given by section 202-20; and
- (b) for an income year in which, or in relation to which, an event specified in a table in one of the following sections occurs:
 - (i) section 205-15 (general table of *franking credits);
 - (ii) section 205-30 (general table of *franking debits);
 - (iii) section 208-115 (table of *exempting credits);
 - (iv) section 208-120 (table of *exempting debits);
 - (v) section 208-130 (table of franking credits that arise because of an entity's status as a *former exempting entity or *exempting entity);
 - (vi) section 208-145 (table of franking debits that arise because of an entity's status as a former exempting entity or exempting entity); and
- (c) for an entity receiving a distribution—has the meaning given by section 207-75; and

33 Subsection 995-1(1) (definition of share of a franking credit)

Repeal the definition, substitute:

share:

- (a) of a *franking credit—has the meaning given by section 207-55; and

- (b) of an *exempting credit—has the meaning given by section 208-180.

34 Subsection 995-1(1) (definition of surplus)

Repeal the definition, substitute:

surplus:

- (a) section 205-40 sets out when a *franking account is in surplus; and
- (b) section 208-125 sets out when an *exempting account is in surplus.

Schedule 14—Loss integrity rules: global method of valuing assets

Part 1—Income Tax Assessment Act 1997

1 Section 165-115

Repeal the section, substitute:

165-115 What this Subdivision is about

If a change occurs in the ownership or control of a company that has an unrealised net loss, the company cannot, to the extent of the unrealised net loss, have capital losses taken into account, or deduct revenue losses, in respect of CGT events that happen to CGT assets that it owned at the time of the change, unless it satisfies the same business test.

165-115AA Special rules to save compliance costs

- (1) A company is exempt from these rules if, at the time of the change in ownership or control, it (together with certain related entities) has a net asset value of not more than \$5,000,000 under the test in section 152-15 (for small business CGT relief).
- (2) In working out whether it has an unrealised net loss, a company can choose to work out the market value of each of its assets individually, or of all of its assets together.
- (3) If a company works out the market value of each of its assets individually, it may choose to exclude every asset that it acquired for less than \$10,000, in which case:
 - (a) unrealised losses and gains on the excluded assets will not be taken into account in calculating the company's unrealised net loss; and
 - (b) losses on the excluded assets will be allowed without the company being subject to the same business test.

2 At the end of subsection 165-115A(1B)

Add:

However, the choice does not affect the application of the *global method of working out whether the company has an unrealised net loss (see subsection 165-115E(2)).

3 Section 165-115E

After “this way”, insert “(the *individual asset method*), unless the company chooses to work it out using the *global method (set out in subsection (2))”.

4 At the end of section 165-115E

Add:

- (2) The *global method* of working out whether the company has an *unrealised net loss* at the relevant time is as follows:

Method statement

Step 1. Work out the total market value of all *CGT assets that the company owned at the relevant time (including those it *acquired for less than \$10,000), using a valuation method that would generally be regarded as appropriate in the circumstances.

Step 2. Work out the total of the *cost bases of those *CGT assets at the relevant time.

Note: If a CGT asset that the company owned at the relevant time was also trading stock or a revenue asset at that time, see subsection (3) of this section.

Step 3. If the step 2 amount exceeds the step 1 amount, the excess is the company’s *preliminary unrealised net loss* at the relevant time.

Step 4. Add up the company’s preliminary unrealised net loss and any *capital loss, deduction or share of a deduction disregarded under section 170-270 in relation to an asset

referred to in paragraph 165-115A(1A)(b). The total is the company's *unrealised net loss* at the relevant time.

(3) If:

- (a) a *CGT asset that the company owned at the relevant time was also *trading stock or a *revenue asset at that time; and
- (b) the asset's *cost base at the relevant time is *less than* the amount that would be compared under section 165-115F with the asset's market value in working out a notional revenue gain or notional revenue loss that the company has at the relevant time in respect of the asset;

then, for the purposes of step 2 of the method statement in subsection (2) of this section, the amount that would be so compared is to be taken into account *instead of* that cost base.

(4) A choice to use the *global method must be made on or before:

- (a) the day on which the company lodges its income tax return for the income year in which the relevant time occurred; or
- (b) such later day as the Commissioner allows.

5 Subsection 165-115F(7)

Repeal the subsection.

6 Section 165-115G

Repeal the section, substitute:

165-115GA What this Subdivision is about

This Subdivision prevents multiple recognition of a company's losses when significant equity and debt interests that entities (not individuals) have in the company are realised.

165-115GB When adjustments must be made

- (1) The operation of this Subdivision is triggered at an alteration time, which is when:
 - (a) an alteration takes place in the ownership or control of the company; or

- (b) the liquidator of the company declares that shares in the company are worthless (CGT event G3).
- (2) An alteration time is the trigger for making reductions and other adjustments to the reduced cost base of significant equity and debt interests in the company that are owned by an entity (not an individual) that, alone or with its associates, has a controlling stake in the company and either:
 - (a) has a direct or indirect equity interest of at least 10% in the company; or
 - (b) is owed a debt of at least \$10,000 by the company or by another entity that has a significant equity or debt interest in the company.Deductions that relate to such interests held as trading stock or otherwise on revenue account are also reduced.
- (3) Adjustments may also be made when such an entity's interests in the company are partly realised within 12 months before an alteration time or if, under an arrangement, such interests are realised partly within that period or at the alteration time and partly at an earlier time.
- (4) However, entities in which there are no interests in respect of which the company's losses have been, or can be, duplicated are not affected by this Subdivision.

165-115GC How adjustments are calculated

- (1) Adjustments are based on the overall loss of the company. This comprises its realised losses and unrealised losses on CGT assets.
- (2) Special rules, directed at saving compliance costs, apply to determine whether unrealised losses have to be counted at an alteration time and, if so, how to work them out.
- (3) The company may not have to calculate its unrealised losses if the alteration time is not also a changeover time for the purposes of Subdivision 165-CC (about change of ownership or control of a company that has an unrealised net loss), and the company has no realised losses.

- (4) The company does not have to count unrealised losses at an alteration time if (together with certain related entities) it has a net asset value of not more than \$5,000,000 under the test in section 152-15 (for small business CGT relief).
- (5) In working out its unrealised losses on CGT assets, the company can choose to work out the market value of each of its assets individually, or of all of its assets together.
- (6) If the company works out the market value of each of its assets individually, unrealised losses on assets acquired for less than \$10,000 do not have to be calculated at any time.
- (7) Amounts (whether realised or unrealised) counted at a previous alteration time are not counted again at a later alteration time. (This does not apply to unrealised losses worked out by reference to the market value of all the company's assets together.)
- (8) However, if unrealised amounts are *not* counted at a previous alteration time (for example, because of the \$10,000 or small business entity exclusions) and are not required to be taken into account in adjustments made at that time, they may be counted at a later time as part of a realised loss.
- (9) A formula is provided for making adjustments in straightforward cases if applying the formula gives a reasonable result having regard to the object of the Subdivision. Otherwise, reasonable adjustments must be made having regard to a number of stated factors.
- (10) To help entities to make the adjustments, any entity that, in its own right, has a controlling stake in the company is required to provide a written notice to its associates setting out relevant information. In limited circumstances, the company itself may have to provide a written notice to entities that, to its knowledge, have a significant equity or debt interest in it.

7 After subsection 165-115R(6)

Insert:

- (6A) Subsection (6) does not apply to paragraphs (3)(e) and (5)(e) if the company has chosen to use the *global method of working out whether it has an adjusted unrealised loss at the alteration time.

8 After subsection 165-115S(6)

Insert:

- (6A) Subsection (6) does not apply to paragraphs (3)(c) and (5)(c) if the company has chosen to use the *global method of working out whether it has an adjusted unrealised loss at the current alteration time.

9 At the end of section 165-115T

Add:

- (2) Subsection (1) does not apply to an adjusted unrealised loss that the company had at a previous alteration time if the company has chosen to use the *global method of working out whether it has an adjusted unrealised loss at that previous time.

10 Subsection 165-115U(1)

After “this way”, insert “(the *individual asset method*), unless the company chooses to work it out using the *global method (set out in subsection (1B))”.

11 After subsection 165-115U(1)

Insert:

- (1A) Step 1 in the method statement in subsection (1) does not apply to an amount that was counted at an earlier alteration time if the company has chosen to use the *global method of working out whether it has an adjusted unrealised loss at that earlier time.
- (1B) The *global method* of working out whether the company has an *adjusted unrealised loss* at the relevant alteration time is as follows:

| |
|-------------------------|
| <i>Method statement</i> |
|-------------------------|

- Step 1.* Work out the total market value of all *CGT assets that the company owned at the relevant alteration time (including those it *acquired for less than \$10,000), using a valuation method that would generally be regarded as appropriate in the circumstances.
- Step 2.* Work out the total of the *cost bases of those *CGT assets at the relevant time.
- Note: If a CGT asset that the company owned at the relevant time was also trading stock or a revenue asset at that time, see subsection (1C) of this section.
- Step 3.* If the step 2 amount exceeds the step 1 amount, the excess is the company's *adjusted unrealised loss* at the relevant time.

(1C) If:

- (a) a *CGT asset that the company owned at the relevant alteration time was also *trading stock or a *revenue asset at that time; and
- (b) the asset's *cost base at the relevant alteration time is *less than* the amount that, if the relevant alteration time were a changeover time, would be compared under section 165-115F with the asset's market value in working out a notional revenue gain or notional revenue loss that the company would have at the changeover time in respect of the asset;

then, for the purposes of step 2 of the method statement in subsection (1B) of this section, the amount that would be so compared is to be taken into account *instead of* that cost base.

(1D) A choice to use the *global method must be made on or before:

- (a) the day on which the company lodges its income tax return for the income year in which the relevant alteration time occurred; or
- (b) such later day as the Commissioner allows.

12 Subsection 165-115V(8)

Repeal the subsection.

13 After subsection 165-115W(1)

Insert:

- (1A) Step 2 in the method statement in subsection (1) does not apply to an amount counted at an earlier alteration time if the company has chosen to use the *global method of working out whether it has an adjusted unrealised loss at that earlier time.

14 At the end of subsection 165-115ZA(1)

Add:

Note: This section and section 165-115ZB can apply differently for a company that has used the global method of working out whether it has an adjusted unrealised loss at an alteration time. See section 165-115ZD.

15 At the end of Subdivision 165-CD

Add:

165-115ZD Adjustment (or further adjustment) for interest realised at a loss after global method has been used

- (1) This section affects how sections 165-115ZA and 165-115ZB apply to an interest (the *equity*) in, or a debt owed by, a company if, apart from this section, a loss:
- (a) would be *realised for income tax purposes by a *realisation event that happens to the equity or debt; or
 - (b) would be so realised but for Subdivision 170-D (which defers realisation of capital losses and deductions);
- and the company chose to use the *global method of working out whether it had an adjusted unrealised loss at the last alteration time:
- (c) that happened for the company before the realisation event; and
 - (d) immediately before which the equity or debt was, or was part of:
 - (i) if the company was a *loss company at that alteration time—a relevant equity interest, or a relevant debt interest, that an entity had in the company; or

- (ii) otherwise—what would have been such an interest if the company had been a loss company at that alteration time.

Note: If that last alteration time is before the day on which the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* received the Royal Assent, the owner of the equity or debt may choose to apply section 165-115ZD of the *Income Tax (Transitional Provisions) Act 1997* instead of this section.

- (2) In addition to any application to the equity or debt, in relation to that last alteration time, that sections 165-115ZA and 165-115ZB have apart from this section, those sections apply (and are taken always to have applied) to the equity or debt, in relation to that last alteration time, as if:
- (a) the company had an adjusted unrealised loss at that time worked out under this section; and
 - (b) the company were therefore a *loss company at that time; and
 - (c) that adjusted unrealised loss were the company's overall loss at that time.
- (3) For the purposes of how sections 165-115ZA and 165-115ZB apply because of this section, the adjustment amount under section 165-115ZB is to be worked out and applied in accordance with subsection 165-115ZB(6) (the non-formula method).

Adjusted unrealised loss worked out under this section

- (4) The adjusted unrealised loss referred to in paragraph (2)(a) is worked out using this method statement:

Method statement

- Step 1.* Add up the amount or value of each thing covered by subsection (5).
- Step 2.* If the step 1 amount exceeds the loss referred to in paragraph (1)(a), reduce the step 1 amount by the excess.
- Step 3.* Reduce the step 2 amount by so much of the loss referred to in paragraph (1)(a) as it is reasonable to conclude is attributable to *none* of these:

- (a) a notional capital loss, or a notional revenue loss, that the company has at that last alteration time in respect of a *CGT asset;
- (b) a trading stock decrease in relation to that time for a CGT asset that was *trading stock of the company at that time.

- (5) This subsection covers each thing covered by an item in the table, except to the extent that:
- (a) it is reasonable to conclude that the thing was *not* attributable to value that is reflected in a notional capital gain or notional revenue gain that the company has at that last alteration time in respect of a *CGT asset; or
 - (b) the thing has resulted in a reduction of the *reduced cost base of the equity or debt.

Things that might expose an unrealised loss netted off by use of global method

| Item | Thing covered |
|------|--|
| 1 | A *dividend that the company pays during the period referred to in subsection (6) |
| 2 | A thing that is taken under this Act to be a dividend and that the company pays during the period referred to in subsection (6) |
| 3 | A distribution of income or capital to a *member that the company makes during the period referred to in subsection (6) and is not covered by item 1 or 2 |
| 4 | An amount of income tax to which the company becomes liable at any time, to the extent that it is reasonably attributable to a realisation event that happens, during the period referred to in subsection (6), to a *CGT asset (in its character as a CGT asset, *trading stock or a *revenue asset) that the company owned at that last alteration time and *acquired for not less than \$10,000 |
| 5 | A loss or outgoing to which the company becomes liable at any time, to the extent that it is reasonably attributable to a realisation event of the kind referred to in item 4 |

Things that might expose an unrealised loss netted off by use of global method

Item Thing covered

- 6 The difference between:
- (a) the *capital proceeds (as worked out under subsection (7)) of a *CGT event:
- (i) that happens, during the period referred to in subsection (6), to a *CGT asset that the company owned at that last alteration time and *acquired for not less than \$10,000; and
- (ii) as a result of which the asset is *acquired by an entity that is an *associate of the company at the time of the CGT event; and
- (b) the market value of the asset at the time of the CGT event;
- but only if those capital proceeds are *less than* that market value
-
- (6) The period starts at that last alteration time and ends at the earlier of:
- (a) the time of the *realisation event referred to in paragraph (1)(a); or
- (b) the time immediately before the earliest time when the equity or debt is no longer, or is no longer part of:
- (i) if the company was a *loss company at that last alteration time—a relevant equity interest, or a relevant debt interest, that an entity has in the company; or
- (ii) otherwise—what would have been such an interest if the company had been a loss company at that last alteration time.
- (7) For the purposes of item 6 of the table in subsection (5), the *capital proceeds of the *CGT event are to be worked out:
- (a) under subsection 116-20(1) only; and
- (b) disregarding subsection 103-10(1) and paragraph 103-10(2)(a) (about entitlement to receive money or property).

Notices under section 165-115ZC not affected

- (8) To avoid doubt:
- (a) a notice need not be given under section 165-115ZC because of this section; and
- (b) this section does not affect the requirements that apply to a notice that otherwise must be given under that section.
-

Part 2—Income Tax (Transitional Provisions) Act 1997

16 Before Subdivision 165-C

Insert:

Subdivision 165-CC—Change of ownership or control of company that has an unrealised net loss

165-115E Choice to use global method to work out unrealised net loss

A choice under section 165-115E of the *Income Tax Assessment Act 1997* to use the global method of working out whether a company has an unrealised net loss at a particular time must be made within 6 months after the day on which the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* received the Royal Assent if:

- (a) that time is before that day; and
- (b) subsection 165-115E(4) of that Act would otherwise require the choice to be made before the end of those 6 months.

Subdivision 165-CD—Reductions after alterations in ownership or control of loss company

Table of sections

| | |
|-----------|--|
| 165-115U | Choice to use global method to work out adjusted unrealised loss |
| 165-115ZC | When certain notices to be given |
| 165-115ZD | Adjustment (or further adjustment) for interest realised at a loss after global method has been used |

165-115U Choice to use global method to work out adjusted unrealised loss

A choice under section 165-115U of the *Income Tax Assessment Act 1997* to use the global method of working out whether a company has an adjusted unrealised loss at a particular time must

be made within 6 months after the day on which the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* received the Royal Assent if:

- (a) that time is before that day; and
- (b) subsection 165-115U(1D) of that Act would otherwise require the choice to be made before the end of those 6 months.

165-115ZC When certain notices to be given

- (1) A notice under subsection 165-115ZC(4) or (5) of the *Income Tax Assessment Act 1997* must be given within 6 months after the day on which the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* received the Royal Assent if the alteration time is before that day.
- (2) If, because of amendments made by Schedule 14 to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*, a notice already given under subsection 165-115ZC(4) or (5) of the *Income Tax Assessment Act 1997* before the day referred to in subsection (1) of this section no longer complies with section 165-115ZC of the *Income Tax Assessment Act 1997*, the entity required to give the notice may comply with that section 165-115ZC by giving a further notice.
- (3) The further notice:
 - (a) must vary the notice referred to in subsection (2) in such a way (which may include setting out additional information) that the notice as varied complies with section 165-115ZC of the *Income Tax Assessment Act 1997* as affected by the amendments; and
 - (b) must be given within the 6 months referred to in subsection (1) of this section, or within a further period allowed by the Commissioner; and
 - (c) must otherwise be given in accordance with that section.

165-115ZD Adjustment (or further adjustment) for interest realised at a loss after global method has been used

- (1) This section affects how sections 165-115ZA and 165-115ZB of the *Income Tax Assessment Act 1997* apply to an interest (the **equity**) in, or a debt owed by, a company if apart from this section, a loss:
- (a) would be realised for income tax purposes by a realisation event that happens to the equity or debt; or
 - (b) would be so realised but for Subdivision 170-D of that Act (which defers realisation of capital losses and deductions);
- and the company chose to use the global method of working out whether it had an adjusted unrealised loss at the last alteration time:
- (c) that happened for the company, before the realisation event; and
 - (d) immediately before which the equity or debt was, or was part of:
 - (i) if the company was a loss company at that alteration time—a relevant equity interest, or a relevant debt interest, that an entity had in the company; or
 - (ii) otherwise—what would have been such an interest if the company had been a loss company at that alteration time;
- and these conditions are satisfied:
- (e) that last alteration time is before the day on which the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002* received the Royal Assent; and
 - (f) the entity that owns the equity or debt immediately before the realisation event chooses to apply this section to the equity or debt, in relation to that last alteration time, instead of section 165-115ZD of the *Income Tax Assessment Act 1997*; and
 - (g) the choice is made on or before the latest of these:
 - (i) the last day of the period of 6 months after the day referred to in paragraph (c) of this subsection;

(ii) the day on which the entity lodges its income tax return for the income year in which the realisation event occurred;

(iii) such later day as the Commissioner allows.

If the entity makes that choice, this section applies accordingly instead of that section.

- (2) In addition to any application to the equity or debt, in relation to that last alteration time, that sections 165-115ZA and 165-115ZB of the *Income Tax Assessment Act 1997* have apart from this section, those sections apply (and are taken always to have applied) to the equity or debt, in relation to that last alteration time, as if:
- (a) the company had an adjusted unrealised loss at that time equal to the loss referred to in paragraph (1)(a) of this section, except so much of the loss as it is reasonable to conclude is attributable to *none* of these:
 - (i) a notional capital loss, or a notional revenue loss, that the company has at that last alteration time in respect of a CGT asset;
 - (ii) a trading stock decrease in relation to that time for a CGT asset that was trading stock of the company at that time; and
 - (b) the company were therefore a *loss company at that time; and
 - (c) that adjusted unrealised loss were the company's overall loss at that time.
- (3) For the purposes of how sections 165-115ZA and 165-115ZB of the *Income Tax Assessment Act 1997* apply because of this section, the adjustment amount under section 165-115ZB of that Act is to be worked out and applied in accordance with subsection 165-115ZB(6) (the non-formula method) of that Act.
- (4) To avoid doubt:
- (a) a notice need not be given under section 165-115ZC of the *Income Tax Assessment Act 1997* because of this section; and
 - (b) this section does not affect the requirements that apply to a notice that otherwise must be given under that section.

Part 3—Dictionary amendments

Income Tax Assessment Act 1997

17 Subsection 995-1(1)

Insert:

global method:

- (a) of working out whether a company has an unrealised net loss at a particular time, has the meaning given by section 165-115E; and
- (b) of working out whether a company has an adjusted unrealised loss at a particular time, has the meaning given by section 165-115U.

18 Subsection 995-1(1)

Insert:

individual asset method:

- (a) of working out whether a company has an unrealised net loss at a particular time, has the meaning given by section 165-115E; and
- (b) of working out whether a company has an adjusted unrealised loss at a particular time, has the meaning given by section 165-115U.

Part 4—Application of amendments

19 Application

The amendments made by this Schedule apply to a time at or after 1 pm (by legal time in the Australian Capital Territory) on 11 November 1999.

Schedule 15—Value shifting

Part 1—New Divisions inserted in the Income Tax Assessment Act 1997

1 After Part 3-90

Insert:

Part 3-95—Value shifting

Division 723—Direct value shifting by creating right over non-depreciating asset

Table of Subdivisions

- 723-A Reduction in loss from realising non-depreciating asset
- 723-B Reducing reduced cost base of interests in entity that acquires non-depreciating asset under roll-over

Subdivision 723-A—Reduction in loss from realising non-depreciating asset

Table of sections

- 723-1 Object
- 723-10 Reduction in loss from realising non-depreciating asset over which right has been created
- 723-15 Reduction in loss from realising non-depreciating asset at the same time as right is created over it
- 723-20 Exceptions
- 723-25 Realisation event that is only a partial realisation
- 723-35 Multiple rights created to take advantage of the \$50,000 threshold
- 723-40 Application to CGT asset that is also trading stock or revenue asset
- 723-50 Effects if right created over underlying asset is also trading stock or a revenue asset

723-1 Object

The purpose of this Division is to reduce a loss that would otherwise be *realised for income tax purposes by a *realisation event happening to an asset (except a *depreciating asset), to the extent that:

- (a) value has been shifted out of the asset by the owner creating in an associate a right over the asset; and
- (b) the value shifted was not brought to tax when the right was created and has not since been brought to tax on a realisation of the right.

723-10 Reduction in loss from realising non-depreciating asset over which right has been created

- (1) A loss that would, apart from this Division, be *realised for income tax purposes by a *realisation event is reduced by the amount worked out under subsections (3) and (4) if:
 - (a) the event happens to a *CGT asset (the *underlying asset*) you own that, at the time of the event (the *realisation time*):
 - (i) is *not* a *depreciating asset; or
 - (ii) is an item of your *trading stock; or
 - (iii) is a *revenue asset of yours; and
 - (b) before the realisation time:
 - (i) you created in an *associate of yours; or
 - (ii) an entity covered by subsection (2) (about previous owners of the underlying asset) created in an associate of the entity;
 - a right in respect of the underlying asset; and
 - (c) immediately before the realisation time, the right is still in existence and is owned by an associate of yours; and
 - (d) a decrease in the underlying asset's market value is reasonably attributable to the creating of the right; and
 - (e) creating the right involved a *CGT event:
 - (i) whose *capital proceeds are *less* than the market value of the right when created (the difference between those capital proceeds and that market value is called the *shortfall on creating the right*); and

- (ii) that is *not* a CGT event that happens to some part of the underlying asset but not to the remainder of it; and
- (f) the shortfall on creating the right is more than \$50,000; and
- (g) the market value of the underlying asset at the realisation time is less than it would have been if the right no longer existed at that time (the difference is called the *deficit on realisation*).

Note: If subparagraph (1)(e)(ii) applies, the cost base and reduced cost base of the underlying asset is apportioned under section 112-30, so there is no need for this section to apply to the right.

- (2) This subsection covers an entity if:
 - (a) the entity *acquired the underlying asset before you did; and
 - (b) there has been a roll-over for each *CGT event (if any) as a result of which an entity (including you) acquired the asset after the first entity acquired it, and before the realisation time; and
 - (c) for each such CGT event (if any), the entity (including you) that acquired the underlying asset as a result of the event was, immediately after the event, an *associate of the entity that last acquired the asset before the event.
- (3) The amount by which this section reduces the loss is the lesser of:
 - (a) the shortfall on creating the right; and
 - (b) the deficit on realisation.

However, that amount is reduced by each gain that:

- (c) is *realised for income tax purposes by a *realisation event that happens to the right:
 - (i) before or at the realisation time for the underlying asset; and
 - (ii) at a time when the right is owned by an entity that is your *associate immediately before the realisation time for the underlying asset; and
- (d) is not disregarded.

Note: To work out a gain realised for income tax purposes by a realisation event that happens to the right, see sections 977-15, 977-35, 977-40 and 977-55. If more than one of those sections applies to the right, see section 723-50.

- (4) For each gain that:
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- (a) is *realised for income tax purposes by a *realisation event that happens to the right:
 - (i) within 4 years after the realisation time for the underlying asset; and
 - (ii) at a time when the right is owned by an entity that is your *associate immediately before the realisation time for the underlying asset; and
 - (b) is not disregarded;

the amount worked out under subsection (3) is taken to have been reduced by the amount of that gain.

Note: This subsection may result in amendment of an assessment for the income year in which the realisation time happens.

723-15 Reduction in loss from realising non-depreciating asset at the same time as right is created over it

- (1) A loss that would, apart from this Division, be *realised for income tax purposes by a *realisation event is reduced by the amount worked out under subsections (2) and (3) if:
 - (a) the event happens to a *CGT asset (the *underlying asset*) you own that, at the time of the event (the *realisation time*):
 - (i) is *not* a *depreciating asset; or
 - (ii) is an item of your *trading stock;
 - (iii) is a *revenue asset of yours; and
 - (b) at the realisation time, you create in an *associate of yours a right in respect of the underlying asset; and
 - (c) creating the right involves a *CGT event:
 - (i) whose *capital proceeds are *less* than the market value of the right when created (the difference between those capital proceeds and that market value is called the *shortfall on creating the right*); and
 - (ii) that is *not* a CGT event that happens to some part of the underlying asset but not to the remainder of it; and
 - (d) the shortfall on creating the right is more than \$50,000; and
 - (e) the market value of the underlying asset at the realisation time is less than it would have been if the right had not been created (the difference is called the *deficit on realisation*).

Note: If subparagraph (1)(c)(ii) applies, the cost base and reduced cost base of the underlying asset is apportioned under section 112-30, so there is no need for this section to apply to the right.

- (2) The amount by which this section reduces the loss is the lesser of:
- (a) the shortfall on creating the right; and
 - (b) the deficit on realisation.
- (3) For each gain that:
- (a) is *realised for income tax purposes by a *realisation event that happens to the right:
 - (i) within 4 years after the realisation time for the underlying asset; and
 - (ii) at a time when the right is owned by an entity that is your *associate immediately before the realisation time for the underlying asset; and
 - (b) is not disregarded;

the amount worked out under subsection (2) is taken to have been reduced by the amount of that gain.

Note 1: To work out a gain realised for income tax purposes by a realisation event that happens to the right, see sections 977-15, 977-35, 977-40 and 977-55. If more than one of those sections applies to the right, see section 723-50.

Note 2: This subsection may require amendment of an assessment for the income year in which the realisation time happens.

723-20 Exceptions

Conservation covenant over land

- (1) Section 723-10 or 723-15 does not reduce a loss if:
- (a) the underlying asset is land; and
 - (b) the right referred to in paragraph 723-10(1)(b) or 723-15(1)(b) is a *conservation covenant over the land.

Right created on death of owner

- (2) Section 723-10 or 723-15 does not reduce a loss if the right referred to in paragraph 723-10(1)(b) or 723-15(1)(b) is created by:
- (a) a will or codicil; or
 - (b) an order of a court varying or modifying a will or codicil; or
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- (c) a total or partial intestacy; or
 - (d) an order of a court varying or modifying the application of the law about distributing the estate of someone who dies intestate.

723-25 Realisation event that is only a partial realisation

- (1) Section 723-10 or 723-15 applies differently if:
 - (a) a *realisation event happens to some part of a *CGT asset (the *underlying asset*) you own that, at the time of the event:
 - (i) is *not* a *depreciating asset; or
 - (ii) is an item of your *trading stock; or
 - (iii) is a *revenue asset of yours; but not to the remainder of the underlying asset; or
 - (b) a realisation event consists of creating an interest in a CGT asset (also the *underlying asset*) you own that, at the time of the event, is covered by subparagraph (a)(i), (ii) or (iii).
- (2) The section applies on the basis that:
 - (a) the *realisation event happens to the underlying asset; and
 - (b) the shortfall on creating the right referred to in paragraph 723-10(1)(e) or 723-15(1)(c); and
 - (c) the deficit on realisation referred to in paragraph 723-10(1)(g) or 723-15(1)(e);
 are each reduced by multiplying its amount by this fraction:

$$\frac{\text{Market value of part}}{\text{Market value of underlying asset}}$$

- (3) For the purposes of the formula in subsection (2):

market value of part means the market value, at the time of the *realisation event, of the part referred to in paragraph (1)(a) or the interest referred to in paragraph (1)(b), as appropriate.

market value of underlying asset means the market value, immediately before the *realisation event, of the underlying asset.

[The next section is section 723-35.]

723-35 Multiple rights created to take advantage of the \$50,000 threshold

- (1) Sections 723-10 and 723-15 apply differently if, having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why a right was created as a different right from one or more other rights created in respect of the same thing was so that paragraph 723-10(1)(f) or 723-15(1)(d) would not be satisfied for one or more of the rights mentioned in this subsection.
- (2) Those sections:
 - (a) apply to that thing, in relation to each of the rights mentioned in subsection (1) of this section, as if paragraphs 723-10(1)(f) and 723-15(1)(d) were omitted; and
 - (b) are taken always to have so applied.

723-40 Application to CGT asset that is also trading stock or revenue asset

If a *CGT asset you own is also an item of your *trading stock or a *revenue asset, this Division applies to the asset once in its character as a CGT asset and again in its character as trading stock or a revenue asset.

[The next section is section 723-50.]

723-50 Effects if right created over underlying asset is also trading stock or a revenue asset

- (1) Subsection 723-10(3) or (4) or 723-15(3) applies differently if the right created in respect of the underlying asset is also *trading stock or a *revenue asset at the time of a *realisation event that happens to the right.
 - (2) The gain that is taken into account for the purposes of that subsection is:
 - (a) if the right is also trading stock—worked out under section 977-35 or 977-40 (about realisation events for trading stock); or
 - (b) if the right is also a revenue asset—the greater of:
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- (i) the gain worked out under section 977-15 (about realisation events for CGT assets); and
 - (ii) the gain worked out under section 977-55 (about realisation events for revenue assets).

Subdivision 723-B—Reducing reduced cost base of interests in entity that acquires non-depreciating asset under roll-over

Table of sections

| | |
|---------|--|
| 723-105 | Reduced cost base of interest reduced when interest realised at a loss |
| 723-110 | Direct and indirect roll-over replacement for underlying asset |

723-105 Reduced cost base of interest reduced when interest realised at a loss

- (1) The *reduced cost base of a *primary equity interest, *secondary equity interest, or *indirect primary equity interest, in a company or trust is reduced just before a *realisation event that is a *CGT event happens to the interest if:
 - (a) apart from this Division, a loss would be *realised for income tax purposes by the CGT event; and
 - (b) apart from this Division, a loss would have been *realised for income tax purposes by a realisation event if the event had happened, just before the CGT event, to a *CGT asset (the *underlying asset*) that the company or trust then owned and that:
 - (i) was *not* then a *depreciating asset; or
 - (ii) was then an item of *trading stock of the company or trust; or
 - (iii) was then a *revenue asset of the company or trust; and
 - (c) the loss referred to in paragraph (b) would have been reduced under Subdivision 723-A by an amount (the *underlying asset loss reduction*); and
 - (d) for the entity (the *transferor*) that owned the interest just before the CGT event, the interest was a *direct roll-over replacement or *indirect roll-over replacement for the underlying asset.

- (2) If the interest was a *direct roll-over replacement, its *reduced cost base is reduced by the amount worked out using this formula, unless that amount does not appropriately reflect the matters referred to in subsection (4):

$$\frac{\text{RCB of interest}}{\text{Total of RCBs of direct roll-over replacements}} \times \text{Underlying asset loss reduction}$$

- (3) For the purposes of the formula in subsection (2):

RCB of interest means the interest's *reduced cost base when the transferor *acquired it.

total of RCBs of direct roll-over replacements means the total of the *reduced cost bases of all *direct roll-over replacements for the underlying asset when the transferor *acquired them.

- (4) If:

- (a) the interest was an *indirect roll-over replacement; or
 - (b) the amount worked out under subsection (2) does not appropriately reflect the matters referred to in this subsection;
- the interest's *reduced cost base is reduced by an amount that is appropriate having regard to these matters:
- (c) the underlying asset loss reduction; and
 - (d) the quantum of the interest relative to all *direct roll-over replacements and indirect roll-over replacements that the transferor owns or has previously owned.

723-110 Direct and indirect roll-over replacement for underlying asset

- (1) For an entity (the **transferor**) that owns a *CGT asset, the CGT asset is a **direct roll-over replacement** for something (the **underlying asset**) that another entity owns if, and only if:
- (a) a *CGT event happened to the underlying asset while the transferor owned it; and
 - (b) the other entity *acquired the underlying asset as a result of that CGT event; and

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- (c) there was a *replacement-asset roll-over for the CGT event; and
 - (d) the transferor received the CGT asset (or CGT assets including it) in respect of the CGT event as the replacement asset (or the replacement assets).
- (3) For an entity (the *transferor*) that owns a *CGT asset, the CGT asset is an *indirect roll-over replacement* for something (the *underlying asset*) that another entity owns if, and only if:
- (a) a *CGT event happened to another CGT asset at a time when the transferor owned it and the other entity already owned the underlying asset; and
 - (b) for the transferor, the other CGT asset was at that time:
 - (i) a *direct roll-over replacement for the underlying asset; or
 - (ii) an indirect roll-over replacement for the underlying asset because of any other application or applications of this subsection; and
 - (c) there was a *replacement-asset roll-over for the CGT event; and
 - (d) the transferor received the first CGT asset (or CGT assets including it) in respect of the CGT event as the replacement asset (or the replacement assets).

Division 725—Direct value shifting affecting interests in companies and trusts

Table of Subdivisions

Guide to Division 725

- 725-A Scope of the direct value shifting rules
- 725-B What is a direct value shift
- 725-C Consequences of a direct value shift
- 725-D Consequences for down interest or up interest as CGT asset
- 725-E Consequences for down interest or up interest as trading stock or a revenue asset
- 725-F Value adjustments and taxed gains

Guide to Division 725

725-1 What this Division is about

If, under a scheme, value is shifted from equity or loan interests in a company or trust to other equity or loan interests in the same company or trust (including interests issued at a discount), this Division:

- (a) adjusts the value of those interests for income tax purposes to take account of material changes in market value that are attributable to the value shift; and
- (b) treats the value shift as a partial realisation to the extent that value is shifted between interests held by different owners, and in some other cases.

However, it does so only for interests that are owned by entities involved in the value shift.

Subdivision 725-A—Scope of the direct value shifting rules

Table of sections

- 725-45 Main object
 - 725-50 When a direct value shift has consequences under this Division
-

| | |
|--------|---|
| 725-55 | Controlling entity test |
| 725-65 | Cause of the value shift |
| 725-70 | Consequences for down interest only if there is a material decrease in its market value |
| 725-80 | Who is an affected owner of a down interest? |
| 725-85 | Who is an affected owner of an up interest? |
| 725-90 | Direct value shift that will be reversed |
| 725-95 | Direct value shift resulting from reversal |

725-45 Main object

- (1) The main object of this Division is:
 - (a) to prevent inappropriate losses from arising on the realisation of *equity or loan interests from which value has been shifted to other equity or loan interests in the same entity; and
 - (b) to prevent inappropriate gains from arising on the realisation of equity or loan interests in the same entity to which the value has been shifted;so far as those interests are owned by entities involved in the value shift.
- (2) This is done by:
 - (a) adjusting the value of those interests for income tax purposes to take account of changes in market value that are attributable to the value shift; and
 - (b) treating the value shift as a partial realisation to the extent that value is shifted:
 - (i) between interests held by different owners; or
 - (ii) in the case of interests in their character as CGT assets—from post-CGT assets to pre-CGT assets; or
 - (iii) between interests of different characters.

725-50 When a direct value shift has consequences under this Division

A *direct value shift under a *scheme involving *equity or loan interests in an entity (the *target entity*) has consequences for you under this Division if, and only if:

- (a) the target entity is a company or trust at some time during the *scheme period; and

- (b) section 725-55 (Controlling entity test) is satisfied; and
- (c) section 725-65 (Cause of the value shift) is satisfied; and
- (d) you are an *affected owner of a *down interest, or an *affected owner of an *up interest, or both; and
- (e) neither of sections 725-90 and 725-95 (about direct value shifts that are reversed) applies.

Note: For a down interest of which you are an affected owner, the direct value shift has consequences under this Division only if section 725-70 (about material decrease in market value) is satisfied.

725-55 Controlling entity test

An entity (the *controller*) must *control (for value shifting purposes) the target entity at some time during the period starting when the *scheme is entered into and ending when it has been carried out. (That period is the *scheme period*.)

For the concept of *control (for value shifting purposes)*, see sections 727-355 to 727-375.

[The next section is section 725-65.]

725-65 Cause of the value shift

- (1) It must be the case that one or more of the following:
 - (a) the target entity;
 - (b) the controller;
 - (c) an entity that was an *associate of the controller at some time during or after the *scheme period;
 - (d) an *active participant in the *scheme;(either alone or together with one or more other entities) did under the scheme the one or more things:
 - (e) to which the decrease in the market value of the *down interests is reasonably attributable; and
 - (f) to which the increase in the market value of the *up interests, or the issue of up interests at a *discount, is reasonably attributable, or that is or include the issue of up interests at a *discount.

Active participants (if target entity is closely held)

- (2) An entity (the **first entity**) is an **active participant** in the *scheme if, and only if:
- (a) at some time during the *scheme period, the target entity has fewer than 300 members (in the case of a company) or fewer than 300 beneficiaries (in the case of a trust); and
 - (b) the first entity has actively participated in, or directly facilitated, the entering into or carrying out of the *scheme (whether or not it did so at the direction of some other entity); and
 - (c) the first entity:
 - (i) owns a *down interest at the *decrease time; or
 - (ii) owns an *up interest at the *increase time or has an up interest issued to it at a *discount because of the *direct value shift.

When an entity has 300 or more members or beneficiaries

- (3) Section 124-810 (under which certain companies and trusts are not regarded as having 300 or more members or beneficiaries) also applies for the purposes of this Division.
- (4) In addition, this Division applies to a *non-fixed trust as if it did not have 300 or more beneficiaries.

725-70 Consequences for down interest only if there is a material decrease in its market value

- (1) For a *down interest of which you are an *affected owner, the *direct value shift has consequences under this Division only if the sum of the decreases in the market value of all down interests because of direct value shifts under the same *scheme as the direct value shift is at least \$150,000.

Note: In working out the sum of the decreases in market value of all down interests, it will be necessary to include decreases not only in your down interests, but also in those of other affected owners and of entities that are not affected owners.

- (2) However, if, having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why a *direct

value shift happened under a different scheme from one or more other direct value shifts was so that subsection (1) would not be satisfied for one or more of the direct value shifts mentioned in this subsection, subsection (1) does not apply (and is taken never to have applied) to any of the direct value shifts.

[The next section is section 725-80.]

725-80 Who is an affected owner of a down interest?

An entity is an *affected owner* of a *down interest if, and only if, the entity owns the down interest at the *decrease time and at least one of these paragraphs is satisfied:

- (a) the entity is the controller;
- (b) the entity was an *associate of the controller at some time during or after the *scheme period;
- (c) the entity is an *active participant in the *scheme.

725-85 Who is an affected owner of an up interest?

An entity is an *affected owner* of an *up interest if, and only if:

- (a) there is at least one *affected owner of *down interests; and
- (b) the entity owns the up interest at the *increase time, or the interest is an up interest because it was issued to the entity at a *discount;

and at least one of these paragraphs is satisfied:

- (c) the entity is the controller;
- (d) the entity was an *associate of the controller at some time during or after the *scheme period;
- (e) at some time during or after the scheme period, the entity was an associate of an entity that is an affected owner of down interests because it was an associate of the controller at some time during or after that period;
- (f) the entity is an *active participant in the *scheme.

725-90 Direct value shift that will be reversed

- (1) The *direct value shift does *not* have consequences for you under this Division if:
- (a) the one or more things referred to in paragraph 725-145(1)(b) brought about a state of affairs, but for which the direct value shift would not have happened; and
 - (b) as at the time referred to in that paragraph, it is more likely than not that, because of the *scheme, that state of affairs will cease to exist within 4 years after that time.

Example: Under a scheme, the voting rights attached to a class of shares in a company are changed. As a result, the market value of shares in that class decreases, and the market value of other classes of shares in the company increases. The company's constitution provides that the change is to last for only 3 years.

- (2) However, this section stops applying if the state of affairs referred to in paragraph (1)(a) still exists:
- (a) at the end of those 4 years; or
 - (b) when a *realisation event happens to *down interests or *up interests of which you are, or any other entity is, an *affected owner;
- whichever happens sooner.
- (3) If this section stops applying, it is taken *never* to have applied to the *direct value shift.

Note: This may result in an assessment for an earlier income year having to be amended to give effect to the consequences that the direct value shift would have had for you under this Division if this section hadn't applied.

725-95 Direct value shift resulting from reversal

- (1) A *direct value shift does not have consequences for any entity under this Division if:
- (a) section 725-90 applies, and the state of affairs referred to in paragraph 725-90(1)(a) ceases to exist; and
 - (b) the direct value shift would not have happened but for that state of affairs ceasing to exist.

- (2) However, if section 725-90 stops applying, this section is taken *never* to have applied to the later direct value shift.

Subdivision 725-B—What is a direct value shift

Table of sections

| | |
|---------|--|
| 725-145 | When there is a <i>direct value shift</i> |
| 725-150 | Issue of equity or loan interests at a <i>discount</i> |
| 725-155 | Meaning of <i>down interests, decrease time, up interests</i> and <i>increase time</i> |
| 725-160 | What is the nature of a direct value shift? |
| 725-165 | If market value decrease or increase is only partly attributable to the scheme |

725-145 When there is a direct value shift

- (1) There is a *direct value shift* under a *scheme involving *equity or loan interests in an entity (the *target entity*) if:
- (a) there is a decrease in the market value of one or more equity or loan interests in the target entity; and
 - (b) the decrease is reasonably attributable to one or more things done under the scheme, and occurs at or after the time when that thing, or the first of those things, is done; and
 - (c) either or both of subsections (2) and (3) are satisfied.

Examples of something done under a scheme are issuing new shares at a *discount, buying back shares or changing the voting rights attached to shares.

- (2) One or more *equity or loan interests in the target entity must be issued at a *discount. The issue must be, or must be reasonably attributable to, the thing, or one or more of the things, referred to in paragraph (1)(b). It must also occur at or after the time referred to in that paragraph.

Example: A company runs a family business. There are 2 shares originally issued for \$2 each. They are owned by husband and wife. The market value of the shares is much greater (represented by the value of the assets of the company less its liabilities). The company issues one more share for \$2 to their son.

Caution is needed in such a situation. The example would result in a large CGT liability for the husband and wife under this Division, because they have shifted 1/3 of the value of their own shares to their son. No such liability would arise if the share had been issued for its market value.

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- (3) Or, there must be an increase in the market value of one or more *equity or loan interests in the target entity. The increase must be reasonably attributable to the thing, or to one or more of the things, referred to in paragraph (1)(b). It must also occur at or after the time referred to in that paragraph.

725-150 Issue of equity or loan interests at a discount

- (1) An *equity or loan interest is issued at a *discount* if, and only if, the market value of the interest when issued exceeds the amount of the payment that the issuing entity receives. The excess is the amount of the *discount*.
- (2) The payment that the issuing entity receives can include property. If it does, use the market value of the property in working out the amount of the payment.

Amounts for which bonus equities are treated as being issued

- (3) If:
- (a) a *primary equity interest is issued as mentioned in subsection 130-20(1) (about bonus equities issued in relation to original equities); and
 - (b) subsection 130-20(3) does *not* apply (about bonus equities that are a dividend or otherwise assessable income);
- subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the *cost base of the interest when issued (as worked out under section 130-20).
- (4) If:
- (a) a *primary equity interest is issued as mentioned in subsection 6BA(1) of the *Income Tax Assessment Act 1936* (about bonus shares issued in relation to original shares); and
 - (b) subsection 6BA(2) of that Act applies (about bonus shares that are a dividend);
- subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the consideration worked out under subsection 6BA(2) of that Act.

- (5) If both of subsections (3) and (4) apply to the issue of the same *primary equity interest, subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the greater of the amounts worked out under subsections (3) and (4).

Application of subsections (3), (4) and (5)

- (6) Subsection (3) does not apply if, for the income year in which the interest is issued, the issuing entity is:
- (a) a corporate unit trust within the meaning of section 102J of the *Income Tax Assessment Act 1936*; or
 - (b) a public trading trust within the meaning of section 102R of that Act.
- (7) Subsections (3), (4) and (5) have effect only for the purposes of working out whether a *direct value shift has happened and, if so, its consequences (if any) under this Division.

725-155 Meaning of down interests, decrease time, up interests and increase time

- (1) An *equity or loan interest in the target entity is a ***down interest*** if a decrease in its market value is reasonably attributable to the one or more things referred to in paragraph 725-145(1)(b), and occurs at or after the time referred to in that paragraph. The time when the decrease happens is called the ***decrease time*** for that interest.
- (2) An *equity or loan interest in the target entity is an ***up interest*** if subsection 725-145(2) or (3) is satisfied for the interest. The time when the interest is issued at a *discount, or the increase in market value happens, is called the ***increase time*** for that interest.

725-160 What is the nature of a direct value shift?

- (1) The *direct value shift has 2 aspects.
- (2) Overall, it consists of:
- (a) the decreases in market value of the down interests; and
 - (b) the issue at a *discount of the up interests covered by subsection 725-145(2); and
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- (c) the increases in market value of the up interests covered by subsection 725-145(3).
- (3) This Division also proceeds on the basis that the *direct value shift is from *each* of the *down interests to *each* of the *up interests.

725-165 If market value decrease or increase is only partly attributable to the scheme

If it is reasonable to conclude that an increase or decrease in market value, or the issuing of an *equity or loan interest at a *discount, is only partly caused by the doing of the one or more things under the *scheme, this Division applies to the increase, decrease, or issue at a discount, to that extent only.

Subdivision 725-C—Consequences of a direct value shift

Table of sections

General

- 725-205 Consequences depend on character of down interests and up interests
 725-210 Consequences for down interests depend on pre-shift gains and losses

Special cases

- 725-220 Neutral direct value shifts
 725-225 Issue of bonus shares or units
 725-230 Off-market buy-backs

General

725-205 Consequences depend on character of down interests and up interests

- (1) The consequences for you of the *direct value shift depend on the character of the *down interests and *up interests of which you are an *affected owner.
- (2) There are consequences for all your *down interests and *up interests in their character as *CGT assets. However, some of them may also be *trading stock or *revenue assets. There are additional
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consequences for those interests in their character as trading stock or revenue assets.

Note: For example, you may own a down interest that is a CGT asset and a revenue asset.

Sections 725-240 to 725-255 set out the consequences for you of a shift in value from that interest in its character as a CGT asset. The cost base of the asset will be decreased, which will affect the calculation of a capital gain when a CGT event happens to the interest.

Section 725-320 sets out the consequences for you of a shift in value from that interest in its character as a revenue asset. The adjustment made under that section will affect the calculation of any profit on the sale of the interest.

Any overlap between the capital gain and the profit realised on the sale of the interest is then dealt with under section 118-20.

In some instances, the direct value shift may result in a taxing event generating a gain for you in the income year in which the shift happens. That gain will be both a capital gain (because the down interest can be characterised as a CGT asset) and an increase in your assessable income (because the down interest can be characterised as a revenue asset). Again, any overlap is dealt with under section 118-20.

725-210 Consequences for down interests depend on pre-shift gains and losses

- (1) The consequences for a *down interest also depend on whether it has a *pre-shift gain or a *pre-shift loss.
- (2) It has a *pre-shift gain* if, immediately before the *decrease time, its market value was *greater than* its *adjustable value.
- (3) It has a *pre-shift loss* if, immediately before the *decrease time, its market value was *equal to or less than* its *adjustable value.

[The next section is section 725-220.]

Special cases

725-220 Neutral direct value shifts

- (1) The consequences are different if the total decrease in market value of your *down interests is equal to the sum of:
 - (a) the total increase in market value of your *up interests; and

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- (b) the total *discounts given to you on the issue of your up interests.
- (2) In that case, this Subdivision and Subdivisions 725-D to 725-F apply to you as if the *direct value shift:
- (a) consisted only of:
 - (i) the decreases in market value of your *down interests; and
 - (ii) the issue at a *discount of your *up interests covered by subsection 725-145(2); and
 - (iii) the increases in market value of your up interests covered by subsection 725-145(3); and
 - (b) were from each of your down interests to each of your up interests.
- (3) This section has effect despite section 725-160.

725-225 Issue of bonus shares or units

- (1) The consequences are different if you are an *affected owner of *up interests (the *bonus interests*) that the target entity issues to you, at a *discount, under the *scheme, in relation to *down interests (the *original interests*) of which you are an affected owner.

Effect of treatment under subsection 130-20(3)

- (2) To the extent that the *direct value shift is *to* the bonus interests *from* original interests in relation to which the target entity issued bonus interests to which:
- (a) subsection 130-20(3) applies (because none of them is a dividend or otherwise assessable income); and
 - (b) item 1 of the table in that subsection applies (because the original interests are post-CGT assets);
- these paragraphs apply:
- (c) the respective *cost bases and *reduced cost bases of those original interests are not reduced;
 - (d) the bonus interests referred to in subsection (1) do not give rise to a *taxing event generating a gain for you under the table in section 725-245 on any of those original interests.

- (3) To the extent that the *direct value shift is *from* the original interests *to* bonus interests to which subsection 130-20(3) applies (because none of them is a dividend or otherwise assessable income) and:
- (a) item 1 of the table in that subsection applies (because the original interests are post-CGT assets); or
 - (b) item 2 of that table applies (because the original interests are pre-CGT assets and an amount has been paid for the bonus interests that you were required to pay);
- the respective *cost bases and *reduced cost bases of those bonus interests are not uplifted.

Effect of treatment under subsection 6BA(3) of the Income Tax Assessment Act 1936

- (4) To the extent that the *direct value shift is *to* the bonus interests *from* original interests in relation to which the target entity issued bonus interests to which subsection 6BA(3) of the *Income Tax Assessment Act 1936* applies (either because they are shares issued for no consideration and none of them is a dividend or because they qualify for the intercorporate dividend rebate):
- (a) the respective *adjustable values of those original interests, in their character as *trading stock or *revenue assets, are not reduced; and
 - (b) the bonus interests referred to in subsection (1) do not give rise to a *taxing event generating a gain for you under the table in section 725-335 on any of those original interests.
- (5) To the extent that the *direct value shift is *from* the original interests *to* bonus interests to which subsection 6BA(3) of the *Income Tax Assessment Act 1936* applies, the respective *adjustable values of those bonus interests of which you are an affected owner, in their character as trading stock or revenue assets, are not uplifted.

725-230 Off-market buy-backs

- (1) The consequences are different if:
- (a) a decrease in the market value of a *down interest of which you are an *affected owner is reasonably attributable to the
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target entity proposing to buy back that interest for less than its market value; and

- (b) the target entity does buy back that down interest; and
 - (c) subsection 159GZZZQ(2) of the *Income Tax Assessment Act 1936* treats you as having received the down interest's market value worked out as if the buy-back had not occurred and was never proposed to occur.
- (2) The *adjustable value of the *down interest is not reduced, and there is no *taxing event generating a gain.

Note: The down interest is not dealt with here because it is already dealt with in Division 16K of Part III of the *Income Tax Assessment Act 1936*.

- (3) Also, to the extent that the *direct value shift is from the *down interest to *up interests of which you are an *affected owner, uplifts in the *adjustable value of the up interests are worked out under either or both of:
- (a) item 8 of the table in subsection 725-250(2); and
 - (b) item 9 of the table in subsection 725-335(3);
- as if the down interest were one owned by another affected owner.

Subdivision 725-D—Consequences for down interest or up interest as CGT asset

Table of sections

| | |
|---------|---|
| 725-240 | CGT consequences; meaning of <i>adjustable value</i> |
| 725-245 | Table of <i>taxing events generating a gain</i> for interests as CGT assets |
| 725-250 | Table of consequences for adjustable values of interests as CGT assets |
| 725-255 | Multiple CGT consequences for the same down interest or up interest |

725-240 CGT consequences; meaning of adjustable value

- (1) The CGT consequences for you of a *direct value shift are of one or more of these 3 kinds:
- (a) there are one or more *taxing events generating a gain for *down interests of which you are an affected owner (see subsection (2));

- (b) the *cost base and *reduced cost base of down interests of which you are an *affected owner are reduced (see subsection (3));
- (c) the cost base and reduced cost base of *up interests of which you are an affected owner are uplifted (see subsection (4)).

Note: If there is a taxing event generating a gain, CGT event K8 happens. See section 104-240.

Taxing event generating a gain

- (2) To work out:
 - (a) whether under the table in section 725-245 there is a *taxing event generating a gain for you on a *down interest; and
 - (b) if so, the amount of the gain;

assume that the *adjustable value* from time to time of that or any other *equity or loan interest in the *target entity is its *cost base.

Note: For example, for that purpose the question whether the interest has a pre-shift gain or a pre-shift loss is determined on the basis that the interest's adjustable value is its cost base.

Reduction or uplift of cost base and reduced cost base

- (3) The *cost base and the *reduced cost base of a *down interest are reduced at the *decrease time to the extent that section 725-250 provides for the *adjustable value of the interest to be reduced.
- (4) The *cost base and the *reduced cost base of an *up interest are uplifted at the *increase time to the extent that section 725-250 provides for the *adjustable value of the interest to be uplifted.
- (5) However, the *cost base or *reduced cost base is *uplifted* only to the extent that the amount of the uplift is still reflected in the market value of the interest when a later *CGT event happens to the interest.
- (6) To work out:
 - (a) whether the *cost base or *reduced cost base of the interest is reduced or uplifted; and
 - (b) if so, by how much;assume that:

- (c) the *adjustable value* from time to time of that or any other *equity or loan interest in the *target entity is its cost base or reduced cost base, as appropriate; and
- (d) if the interest is an *up interest because it was issued at a *discount—the *adjustable value* of the interest immediately before it was issued was its cost base or reduced cost base, as appropriate, when it was issued.

Note: For example, for that purpose the question whether the interest has a pre-shift gain or a pre-shift loss is determined on the basis that the interest’s adjustable value is its cost base or reduced cost base, as appropriate.

Reductions and uplifts also apply to pre-CGT assets

- (7) A reduction or uplift occurs regardless of whether the entity that owns the interest *acquired it before, on or after 20 September 1985.

725-245 Table of taxing events generating a gain for interests as CGT assets

To the extent that the *direct value shift is from *down interests of which you are an *affected owner, and that are specified in an item in the table, to *up interests specified in that item, those up interests give rise to a *taxing event generating a gain* for you on each of those down interests. The gain is worked out under section 725-365.

Taxing events generating a gain for down interests as CGT assets

| Item | Down interests: | Up interests: |
|-------------|--|--|
| 1 | *down interests that: (a) are owned by <i>you</i> ; and (b) are <i>neither your *revenue assets nor your *trading stock</i> ; and (c) have <i>*pre-shift gains</i> ; and (d) are <i>*post-CGT assets</i> | *up interests owned by <i>you</i> that: (a) are <i>neither your *revenue assets nor your *trading stock</i> ; and (b) are <i>*pre-CGT assets</i> |

Taxing events generating a gain for down interests as CGT assets

| Item | Down interests: | Up interests: |
|-------------|---|---|
| 2 | *down interests that: (a) are owned by <i>you</i> ; and (b) are <i>neither your *revenue assets nor your *trading stock</i> ; and (c) have <i>*pre-shift gains</i> | *up interests owned by <i>you</i> that are <i>your *trading stock or *revenue assets</i> |
| 3 | *down interests owned by <i>you</i> that: (a) are of the one kind (either <i>your *trading stock or your *revenue assets</i>); and (b) have <i>*pre-shift gains</i> | *up interests owned by <i>you</i> that: (a) are <i>of the other kind</i> (either <i>your *revenue assets or your *trading stock</i>); or (b) are <i>neither your *revenue assets nor your *trading stock</i> |
| 4 | *down interests owned by <i>you</i> that have <i>*pre-shift gains</i> | up interests owned by <i>other *affected owners</i> |

Note: If there is a taxing event generating a gain on a down interest, CGT event K8 happens: see section 104-240. However, a capital gain you make under CGT event K8 is disregarded if the down interest:

- is your trading stock (see section 118-25); or
- is a pre-CGT asset (see subsection 104-240(5)).

725-250 Table of consequences for adjustable values of interests as CGT assets

- (1) The table in subsection (2) sets out consequences of the *direct value shift for the *adjustable values of *down interests and *up interests of which you are an *affected owner, in their character as *CGT assets.
- (2) To the extent that the *direct value shift is from *down interests specified in an item in the table to *up interests specified in that item:
 - (a) the *adjustable value of each of those down interests is decreased by the amount worked out under the section (if any) specified for the down interests in the last column of that item; and
 - (b) the adjustable value of each of those *up interests is uplifted by the amount worked out under the section (if any) specified for the up interests in that column.

| Consequences of the direct value shift for adjustable values of CGT assets | | | |
|---|---|--|---|
| Item | To the extent that the direct value shift is from: | To: | The decrease or uplift is worked out under: |
| 1 | *down interests that: (a) are owned by <i>you</i> ; and (b) have <i>pre-shift gains</i> ; and (c) are <i>post-CGT assets</i> | *up interests owned by <i>you</i> that do <i>not</i> give rise to a <i>taxing event</i> generating a gain for <i>you</i> on those down interests under section 725-245 | for the down interests: section 725-365; and for the up interests: section 725-370 |
| 2 | *down interests that: (a) are owned by <i>you</i> ; and (b) have <i>pre-shift gains</i> ; and (c) are <i>pre-CGT assets</i> | *up interests owned by <i>you</i> that are <i>pre-CGT assets</i> | for the down interests: section 725-365; and for the up interests: section 725-370 |
| 3 | *down interests that: (a) are owned by <i>you</i> ; and (b) have <i>pre-shift gains</i> ; and (c) are <i>pre-CGT assets</i> | *up interests owned by <i>you</i> that are <i>post-CGT assets</i> | for the down interests: section 725-365; and for the up interests: section 725-375 |
| 4 | *down interests owned by <i>you</i> that have <i>pre-shift gains</i> | *up interests owned by <i>you</i> that give rise to a <i>taxing event</i> generating a gain on those down interests under section 725-245 | for the down interests: section 725-365; and for the up interests: section 725-375 |
| 5 | *down interests owned by <i>you</i> that have <i>pre-shift losses</i> | *up interests owned by <i>you</i> | for the down interests: section 725-380; and for the up interests: section 725-375 |
| 6 | *down interests owned by <i>you</i> that have <i>pre-shift gains</i> | *up interests owned by <i>other affected owners</i> | for the down interests: section 725-365 |
| 7 | *down interests owned by <i>you</i> that have <i>pre-shift losses</i> | *up interests owned by <i>other affected owners</i> | for the down interests: section 725-380 |

| Consequences of the direct value shift for adjustable values of CGT assets | | | |
|---|--|--|--|
| Item | To the extent that the direct value shift is from: | To: | The decrease or uplift is worked out under: |
| 8 | *down interests owned by <i>other</i> *affected owners | *up interests owned by <i>you</i> | for the up interests: section 725-375 |
| 9 | *down interests owned by <i>you</i> | *up interests owned by <i>entities that are not</i> *affected owners | (there are no decreases or uplifts) |
| 10 | *down interests owned by <i>entities that are not</i> *affected owners | *up interests owned by <i>you</i> | (there are no decreases or uplifts) |

725-255 Multiple CGT consequences for the same down interest or up interest

- (1) A *down interest or *up interest of which you are an *affected owner may be covered by 2 or more items in the table in subsection 725-250(2).
- (2) If the *cost base or *reduced cost base of the same *down interest or *up interest is decreased or uplifted under 2 or more items, it is decreased or uplifted by the total of the amounts worked out under those items.
- (3) If for a particular *down interest there is a *taxing event generating a gain under an item in the table in section 725-245, that taxing event is in addition to:
 - (a) each taxing event generating a gain for that interest under any other item in that table; and
 - (b) each decrease in the *cost base or *reduced cost base of the interest under an item in the table in subsection 725-250(2).

Subdivision 725-E—Consequences for down interest or up interest as trading stock or a revenue asset

Table of sections

725-310 Consequences for down interest or up interest as trading stock

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- 725-315 *Adjustable value* of trading stock
 - 725-320 Consequences for down interest or up interest as a revenue asset
 - 725-325 *Adjustable value* of revenue asset
 - 725-335 How to work out those consequences
 - 725-340 Multiple trading stock or revenue asset consequences for the same down interest or up interest

725-310 Consequences for down interest or up interest as trading stock

- (1) The consequences of the *direct value shift for your *trading stock are of one or more of these 3 kinds:
 - (a) the *adjustable values of *down interests of which you are an *affected owner are reduced (see subsection (2));
 - (b) the adjustable values of *up interests of which you are an affected owner are uplifted (see subsection (3));
 - (c) there are one or more *taxing events generating a gain for down interests of which you are an affected owner (see subsection (5)).

Effect of reduction or uplift of adjustable value

- (2) If the *adjustable value of a *down interest that is your trading stock is reduced under section 725-335, you are treated as if:
 - (a) *immediately before the *decrease time, you had sold the interest to someone else (at *arm's length and in the ordinary course of business) for its *adjustable value immediately before the decrease time; and
 - (b) immediately after the decrease time, you had bought the interest back for the reduced adjustable value.
- (3) If the *adjustable value of an *up interest that is your *trading stock is uplifted under section 725-335, you are treated as if:
 - (a) *immediately before the *increase time, you had sold the interest to someone else (at *arm's length and in the ordinary course of business) for its *adjustable value immediately before the increase time; and
 - (b) immediately after the increase time, you had bought the interest back for the uplifted adjustable value.

- (4) However, the increase in the cost of an *up interest because of paragraph (3)(b) is taken into account from time to time only to the extent that the amount of the increase is still reflected in the market value of the interest.

Note: The situations where the increase in cost would be taken into account include:

- in working out your deductions for the cost of trading stock acquired during the income year in which the increase time happens; and
- the end of an income year if the interest's closing value as trading stock is worked out on the basis of its cost; and
- the start of the income year in which the interest is disposed of, if that happens in a later income year and the interest's closing value as trading stock at the end of the previous income year was worked out on the basis of its cost.

If the interest stops being trading stock, section 70-110 treats you as having disposed of it.

Taxing event generating a gain

- (5) For each *taxing event generating a gain under an item in the table in subsection 725-335(3), the gain is included in your assessable income for the income year in which the *decrease time happens.

725-315 Adjustable value of trading stock

If a *down interest or *up interest is your trading stock, its **adjustable value** at a particular time is:

- (a) if the interest has been *trading stock of yours ever since the start of the income year in which that time occurs—its *value as trading stock at the start of the income year; or
- (b) otherwise—its cost.

Note 1: If an interest has been affected by an earlier direct value shift during the same income year, it will be treated as having already been sold and repurchased (because of an earlier application of section 725-310). As a result, the cost on repurchase becomes its adjustable value immediately before the decrease time or increase time for the later direct value shift.

Note 2: The adjustable value of an interest that is an up interest because it was issued at a discount is worked out under paragraph (b).

725-320 Consequences for down interest or up interest as a revenue asset

- (1) The consequences of the *direct value shift for your *revenue assets are of one or more of these 3 kinds:
 - (a) the *adjustable values of *down interests of which you are an *affected owner are reduced (see subsection (2));
 - (b) the adjustable values of *up interests of which you are an affected owner are uplifted (see subsection (3));
 - (c) one or more *taxing events generating a gain for down interests of which you are an affected owner (see subsection (5)).

Effect of reduction or uplift of adjustable value

- (2) If the *adjustable value of a *down interest that is your *revenue asset is decreased under section 725-335, you are treated as if:
 - (a) *immediately before the *decrease time, you had sold the interest to someone else for its *adjustable value immediately before the decrease time; and
 - (b) immediately afterwards, you had bought the interest back for the reduced adjustable value; and
 - (c) from the time when you bought it back, the interest continued to be a revenue asset, for the same reasons as it was a revenue asset before you sold it.
- (3) If the *adjustable value of an *up interest that is your *revenue asset is uplifted under section 725-335, you are treated as if:
 - (a) *immediately before the *increase time, you had sold the interest to someone else for its *adjustable value immediately before the increase time; and
 - (b) immediately afterwards, you had bought the interest back for the uplifted adjustable value; and
 - (c) from the time when you bought it back, the interest continued to be a revenue asset, for the same reasons as it was a revenue asset before you sold it.
- (4) However, the uplift in *adjustable value is taken into account only to the extent that the amount of the uplift is still reflected in the

market value of the interest when it is disposed of or otherwise realised.

Taxing event generating a gain

- (5) For each *taxing event generating a gain under an item in the table in subsection 725-335(3), the gain is included in your assessable income for the income year in which the *decrease time happens.

725-325 Adjustable value of revenue asset

- (1) If a *down interest is your *revenue asset, its *adjustable value* immediately before the *decrease time is the total of the amounts that would be subtracted from the gross disposal proceeds in calculating any profit or loss on disposal of the interest if you disposed of it immediately before the decrease time.
- (2) If an *up interest is your *revenue asset and it increases in market value because of the *direct value shift, its *adjustable value* immediately before the *increase time is the total of the amounts that would be subtracted from the gross disposal proceeds in calculating any profit or loss on disposal of the interest if you disposed of it immediately before the increase time.
- (3) If an *up interest is your *revenue asset and it is issued at a *discount, it is taken to have an *adjustable value* immediately before it is issued equal to the consideration paid or given by you for the interest.

Note: If an interest has been affected by an earlier direct value shift during the same income year, it will be treated as having already been sold and repurchased (because of an earlier application of section 725-320). As a result, the cost on repurchase becomes its adjustable value immediately before the decrease time or increase time for the later direct value shift.

[The next section is section 725-335.]

725-335 How to work out those consequences

- (1) This section sets out the consequences of the *direct value shift for a *down interest or *up interest as *trading stock or a *revenue asset.
-

- (2) If you have both trading stock and revenue assets, items 1 and 2 of the table in subsection (3) can apply once to the trading stock and again to the revenue assets. The other items apply (if at all) to the trading stock and revenue assets together.

Decreases and uplifts in adjustable value

- (3) To the extent that the *direct value shift is from *down interests specified in an item in the table to *up interests specified in that item:
- (a) the *adjustable value of each of those down interests is decreased by the amount worked out under the section (if any) specified for the down interests in the last column of that item; and
 - (b) the adjustable value of each of those *up interests is uplifted by the amount worked out under the section (if any) specified for the up interests in that column.

Consequences for down interest or up interest as trading stock or revenue asset

| Item | To the extent that the direct value shift is from: | To: | The decrease or uplift is worked out under: |
|-------------|--|--|--|
| 1 | *down interests owned by you that: (a) are of the one kind (either your *trading stock or your *revenue assets); and (b) have *pre-shift gains | *up interests owned by you that are of that same kind | for the down interests: section 725-365; and for the up interests: section 725-370 |
| 2 | *down interests owned by you that: (a) are of the one kind (either your *trading stock or your *revenue assets); and (b) have *pre-shift gains | *up interests owned by you that are of the other kind (either your *revenue assets or your *trading stock) | for the down interests: section 725-365; and for the up interests: section 725-375 |

| Consequences for down interest or up interest as trading stock or revenue asset | | | |
|--|---|--|--|
| Item | To the extent that the direct value shift is from: | To: | The decrease or uplift is worked out under: |
| 3 | *down interests owned by you that: (a) are your *trading stock or *revenue assets; and (b) have *pre-shift losses | *up interests owned by you that are of that same kind or of the other kind | for the down interests: section 725-380; and for the up interests: section 725-375 |
| 4 | *down interests owned by you that: (a) are your *trading stock or *revenue assets; and (b) have *pre-shift gains | *up interests owned by you that are neither your *revenue assets nor your *trading stock | for the down interests: section 725-365 |
| 5 | *down interests owned by you that: (a) are your *trading stock or *revenue assets; and (b) have *pre-shift losses | *up interests owned by you that are neither your *revenue assets nor your *trading stock | for the down interests: section 725-380 |
| 6 | *down interests owned by you that are neither your *revenue assets nor your *trading stock | *up interests owned by you that are your *trading stock or *revenue assets | for the up interests: section 725-375 |
| 7 | *down interests owned by you that: (a) are your *trading stock or *revenue assets; and (b) have *pre-shift gains | up interests owned by other *affected owners | for the down interests: section 725-365 |
| 8 | *down interests owned by you that: (a) are your *trading stock or *revenue assets; and (b) have *pre-shift losses | *up interests owned by other *affected owners | for the down interests: section 725-380 |
| 9 | *down interests owned by other *affected owners | *up interests owned by you that are your *trading stock or *revenue assets | for the up interests: section 725-375 |

| Consequences for down interest or up interest as trading stock or revenue asset | | | |
|--|--|--|--|
| Item | To the extent that the direct value shift is from: | To: | The decrease or uplift is worked out under: |
| 10 | *down interests owned by you that are your *trading stock or *revenue assets | *up interests owned by entities that are not *affected owners | (there are no decreases or uplifts) |
| 11 | *down interests owned by entities that are not *affected owners | *up interests owned by you that are your *trading stock or *revenue assets | (there are no decreases or uplifts) |

Taxing events generating a gain

- (4) To the extent that the *direct value shift is from *down interests:
- of which you are an *affected owner; and
 - that are specified in item 2, 4 or 7 in the table in subsection (3);
- to *up interests specified in that item, those up interests give rise to a **taxing event generating a gain** for you under that item on each of those down interests. The gain is worked out under section 725-365.

725-340 Multiple trading stock or revenue asset consequences for the same down interest or up interest

- A *down interest or *up interest of which you are an *affected owner may be covered by 2 or more items in the table in subsection 725-335(3).
- If the *adjustable value of the same *down interest or *up interest is decreased or uplifted under 2 or more items, it is decreased or uplifted by the total of the amounts worked out under those items.
- If for a particular *down interest there is a *taxing event generating a gain under an item, that taxing event is in addition to:
 - each taxing event generating a gain for that interest under any other item in the table; and
 - each decrease in the *adjustable value of the interest under that or any other item in the table.

Subdivision 725-F—Value adjustments and taxed gains

Table of sections

| | |
|---------|--|
| 725-365 | Decreases in adjustable values of down interests (with pre-shift gains), and taxing events generating a gain |
| 725-370 | Uplifts in adjustable values of up interests under certain table items |
| 725-375 | Uplifts in adjustable values of up interests under other table items |
| 725-380 | Decreases in adjustable value of down interests (with pre-shift losses) |

725-365 Decreases in adjustable values of down interests (with pre-shift gains), and taxing events generating a gain

Use the following method statement:

- (a) to work out the amount of the gain for a *taxing event generating a gain under:
 - (i) section 725-245; or
 - (ii) item 2, 4 or 7 of the table in subsection 725-335(3); and
- (b) to work out the decrease in *adjustable value of a *down interest under:
 - (i) item 1, 2, 3, 4 or 6 of the table in subsection 725-250(2); or
 - (ii) item 1, 2, 4 or 7 of the table in subsection 725-335(3).

Method statement

Step 1. Group together all *down interests that:

- (a) are of the kind referred to in the relevant item; and
- (b) immediately before the *decrease time, had the same *adjustable value as the down interest; and
- (c) immediately before that time had the same market value as the down interest; and
- (d) sustained the same decrease in market value as the down interest because of the *direct value shift.

Step 2. Work out the value shifted from that group of *down interests to the *up interests referred to in the relevant item using the following formula:

$$\frac{\text{Sum of the decreases in *market value of all *down interests in the group because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift}} \times \frac{\text{Sum of the increases in *market value of, and *discounts given on the issue of, all *up interests because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift}}$$

Step 3. Work out the notional adjustable value of the value shifted from that group of *down interests to those *up interests using the formula:

$$\frac{\text{Sum of the *adjustable values, immediately before the *decrease time, of all *down interests in the group}}{\text{Sum of the *market values, immediately before the *decrease time, of all *down interests in the group}} \times \frac{\text{Value shifted}}{\text{Sum of the *market values, immediately before the *decrease time, of all *down interests in the group}}$$

Step 4. The decrease in the *adjustable value of the *down interest under the relevant item is equal to:

$$\frac{\text{Notional adjustable value}}{\text{Number of *down interests in the group}}$$

Step 5. For a *taxing event generating a gain under the relevant item, the amount of the gain is equal to:

$$\frac{\text{Value shifted} - \text{Notional adjustable value}}{\text{Number of *down interests in the group}}$$

725-370 Uplifts in adjustable values of up interests under certain table items

Use the following method statement to work out the uplift in *adjustable value of an *up interest under:

- (a) item 1 or 2 of the table in subsection 725-250(2); or
- (b) item 1 of the table in subsection 725-335(3).

Method statement

Step 1. If the market value of the *up interest increases because of the *direct value shift, group together all up interests of the kind referred to in the relevant item that:

- (a) immediately before the *increase time, had the same *adjustable value as the up interest; and
- (b) sustained the same increase in market value as the up interest because of the *direct value shift.

If the *up interest is issued at a *discount, group together all *up interests of the kind referred to in the relevant item that:

- (c) immediately before the *increase time, had the same *adjustable value as the up interest; and
- (d) because of the direct value shift, are issued at the same discount as the up interest.

Step 2. The notional adjustable value of the value shifted from the *down interests referred to in the relevant item to all the *up interests referred to in that item has already been worked out under one or more applications of step 3 of the method statement in section 725-365.

Step 3. Use the following formula to work out how much of that notional adjustable value is attributable to the value shifted to the group of *up interests referred to in step 1 of this method statement:

$$\text{Notional adjustable value} \times \frac{\text{Sum of the * market values, immediately after the * increase time, of all * up interests in the group}}{\text{Sum of the * market values, immediately after the * increase time, of all * up interests referred to in the relevant item}}$$

Step 4. The uplift in the *adjustable value of the *up interest under the relevant item is equal to:

$$\frac{\text{The amount worked out under step 3}}{\text{Number of interests in that group of * up interests}}$$

725-375 Uplifts in adjustable values of up interests under other table items

Use the following method statement to work out the uplift in *adjustable value of an *up interest under:

- (a) item 3, 4, 5 or 8 of the table in subsection 725-250(2); or
- (b) item 2, 3, 6 or 9 of the table in subsection 725-335(3).

Method statement

Step 1. If the market value of the *up interest increases because of the direct value shift, group together all *up interests of the kind referred to in the relevant item that sustained the same increase in market value as the up interest because of the direct value shift.

If the up interest is issued at a discount, group together all up interests of the kind referred to in the relevant item

that are issued at a discount of the same amount as the up interest because of the direct value shift.

Step 2. The value shifted to that group of *up interests from the *down interests referred to in the relevant item is the amount worked out using the formula:

$$\frac{\text{Sum of the group increases or discounts} \times \text{Sum of the decreases in *market value of those *down interests}}{\text{Total value of the *direct value shift}}$$

where:

sum of the group increases or discounts means (as appropriate):

- (a) the sum of the increases in market value of all *up interests in the group because of the *direct value shift; or
- (b) the sum of the *discounts at which all *up interests in the group were issued because of the *direct value shift.

total value of the direct value shift means:

- (a) if the sum of the decreases in market value of all *down interests because of the *direct value shift is equal to or greater than the sum of the increases in market value of all *up interests and all *discounts given because of the shift—the sum of the decreases; or
- (b) if the sum of the decreases in market value of all down interests because of the direct value shift is less than the sum of the increases in market value of all up interests and all discounts given because

of the shift—the sum of the increases and discounts.

Step 3. The uplift in the *adjustable value of the *up interest under the relevant item is equal to:

$$\frac{\text{Value shifted}}{\text{Number of *up interests in the group}}$$

725-380 Decreases in adjustable value of down interests (with pre-shift losses)

Use the following method statement to work out the decrease in *adjustable value of a *down interest under:

- (a) item 5 or 7 of the table in subsection 725-250(2); or
- (b) item 3, 5 or 8 of the table in subsection 725-335(3).

Method statement

Step 1. Group together all *down interests of the kind referred to in the relevant item that:

- (a) immediately before the *decrease time, had the same *adjustable value as the down interest; and
- (b) immediately before that time had the same market value as the down interest; and
- (c) sustained the same decrease in market value as the down interest because of the *direct value shift.

Step 2. Work out the value shifted from that group of *down interests to the *up interests referred to in the relevant item using the formula:

| | | |
|---|----------|--|
| <p>Sum of the decreases in *market value of all *down interests in the group because of the *direct value shift</p> | <p>×</p> | <p>Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift</p> <hr style="width: 100%;"/> <p>Sum of the increases in *market value of, and *discounts given on the issue of, all *up interests because of the *direct value shift</p> |
| <p><i>Step 3.</i> The decrease in *adjustable value of the *down interest under the relevant item is equal to:</p> | | |
| $\frac{\text{Value shifted}}{\text{Number of *down interests in the group}}$ | | |

Division 727—Indirect value shifting affecting interests in companies and trusts, and arising from non-arm’s length dealings

Table of Subdivisions

Guide to Division 727

- 727-A Scope of the indirect value shifting rules
- 727-B What is an indirect value shift
- 727-C Exclusions
- 727-D Working out the market value of economic benefits
- 727-E Key concepts
- 727-F Consequences of an indirect value shift
- 727-G The realisation time method
- 727-H The adjustable value method
- 727-K Reduction of loss on equity or loan interests realised before the IVS time
- 727-L Indirect value shift resulting from a direct value shift

Guide to Division 727

727-1 What this Division is about

If there is a net shift of value between 2 related entities because of a non-arm's length dealing, this Division:

- (a) prevents losses from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the losing entity; and
- (b) within limits, prevents gains from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the gaining entity.

However, it does so only for interests that are owned by entities involved in the value shift.

Table of sections

727-5 What is an indirect value shift?

- 727-10 How does this Division deal with indirect value shifts?
727-15 When does an indirect value shift have consequences under this Division?
727-25 Effect of this Division on realisations at a loss that occur before the nature or extent of an indirect value shift can be fully determined

727-5 What is an indirect value shift?

- (1) An indirect value shift arises when there is a net shift of value from one entity to another.

Example: Company A transfers property to company B in return for a cash payment. If the market value of the property is \$180 million but the cash payment is only \$50 million, there is a net shift of value from company A to company B of \$130 million.

- (2) It is called *indirect* because the transaction will have the indirect effect of shifting value from equity or loan interests in the losing entity to equity or loan interests in the gaining entity.

This is because the net shift in value between the entities will usually *decrease* the market value of interests in the losing entity and *increase* the market value of interests in the gaining entity.

Example: Assume that company C owns all the shares in company A and company D owns all the shares in company B. The net shift of value from company A to company B will reduce the value of company C's shares in company A and increase the value of company D's shares in company B.

- (3) It will also produce corresponding effects further up a chain of entities.

Example: Assume that company E owns all the shares in company C and company D. The net shift of value from company A to company B will also reduce the value of company E's shares in company C and increase the value of its shares in company D.



- (4) This Division is *not* concerned with the tax treatment of the net shift in value between the entities at the bottom of the chains. Instead, it deals with the effects on the market value of interests (both direct and indirect) in those entities.
- (5) An indirect value shift distorts the relationship between the market value of an equity or loan interest and its value for income tax purposes. When the interest is realised, this can produce an inappropriate loss for income tax purposes, or an inappropriate gain.

Example: If company E sold its shares in company C, the indirect value shift could (apart from this Division) result in a loss for income tax purposes. Company E could defer the corresponding gain on its shares in company D by not selling these.

727-10 How does this Division deal with indirect value shifts?

- (1) To prevent an inappropriate loss or gain from arising on realisation of an interest, this Division reduces the amount of the loss or gain (realisation time method). However, a choice can be made to adjust

the interest's value for income tax purposes in a way that takes account of the indirect value shift (adjustable value method).

- (2) This Division does *not* create taxing events giving rise to gains or losses.

727-15 When does an indirect value shift have consequences under this Division?

- (1) Indirect value shift is defined very broadly, but the application of this Division is limited in various ways.
- (2) The losing entity must be a company or trust (except a superannuation entity). However, the gaining entity can be any kind of entity, including an individual.
- (3) This Division does *not* apply if entities deal with each other at arm's length, or provide economic benefits in return for full market value.
- (4) The losing entity and the gaining entity must be connected by having had the same *ultimate controller*. In the case of closely held entities, they may instead be connected by having had a high level of *common ownership*.
- (5) The only interests affected are those owned by entities involved in the indirect value shift or by their associates.
- (6) There are a range of exclusions, such as:
- (a) exclusions for minor indirect value shifts; and
 - (b) a series of rules designed to provide safe harbour treatment for common transactions relating to services; and
 - (c) anti-overlap provisions to prevent double-counting.
- (7) Rules of thumb are included to make it easier to determine the market value of some kinds of economic benefits.
- (8) To reduce compliance costs for:
- (a) entities in the Simplified Tax System; and
 - (b) entities that meet the CGT small business net asset threshold (\$5 million);
- interests owned by those entities are not affected by this Division.
-

[The next section is section 727-25.]

727-25 Effect of this Division on realisations at a loss that occur before the nature or extent of an indirect value shift can be fully determined

- (1) To determine whether a scheme gives rise to an indirect value shift, it must be possible to identify all the economic benefits under the scheme, and the providers and recipients of those benefits.
- (2) Before then, interests that might be affected by the scheme may be realised at a loss. Subdivision 727-K contains special rules that apply if that happens.

Subdivision 727-A—Scope of the indirect value shifting rules

Table of sections

| | |
|---------|--|
| 727-95 | Main object |
| 727-100 | When an indirect value shift has consequences under this Division |
| 727-105 | Ultimate controller test |
| 727-110 | Common-ownership nexus test (if both losing and gaining entities are closely held) |
| 727-125 | No consequences if losing entity is a superannuation entity |

727-95 Main object

The main object of this Division is:

- (a) to prevent inappropriate losses from arising on the realisation of direct or indirect equity or loan interests in an entity from which there has been a net shift of value because of a non-arm's length dealing; and
- (b) to prevent inappropriate gains from arising on the realisation of direct or indirect equity interests in the entity to which that value has been shifted;

in cases where the 2 entities are related as set out in this Division.

727-100 When an indirect value shift has consequences under this Division

An *indirect value shift (see Subdivision 727-B) has consequences under this Division if, and only if:

- (a) the *losing entity is at the time of the indirect value shift a company or trust (except one listed in section 727-125 (about superannuation entities)); and
 - (b) in relation to either or both of the following:
 - (i) the losing entity *providing one or more economic benefits to the gaining entity *in connection with the *scheme from which the indirect value shift results;
 - (ii) the gaining entity providing one or more economic benefits to the losing entity in connection with the scheme;
- the 2 entities are not dealing with each other at *arm's length; and
- (c) either or both of sections 727-105 and 727-110 are satisfied; and
 - (d) no exclusion in Subdivision 727-C applies.

Note 1: The consequences for direct and indirect interests in the losing entity or in the gaining entity are set out in Subdivision 727-F. If those consequences are to be worked out using the realisation time method (under Subdivision 727-G), there are further exclusions for certain 95% services indirect value shifts: see section 727-700.

Note 2: An indirect value shift does not have consequences for interests in the losing entity or gaining entity owned immediately before the IVS time by an entity that:

- is eligible to be an STS taxpayer for each income year that includes any of the IVS period; or
- would satisfy the maximum net asset value test in section 152-15 throughout the IVS period.

See subsection 727-470(2).

727-105 Ultimate controller test

It must be the case that, at some time during the *IVS period:

- (a) the *losing entity and the *gaining entity have the same *ultimate controller; or

-
- (b) the ultimate controller of the losing entity is the same entity that was the ultimate controller of the gaining entity at a different time during that period; or
 - (c) the gaining entity is the ultimate controller of the losing entity; or
 - (d) the losing entity is the ultimate controller of the gaining entity.

For the concept of *IVS period*, see section 727-150.

For the concept of *ultimate controller*, see section 727-350.

727-110 Common-ownership nexus test (if both losing and gaining entities are closely held)

- (1) Or, it must be the case that:
 - (a) at some time during the *IVS period, neither the *losing entity nor the *gaining entity has 300 or more members (in the case of a company) or 300 or more beneficiaries (in the case of a trust); and
 - (b) the losing entity and the gaining entity have a *common-ownership nexus within the IVS period.

For the concept of *IVS period*, see section 727-150.

For the concept of *common-ownership nexus*, see section 727-400.

- (2) Section 124-810 (under which certain companies and trusts are not regarded as having 300 or more members or beneficiaries) also applies for the purposes of this Division.
- (3) In addition, this Division applies to a *non-fixed trust as if it did not have 300 or more beneficiaries.

727-125 No consequences if losing entity is a superannuation entity

An *indirect value shift has no consequences under this Division if the *losing entity is one of these in relation to the income year in which the indirect value shift happens:

- (a) a *complying superannuation fund; or
 - (b) a *non-complying superannuation fund; or
 - (c) a *complying approved deposit fund; or
 - (d) a *non-complying approved deposit fund; or
-

- (e) a *pooled superannuation trust.

Subdivision 727-B—What is an indirect value shift

Table of sections

| | |
|---------|---|
| 727-150 | How to determine whether a scheme results in an indirect value shift |
| 727-155 | Providing economic benefits |
| 727-160 | When an economic benefit is provided <i>in connection with</i> a scheme |
| 727-165 | Preventing double-counting of economic benefits |

727-150 How to determine whether a scheme results in an indirect value shift

- (1) A *scheme can result in one or more *indirect value shifts only if one or more economic benefits have been, are being, or are to be, *provided *in connection with the scheme.
- (2) The question whether the *scheme has that result must be determined by reference to the facts and circumstances that exist at the earliest time (either when the scheme is entered into or later) when it is reasonable to conclude that:
 - (a) all the economic benefits that have been, are being, or are to be, *provided *in connection with the scheme can be identified; and
 - (b) for each of those economic benefits:
 - (i) the entity that has provided, is providing, or is to provide, the economic benefit can be identified; and
 - (ii) the entity to which the economic benefit has been, is being, or is to be, provided can be identified; and
 - (iii) if the economic benefit is to be provided—those entities are in existence, and the providing of the economic benefit is not contingent; and
 - (c) there are no other economic benefits that are to be provided in connection with the scheme if some contingency is met.

That time is called the *IVS time* for the scheme.

Note: In most cases, the IVS time will be at or soon after the scheme is entered into. However, if:

- direct or indirect interests in a company or trust are realised at a loss when the IVS time for the scheme has not yet happened (even if it never happens); and

- the company or trust has provided, is providing, is to provide, or might provide, economic benefits in connection with the scheme;

there may be consequences for those interests similar to those of an indirect value shift resulting from the scheme. See Subdivision 727-K.

- (3) The *scheme results in an **indirect value shift** from one entity (the **losing entity**) to another entity (the **gaining entity**) if the total market value of the one or more economic benefits (the **greater benefits**) that the losing entity has *provided, is providing, or is to provide, to the gaining entity *in connection with the scheme exceeds:
- (a) the total market value of the one or more economic benefits (**lesser benefits**) that the gaining entity has provided, is providing, or is to provide, to the losing entity in connection with the scheme; or
 - (b) if there are no economic benefits covered by paragraph (a)—nil.

That excess is the amount of the indirect value shift.

- (4) The market value of an economic benefit is to be determined as at the earliest time when it is reasonable to conclude that:
- (a) the economic benefit can be identified; and
 - (b) paragraph (2)(b) is satisfied for that benefit.

For more rules affecting how the market value of an economic benefit is determined, see Subdivision 727-D.

- (5) Neither the *losing entity nor the *gaining entity needs to be a party to the *scheme. A benefit can be provided by act or omission.
- (6) The indirect value shift happens at the *IVS time.
- (7) The **IVS period** for a *scheme starts immediately before the scheme is entered into and ends at the *IVS time.
- (8) A contingency that is artificial, or is virtually certain to be met, is treated under this Division as if it had been met.

727-155 Providing economic benefits

Examples

- (1) These are some examples of an entity providing an economic benefit to another entity:
 - (a) the first entity pays an amount to the other entity (in this case the market value of the benefit is the amount of the payment);
 - (b) the first entity provides an asset or services to the other entity;
 - (c) the first entity does something that creates an asset in the hands of the other entity (for example, a company issues shares to its members);
 - (d) the first entity incurs a liability to the other entity, or increases a liability it already owes to the other entity;
 - (e) the first entity terminates all or part of a liability owed by the other entity;
 - (f) the first entity does something that increases the market value of an asset that the other entity holds.
- (2) These examples are not intended to limit the meaning of providing an economic benefit.

Things treated as economic benefits

- (3) This Division applies as if the ending of:
 - (a) a *primary equity interest or *secondary equity interest in an entity; or
 - (b) a right that the owner of a *primary equity interest or *secondary equity interest in an entity has because of owning the interest;were an economic benefit that the owner of the interest provides to that entity.

727-160 When an economic benefit is provided in connection with a scheme

- (1) An economic benefit has been, is being, is to be, or might be, *provided by an entity to another entity *in connection with* a *scheme if, and only if:
- (a) the benefit has been, is being, is to be, or might be, provided under the scheme; or
 - (b) the providing of the benefit is reasonably attributable to:
 - (i) something that has been, is being, is to be, or might be, done or omitted under the scheme (whether before, at the time of, or after, the providing of the benefit) by an entity that is either of those entities or a third entity; or
 - (ii) 2 or more such things.
- (2) An entity referred to in paragraph (1)(b) need not be a party to the *scheme. A benefit can be provided by act or omission.

727-165 Preventing double-counting of economic benefits

Rights to have economic benefits provided

- (1) If an economic benefit that has been, is being, is to be, or might be, *provided as mentioned in subsection 727-150(3) or 727-855(1) consists of a right to have economic benefits provided, that subsection applies to the right but does not also apply to those economic benefits.

Example: Acme Ltd enters into an agreement with Paragon Pty Ltd under which Acme is to provide services to Paragon over a 5 year period in return for payments.

Paragon's rights under the agreement are economic benefits that Acme provides to Paragon when the agreement is made. The services are economic benefits that Acme is to provide to Paragon.

Because of this subsection, the market value of the rights is taken into account in working out whether there has been an indirect value shift, but the market value of the services is not.

Effect of an economic benefit on interests in the entity to which it is provided

- (2) If an economic benefit has been, is being, or is to be, *provided to an entity, then, for the purposes of subsection 727-150(3) or 727-855(1), disregard an economic benefit to the extent that:
- (a) it consists of an increase in the market value of:
 - (i) an *equity or loan interest in the entity; or
 - (ii) an *indirect equity or loan interest in the entity; and
 - (b) the increase is reasonably attributable to the first-mentioned benefit.

Subdivision 727-C—Exclusions

Guide to Subdivision 727-C

727-200 What this Subdivision is about

Some indirect value shifts do not have consequences under this Division.

Note 1: If the consequences of an indirect value shift are to be worked out using the realisation time method (under Subdivision 727-G), there are further exclusions for certain 95% services indirect value shifts: see section 727-700.

Note 2: For cases where there may be both a direct value shift and an indirect value shift, see Subdivision 727-L.

Table of sections

General

727-215 Amount does not exceed \$50,000

727-220 Disposal of asset at cost, or at undervalue if full value is not reflected in adjustable values of equity or loan interests in the losing entity

Indirect value shifts involving services

727-230 Services provided by losing entity to gaining entity for at least their direct cost

727-235 Services provided by gaining entity to losing entity for no more than a commercially realistic price

727-240 What services certain provisions apply to

727-245 How to work out certain amounts for the purposes of sections 727-230 and 727-235

Anti-overlap provisions

727-250 Distribution by an entity to a member or beneficiary

Miscellaneous

727-260 Shift down a wholly-owned chain of entities

[This is the end of the Guide.]

General

727-215 Amount does not exceed \$50,000

- (1) An *indirect value shift does not have consequences under this Division if the amount of it does not exceed \$50,000.
- (2) However, subsection (1) does not apply to an *indirect value shift (and is taken never to have applied to it) if:
 - (a) before, at the same time as, or after it, another indirect value shift happens for which the same entity is the losing entity as for the first indirect value shift; and
 - (b) having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why one of the indirect value shifts happened under a different *scheme from the other was so that its amount would not exceed \$50,000.

727-220 Disposal of asset at cost, or at undervalue if full value is not reflected in adjustable values of equity or loan interests in the losing entity

- (1) An *indirect value shift does not have consequences under this Division if the conditions in this section are met.
- (2) The *greater benefits must consist entirely of:
 - (a) the *losing entity transferring a *CGT asset to the *gaining entity; or

- (b) a right to have the losing entity transfer an asset to the gaining entity.
- (3) There must be *lesser benefits and, as at the *IVS time, the total market value of the lesser benefits must not be less than the greatest of these amounts:
 - (a) the asset's *cost base at that time;
 - (b) the asset's cost;
 - (c) the asset's market value immediately before the most recent time (if any), since the *losing entity *acquired the asset, when an *affected owner has acquired:
 - (i) a *primary equity interest in the losing entity; or
 - (ii) an *indirect primary equity interest in the losing entity.
- (4) A *primary equity interest in an entity is an ***indirect primary equity interest*** in another entity if, and only if:
 - (a) the first entity owns a primary equity interest in the other entity; or
 - (b) the first entity owns a primary equity interest that is an indirect primary equity interest in the other entity because of one or more other applications of this subsection.

[The next section is section 727-230.]

Indirect value shifts involving services

727-230 Services provided by losing entity to gaining entity for at least their direct cost

An *indirect value shift does not have consequences under this Division if:

- (a) to the extent of at least 95% of their total market value, the *greater benefits consist entirely of:
 - (i) a right to have services that are covered by section 727-240 provided directly by the losing entity to the gaining entity; or
 - (ii) services that are covered by section 727-240 and have been, are being, or are to be, so provided;

or both; and

- (b) there are *lesser benefits and, as at the *IVS time, the total market value of the lesser benefits is not less than the total of:
- (i) the present value of the direct cost to the losing entity of providing the services; and
 - (ii) the present value of a reasonable allocation of the total direct cost to the losing entity of providing services that include the first-mentioned services (so far as it is not already covered by subparagraph (i)).

To work out the costs and present values referred to in paragraph (b), see section 727-245.

727-235 Services provided by gaining entity to losing entity for no more than a commercially realistic price

- (1) An *indirect value shift does not have consequences under this Division if:
- (a) there are *lesser benefits and, to the extent of at least 95% of their total market value, the lesser benefits consist entirely of:
 - (i) a right to have services that are covered by section 727-240 provided directly by the gaining entity to the losing entity; or
 - (ii) services that are covered by section 727-240 and have been, are being, or are to be, so provided;
 or both; and
 - (b) as at the *IVS time, the total market value of the greater benefits is not more than the total of:
 - (i) the present value of the direct cost to the gaining entity of providing the services; and
 - (ii) the present value of a reasonable allocation of the total direct cost to the gaining entity of providing services that include the first-mentioned services (so far as it is not already covered by subparagraph (i)); and
 - (iii) the present value of a reasonable allocation of the indirect cost to the gaining entity of providing the first-mentioned services; and
 - (iv) the mark-up worked out under subsection (2) or (3) of this section.

To work out the costs and present values referred to in paragraph (1)(b), see section 727-245.

- (2) If it is reasonable to estimate that an entity providing the same quantity of services of the same kind in the same market would charge for them on the basis of a particular percentage mark-up, or on the basis of a percentage mark-up within a particular range, the mark-up for the purposes of subparagraph (1)(b)(iv) is:
- the total of the respective present values of the costs mentioned in subparagraphs (1)(b)(i), (ii) and (iii);
- multiplied by:
- that percentage mark-up, or the highest percentage in that range.
- (3) Otherwise, the mark-up for the purposes of subparagraph (1)(b)(iv) is 10% of the total of the respective present values of the costs mentioned in subparagraphs (1)(b)(i), (ii) and (iii).

727-240 What services certain provisions apply to

- (1) Sections 727-230, 727-235, 727-700 and 727-725 apply only to services consisting of:
- (a) doing work (including professional work and giving professional advice or any other kind of advice); or
- Note: Examples include accounting or legal services; advertising services and financial management services.
- (b) providing (including allowing use of) facilities for entertainment, recreation or instruction; or
 - (c) leasing, renting, hiring, or allowing the use of, any asset; or
 - (d) packaging, transporting or storing any property; or
 - (e) providing insurance; or
 - (f) services provided, by a banker to a customer, in the course of the banker carrying on the business of banking; or
 - (g) lending money or providing any other form of financial accommodation.
- (2) It does not matter whether services covered by paragraph (1)(a) also involve supplying property.

727-245 How to work out certain amounts for the purposes of sections 727-230 and 727-235

- (1) The costs mentioned in paragraph 727-230(b) or 727-235(1)(b) are to be worked out:
 - (a) in accordance with generally accepted accounting practices; and
 - (b) to the extent that the services are to be provided in the future, on the basis of a reasonable estimate of those costs.
- (2) To avoid doubt, the direct cost or indirect cost mentioned in paragraph 727-230(b) or 727-235(1)(b) does *not* include:
 - (a) to the extent that the services consist of or include lending money or providing any other form of financial accommodation—the amount of the loan or other accommodation; or
 - (b) to the extent that the services consist of or include leasing, renting, hiring, or allowing the use of, any asset:
 - (i) the cost of acquiring the asset; or
 - (ii) the cost of acquiring an interest in, or right in respect of, the asset in order to provide the services.

Example: Acme Ltd is the holding company of Group Financier Pty Ltd. Group Financier Pty Ltd borrows \$20 million at 7% per annum, and on lends it to other subsidiaries of Acme Ltd at 8% per annum.

The \$20 million does not form part of Group Financier Pty Ltd's direct cost of the services it provides to the other subsidiaries in the form of the on lending. However, the 7% interest that Group Financier Pty Ltd pays on the \$20 million does form part of that direct cost.

- (3) The present values mentioned in paragraph 727-230(b) or 727-235(1)(b) are to be worked out using a discount rate equal to the rate that, for the purposes of section 109N of *Income Tax Assessment Act 1936*, is the benchmark interest rate for the income year in which the *IVS time occurs.

Note: That section is about distributions to entities connected with a private company.

Anti-overlap provisions

727-250 Distribution by an entity to a member or beneficiary

- (1) An *indirect value shift does not have consequences under this Division if:
- (a) the *greater benefits consist entirely of:
 - (i) a distribution of income or capital that the *losing entity makes to the *gaining entity; or
 - (ii) a right to a distribution of income or capital that the losing entity is to make to the gaining entity; because the gaining entity holds *primary equity interests in the losing entity; and
 - (b) either:
 - (i) an amount covered by one or more of subsections (2), (3) and (4); or
 - (ii) the total of 2 or more such amounts; equals or exceeds the amount of the distribution.

Conditions

- (2) This subsection covers an amount that the assessable income or exempt income of the gaining entity for any income year includes because of the distribution or right.
- (3) This subsection covers an amount by which the *cost base or *reduced cost base (or both) of some or all of the *primary equity interests referred to in subsection (1) changes because of the distribution or right.
- (4) This subsection covers an amount that, because of the distribution or right, is taken into account:
 - (a) under section 116-20 in working out the *capital proceeds of a *CGT event that happens during any income year to some or all of the *primary equity interests referred to in subsection (1); or
 - (b) in working out a *capital gain that an entity makes from CGT event E4 or G1 happening during any income year to some or all of those primary equity interests; or

-
- (c) in working out whether a loss or gain is *realised for income tax purposes by a *realisation event that happens to some or all of those primary equity interests (in their character as *trading stock or *revenue assets).

Application of section to deemed dividend

- (5) If a *corporate tax entity makes a *distribution that is not otherwise a distribution of income or capital, this section applies as if the distribution were a distribution of income or capital the entity made.

Note: Subsection (5) extends this section to cover something that is taken to be a dividend paid by a company. Compare item 1 of the table in subsection 960-120(1).

[The next section is section 727-260.]

Miscellaneous

727-260 Shift down a wholly-owned chain of entities

- (1) An *indirect value shift does not have consequences under this Division if the *gaining entity is a *wholly-owned subsidiary of the *losing entity throughout the *IVS period.

Exception: impact on market value of primary loan interest

- (2) However, subsection (1) does not apply if the *indirect value shift has produced a *disaggregated attributable decrease, in the market value of an *affected interest in the *losing entity that is also a *primary loan interest in an entity covered by subsection (3), for the owner of the interest.
- (3) This subsection covers:
- (a) the *losing entity; and
 - (b) an entity that owns *primary equity interests in an entity that this subsection covers because of one or more previous applications of it.

Subdivision 727-D—Working out the market value of economic benefits

Table of sections

| | |
|---------|--|
| 727-300 | What the rules in this Subdivision are for |
| 727-315 | Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000 |

727-300 What the rules in this Subdivision are for

This Subdivision is used in determining whether there has been an *indirect value shift and, if so:

- (a) whether it has consequences under this Division; and
- (b) if it does, the amount of it.

[The next section is section 727-315.]

727-315 Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000

- (1) This Division applies to an economic benefit consisting of:
 - (a) an entity transferring to another entity a *depreciating asset (except a building or structure) for which the transferring entity has deducted or can deduct an amount under Division 40; or
 - (b) a right to have an entity transfer such a depreciating asset to another entity;as if the economic benefit's market value were equal to the greater (the *residual value*) of:
 - (c) the asset's *adjustable value at the time when the economic benefit was or is *provided; and
 - (d) the value assigned to the asset at that time in the transferring entity's books;but only if:
 - (e) as at that time, the *cost of the unit to the transferring entity is less than \$1,500,000; and
 - (f) it is reasonable for the transferring entity to conclude that the unit's actual market value at that time was, is, or will be, not

less than 80%, and not more than 120%, of the residual value; and

- (g) both the transferring entity and the other entity choose to have the market value of that economic benefit treated as being equal to the residual value.

(2) If:

- (a) each of 2 or more economic benefits of the kind mentioned in subsection (1) has been, is being, is to be, or might be, provided by the same transferring entity, to the same other entity, *in connection with the same *scheme; and
- (b) it is reasonable for the transferring entity to conclude that the total of the *depreciating assets' actual market values at the respective times when the economic benefits were or are *provided was, is, or will be, not less than 80%, and not more than 120%, of the total of their respective residual values under subsection (1);

paragraph (1)(f) is taken to be satisfied for each of the economic benefits.

Subdivision 727-E—Key concepts

Table of sections

Ultimate controller

| | |
|---------|---|
| 727-350 | <i>Ultimate controller</i> |
| 727-355 | <i>Control (for value shifting purposes)</i> of a company |
| 727-360 | <i>Control (for value shifting purposes)</i> of a fixed trust |
| 727-365 | <i>Control (for value shifting purposes)</i> of a non-fixed trust |
| 727-370 | Preventing double counting for percentage stake tests |
| 727-375 | Tests in this Subdivision are exhaustive |

Common-ownership nexus and ultimate stake of a particular percentage

| | |
|---------|---|
| 727-400 | When 2 entities have a common-ownership nexus within a period |
| 727-405 | <i>Ultimate stake</i> of a particular percentage in a company |
| 727-410 | <i>Ultimate stake</i> of a particular percentage in a fixed trust |
| 727-415 | Rules for tracing |

Ultimate controller

727-350 Ultimate controller

An entity is an *ultimate controller* of another entity if, and only if:

- (a) the first entity *controls (for value shifting purposes) the other entity; and
- (b) there is no entity that controls (for value shifting purposes) both the first entity and the other entity.

727-355 Control (for value shifting purposes) of a company

50% stake test

- (1) An entity *controls (for value shifting purposes)* a company if the entity, or the entity and its *associates between them:
 - (a) can exercise, or can control the exercise of, at least 50% of the voting power in the company (either directly, or indirectly through one or more interposed entities); or
 - (b) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 50% of any dividends that the company may pay; or
 - (c) have the right to receive for (either directly, or indirectly through one or more interposed entities) at least 50% of any distribution of capital of the company.

40% stake test

- (2) An entity also *controls (for value shifting purposes)* a company if the entity, or the entity and its *associates between them:
 - (a) can exercise, or can control the exercise of, at least 40% of the voting power in the company (either directly, or indirectly through one or more interposed entities); or
 - (b) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any dividends that the company may pay; or
 - (c) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of capital of the company;
-

unless an entity (other than the first entity and its associates) either alone or together with its associates in fact controls the company.

Actual control test

- (3) An entity also **controls (for value shifting purposes)** a company if the entity, either alone or together with its *associates, in fact controls the company.

727-360 Control (for value shifting purposes) of a fixed trust

40% stake test

- (1) An entity **controls (for value shifting purposes)** a *fixed trust if the entity, or the entity and its *associates between them, have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of trust income, or trust capital, to beneficiaries of the trust.

Other tests

- (2) An entity also **controls (for value shifting purposes)** a *fixed trust if:
- (a) the entity, or an *associate of the entity, whether alone or with other associates (the **relevant entity**), has the power to obtain the beneficial enjoyment of the trust's capital or income (whether or not by exercising its power of appointment or revocation, and whether with or without another entity's consent); or
 - (b) the relevant entity is able to control the application of the trust's capital or income in any manner (whether directly or indirectly); or
 - (c) the relevant entity is able to do a thing mentioned in paragraph (a) or (b) under a *scheme; or
 - (d) a trustee of the trust is accustomed or is under an obligation (whether formally or informally), or might reasonably be expected, to act in accordance with the relevant entity's directions, instructions or wishes; or
 - (e) the relevant entity is able to remove or appoint a trustee of the trust.

727-365 Control (for value shifting purposes) of a non-fixed trust

Trustee tests

- (1) An entity ***controls (for value shifting purposes)*** a *non-fixed trust if:
- (a) the entity or an *associate of the entity is a trustee of the trust; or
 - (b) the entity, or the entity and its *associates between them, can remove or appoint the trustee, or one or more of the trustees, of the trust; or
 - (c) a trustee of the trust is accustomed to act, is under an obligation (whether formally or informally) to act, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of:
 - (i) the entity or an *associate of the entity; or
 - (ii) 2 or more entities, at least one of which is the entity or an associate of the entity.

Tests based on control of the trust income or capital

- (2) An entity also ***controls (for value shifting purposes)*** a *non-fixed trust if the entity, or the entity and its *associates between them:
- (a) have the power to obtain the beneficial enjoyment of trust income or capital; or
 - (b) can control in any way at all, whether directly or indirectly, the application of trust income or capital; or
 - (c) can, under a *scheme, gain the enjoyment or control referred to in paragraph (a) or (b).
- (3) An entity also ***controls (for value shifting purposes)*** a *non-fixed trust if:
- (a) the entity, or any of its *associates, can benefit under the trust otherwise than because of a *fixed entitlement to a share of the income or capital of the trust; or
 - (b) if the entity, or the entity and its *associates between them, have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of trust income, or trust capital.

727-370 Preventing double counting for percentage stake tests

If an interest giving an entity, or an entity and its *associates:

- (a) the ability to exercise, or control the exercise of, any of the voting power in a company; or
- (b) the right to receive dividends that a company may pay; or
- (c) the right to receive a distribution of capital of a company; or
- (d) the right to receive a distribution of trust income or trust capital;

is both direct and indirect, and (apart from this section) would be counted more than once in applying subsection 727-355(1) or (2) or section 727-360, only the direct interest is to be counted.

727-375 Tests in this Subdivision are exhaustive

An entity does not *control (for value shifting purposes)* a company or trust except as provided in this Subdivision.

Common-ownership nexus and ultimate stake of a particular percentage**727-400 When 2 entities have a common-ownership nexus within a period**

- (1) 2 entities have a *common-ownership nexus* within a period if, and only if, they satisfy the test in any of the one or more items in the table applicable to them.

Common-ownership nexus within a period

| Item | If the entities are: | This is the test: |
|-------------|-----------------------------|---|
| 1 | both companies | There must be 2 or more *ultimate owners who: <ul style="list-style-type: none"> (a) at some time during that period, because of the same test in section 727-405, have *ultimate stakes, of percentages totalling at least 80%, in one of the companies; and (b) at that or a different time during that period, because of that same test, have * ultimate stakes, of percentages totalling at least 80%, in the other company Also, subsection (2) of this section must be satisfied |

Common-ownership nexus within a period

| Item | If the entities are: | This is the test: |
|------|---------------------------------------|--|
| 2 | both *fixed trusts | <p>There must be 2 or more *ultimate owners who:</p> <p>(a) at some time during that period, because of the same test in section 727-410, have *ultimate stakes, of percentages totalling at least 80%, in one of the trusts; and</p> <p>(b) at that or a different time during that period, because of that same test, have *ultimate stakes, of percentages totalling at least 80%, in the other trust</p> <p>Also, subsection (2) of this section must be satisfied</p> |
| 3 | a company and a *fixed trust | <p>There must be 2 or more *ultimate owners who:</p> <p>(a) at some time during that period, because of the same test in section 727-405, have *ultimate stakes, of percentages totalling at least 80%, in the company; and</p> <p>(b) at that or a different time during that period, because of the same test in section 727-410, have *ultimate stakes, of percentages totalling at least 80%, in the trust</p> <p>Also, subsection (2) of this section must be satisfied</p> |
| 4 | a company and a *non-fixed trust | <p>There must be 2 or more *ultimate owners:</p> <p>(a) each of whom *controls (for value shifting purposes) the non-fixed trust because of section 727-365 at the same time during that period; and</p> <p>(b) who, at that or a different time during that period, have *ultimate stakes, of percentages totalling at least 80%, in the company because of the same test in section 727-405</p> |
| 5 | a *fixed trust and a *non-fixed trust | <p>There must be 2 or more *ultimate owners:</p> <p>(a) each of whom *controls (for value shifting purposes) the non-fixed trust because of section 727-365 at the same time during that period; and</p> <p>(b) who, at that or a different time during that period, have *ultimate stakes, of percentages totalling at least 80%, in the fixed trust because of the same test in section 727-410</p> |

Additional condition about profile of percentage ultimate stakes held by 2 or more ultimate owners

- (2) In order to satisfy the test in item 1, 2 or 3 in the table in subsection (1), at least one of subsections (3), (4) and (5) must be satisfied.

-
- (3) For at least one of the *ultimate owners referred to in that item, the percentage of the *ultimate stake that owner has as mentioned in paragraph (a) in the last column of that item must be at least 40%, and so must the percentage of the ultimate stake that owner has as mentioned in paragraph (b) in the last column of that item.
 - (4) Alternatively, for *each* of those *ultimate owners, the percentage of the *ultimate stake that owner has as mentioned in that paragraph (a) must be the same as the percentage of the ultimate stake that owner has as mentioned in that paragraph (b).
 - (5) Alternatively, the number of those *ultimate owners must not exceed 16.

727-405 Ultimate stake of a particular percentage in a company

- (1) This section sets out 3 tests of whether an entity has an *ultimate stake* of a particular percentage (the *test percentage*) in a company.

Note: In applying the tests, follow the rules in section 727-415.

Voting power

- (2) The first test is that, after tracing, to the *ultimate owners who ultimately hold it, the direct and indirect ownership of all *shares in the company that carry the right to exercise voting power in the company, that ownership is held by the entity to the extent of the test percentage of that voting power.

Dividends

- (3) The second test is that, after tracing, to the *ultimate owners who ultimately hold it, the direct and indirect ownership of all *shares in the company that carry the right to receive any dividends that the company may pay, that ownership is held by the entity to the extent of the test percentage of those dividends.

Capital distributions

- (4) The third test is that, after tracing, to the *ultimate owners who ultimately hold it, the direct and indirect ownership of all *shares in the company that carry the right to receive any distribution of

capital of the company, that ownership is held by the entity to the extent of the test percentage of the distribution.

Certain shares ignored

- (5) In tracing the ownership of *shares in a company, ignore *shares whose *dividends can reasonably be regarded as being equivalent to the payment of interest on a loan having regard to:
- (a) how the dividends are calculated; and
 - (b) the conditions applying to the payment of the dividends; and
 - (c) any other relevant matters.

727-410 Ultimate stake of a particular percentage in a fixed trust

- (1) This section sets out 2 tests of whether an entity has an *ultimate stake* of a particular percentage (the *test percentage*) in a *fixed trust.

Note: In applying the tests, follow the rules in section 727-415.

Income distributions

- (2) The first test is that, after tracing, to the *ultimate owners who ultimately hold them, the direct and indirect rights to receive distributions of trust income, those rights are held by the entity to the extent of the test percentage of each such distribution.

Capital distributions

- (3) The second test is that, after tracing, to the *ultimate owners who ultimately hold them, the direct and indirect rights to receive distributions of trust capital, those rights are held by the entity to the extent of the test percentage of each such distribution.

727-415 Rules for tracing

- (1) In applying sections 727-400, 727-405 and 727-410, follow the rules in this section.

Interposed entities

- (2) Tracing is to be done through any interposed entities.
-

Ownership or rights held jointly

- (3) If some of the ownership or rights of a particular kind in relation to a company or trust are held by 2 or more entities jointly or in common, each of the entities is treated as holding a proportion of the ownership or rights so held. The proportion is to be worked out on a reasonable basis, so that the total of the proportions equals the total of the ownership or rights so held.

Ownership or rights held by associate

- (4) If, at a particular time:
- (a) an *ultimate owner is an *associate of another ultimate owner; and
 - (b) the associate ultimately holds some of the ownership or rights of a particular kind in relation to a company or trust; then, in determining whether the other ultimate owner is one of 2 or more ultimate owners because of whom the conditions in an item in the table in section 727-400 are satisfied, the ownership or rights of that kind in relation to the company or trust held by the associate at that time:
 - (c) to the extent of a particular percentage, may be treated as being instead held by the other ultimate owner; and
 - (d) to the extent so treated, cannot be treated as being instead held by any other ultimate owner of whom the first ultimate owner is an associate.
- (5) If one or more applications of subsection (4) are necessary to establish that an *ultimate owner is one of 2 or more ultimate owners because of whom the conditions in an item in the table in section 727-400 are satisfied, that subsection must be applied accordingly.

Subdivision 727-F—Consequences of an indirect value shift

Guide to Subdivision 727-F

727-450 What this Subdivision is about

This Subdivision tells you:

- which method to use to work out the consequences of an indirect value shift for equity or loan interests, and indirect equity or loan interests, in the losing entity and in the gaining entity; and
- which interests, and which owners, are affected.

Table of sections

Operative provisions

727-455 Consequences of the indirect value shift

Affected interests

727-460 *Affected interests* in the losing entity

727-465 *Affected interests* in the gaining entity

727-470 Exceptions

727-520 *Equity or loan interest* and related terms

727-525 *Indirect equity or loan interest*

Affected owners

727-530 Who are the *affected owners*

Choices about method to be used

727-550 Choosing the adjustable value method

727-555 Giving other affected owners information about the choice

[This is the end of the Guide.]

Operative provisions

727-455 Consequences of the indirect value shift

The consequences (if any) of an *indirect value shift must be worked out using the *realisation time method unless the *adjustable value method is chosen in accordance with section 727-550.

Note: Later provisions of this Subdivision set out the interests to which those consequences apply (see sections 727-460 to 727-525), which are in turn determined by who are the affected owners (see section 727-530).

Affected interests

727-460 Affected interests in the losing entity

These are the *affected interests* in the *losing entity:

- (a) each *equity or loan interest that an *affected owner owns in the losing entity immediately before the *IVS time; and
- (b) each equity or loan interest that:
 - (i) an affected owner owns in another affected owner immediately before the IVS time; and
 - (ii) is an *indirect equity or loan interest in the losing entity;(except one covered by an exception in section 727-470).

727-465 Affected interests in the gaining entity

If immediately before the *IVS time the *gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)), these are the *affected interests* in the gaining entity:

- (a) each *equity or loan interest that an *affected owner owns in the gaining entity immediately before the *IVS time; and
- (b) each equity or loan interest that:
 - (i) an affected owner owns in another affected owner immediately before the IVS time; and
 - (ii) is an *indirect equity or loan interest in the gaining entity.

(except one covered by an exception in section 727-470).

727-470 Exceptions

Mere active participants

- (1) An *equity or loan interest that an *active participant in the *scheme owns in another active participant immediately before the *IVS time is not an *affected interest in the *losing entity or in the *gaining entity unless one of the active participants is also covered by 1, 2, 3 or 4 in the table in subsection 727-530(1) (about who is an affected owner).

Entity that is eligible to be an STS taxpayer, or satisfies the maximum net asset value test for small business relief

- (2) An *equity or loan interest that an entity (the **owner**) owns immediately before the *IVS time is not an *affected interest in the *losing entity or in the *gaining entity if the owner:
 - (a) is eligible to be an *STS taxpayer for each income year that includes any of the *IVS period; or
 - (b) would satisfy the maximum net asset value test in section 152-15 throughout the *IVS period.
- (3) If the owner is not in existence for part of the *IVS period, disregard that part in applying subsection (2).

Interests in superannuation entities not covered

- (4) An *equity or loan interest in an *affected owner is not an *affected interest in the *losing entity or in the *gaining entity if the affected owner is an entity listed in section 727-125 (about superannuation entities) in relation to the income year in which the *IVS time happens.

[The next section is section 727-520.]

727-520 Equity or loan interest and related terms

- (1) An **equity or loan interest** in an entity is a *primary interest, or a *secondary interest, in the entity.
-

- (2) A **primary interest** in an entity is a *primary equity interest, or a *primary loan interest, in the entity.
- (3) The meaning of **primary equity interest** in an entity is set out in the table.

Primary equity interests

| Item | In the case of this kind of entity: | Primary equity interest means: |
|-------------|--|---|
| 1 | a company | a *share in the company; or an interest as joint owner (including as tenant in common) of a *share in the company |
| 2 | a trust | any of these: (a) an interest in the trust income or trust capital; or (b) any other interest in the trust; or (c) an interest as joint owner (including as tenant in common) of an interest covered by paragraph (a) or (b) |

- (4) A **primary loan interest** in an entity is:
- (a) a *loan to the entity; or
 - (b) an interest as joint owner (including as tenant in common) of a loan to the entity.
- (5) A **secondary interest** in an entity is a *secondary equity interest, or a *secondary loan interest, in the entity.
- (6) A **secondary equity interest** in an entity is a right or option:
- (a) to *acquire an existing *primary equity interest in the entity; or
 - (b) to have the entity issue a new primary equity interest.
- (7) A **secondary loan interest** in an entity is a right or option:
- (a) to *acquire an existing *primary loan interest in the entity; or
 - (b) to have the entity issue a new primary loan interest.

727-525 Indirect equity or loan interest

An *equity or loan interest in an entity is an *indirect equity or loan interest* in another entity if, and only if:

- (a) the first entity owns an equity or loan interest in the other entity; or
- (b) the first entity owns an equity or loan interest that is an indirect equity or loan interest in the other entity because of one or more other applications of this section.

[The next section is section 727-530.]

Affected owners

727-530 Who are the affected owners

- (1) The table sets out the *affected owners* for the *indirect value shift.

| Affected owners | | |
|------------------------|--|--|
| Item | In this case: | The affected owners include: |
| 1 | At least one condition in section 727-105 (ultimate controller test) is satisfied | each *ultimate controller because of which a condition in that section is satisfied; and each entity that, at a time during the *IVS period when such an ultimate controller *controlled (for value shifting purposes) the <i>losing</i> entity, was an *intermediate controller of the <i>losing</i> entity; and each entity that, at a time during the IVS period when such an ultimate controller controlled (for value shifting purposes) the <i>gaining</i> entity, was an intermediate controller of the <i>gaining</i> entity |
| 2 | The conditions in section 727-110 (common-ownership nexus test) are satisfied in respect of: (a) one or more times; or (b) one or more sets of 2 times | each *ultimate owner who is one of 2 or more ultimate owners because of whom the condition in the applicable item of that table is satisfied in respect of any of those times; and each entity through which ownership or rights are traced to such an ultimate owner in applying the applicable item of that table in respect of any of those times |

| Affected owners | | |
|------------------------|----------------------|---|
| Item | In this case: | The affected owners include: |
| 3 | Any case | the *losing entity and the *gaining entity |
| 4 | Any case | each entity that, at any time after the *scheme was entered into, is an *associate of an entity that is an affected owner because of item 1, 2 or 3 of this table |
| 5 | Any case | each *active participant in the *scheme |

- (2) An entity is an *intermediate controller* of another entity if, and only if:
- (a) the first entity *controls (for value shifting purposes) the other entity; and
 - (b) the first entity is *controlled (for value shifting purposes) by an *ultimate controller of the other entity.

Active participants (if both losing and gaining entities are closely held)

- (3) An entity (the *first entity*) is an *active participant* in the *scheme if:
- (a) at some time during the *IVS period, neither the losing entity nor the gaining entity has 300 or more members (in the case of a company) or 300 or more beneficiaries (in the case of a trust); and
 - (b) the first entity:
 - (i) actively participated in, or directly facilitated, the entering into of the *scheme; or
 - (ii) at some time during the *IVS period actively participated in, or directly facilitated, the carrying out of the scheme;
 (whether or not it did so at the direction of some other entity); and
 - (c) at some time during the *IVS period, the first entity owned:
 - (i) an *equity or loan interest in the losing entity or in the gaining entity; or
 - (ii) an *indirect equity or loan interest in the losing entity or in the gaining entity; and

- (d) the first entity is neither the losing entity nor the gaining entity.

Note: Subsections 727-110(2) and (3) contain rules about when an entity is treated as having or not having 300 or more members or beneficiaries.

Choices about method to be used

727-550 Choosing the adjustable value method

- (1) This section sets out rules for:
- (a) choosing to use the *adjustable value method to work out the consequences of an *indirect value shift; or
 - (b) choosing (when using the adjustable value method) *not* to work out on a *loss-focussed basis the reductions in the *adjustable values of *affected interests.

Who makes the choice

- (2) The choice must be made in accordance with the table.

| Who makes the choice | | |
|-----------------------------|---|---|
| Item | In this case: | The choice must be made by: |
| 1 | If the conditions in section 727-110 (common-ownership nexus test) are satisfied | jointly by the *ultimate owners because of whom the condition in the applicable item of the table in section 727-400 is satisfied |
| 2 | Item 1 does not apply, and there is an entity: <ul style="list-style-type: none"> (a) who is the sole *ultimate controller because of whom the conditions in section 727-105 (ultimate controller test) are satisfied; or (b) who would be that sole ultimate controller if sections 727-355 to 727-375 were applied ignoring that entity's *associates | that entity |

| Who makes the choice | | |
|-----------------------------|----------------------------------|---|
| Item | In this case: | The choice must be made by: |
| 3 | Neither of items 1 and 2 applies | jointly by the 2 or more *ultimate controllers because of whom the conditions in section 727-105 (ultimate controller test) are satisfied |

When choice must be made

- (3) The choice must be made within 2 years after the *first* *realisation event that happens to an *affected interest at or after the IVS time.

Choice binds all affected owners

- (4) The choice binds all *affected owners for the *indirect value shift.

727-555 Giving other affected owners information about the choice

- (1) An entity that makes a choice under section 727-550 (including a choice made jointly with one or more other entities) must inform all entities that it knows to be *affected owners for the *indirect value shift about the content of the choice. The entity must do so in writing within one month after making the choice.

Penalty: 30 penalty units.

- (2) If:
- (a) a choice under section 727-550 is made jointly by 2 or more entities; and
 - (b) one of the entities complies with subsection (1);
- no other entity need comply with that subsection in relation to that choice.
- (3) If an *affected owner for an *indirect value shift has reason to believe that an entity may have made a choice under section 727-550 (including a choice made jointly with one or more other entities), the affected owner may give the entity a written notice asking whether the entity has made such a choice.

- (4) Within one month after receiving a notice under subsection (3), an entity must inform the *affected owner in writing whether the entity has made a choice under section 727-550 and, if so, about the content of the choice.

Penalty: 30 penalty units.

- (5) The Commissioner may extend the period for complying with a provision of this section.

Subdivision 727-G—The realisation time method

727-600 What this Subdivision is about

Under the realisation time method:

- losses on realisation of affected interests in the losing entity are reduced; and
- gains on realisation of affected interests in the gaining entity are reduced, within limits worked out by reference to the reductions in losses on affected interests in the losing entity; and
- certain 95% services indirect value shifts are disregarded.

This Subdivision also explains how its reduction of a loss or gain affects CGT assets, trading stock and revenue assets.

Table of sections

Operative provisions

| | |
|---------|--|
| 727-610 | Consequences of indirect value shift |
| 727-615 | Reduction of loss on realisation event for affected interest in losing entity |
| 727-620 | Reduction of gain on realisation event for affected interest in gaining entity |
| 727-625 | Total gain reductions not to exceed total loss reductions |
| 727-630 | How cap in section 727-625 applies if affected interest is also trading stock or a revenue asset |
| 727-635 | Splitting an equity or loan interest |
| 727-640 | Merging equity or loan interests |

727-645 Effect of CGT roll-over

Further exclusion for certain 95% services indirect value shifts if realisation time method must be used

727-700 When 95% services indirect value shift is excluded

95% services indirect value shifts that are *not* excluded

727-705 Another provision of the income tax law affects amount related to services by at least \$100,000

727-710 Ongoing or recent service arrangement reduces value of losing entity by at least \$100,000

727-715 Service arrangements reduce value of losing entity that *is* a group service provider by at least \$500,000

727-720 Abnormal service arrangement reduces value of losing entity that is *not* a group service provider by at least \$500,000

727-725 Meaning of *predominantly-services indirect value shift*

[This is the end of the Guide.]

Operative provisions

727-610 Consequences of indirect value shift

- (1) This Subdivision sets out the *realisation time method* of working out the consequences (if any) of an *indirect value shift.
- (2) If those consequences are to be worked out using that method, this Subdivision applies to each *realisation event:
 - (a) by which a loss would, apart from this Division, be *realised for income tax purposes; and
 - (b) that happens to an *affected interest in the *losing entity; and
 - (c) that is the first realisation event that happens to that interest at or after the *IVS time; and
 - (d) that happens:
 - (i) if the amount of the indirect value shift is \$500,000 or more—at any time after the IVS time; or
 - (ii) otherwise—within 4 years after the IVS time.
- (3) If:
 - (a) those consequences are to be worked out using that method; and

- (b) the *gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)) immediately before the *IVS time;

this Subdivision applies to each *realisation event:

- (c) by which a gain would, apart from this Division, be *realised for income tax purposes; and
 - (d) that happens to an *affected interest in the *gaining entity; and
 - (e) that is the first realisation event that happens to that interest at or after the IVS time.
- (4) The consequences for the *affected interest depend on its character. There are consequences for the interest in its character as a *CGT asset. However, if the interest is also *trading stock or a *revenue asset, there are additional consequences for it in that character.
- (5) In working out the consequences for an *affected interest in the *losing entity or *gaining entity, in the interest's character as *trading stock, a *realisation event is disregarded for the purposes of identifying under paragraph (2)(c) or (3)(e) the first realisation event that happens to that interest at or after the *IVS time, if:
- (a) the realisation event consists of the ending of an income year; and
 - (b) the *value of the interest as trading stock on hand of an entity at the end of the income year is the interest's *cost; and
 - (c) the interest became part of the entity's trading stock on hand during that income year, or the value of the interest as trading stock of the entity on hand at the start of the income year was also the interest's cost.

727-615 Reduction of loss on realisation event for affected interest in losing entity

If this Subdivision applies to a *realisation event that happens to an *affected interest in the *losing entity, a loss that would, apart from this Division, be *realised for income tax purposes by the event is reduced by an amount that is reasonable having regard to:

- (a) a reasonable estimate of the amount (if any) by which the *indirect value shift has reduced the interest's market value; and
-

-
- (b) if the interest is also an affected interest in the *gaining entity—a reasonable estimate of the extent (if any) to which the interest’s market value at the time of the realisation event still reflects the effect of the indirect value shift on the market value of *equity or loan interests in the gaining entity.

727-620 Reduction of gain on realisation event for affected interest in gaining entity

If this Subdivision applies to a *realisation event that happens to an *affected interest in the *gaining entity, a gain that would, apart from this Division, be *realised for income tax purposes by the event is reduced by an amount that is reasonable having regard to:

- (a) a reasonable estimate of the amount (if any) by which the *indirect value shift has increased the interest’s market value; and
- (b) a reasonable estimate of the extent (if any) to which the interest’s market value at the time of the realisation event still reflects the effect of the indirect value shift on the market value of *equity or loan interests in the gaining entity.

727-625 Total gain reductions not to exceed total loss reductions

- (1) This section ensures that the total (*total gain reductions*) of the amounts by which section 727-620 reduces gains *realised for income tax purposes by *realisation events happening at the same time does not exceed the total (*total loss reductions*) of:
 - (a) the amounts by which section 727-615 reduces losses that:
 - (i) would, apart from this Division, be *realised for income tax purposes by *realisation events happening before or at that time; and
 - (ii) have not already been taken into account in a previous application of this section; and
 - (b) the amounts by which section 727-850 (as applying to the *scheme from which the *indirect value shift results) reduces losses that:
 - (i) would, apart from this Division, be realised for income tax purposes by realisation events happening before the

*IVS time to *equity or loan interests, or *indirect equity or loan interests, in the *losing entity; and

(ii) have not already been taken into account in a previous application of this section.

(2) If, apart from this section, the total gain reductions would exceed the total loss reductions, the amount by which section 727-620 reduces each of the gains is itself reduced by the amount worked out using this formula:

$$\frac{(\text{Total gain reductions} - \text{Total loss reductions})}{\text{Number of interests}}$$

(3) For the purposes of the formula:

number of interests means the number of *affected interests in the *gaining entity to which *realisation events happened at that time.

727-630 How cap in section 727-625 applies if affected interest is also trading stock or a revenue asset

(1) This section affects how to work out the total gain reductions and the total loss reductions for the purposes of section 727-625 if:

- (a) a *realisation event covered by that section happens to an *equity or loan interest, or to an *indirect equity or loan interest, in the *losing entity or in the *gaining entity; and
- (b) the interest is also *trading stock or a *revenue asset at the time of the event.

Trading stock

(2) In the case of an *equity or loan interest, or an *indirect equity or loan interest, in the *losing entity that is *trading stock at that time:

- (a) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-25 or 977-30 (about realisation events for trading stock) that would, apart from this Division, be *realised for income tax purposes by the event is taken into account; and
- (b) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-10 (about realisation events for CGT assets) that would, apart from this

Division, be *realised for income tax purposes by the event is *not* taken into account;
in working out the total loss reductions.

- (3) In the case of an *affected interest in the *gaining entity that is *trading stock at that time:
- (a) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-35 or 977-40 (about realisation events for trading stock) that would, apart from this Division, be *realised for income tax purposes by the event is taken into account; and
 - (b) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-15 (about realisation events for CGT assets) that would, apart from this Division, be *realised for income tax purposes by the event is *not* taken into account;
- in working out the total gain reductions.

Revenue asset

- (4) In the case of an *equity or loan interest, or an *indirect equity or loan interest, in the *losing entity that is a *revenue asset at that time, the greater of the following is taken into account in working out the total loss reductions:
- (a) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-55 (about realisation events for revenue assets) that would, apart from this Division, be *realised for income tax purposes by the event;
 - (b) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-10 (about realisation events for CGT assets) that would, apart from this Division, be *realised for income tax purposes by the event.
- (5) In the case of an *affected interest in the *gaining entity that is a *revenue asset at that time, the greater of the following amounts is taken into account in working out the total gain reductions:
- (a) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-55 (about realisation events for

revenue assets) that would, apart from this Division, be *realised for income tax purposes by the event;

- (b) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-15 (about realisation events for CGT assets) that would, apart from this Division, be *realised for income tax purposes by the event.

727-635 Splitting an equity or loan interest

If an *equity or loan interest in the *losing entity or in the *gaining entity is split into 2 or more equity or loan interests at or after the *IVS time:

- (a) each of the 2 or more interests inherits whatever characteristics would have been relevant to applying this Subdivision to the first interest if the split had not happened; and
- (b) those characteristics include characteristics the first interest has inherited because of any other application or applications of this section or section 727-640; and
- (c) if a characteristic of the first interest involves an amount or quantity, the amount or quantity for that characteristic as inherited by each of the 2 or more interests is a reasonable proportion of the amount or quantity for that characteristic of the first interest.

727-640 Merging equity or loan interests

If 2 or more *equity or loan interests (the *original interests*) in the *losing entity or in the *gaining entity are merged into 1 or more *equity or loan interests (the *new interests*) at or after the *IVS time:

- (a) each of the new interests inherits whatever characteristics would have been relevant to applying this Subdivision to the original interests if the merging had not happened; and
 - (b) those characteristics include characteristics inherited by any of the original interests because of any other application or applications of this section or section 727-635; and
 - (c) if a characteristic of any of the original interests involves an amount or quantity, the amount or quantity for that
-

characteristic as inherited by any of the new interests is a reasonable proportion of the amount or quantity for that characteristic of the original interest.

727-645 Effect of CGT roll-over

(1) If:

- (a) this Subdivision applies to a *realisation event that is a *CGT event that happens to an *affected interest in the *losing entity; and
- (b) section 727-615 reduces a loss that would, apart from this Division, be *realised for income tax purposes by the CGT event; and
- (c) there is a roll-over for the CGT event;

the interest's *reduced cost base at the time of the CGT event is taken to have been reduced by the amount by which section 727-615 reduces that loss, but is so taken only for the purposes of working out:

- (d) the interest's reduced cost base, from time to time after the roll-over, for the entity that *acquired the interest because of the CGT event; and
- (e) in the case of a *replacement-asset roll-over—the reduced cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that *disposed of the interest.

Note: Because of the roll-over, the loss reduction under section 727-615 will have no tax effect. This subsection ensures that the loss reduction is passed on, through the reduction in reduced cost base, to prevent or reduce a loss arising on a later CGT event.

(2) If:

- (a) this Subdivision applies to a *realisation event that is a *CGT event that happens to an *affected interest in the *gaining entity; and
- (b) section 727-620 reduces a gain that would, apart from this Division, be *realised for income tax purposes by the CGT event; and
- (c) there is a roll-over for the CGT event;

the interest's *cost base at the time of the CGT event is taken to have been uplifted by the amount by which section 727-620

reduces that gain, but is so taken only for the purposes of working out:

- (d) the interest's cost base, from time to time after the roll-over, for the entity that *acquired the interest because of the CGT event; and
- (e) in the case of a *replacement-asset roll-over—the cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that *disposed of the interest.

Note: Because of the roll-over, the gain reduction under section 727-620 will have no tax effect. This subsection ensures that the gain reduction is passed on, through the uplift in cost base, to prevent or reduce a gain arising on a later CGT event.

[The next section is section 727-700.]

Further exclusion for certain 95% services indirect value shifts if realisation time method must be used

727-700 When 95% services indirect value shift is excluded

- (1) If the *indirect value shift is a *95% services indirect value shift, this Subdivision does not apply to a *realisation event that:
 - (a) happens to an *affected interest in the *losing entity that is owned by an entity (the *owner*); and
 - (b) is covered by subsection 727-610(2);unless:
 - (c) the conditions in section 727-705 are met for the indirect value shift; or
 - (d) the conditions in section 727-710, 727-715 or 727-720 are met for the indirect value shift and for that realisation event.
- (2) An *indirect value shift is a **95% services indirect value shift** if, and only if, to the extent of at least 95% of their total market value, the *greater benefits consist entirely of:
 - (a) a right to have services that are covered by section 727-240 provided directly by the *losing entity to the *gaining entity; or
 - (b) services that are covered by section 727-240 and have been, are being, or are to be, so provided;

or both.

- (3) This section does not limit any other exclusion in this Subdivision or in Subdivision 727-C.

95% services indirect value shifts that are not excluded

727-705 Another provision of the income tax law affects amount related to services by at least \$100,000

The conditions in this section are met if:

- (a) the *losing entity or the *gaining entity lodges an *income tax return for an income year during some or all of which the owner owned the interest; and
- (b) a provision of this Act:
 - (i) reduces or excludes an amount that is included in the return; or
 - (ii) increases an amount that is so included; or
 - (iii) includes an amount not included in the return;for the purposes of working out the taxable income, a *tax loss, or a *net capital loss, of that entity for that income year; and
- (c) the amount is related to the right mentioned in paragraph 727-700(2)(a), or to some or all of the services mentioned in paragraph 727-700(2)(a) or (b), from the point of view of the losing entity providing the services or of the gaining entity receiving them; and
- (d) if the amount is so reduced or increased—the reduction or increase is at least \$100,000; and
- (e) if the amount is so excluded or included—the amount is at least \$100,000; and
- (f) at some time after the return is lodged, the entity that lodged it is aware, or ought reasonably to be aware, of the reduction, exclusion, increase or inclusion.

Example: If the Commissioner has notified an entity affected by a determination under Part IVA of the *Income Tax Assessment Act 1936*, the entity ought reasonably to be aware of the effect of the determination.

727-710 Ongoing or recent service arrangement reduces value of losing entity by at least \$100,000

- (1) Either or both of these must be true:
 - (a) when the *realisation event mentioned in subsection 727-700(1) happens, some or all of the services mentioned in paragraph 727-700(2)(a) or (b) have not yet been provided; or
 - (b) some or all of those services have been provided in the income year (of the *losing entity) in which the realisation event happens, or in the previous income year.
- (2) It must be reasonable to conclude that the total (the *total market value*) of the market values, immediately before the *realisation event, of *primary interests in the *losing entity then owned by *affected owners is less than it would have been if none of the following had happened:
 - (a) the *95% services indirect value shift; and
 - (b) all other *predominantly-services indirect value shifts that satisfy subsection (1) (or that would satisfy it if they were *95% services indirect value shifts).
- (3) It must also be reasonable to conclude that the total market value is less than it would have been by at least:
 - (a) \$100,000, if the total of the *adjustable values, immediately before the *realisation event, of the *primary interests referred to in subsection (2) is less than or equal to \$2,000,000; or
 - (b) 5% of the total of those *adjustable values, if that total is greater than \$2,000,000 and less than or equal to \$10,000,000; or
 - (c) \$500,000, if that total is greater than \$10,000,000.
- (4) For the purposes of subsections (2) and (3), disregard an *indirect value shift referred to in paragraph (2)(a) or (b) if services are provided directly by the *losing entity to the *gaining entity under the *scheme before the income year (of the losing entity) before the one in which the *realisation event happened.

727-715 Service arrangements reduce value of losing entity that is a group service provider by at least \$500,000

- (1) At some time during the period (the *ownership period*) when the owner owned the interest, the sole or dominant activity of the *losing entity must consist of providing services directly to one or more entities (the *group entities*) each of which is covered by one or more of the following paragraphs:
 - (a) the *gaining entity;
 - (b) an *affected owner;
 - (c) an entity that has at that time the same *ultimate controller as the losing entity or the gaining entity;
 - (d) if the conditions in section 727-110 (common-ownership nexus test) are satisfied for the *indirect value shift—an entity that has with the losing entity or with the gaining entity a *common-ownership nexus within that period.

- (2) It must be reasonable to conclude that the total (the *total market value*) of the market values, immediately before the *realisation event, of *primary interests in the *losing entity then owned by *affected owners is less than it would have been if none of the following had happened:
 - (a) the *95% services indirect value shift; and
 - (b) each *predominantly-services indirect value shift for which the same entity is the losing entity as for the 95% services indirect value shift, and that happened:
 - (i) if the amount of the *indirect value shift is \$500,000 or more—at any time during the ownership period; or
 - (ii) otherwise—during the ownership period but within 4 years before the realisation event, or at the same time as the realisation event.

Thresholds for reduction of the total market value

- (3) It must also be reasonable to conclude that the total market value is less than it would have been by at least \$500,000, and by at least the lesser of:
 - (a) 5% of the total of the *adjustable values of *primary interests in the *losing entity owned by *affected owners at:

- (i) if subsection (4) applies—the time determined under that subsection; or
 - (ii) otherwise—the start of the income year in which the *realisation event happens; and
- (b) the amount worked out under the table.

Alternative threshold for reduction of the total market value

| Item | In this case: | The amount is: |
|------|---|---|
| 1 | The ownership period is 4 years or less | worked out using this formula: $\$5,000,000 \times \frac{\text{Number of days in that period}}{365}$ |
| 2 | The ownership period is more than 4 years | \$25,000,000 |

- (4) If the owner of the interest is an *affected owner because of item 1, 2, 3 or 4 in the table in subsection 727-530(1) (about who is an affected owner), the time for the purposes of subparagraph (3)(a)(i) of this section is the latest of:
- (a) the start of the income year in which the *realisation event happens; and
 - (b) the most recent time (if any), before or at the time of the *realisation event, when at least one of the group entities has the same *ultimate controller as the losing entity or the gaining entity; and
 - (c) the start of the most recent period (if any):
 - (i) that ended before or at the time of the realisation event; and
 - (ii) within which at least one of the group entities has with the losing entity or with the gaining entity a *common-ownership nexus.

727-720 Abnormal service arrangement reduces value of losing entity that is not a group service provider by at least \$500,000

- (1) It must be the case that at *no* time during the period when the owner owned the interest did the sole or dominant activity of the
-

*losing entity consist of providing services as mentioned in subsection 727-715(1).

- (2) It must be reasonable to conclude that the total (the ***total market value***) of the market values, immediately before the *realisation event, of *primary interests in the *losing entity then owned by *affected owners is less than it would have been if none of the following had happened:
- (a) the *95% services indirect value shift;
 - (b) each *predominantly-services indirect value shift that meets either of these conditions:
 - (i) its amount was less than \$500,000 and it happened within 4 years before the realisation event, or at the same time as the realisation event;
 - (ii) its amount was \$500,000 or more and it happened at any time before the realisation event, or at the same time as the realisation event;and that meets all of these conditions:
 - (iii) the same entity is the losing entity for it as for the 95% services indirect value shift;
 - (iv) it happened under a different *scheme from the 95% services indirect value shift; and
 - (v) having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why it happened under a different scheme was to prevent the conditions in section 727-705, 727-710, 727-715 or this section from being met.
- (3) It must also be reasonable to conclude that the total market value is less than it would have been by at least:
- (a) \$500,000, if the total of the *adjustable values, immediately before the *realisation event, of the *primary interests referred to in subsection (2) is less than or equal to \$10,000,000; or
 - (b) 5% of the total of those *adjustable values, if that total is greater than \$10,000,000 and less than or equal to \$100,000,000; or
 - (c) \$5,000,000, if that total is greater than \$100,000,000.

- (4) The providing of the services mentioned in paragraph 727-700(2)(a) or (b) by the losing entity must *not* be in the ordinary course of its business.

727-725 Meaning of predominantly-services indirect value shift

An *indirect value shift is a *predominantly-services indirect value shift* if, and only if, the *greater benefits consist entirely or predominantly of:

- (a) a right to have services that are covered by section 727-240 provided directly by the *losing entity to the *gaining entity; or
 - (b) services that are covered by section 727-240 and have been, are being, or are to be, so provided;
- or both.

Subdivision 727-H—The adjustable value method

Guide to Subdivision 727-H

727-750 What this Subdivision is about

Under the adjustable value method:

- the adjustable values of affected interests in the losing entity are reduced; and
- the adjustable values of affected interests in the gaining entity are uplifted, within limits worked out by references to the reductions in the adjustable values of affected interests in the losing entity.

The consequences of that are:

- the cost base and reduced cost base of the interests are reduced or uplifted (or both); and
- if the interests are also trading stock or revenue assets, there are further consequences for them in their character as such.

Table of sections

727-755 Consequences of indirect value shift

Reductions of adjustable value

727-770 Reduction under the adjustable value method

727-775 Has there been a disaggregated attributable decrease?

727-780 Working out the reduction on a *loss-focussed basis*

Uplifts of adjustable value

727-800 Uplift under the attributable increase method

727-805 Has there been a disaggregated attributable increase?

727-810 Scaling-down formula

Consequences of the method for various kinds of assets

727-830 CGT assets

727-835 Trading stock

727-840 Revenue assets

[This is the end of the Guide.]

727-755 Consequences of indirect value shift

- (1) This Subdivision sets out the *adjustable value method* of working out the consequences (if any) of an *indirect value shift.
- (2) If those consequences are to be worked out using that method:
 - (a) the *adjustable value of each *affected interest in the *losing entity is reduced as provided in this Subdivision; and
 - (b) if the *gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)) immediately before the *IVS time, the *adjustable value of each *affected interest in the *gaining entity is uplifted as provided in this Subdivision.
- (3) The consequences for the *affected interest depend on its character. There are consequences for the interest in its character as a *CGT asset. However, if the interest is also *trading stock or a *revenue asset, there are additional consequences for it in that character.

[The next section is section 727-770.]

Reductions of adjustable value

727-770 Reduction under the adjustable value method

- (1) This section sets out how to work out the amount (if any) by which the *adjustable value of an *affected interest in the *losing entity is reduced.
- (2) First, work out under section 727-775 whether the *indirect value shift has produced for the owner of the interest a *disaggregated attributable decrease in the market value of the interest.
- (3) If it has not, the interest's *adjustable value is *not* reduced because of the *indirect value shift.
- (4) If it has, the amount (if any) by which the interest's *adjustable value is reduced is worked out on a *loss-focussed basis under section 727-780.
- (5) However, if a choice is made in accordance with section 727-550 for the reduction *not* to be worked out on a *loss-focussed basis, the reduction is equal to the *disaggregated attributable decrease.

Reduction not to exceed reasonable amount

- (6) If the reduction worked out as provided in subsection (4) or (5) is not reasonable in the circumstances, having regard to the objects of this Division, the interest's *adjustable value is instead reduced by so much of that reduction as is reasonable in the circumstances, having regard to those objects.

Note: The main object of this Division is set out in section 727-95.

727-775 Has there been a disaggregated attributable decrease?

- (1) This section sets out how to determine whether an *indirect value shift has produced, for the owner of an *equity or loan interest, a ***disaggregated attributable decrease*** in the market value of the interest and, if so, the amount of it.

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- (2) Work out the market value of the interest at the *IVS time, but disregarding:
- (a) all effects on the market value of the interest during the *IVS period, except effects that are reasonably attributable to the *indirect value shift; and
 - (b) the effects (if any) of the indirect value shift on the market value of *equity or loan interests, or *indirect equity or loan interests, in the gaining entity.

(This result is called the *notional resulting market value*.)

Note: Paragraph (2)(b) is necessary because the market value of the interest may also have been affected by the increase in the market value of interests in the gaining entity, because the entity in which the interest is held had direct or indirect interests in both the losing entity and the gaining entity.

In such a case, the reduction in adjustable value under this Division will usually be offset by an uplift under this Division.

- (3) If the notional resulting market value is *less than* the market value (the *old market value*) of the interest:
- (a) at the start of the *IVS period; or
 - (b) if the owner last began to own the interest during that period—when the owner last began to own the interest;
- the difference is the *disaggregated attributable decrease*.
- (4) The *indirect value shift has *not* produced a disaggregated attributable decrease for the owner of the interest if the notional resulting market value is *greater than or equal to* the old market value.
- (5) The market value of the interest at a particular time may be worked out under subsection (2) or (3) by making a reasonable estimate of that market value.

727-780 Working out the reduction on a loss-focussed basis

- (1) Use the table in subsection (2) of this section to work out on a *loss-focussed basis* the amount (if any) by which the interest's *adjustable value is reduced.

- (2) This involves comparing the old market value, and the notional resulting market value, with the interest's *adjustable value (the *old adjustable value*) immediately before the *IVS time.

| Reduction under the attributable decrease method | | | |
|---|---|---|--|
| Item | If the old market value: | And the notional resulting market value: | This is the result: |
| 1 | is <i>greater than or equal to</i> the old adjustable value | is <i>less than</i> the old adjustable value | the *adjustable value is reduced to the notional resulting market value |
| 2 | is <i>greater than or equal to</i> the old adjustable value | is <i>greater than or equal to</i> the old adjustable value | the *adjustable value is <i>not</i> reduced because of the *indirect value shift |
| 3 | is <i>less than</i> the old adjustable value | is <i>less than</i> the old adjustable value | the *adjustable value is reduced by the amount of the *disaggregated attributable decrease |

Note 1: Because of item 1, the indirect value shift cannot cause a loss to arise on disposal of the interest.

Note 2: Because of item 3 the loss already embedded in the interest is preserved, but the indirect value shift does not increase it.

[The next section is section 727-800.]

Uplifts of adjustable value

727-800 Uplift under the attributable increase method

- (1) This section sets out how to work out the amount (if any) by which the *adjustable value of an *affected interest in the *gaining entity is uplifted.
- (2) First, work out under section 727-805 whether the *indirect value shift has produced for the owner of the interest a *disaggregated attributable increase in the market value of the interest.
- (3) If it has not, the interest's *adjustable value is *not* uplifted because of the *indirect value shift.

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- (4) If it has, the *adjustable value is uplifted by the amount worked out using the scaling-down formula in section 727-810, subject to the rest of this section.

Note: The uplift will be less than or equal to the disaggregated attributable increase.

Cap if interest has both a disaggregated attributable increase and a disaggregated attributable decrease

- (5) If the *indirect value shift has also produced for the owner of the interest a *disaggregated attributable decrease in the market value of the interest, the interest's *adjustable value:
- (a) is *not* uplifted if it is not also reduced under this Division because of the indirect value shift; and
 - (b) if it is also reduced under this Division because of the indirect value shift—is not uplifted by more than the reduction.

Cap based on notional distribution by gaining entity of dividends or capital equal to total reductions in adjustable value of affected interests in losing entity

- (6) However, the interest's *adjustable value is not uplifted by more than the greater of these amounts:
- (a) the amount (if any) that the *affected owner of the interest would receive (directly, or indirectly through one or more interposed entities) in respect of the interest if:
 - (i) the *gaining entity were to pay as *dividends, at the time (the *payment time*) immediately before the *IVS time, an amount (the *total reduction amount*) equal to the total of the amounts by which the *adjustable values of *equity or loan interests in the *losing entity are reduced under this Subdivision because of the *indirect value shift; and
 - (ii) those dividends were successively paid or distributed at the payment time by each entity interposed between the gaining entity and that affected owner; and
 - (b) the amount (if any) that the *affected owner of the interest would receive (directly, or indirectly through one or more interposed entities) in respect of the interest if:
-

- (i) the gaining entity were to pay the total reduction amount at the payment time as a distribution of capital; and
- (ii) that capital was successively paid or distributed at the payment time by each entity interposed between the gaining entity and that affected owner.

Uplift not to exceed reasonable amount

- (7) If the uplift worked out as provided in subsections (4), (5) and (6) is not reasonable in the circumstances, having regard to the objects of this Division, the interest's *adjustable value is instead uplifted by an amount that is reasonable in the circumstances, having regard to those objects.

Note: The main object of this Division is set out in section 727-95.

727-805 Has there been a disaggregated attributable increase?

- (1) This section sets out how to determine whether an *indirect value shift has produced, for the owner of an *equity or loan interest, a ***disaggregated attributable increase*** in the market value of the interest and, if so, the amount of it.
- (2) Make a reasonable estimate of the market value of the interest at the *IVS time, but disregarding:
 - (a) all effects on the market value of the interest during the *IVS period, except effects that are reasonably attributable to the *indirect value shift; and
 - (b) the effects (if any) of the indirect value shift on the market value of *equity or loan interests, or *indirect equity or loan interests, in the losing entity.

(This result is called the ***notional resulting market value***.)

Note: Paragraph (2)(b) is necessary because the market value of the interest may also have been affected by the decrease in the market value of interests in the losing entity, because the entity in which the interest is held had direct or indirect interests in both the losing entity and the gaining entity.

In such a case, the increase in adjustable value under this Division will usually be offset by a reduction under this Division.

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- (3) If the notional resulting market value is *greater than* a reasonable estimate of the market value (the ***old market value***) of the interest:
- (a) at the start of the *IVS period; or
 - (b) if the owner last began to own the interest during that period—when the owner last began to own the interest;
- the difference is the ***disaggregated attributable increase***.
- (4) The *indirect value shift has *not* produced a disaggregated attributable increase for the owner of the interest if the notional resulting market value is *less than or equal to* the old market value.

727-810 Scaling-down formula

- (1) The scaling-down formula for the purposes of section 727-800 is:

$$\text{The *disaggregated attributable increase} \times \frac{\text{Total reductions for affected interests}}{\text{Total disaggregated attributable decreases}}$$

Note: The numerator in the fraction can never exceed the denominator. This means that the fraction can never exceed 1, so the uplift will never exceed the disaggregated attributable increase.

- (2) For the purposes of the formula:

total disaggregated attributable decreases means the total of:

- (a) all *disaggregated attributable decreases that the *indirect value shift has produced, in the market values of *affected interests in the *losing entity, for the entities that owned those interests immediately before the *IVS time; and
 - (b) if:
 - (i) section 727-850 (as applying to the *scheme from which the indirect value shift results) reduces losses that are *realised for income tax purposes by *realisation events happening before the *IVS time to *equity or loan interests, or to *indirect equity or loan interests, in the losing entity; and
 - (ii) the indirect value shift is the only indirect value shift, or is the greater or greatest of 2 or more indirect value shifts, that results from the scheme and for which the losing entity is the losing entity;
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for each of those realisation events, the amounts that would, if:

- (iii) the *presumed indirect value shift were an indirect value shift; and
- (iv) the IVS time for the presumed indirect value shift were the time of that realisation event;

be the disaggregated attributable decreases that the presumed indirect value shift has produced, in the market value of the equity or loan interests to which that realisation event happened, for the entities that owned those interests immediately before the time of that realisation event.

total reductions for affected interests means the total of:

- (a) all reductions under this Division, because of the indirect value shift, of *adjustable values of affected interests in the losing entity; and
- (b) if paragraph (b) of the definition of ***total disaggregated attributable decreases*** applies—the amounts by which section 727-850 reduces the losses (if any) referred to in that paragraph.

[The next section is section 727-830.]

Consequences of the method for various kinds of assets

727-830 CGT assets

- (1) The *cost base of an *equity or loan interest is reduced or uplifted immediately before the *IVS time to the extent that this Division provides for the *adjustable value of the interest to be reduced or uplifted.
- (2) The *reduced cost base of an *equity or loan interest is reduced or uplifted immediately before the *IVS time to the extent that this Division provides for the *adjustable value of the interest to be reduced or uplifted.
- (3) However, the *cost base or *reduced cost base is *uplifted* only to the extent that the amount of the uplift is still reflected in the

market value of the interest when a later *CGT event happens to the interest.

- (4) To work out:
- (a) whether the *cost base or *reduced cost base of the interest is reduced or uplifted; and
 - (b) if so, by how much;
- assume that the *adjustable value* from time to time of that or any other *equity or loan interest is its cost base or reduced cost base, as appropriate.
- (5) If this Division provides for the *adjustable value of an *equity or loan interest to be *both* reduced and uplifted:
- (a) the reduction and uplift for which subsection (1) or (2) of this section provides offset each other to the extent of whichever of them is the lesser; but
 - (b) if subsection (3) of this section cancels or reduces the uplift, this subsection is taken always to have applied on that basis.

Reductions and uplifts also apply to pre-CGT assets

- (6) A reduction or uplift occurs regardless of whether the entity that owns the interest *acquired it before, on or after 20 September 1985.

727-835 Trading stock

- (1) This section deals with:
- (a) how this Division applies to an *equity or loan interest that is *trading stock of an entity at the time (the *adjustment time*) immediately before the *IVS time; and
 - (b) the income tax consequences of this Division reducing or uplifting the *adjustable value of the interest.
- (2) The interest's *adjustable value* at a particular time is:
- (a) if the interest has been *trading stock of the entity ever since the start of the income year of the entity in which that time occurs—its *value as trading stock at the start of the income year; or
 - (b) otherwise—its cost.

- (3) If this Division reduces or uplifts the interest's *adjustable value, the entity is treated as if:
- (a) immediately before the adjustment time, the entity had sold the interest to someone else (at *arm's length and in the ordinary course of business) for its *adjustable value immediately before that time; and
 - (b) immediately after the adjustment time, the entity had bought the interest back for the reduced or uplifted adjustable value.

Note: The notional sale and repurchase are separated in time. As a result, if this section is applied to another indirect value shift that happens later in the same income year, the interest's adjustable value will be the cost on the notional repurchase: see paragraph (2)(b).

- (4) However, the increase in the cost of an interest because of paragraph (3)(b) is taken into account from time to time only to the extent that the amount of the increase is still reflected in the market value of the interest.

Note: The situations where the increase in cost would be taken into account include:

- in working out your deductions for the cost of trading stock acquired during the income year in which the increase happens; and
 - the end of an income year if the interest's closing value as trading stock is worked out on the basis of its cost; and
 - the start of the income year in which the interest is disposed of, if that happens in a later income year and the interest's closing value as trading stock at the end of the previous income year was worked out on the basis of its cost.
- (5) If this Division provides for the *adjustable value of the interest to be *both* reduced and uplifted:
- (a) the reduction and uplift offset each other to the extent of whichever of them is the lesser, and subsection (3) of this section applies accordingly; but
 - (b) to the extent that the amount of the uplift is no longer reflected in the market value of the interest, this section is taken always to have applied on the basis that the amount of the uplift was reduced to the same extent.

727-840 Revenue assets

- (1) This section deals with:
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- (a) how this Division applies to an *equity or loan interest that is a *revenue asset of an entity at the time (the *adjustment time*) immediately before the *IVS time; and
 - (b) the income tax consequences of this Division reducing or uplifting the *adjustable value of the interest.
- (2) The interest's *adjustable value* at a particular time is the total of the amounts that would be subtracted from the gross disposal proceeds in calculating any profit or loss on disposal of the interest if the entity disposed of it at that time.
- (3) If this Division reduces or uplifts the interest's *adjustable value, the entity is treated as if:
- (a) immediately before the adjustment time, the entity had sold the interest to someone else (at *arm's length and in the ordinary course of business) for its adjustable value immediately before that time; and
 - (b) immediately after the adjustment time, the entity had bought the interest back for the reduced or uplifted adjustable value.
- Note: The notional sale and repurchase are separated in time. As a result, if this section is applied to another indirect value shift that happens later in the same income year, the interest's adjustable value will be based on the cost on the notional repurchase: see subsection (2).
- (4) However, an uplift in the *adjustable value of the interest is taken into account only to the extent that the amount of the uplift is still reflected in the market value of the interest when it is disposed of or otherwise realised.
- (5) If this Division provides for the *adjustable value of the interest to be *both* reduced and uplifted:
- (a) the reduction and uplift offset each other to the extent of whichever of them is the lesser, and subsection (3) of this section applies accordingly; but
 - (b) to the extent that the amount of the uplift is no longer reflected in the market value of the interest, this section is taken always to have applied on the basis that the amount of the uplift was reduced to the same extent.

Subdivision 727-K—Reduction of loss on equity or loan interests realised before the IVS time

Table of sections

| | |
|---------|---|
| 727-850 | Consequences of scheme under this Subdivision |
| 727-855 | Presumed indirect value shift |
| 727-860 | Conditions about the prospective gaining entity |
| 727-865 | How other provisions of this Division apply to support this Subdivision |
| 727-870 | Effect of CGT roll-over |
| 727-875 | Application to CGT asset that is also trading stock or revenue asset |

727-850 Consequences of scheme under this Subdivision

- (1) If:
- (a) as at the time when a *scheme is entered into, or a later time, an entity (the *prospective losing entity*) has *provided, is providing, is to provide, or might provide, one or more economic benefits *in connection with the scheme; and
 - (b) the prospective losing entity is a company or trust (except one listed in section 727-125 (about superannuation entities)); and
 - (c) a *realisation event happens to an *equity or loan interest, or to an *indirect equity or loan interest, in the prospective losing entity at a time when no *IVS time for the scheme has yet happened (whether or not one happens later); and
 - (d) apart from this Division, a loss would be *realised for income tax purposes by the realisation event; and
 - (e) because of section 727-855, the scheme results in a *presumed indirect value shift affecting the realisation event; and
 - (f) section 727-860 (about prospective gaining entities) is satisfied; and
 - (g) no exclusion in Subdivision 727-C applies to the presumed indirect value shift because of section 727-865; and
 - (h) on the assumptions set out in subsection 727-865(3), the interest would be an *affected interest in the prospective losing entity;

the loss is reduced by an amount that is reasonable having regard to a reasonable estimate of the amount (if any) by which the scheme has reduced the interest's market value during the period that ends at the time of the realisation event and started at the later of:

- (i) when the scheme was entered into; and
- (j) the time of the last realisation event that happened to the interest.

Note 1: This Subdivision does not reduce gains from realisation events, but loss reductions under this Subdivision are taken into account in working out:

- gain reductions under Subdivision 727-G for interests in a gaining entity that are realised after the IVS time for the scheme (see section 727-625); or
- uplifts under Subdivision 727-H in the adjustable values of interests in a gaining entity (see section 727-810).

Note 2: Section 727-865 provides for how other provisions of this Division apply for the purposes of this Subdivision.

Further exclusion for certain 95% services indirect value shifts

- (2) The loss is not reduced if the *presumed indirect value shift is a *95% services indirect value shift because of subsection 727-865(2), unless:
 - (a) the conditions in section 727-705 (as applying because of that subsection) are met for the presumed indirect value shift; or
 - (b) the conditions in section 727-710, 727-715 or 727-720 (as applying because of that subsection) are met for the presumed indirect value shift and for the realisation event.

727-855 Presumed indirect value shift

- (1) The *scheme results in a *presumed indirect value shift* affecting the *realisation event if, and only if, as at the time of the realisation event, it is reasonable to conclude that the total market value of the economic benefits (the *greater benefits*) that:
 - (a) the *prospective losing entity has *provided, is providing, is to provide, or might provide, *in connection with the *scheme, to another entity, or to each of 2 or more other entities; and

- (b) can be identified (even if the other entity or entities cannot be identified or are not all in existence, or the provision of some or all of the economic benefits is contingent);

exceeds:

- (c) the total market value of the economic benefits (the *lesser benefits*) that:
 - (i) have been, are being, are to be, or might be, provided to the prospective losing entity in connection with the scheme; and
 - (ii) can be identified (even if the entity or entities providing the benefits cannot be identified or are not all in existence, or the provision of some or all of the economic benefits is contingent); or
- (d) if there are no economic benefits covered by paragraph (c)—nil.

That excess is the amount of the presumed indirect value shift, which happens at the time of the realisation event.

- (2) The market value of an economic benefit is to be determined as at the earliest time when it is reasonable to conclude that:
 - (a) the economic benefit can be identified; and
 - (b) paragraph 727-150(2)(b) is satisfied for that benefit;if that time is before the *realisation event.
- (3) Otherwise, the market value of the economic benefit is to be determined as at the time immediately before the *realisation event, taking account of any contingency to which provision of the benefit is subject at that time.

For more rules affecting how the market value of an economic benefit is determined, see Subdivision 727-D (as applying because of subsection 727-865(1)).

- (4) An entity referred to in paragraph (1)(a) need not be a party to the *scheme. A benefit can be provided by act or omission.

727-860 Conditions about the prospective gaining entity

- (1) By the deadline set out in subsection (5), the conditions in subsections (2) and (3) must be satisfied for at least one of these entities:

-
- (a) the entity or entities referred to in paragraph 727-855(1)(a);
 - (b) if at the time of the *realisation event it is reasonable to conclude that the entity, or at least one of the entities, referred to in paragraph 727-855(1)(a) will be one of 2 or more entities, but it cannot be determined which—those 2 or more entities.
- (2) Enough must be known about the identity of an entity covered by subsection (1) for it to be reasonable to conclude that, if:
- (a) the *presumed indirect value shift were an *indirect value shift resulting from the *scheme; and
 - (b) the *IVS period for the scheme ended at the time of the *realisation event; and
 - (c) that entity were the *gaining entity for the indirect value shift;
 - (d) the *prospective losing entity were the *losing entity for the indirect value shift; and
- either or both of these would be satisfied for the indirect value shift:
- (e) section 727-105 (Ultimate controller test); and
 - (f) section 727-110 (Common-ownership nexus test).
- (3) Enough must be known about the identity of the entity referred to in subsection (2) for it also to be reasonable to conclude that, in relation to either or both of the following:
- (a) the *prospective losing entity *providing one or more economic benefits to that entity *in connection with the *scheme; or
 - (b) that entity providing one or more economic benefits to the prospective losing entity in connection with the scheme;
- that entity and the prospective losing entity were not, are not, will not be, or would not be, dealing with each other at *arm's length.
- (4) Each entity that is covered by subsection (1), and for which subsections (2) and (3) are satisfied, is called a **prospective gaining entity** for the *scheme.
- (5) The deadline is:
- (a) if the entity that owned the *equity or loan interest immediately before the *realisation event must lodge an
-

- *income tax return for the income year in which the event happens—the time by which the return must be lodged; or
- (b) otherwise—the end of the 6 months immediately after that income year.

727-865 How other provisions of this Division apply to support this Subdivision

- (1) To avoid doubt, these provisions apply for the purposes of working out whether there has been a *presumed indirect value shift and, if so, the amount of it:
- (a) sections 727-155, 727-160 and 727-165 (about economic benefits);
 - (b) section 727-315 (Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000).
- (2) For the purposes of section 727-850, these provisions:
- (a) Subdivision 727-C (Exclusions), except section 727-260 (about a shift down a wholly-owned chain of entities);
 - (b) sections 727-700 to 727-725 (about 95% services indirect value shifts), except subsection 727-700(1);
- apply to the *presumed indirect value shift on the assumptions set out in subsection (3).
- (3) The assumptions are:
- (a) the *presumed indirect value shift is an *indirect value shift resulting from the *scheme; and
 - (b) the *prospective losing entity for the scheme is the *losing entity for that indirect value shift; and
 - (c) each *prospective gaining entity for the scheme is the *gaining entity for that indirect value shift; and
 - (d) the *greater benefits under the presumed indirect value shift are the greater benefits under that indirect value shift; and
 - (e) the *lesser benefits (if any) under the presumed indirect value shift are the lesser benefits under that indirect value shift; and
 - (f) the time of the realisation event mentioned in paragraph 727-850(1)(c) is the *IVS time for the scheme; and
 - (g) the *IVS period for the scheme ends at the time of the realisation event; and
-

-
- (h) section 727-105 (Ultimate controller test) is satisfied for that indirect value shift according to what it is reasonable to conclude under subsection 727-860(2) as applying to the presumed indirect value shift; and
 - (i) section 727-110 (Common-ownership nexus test) is satisfied for that indirect value shift according to what it is reasonable to conclude under subsection 727-860(2) as applying to the presumed indirect value shift; and
 - (j) a reference to the realisation event mentioned in subsection 727-700(1) were a reference to the realisation event mentioned in paragraph 727-850(1)(c); and
 - (k) the interest to which the realisation event mentioned in paragraph 727-850(1)(c) happens were the interest referred to in paragraph 727-700(1)(a); and
 - (l) a reference in any of sections 727-700 to 727-725 (about 95% services indirect value shifts), except subsection 727-700(1), to the owner were a reference to the entity that, at the time of the realisation event mentioned in paragraph 727-850(1)(c), owns the interest to which the event happens.
- (4) Sections 727-635 and 727-640 affect how this Subdivision applies to *equity or loan interests, and *indirect equity or loan interests, in the *prospective losing entity that are split or merged during the period:
- (a) starting when the *scheme is entered into; and
 - (b) ending at the time of the *realisation event mentioned in paragraph 727-850(1)(c);
- in the same way as those sections affect how Subdivision 727-G would apply to those interests on the assumptions set out in subsection (3) of this section.
- (5) The application of a provision because of this section is additional to, and is not intended to limit, any other application of the provision.

727-870 Effect of CGT roll-over

- (1) If:
 - (a) the *realisation event mentioned in paragraph 727-850(1)(c) is a *CGT event; and

(b) section 727-850 reduces a loss that would, apart from this Division, be *realised for income tax purposes by the CGT event; and

(c) there is a roll-over for the CGT event;

the interest's *reduced cost base at the time of the CGT event is taken to have been reduced by the amount by which section 727-850 reduces that loss, but is so taken only for the purposes of working out:

(d) the interest's reduced cost base, from time to time after the roll-over, for the entity that *acquired the interest because of the CGT event; and

(e) in the case of a *replacement-asset roll-over—the reduced cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that *disposed of the interest.

Note: Because of the roll-over, the loss reduction under section 727-850 will have no tax effect. This subsection ensures that the loss reduction is passed on, through the reduction in reduced cost base, to prevent or reduce a loss arising on a later CGT event.

727-875 Application to CGT asset that is also trading stock or revenue asset

If an *equity or loan interest is also an item of *trading stock or a *revenue asset, this Subdivision applies to the interest once in its character as a CGT asset and again in its character as trading stock or a revenue asset.

Subdivision 727-L—Indirect value shift resulting from a direct value shift

Table of sections

| | |
|---------|---|
| 727-905 | How this Subdivision affects the rest of this Division |
| 727-910 | Treatment of value shifted under the direct value shift |

727-905 How this Subdivision affects the rest of this Division

- (1) This Subdivision affects how the rest of this Division applies to a *scheme (the *IVS scheme*) that is or includes a scheme (the *DVS scheme*) under which there is a *direct value shift.

(2) If the *direct value shift:

- (a) has consequences under Division 725 for an entity as an *affected owner of *down interests (or would do so apart from section 725-90 (about direct value shifts that will be reversed)); and
- (b) also has consequences under that Division for another entity as an affected owner of *up interests (or would do so apart from section 725-90);

the rest of this Subdivision has effect, for the purposes of Subdivisions 727-A to 727-K, in order to determine:

- (c) whether the IVS scheme results in an *indirect value shift, from the first entity to the other entity, that has consequences under this Division; and
- (d) whether the IVS scheme has consequences under Subdivision 727-K because it results in a *presumed indirect value shift affecting a *realisation event happening to *equity or loan interests, or to *indirect equity or loan interests, in the first entity; and
- (e) those consequences.

Note: Section 725-50 sets out when a direct value shift has consequences under Division 725.

(3) If:

- (a) the IVS scheme is the DVS scheme; and
- (b) subsection 725-145(2) is satisfied for the *direct value shift (because one or more equity or loan interests in the target entity are issued at a discount); but
- (c) subsection 725-145(3) (about an increase in the market value of one or more equity or loan interests in the target entity) is not satisfied for the direct value shift;

Subdivisions 727-A to 727-K apply to the IVS scheme only as provided in this section.

(4) Otherwise, those Subdivisions apply to the IVS scheme as provided in this section in addition to any other application they have to the scheme.

727-910 Treatment of value shifted under the direct value shift

- (1) The first entity is treated as *providing economic benefits to the other entity, *in connection with the IVS scheme, at the time of a decrease (or future decrease) in the market value of any of the *down interests, to the extent that the decrease is (or will be) covered by subsection 725-155(1).
- (2) Despite subsections 727-150(4) and 727-855(2) and (3), the market value of all economic benefits that subsection (1) of this section treats the first entity as providing to the other entity:
 - (a) is to be determined as at the time immediately before the *IVS time, or immediately before the *realisation event, as appropriate; and
 - (b) is equal to the total value shifted from the *down interests to the *up interests, as worked out under one or more applications of step 2 of the method statement in section 725-365 or 725-380.
- (3) The 2 entities are treated as not dealing with each other at *arm's length in relation to the providing of those benefits.
- (4) None of those benefits is treated as consisting of, or including, services provided or a right to have services provided.

Note: This means that the exclusions in Subdivisions 727-C and 727-G for indirect value shifts involving services will not apply.

- (5) Except as provided in this section, none of the following is treated as the *providing of economic benefits *in connection with the IVS scheme:
 - (a) a decrease (or future decrease) in the market value of *down interests owned by the first entity or the other entity, to the extent that the decrease is (or will be) covered by subsection 725-155(1);
 - (b) an increase (or future increase) in the market value of *up interests owned by the first entity or the other entity, to the extent that the increase is (or will be) covered by subsection 725-145(3);
 - (c) an issue of *up interests at a *discount to the first entity or the other entity, to the extent that the issue is (or will be) covered by subsection 725-145(2).

Note: Value shifted from down interests owned by the other entity to up interests owned by the first entity are dealt with by a separate application of this Subdivision to those interests (because of paragraphs 727-905(2)(a) and (b).

Part 2—Amendment of the Income Tax (Transitional Provisions) Act 1997

2 After Part 3-90

Insert:

Part 3-95—Value shifting

Division 723—Direct value shifting by creating right over non-depreciating asset

723-1 Application of Division 723

- (1) Division 723 applies to a realisation event happening on or after 1 July 2002 to:
 - (a) a CGT asset; or
 - (b) an item of trading stock;
 - (c) a revenue asset.
- (2) Paragraph 723-10(1)(b) or 723-15(1)(b) applies to a right created on or after 1 July 2002.

Division 725—Direct value shifting affecting interests in companies and trusts

725-1 Application of Division 725

Division 725 applies to a scheme entered into on or after 1 July 2002. It also applies to a scheme entered into on or after 27 June 2002, but only if:

- (a) the decrease times for down interests of which entities are affected owners are all on or after 1 July 2002; and
- (b) the increase times for up interests of which entities are affected owners are all on or after 1 July 2002.

Division 727—Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings**727-1 Application of Division 727**

- (1) Division 727 applies to a scheme entered into on or after 1 July 2002.
- (2) It also applies to a scheme entered into on or after 27 June 2002, but only in relation to:
 - (a) an indirect value shift that happens under the scheme on or after 1 July 2002; or
 - (b) a presumed indirect value shift that happens under the scheme and affects a realisation event that happens on or after 1 July 2002.
- (3) Subsection (2) does not apply to an indirect value shift, or a presumed indirect value shift, if:
 - (a) the economic benefits taken into account in determining that the scheme has resulted in that indirect value shift or presumed indirect value shift include economic benefits provided by:
 - (i) an act referred to in Division 138 of the *Income Tax Assessment Act 1997* as the trigger event; or
 - (ii) an event or act referred to in Division 139 of the *Income Tax Assessment Act 1997* as the trigger event; and
 - (b) the act was done, or the event happened, on or after 27 June 2002 and before 1 July 2002.

Note: In that case, the consequences of the trigger event are worked out under Division 138 or 139 of the *Income Tax Assessment Act 1997*: see items 13 and 14 of Schedule 15 to the *New Business Tax System (Consolidation, Value Shifting, Demergers and Other Measures) Act 2002*.

Part 3—Consequential amendment of the Income Tax Assessment Act 1997

Division 1—Amendments

3 Section 104-5 (table row relating to event number G2)

Repeal the row.

4 Section 104-5 (after table row relating to event number K7)

Insert:

| | | | |
|--|-------------------------------------|---|------------------------|
| K8 Direct value shifts affecting your equity or loan interests in a company or trust | the decrease time for the interests | the gain worked out under section 725-365 | <i>no capital loss</i> |
|--|-------------------------------------|---|------------------------|

[See section 104-240 and Division 725]

5 Section 104-140

Repeal the section.

6 After section 104-245

Insert:

104-250 Direct value shifts

- (1) **CGT event K8** happens if there is a *taxing event generating a gain for a *down interest under section 725-245.

Note: That section sets out some of the CGT consequences of a direct value shift for affected owners of down interests. See also the rest of Division 725.

- (2) The time of the event is the *decrease time for the *down interest.

- (3) You make a **capital gain** equal to the gain generated for the taxing event.

Note: You cannot make a capital loss.

-
- (4) If, because of the same *direct value shift, there are 2 or more *taxing events generating a gain that are covered by subsection (1), **CGT event K8** happens for each of those taxing events, and you make a separate *capital gain* for each.

Exceptions

- (5) A *capital gain is disregarded if the *down interest is a *pre-CGT asset.

7 Section 112-45 (table rows relating to event number G2)

Repeal the rows.

8 Section 112-45 (after table row relating to event number G3)

Insert:

| | | | |
|----|---|---|-------------------|
| K8 | Direct value shifts affecting your equity or loan interests in a company or trust | The total cost base and reduced cost base | Subdivision 725-D |
|----|---|---|-------------------|

9 Division 138

Repeal the Division.

10 Division 139

Repeal the Division.

11 Division 140

Repeal the Division.

12 At the end of section 170-270

Add:

- (2) To avoid doubt, the amount of the *capital loss, deduction, or partnership deduction, referred to in this section is:
- (a) the amount remaining after applying Division 723 or section 727-615; or
 - (b) nil, if none of the amount remains after applying that section or Division.

Note: Division 723 and section 727-615 reduce a loss realised for income tax purposes by a realisation event happening to a non-depreciating asset (in the case of Division 723) or an affected interest in a losing entity under an indirect value shift (in the case of section 727-615).

Division 2—Saving and transitional provisions

13 Saving for former Division 138

Despite the repeal by item 9, the repealed provisions continue to apply to an act referred to in Division 138 of the *Income Tax Assessment Act 1997* as the trigger event, if the act was done:

- (a) under a scheme entered into before 27 June 2002; or
- (b) on or after 27 June 2002 and before 1 July 2002.

14 Saving for former Division 139

Despite the repeal by item 10, the repealed provisions continue to apply to an event or act referred to in Division 139 of the *Income Tax Assessment Act 1997* as the trigger event, if the event happened, or the act was done:

- (a) under a scheme entered into before 27 June 2002; or
- (b) on or after 27 June 2002 and before 1 July 2002.

15 Saving for former provisions about direct value shifts

Despite the repeal by item 11, the repealed provisions continue to apply to a scheme, unless Division 725 of the *Income Tax Assessment Act 1997* applies to the scheme.

Part 4—Consequential amendment of the Income Tax Assessment Act 1936

16 Paragraph 245-85(1)(b) in Schedule 2C

After “forgiveness of the debt”, insert “(except a reduction under Division 727 (indirect value shifting) of the *Income Tax Assessment Act 1997*)”.

17 At the end of subsection 245-85(1) in Schedule 2C

Add:

Note: Paragraph (1)(c) does not cover a reduction under Division 727 (indirect value shifting) of the *Income Tax Assessment Act 1997* because that Division is not in Part 3-1 or 3-3 of that Act.

18 Section 245-250 in Schedule 2C

Omit “section 138-25”, substitute “the definition of *under common ownership* in subsection 995-1(1)”.

Part 5—Dictionary amendments

Income Tax Assessment Act 1997

19 After Division 975

Insert:

Division 977—Realisation events, and the gains and losses they realise for income tax purposes

Table of sections

CGT assets

| | |
|--------|---------------------------------------|
| 977-5 | Realisation event |
| 977-10 | Loss realised for income tax purposes |
| 977-15 | Gain realised for income tax purposes |

Trading stock

| | |
|--------|--|
| 977-20 | Realisation event |
| 977-25 | Disposal of trading stock: loss realised for income tax purposes |
| 977-30 | Ending of an income year: loss realised for income tax purposes |
| 977-35 | Disposal of trading stock: gain realised for income tax purposes |
| 977-40 | Ending of an income year: gain realised for income tax purposes |

Revenue assets

| | |
|--------|---------------------------------|
| 977-50 | Meaning of <i>revenue asset</i> |
|--------|---------------------------------|

977-55 Loss or gain realised for income tax purposes

CGT assets

977-5 Realisation event

For a *CGT asset, a *realisation event* is a *CGT event (except CGT event E4 and CGT event G1).

977-10 Loss realised for income tax purposes

- (1) A loss is *realised for income tax purposes* by a *realisation event that happens to a *CGT asset if, and only if, an entity makes a *capital loss from the event. That capital loss is the loss realised by the event.
- (2) If a provision of this Act reduces the loss that would, apart from that provision, be *realised for income tax purposes by the event, the *capital loss is reduced by the same amount.

977-15 Gain realised for income tax purposes

- (1) A gain is *realised for income tax purposes* by a *realisation event that happens to a *CGT asset if, and only if, an entity makes a *capital gain from the event. That capital gain is the gain that is realised by the event.
- (2) If a provision of this Act reduces the gain that would, apart from that provision, be *realised for income tax purposes by the event, the *capital gain is reduced by the same amount.

Trading stock**977-20 Realisation event**

For an item of *trading stock, a *realisation event* is a disposal of the item or the ending of an income year.

977-25 Disposal of trading stock: loss realised for income tax purposes

- (1) A loss is *realised for income tax purposes* by a *realisation event consisting of disposal of an item of *trading stock if, and only if:
 - (a) the item is disposed of, for less than its *cost, in the same income year in which it became part of the trading stock on hand of the entity disposing of it; or
 - (b) the item is disposed of in a later income year for less than its *value as trading stock of the entity on hand at the start of the later income year.

- (2) The loss that is realised for income tax purposes by the event is the difference between the amount included in the entity's assessable income because of the disposal and:
- (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as *trading stock on hand at the start of the later income year;
- as appropriate.
- (3) If a provision of this Act reduces the loss that would, apart from that provision, be *realised for income tax purposes by the event:
- (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as trading stock on hand at the start of the later income year;
- as appropriate, is reduced by the same amount.

977-30 Ending of an income year: loss realised for income tax purposes

- (1) A loss is *realised for income tax purposes* by a *realisation event that happens to an item of *trading stock and consists of the ending of an income year if, and only if, the *value of the item, as trading stock of an entity on hand at the end of that income year, is less than:
- (a) its *cost, if it became part of the trading stock on hand of the entity during that income year; or
 - (b) otherwise, its value as trading stock of the entity on hand at the start of that income year.
- (2) The loss that is realised for income tax purposes by the event is the difference between the *value of the item, as *trading stock of the entity on hand at the end of that income year and:
- (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as trading stock on hand at the start of the income year;
- as appropriate.
- (3) If a provision of this Act reduces the loss that would, apart from that provision, be *realised for income tax purposes by the event:
- (a) the amount that the entity can deduct for the item's *cost; or
-

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- (b) the item's *value as *trading stock on hand at the start of the income year;
as appropriate, is reduced by the same amount.

977-35 Disposal of trading stock: gain realised for income tax purposes

- (1) A gain is *realised for income tax purposes* by a *realisation event consisting of disposal of an item of *trading stock if, and only if:
- (a) the item is disposed of, for more than its *cost, in the same income year in which it became part of the trading stock on hand of the entity disposing of it; or
 - (b) the item is disposed of in a later income year for more than its *value as trading stock of the entity on hand at the start of the later income year.
- (2) The gain that is realised for income tax purposes by the event is the difference between the amount included in the entity's assessable income because of the disposal and:
- (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as trading stock on hand at the start of the later income year;
- as appropriate.
- (3) If a provision of this Act reduces the gain that would, apart from that provision, be *realised for income tax purposes by the event, the amount that is included in the assessable income of the entity because of the disposal is reduced by the same amount.

977-40 Ending of an income year: gain realised for income tax purposes

- (1) A gain is *realised for income tax purposes* by a *realisation event that happens to an item of *trading stock and consists of the ending of an income year if, and only if, the *value of the item, as trading stock of an entity on hand at the end of that income year, is greater than:
- (a) its *cost, if it became part of the trading stock on hand of the entity during that income year; or

- (b) otherwise, its value as trading stock of the entity on hand at the start of that income year.
- (2) The gain that is realised for income tax purposes by the event is the difference between the *value of the item, as *trading stock of the entity on hand at the end of that income year and:
 - (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as trading stock on hand at the start of the income year;as appropriate.
- (3) If a provision of this Act reduces the gain that would, apart from that provision, be *realised for income tax purposes by the event:
 - (a) the amount that the entity can deduct for the item's *cost; or
 - (b) the item's *value as *trading stock on hand at the start of the income year;as appropriate, is increased by the same amount.

[The next section is section 977-50.]

Revenue assets

977-50 Meaning of revenue asset

A *CGT asset is a **revenue asset** if, and only if:

- (a) the profit or loss on your disposing of the asset, ceasing to own it, or otherwise realising it, would be taken into account, in calculating your assessable income or *tax loss, otherwise than as a *capital gain or *capital loss; and
- (b) the asset is neither *trading stock nor a *depreciating asset.

977-55 Loss or gain realised for income tax purposes

For a *revenue asset:

- (a) disposing of, ceasing to own, or otherwise realising, the asset is a **realisation event**; and
- (b) a loss is **realised for income tax purposes** by the *realisation event if, and only if, there is a loss on the event; and

-
- (c) a gain is *realised for income tax purposes* by the realisation event if, and only if, there is a profit on the event; and
 - (d) the loss or profit on the event is the loss or gain realised for income tax purposes; and
 - (e) if a provision of this Act reduces the loss or gain that would, apart from that provision, be realised for income tax purposes by the event, the loss or profit to be taken into account in calculating your assessable income or *tax loss is reduced by the same amount.

20 Subsection 995-1(1)

Insert:

95% services indirect value shift has the meaning given by section 727-700.

21 Subsection 995-1(1)

Insert:

active participant:

- (a) in a *scheme under which there is a *direct value shift, has the meaning given by subsection 725-65(2); and
- (b) in a *scheme under which there is an *indirect value shift, has the meaning given by subsection 727-530(3).

22 Subsection 995-1(1) (definition of adjustable value)

Repeal the definition, substitute:

adjustable value:

- (a) of a *depreciating asset, has the meaning given by section 40-85; and
- (b) of an *equity or loan interest:
 - (i) for the purposes of determining the consequences of a *direct value shift—has the meaning given by sections 725-240, 725-315 and 725-325; and
 - (ii) for the purposes of determining the consequences of an *indirect value shift—has the meaning given by sections 727-830, 727-835 and 727-840.

23 Subsection 995-1(1)

Insert:

adjustable value method means the method (for determining the effect of *indirect value shifts) for which Subdivision 727-H provides.

24 Subsection 995-1(1)

Insert:

affected interest:

- (a) in the *losing entity for an *indirect value shift, has the meaning given by section 727-460; or
- (b) in the *gaining entity for an indirect value shift, has the meaning given by section 727-465.

25 Subsection 995-1(1)

Insert:

affected owner:

- (a) of *down interests, has the meaning given by section 725-80; and
- (b) of *up interests, has the meaning given by section 725-85; and
- (c) for an *indirect value shift, has the meaning given by section 727-530.

26 Subsection 995-1(1) (definition of associate-inclusive control interest)

Repeal the definition.

27 Subsection 995-1(1)

Insert:

common ownership: see *under common ownership*.

28 Subsection 995-1(1)

Insert:

common-ownership nexus: see section 727-400.

29 Subsection 995-1(1)

Insert:

control (for value shifting purposes) has the meaning given by sections 727-355, 727-360, 727-365 and 727-375.

30 Subsection 995-1(1) (definition of decreased value shares)

Repeal the definition.

31 Subsection 995-1(1)

Insert:

decrease time for a *direct value shift has the meaning given by section 725-155.

32 Subsection 995-1(1)

Insert:

direct value shift has the meaning given by section 725-145.

33 Subsection 995-1(1)

Insert:

direct roll-over replacement has the meaning given by section 723-110.

34 Subsection 995-1(1)

Insert:

disaggregated attributable decrease: section 727-775 sets out how to determine whether an *indirect value shift has produced a *disaggregated attributable decrease* in the market value of an *equity or loan interest.

35 Subsection 995-1(1)

Insert:

disaggregated attributable increase: section 727-805 sets out how to determine whether an *indirect value shift has produced a *disaggregated attributable increase* in the market value of an *equity or loan interest.

36 Subsection 995-1(1) (definition of discount)

Repeal the definition, substitute:

discount: an *equity or loan interest is issued at a *discount* as provided in section 725-150.

37 Subsection 995-1(1)

Insert:

down interest has the meaning given by section 725-155.

38 Subsection 995-1(1)

Insert:

equity or loan interest has the meaning given by section 727-520.

39 Subsection 995-1(1) (definition of fixed entitlement)

Repeal the definition, substitute:

fixed entitlement: an entity has a *fixed entitlement* to a share of the income or capital of a trust if the entity has a fixed entitlement to that share within the meaning of Division 272 in Schedule 2F to the *Income Tax Assessment Act 1936*.

40 Subsection 995-1(1) (definition of fixed trust)

Repeal the definition, substitute:

fixed trust: a trust is a *fixed trust* if entities have *fixed entitlements to all of the income and capital of the trust.

41 Subsection 995-1(1)

Insert:

gaining entity for an *indirect value shift has the meaning given by section 727-150.

42 Subsection 995-1(1)

Insert:

greater benefits:

- (a) under an *indirect value shift, has the meaning given by subsection 727-150(3); and
- (b) under a *presumed indirect value shift, has the meaning given by subsection 727-855(1).

43 Subsection 995-1(1)

Insert:

in connection with: an economic benefit is *provided *in connection with* a *scheme if at least one of the tests in section 727-160 is satisfied.

44 Subsection 995-1(1)

Insert:

increase time for a *direct value shift has the meaning given by section 725-155.

45 Subsection 995-1(1) (definition of increased value shares)

Repeal the definition.

46 Subsection 995-1(1) (definition of indexed common ownership market value)

Repeal the definition.

47 Subsection 995-1(1)

Insert:

indirect equity or loan interest has the meaning given by section 727-525.

48 Subsection 995-1(1)

Insert:

indirect primary equity interest has the meaning given by section 727-220.

49 Subsection 995-1(1)

Insert:

indirect roll-over replacement has the meaning given by section 723-110.

50 Subsection 995-1(1)

Insert:

indirect value shift has the meaning given by Subdivision 727-B.

51 Subsection 995-1(1) (definition of indirectly)

Omit “persons” (twice occurring), substitute “entities”.

52 Subsection 995-1(1)

Insert:

intermediate controller has the meaning given by subsection 727-530(2).

53 Subsection 995-1(1)

Insert:

IVS period has the meaning given by section 727-150.

54 Subsection 995-1(1)

Insert:

IVS time has the meaning given by section 727-150.

55 Subsection 995-1(1)

Insert:

lesser benefits:

(a) under an *indirect value shift, has the meaning given by paragraph 727-150(3)(a); and

(b) under a *presumed indirect value shift, has the meaning given by paragraph 727-855(1)(c).

56 Subsection 995-1(1)

Insert:

losing entity for an *indirect value shift has the meaning given by section 727-150.

57 Subsection 995-1(1)

Insert:

loss-focussed basis has the meaning given by section 727-780.

58 Subsection 995-1(1) (at the end of the definition of market value)

Add:

To avoid doubt, paragraph (a) does apply in working out the market value of economic benefits, or of an *equity or loan interest, for the purposes of Part 3-95 (Value shifting).

59 Subsection 995-1(1) (definition of material decrease)

Repeal the definition.

60 Subsection 995-1(1) (definition of material increase)

Repeal the definition.

61 Subsection 995-1(1)

Insert:

non-complying approved deposit fund means a non-complying ADF as defined by subsection 267(1) of the *Income Tax Assessment Act 1936*.

62 Subsection 995-1(1)

Insert:

non-fixed trust means a trust that is not a *fixed trust.

63 Subsection 995-1(1)

Insert:

post-CGT asset means a *CGT asset that is not a *pre-CGT asset.

64 Subsection 995-1(1)

Insert:

predominantly-services indirect value shift has the meaning given by section 727-725.

65 Subsection 995-1(1)

Insert:

pre-shift gain has the meaning given by section 725-210.

66 Subsection 995-1(1)

Insert:

pre-shift loss has the meaning given by section 725-210.

67 Subsection 995-1(1)

Insert:

presumed indirect value shift has the meaning given by section 727-855.

68 Subsection 995-1(1)

Insert:

primary equity interest in an entity has the meaning given by section 727-520.

69 Subsection 995-1(1)

Insert:

primary interest in an entity has the meaning given by section 727-520.

70 Subsection 995-1(1)

Insert:

primary loan interest in an entity has the meaning given by section 727-520.

71 Subsection 995-1(1)

Insert:

prospective gaining entity for a *scheme has the meaning given by section 727-860.

72 Subsection 995-1(1)

Insert:

prospective losing entity for a *scheme has the meaning given by section 727-850.

73 Subsection 995-1(1) (definition of provide)

After “*fringe benefit”, insert “or economic benefit”.

74 Subsection 995-1(1) (definition of residual value)

Repeal the definition.

75 Subsection 995-1(1)

Insert:

realisation event has the meaning given by sections 977-5, 977-20 and 977-55.

76 Subsection 995-1(1)

Insert:

realisation-time method means the method (for determining the effect of *indirect value shifts) for which Subdivision 727-G provides.

77 Subsection 995-1(1)

Insert:

realised for income tax purposes:

- (a) a gain is *realised for income tax purposes* as provided in sections 977-15, 977-35, 977-40 and 977-55; and
- (b) a loss is *realised for income tax purposes* as provided in sections 977-10, 977-25, 977-30 and 977-55.

78 Subsection 995-1(1)

Insert:

revenue asset has the meaning given by section 977-50.

79 Subsection 995-1(1)

Insert:

secondary equity interest has the meaning given by section 727-520.

80 Subsection 995-1(1)

Insert:

scheme period for a *direct value shift has the meaning given by section 725-55.

81 Subsection 995-1(1)

Insert:

secondary interest has the meaning given by section 727-520.

82 Subsection 995-1(1)

Insert:

secondary loan interest has the meaning given by section 727-520.

83 Subsection 995-1(1) (definition of share value shift)

Repeal the definition.

84 Subsection 995-1(1)

Insert:

taxing event generating a gain has the meaning given by sections 725-245 and 725-335.

85 Subsection 995-1(1) (definition of total share value increase)

Repeal the definition.

86 Subsection 995-1(1)

Insert:

ultimate controller has the meaning given by section 727-350.

87 Subsection 995-1(1)

Insert:

ultimate stake of a particular percentage has the meaning given by sections 727-405, 727-410 and 727-415.

88 Subsection 995-1(1) (definition of under common ownership)

Repeal the definition, substitute:

under common ownership: 2 companies are *under common ownership* if, and only if:

- (a) they are members of the same *wholly-owned group; or
- (b) after tracing the direct and indirect ownership of the *shares in each of the companies (through any interposed companies and trusts) to the individuals who ultimately hold it, that ownership is held by the same individuals in the same proportions.

In doing the tracing, ignore *shares whose *dividends can reasonably be regarded as being equivalent to the payment of interest on a loan having regard to:

- (c) how the dividends are calculated; and
- (d) the conditions applying to the payment of the dividends; and
- (e) any other relevant matters.

89 Subsection 995-1(1)

Insert:

up interest has the meaning given by section 725-155.

Schedule 16—Demerger relief

Part 1—CGT relief

Income Tax Assessment Act 1997

1 After Division 124

Insert:

Division 125—Demerger relief

Table of Subdivisions

| | |
|-------|---|
| | Guide to Division 125 |
| 125-A | Object of this Division |
| 125-B | Consequences for owners of interests |
| 125-C | Consequences for members of demerger group |
| 125-D | Corporate unit trusts and public trading trusts |

Guide to Division 125

125-1 What this Division is about

Entities can obtain CGT relief for a demerger.

Owners of ownership interests in the head entity of a demerger group can obtain a roll-over to defer CGT consequences for the CGT events that happen to their interests under the demerger (see Subdivision 125-B).

Capital gains and capital losses made by members of the demerger group from certain CGT events that happen under the demerger are disregarded (see Subdivision 125-C).

Note: Dividend relief is also available: see section 44 of the *Income Tax Assessment Act 1936*.

Subdivision 125-A—Object of this Division

Table of sections

125-5 Object of this Division

125-5 Object of this Division

The object of this Division is to facilitate the demerging of entities by ensuring that capital gains tax considerations are not an impediment to restructuring a *business.

Subdivision 125-B—Consequences for owners of interests

Guide to Subdivision 125-B

125-50 Guide to Subdivision 125-B

You can choose to obtain a roll-over if a CGT event happens to your interests in a company or trust because of a demerger of an entity from the group of which the company or trust is the head entity.

There are cost base adjustments if you receive new interests under a demerger and no CGT event happens to your original interests.

Table of sections

Operative provisions

125-55 When a roll-over is available for a demerger
 125-60 Meaning of *ownership interest* and related terms
 125-65 Meanings of *demerger group*, *head entity* and *demerger subsidiary*
 125-70 Meanings of *demerger*, *demerged entity* and *demerging entity*
 125-75 Exception: employee share schemes
 125-80 What is the roll-over?
 125-85 Cost base adjustments where CGT event happens but no roll-over chosen
 125-90 Cost base adjustments where no CGT event

- 125-95 No other cost base adjustment after demerger
125-100 No further demerger relief in some cases

[This is the end of the Guide.]

Operative provisions

125-55 When a roll-over is available for a demerger

- (1) You can choose to obtain a roll-over if:
- (a) you own an *ownership interest in a company or trust (your *original interest*); and
 - (b) the company or trust is the *head entity of a *demerger group; and
 - (c) a *demerger happens to the demerger group; and
 - (d) under the demerger, a *CGT event happens to your original interest and you *acquire a new or replacement interest (your *new interest*) in the *demerged entity.

Note 1: Section 125-80 sets out what the roll-over is.

Note 2: You have to make cost base adjustments even if there is no CGT event: see section 125-90.

Example: Peter owns shares (his original interests) in Company A, a public company. Company B is a wholly owned subsidiary of Company A. Company A announces a demerger utilising a proportionate capital reduction and the disposal of all its shares in Company B to its 320,000 shareholders. Following the demerger all of the shareholders in Company A, including Peter, will own all of the shares in Company B (their new interests).

- (2) You cannot choose to obtain a roll-over under this Subdivision for an original interest if:
- (a) you are a foreign resident; and
 - (b) the new interest you *acquire under the *demerger in exchange for that original interest does not have the *necessary connection with Australia just after you acquire it.

Note: Section 136-25 tells you when an asset has the necessary connection with Australia.

125-60 Meaning of ownership interest and related terms

- (1) An **ownership interest** in a company or trust is:
 - (a) for a company, a *share in the company or an option, right or similar interest issued by the company that gives the owner an entitlement to *acquire a share in the company; and
 - (b) for a trust, a unit or other interest in the trust or an option, right or similar interest issued by the trustee that gives the owner an entitlement to acquire a unit or other interest in the trust.
- (2) However, this Subdivision applies to a *dual listed company voting share in a company as if it were not an **ownership interest** if there are not more than 5 of those *shares in the company.
- (3) A **dual listed company voting share** is a *share in a company:
 - (a) issued:
 - (i) in the *head entity of a *demerger group; and
 - (ii) as part of a *dual listed company arrangement; and
 - (iii) mainly for the purpose of ensuring that shareholders of both companies involved in the arrangement vote as a single decision-making body on matters affecting them; and
 - (b) that does not carry rights to financial entitlements (except the return of the amount paid up on the share and a dividend that is the equivalent of a dividend paid on an ordinary share).
- (4) A **dual listed company arrangement** is an *arrangement under which 2 publicly listed companies, while maintaining their separate legal entity status, shareholdings and listings, align their strategic directions and the economic interests of their respective shareholders through:
 - (a) the appointment of common (or almost identical) boards of directors; and
 - (b) management of the operations of the 2 companies on a unified basis; and
 - (c) the shareholders of both companies voting in effect as a single decision-making body on substantial issues affecting their combined interests; and

- (d) equalised distributions to shareholders in accordance with an equalisation ratio applying between the 2 companies, both generally and in the event of a winding up of one or both of the companies; and
 - (e) cross-guarantees as to, or similar financial support for, each other's substantial obligations or operations, except where the effect of the relevant regulatory requirements prevents those guarantees or that financial support.
- (5) However, an arrangement is not a *dual listed company arrangement* unless one but not both of the companies is an Australian resident.

125-65 Meanings of demerger group, head entity and demerger subsidiary

- (1) A *demerger group* comprises the *head entity of the group and one or more *demerger subsidiaries.
- Note: An entity may be a member of one or more demerger groups.
- (2) A trust cannot be a member of a *demerger group* unless *CGT event E4 is capable of applying to all of the units and interests in the trust.
- Note: A discretionary trust cannot be a member of a demerger group.
- (3) A company or trust is the *head entity* of a *demerger group if no other member of the group owns *ownership interests in the company or trust.
- (4) If apart from this subsection, a company or trust would be the *head entity of a *demerger group and the company or trust, and all of its *demerger subsidiaries, are also demerger subsidiaries of another company or trust in another demerger group, the first-mentioned company or trust is not the *head entity* of a demerger group.
- (5) A company or trust (the *first company or trust*) that would, apart from this subsection, be a member of a *demerger group* is not a member of the *demerger group* if:
- (a) the first company or trust owns, either alone or together with another company or trust that would, apart from this

-
- subsection, be a member of the *demerger group, more than 20% but less than 80% of the *ownership interests in a *listed public company or *listed widely held trust; and
- (b) the listed public company or listed widely held trust chooses that the first company or trust not be a member of the demerger group.
- (6) A company is a **demerger subsidiary** of another company or a trust that is a member of a *demerger group if the other company or the trust, either alone or together with other members of the group, owns, or has the right to *acquire, *ownership interests in the company that carry between them:
- (a) the right to receive more than 20% of any distribution of income or capital by the company; or
- (b) the right to exercise, or control the exercise of, more than 20% of the voting power of the company.
- (7) A trust is a **demerger subsidiary** of another trust or a company that is a member of a *demerger group if the other trust or the company, either alone or together with other members of the group, owns, or has the right to *acquire, *ownership interests in the trust that carry between them the right to receive more than 20% of any distribution of income or capital by the trustee.

125-70 Meanings of demerger, demerged entity and demerging entity

- (1) A **demerger** happens to a *demerger group if:
- (a) there is a restructuring of the demerger group; and
- (b) under the restructuring:
- (i) members of the demerger group *dispose of at least 80% of their total *ownership interests in another member of the demerger group to owners of original interests in the *head entity of the demerger group; or
- (ii) at least 80% of the total ownership interests of members of the demerger group in another member of the demerger group end and new interests are issued to owners of original interests in the head entity; or
- (iii) the demerged entity issues sufficient new ownership interests in itself with the result that owners of original
-

interests in the head entity own at least 80% of the total ownership interests in the demerged entity; or

- (iv) some combination of the processes referred to in subparagraphs (i), (ii) and (iii) happens with the effect that members of the demerger group stop owning at least 80% of the total ownership interests owned by members of the demerger group in another member of the group; and

Note: CGT event C2 and CGT event C3 are the only relevant CGT events in a subparagraph (ii) case.

- (c) under the restructuring:
 - (i) a *CGT event happens to an original interest owned by an entity in the head entity of the group and the entity *acquires a new interest and nothing else; or
 - (ii) no CGT event happens to an original interest owned by an entity in the head entity of the group and the entity acquires a new interest and nothing else; and
- (d) the acquisition by entities of new interests happens only because those entities own or owned original interests; and
- (e) the new interests acquired are:
 - (i) if the head entity is a company—ownership interests in a company; or
 - (ii) if the head entity is a trust—ownership interests in a trust; and
- (f) just before the restructuring, it is reasonable for the head entity to assume that more than 50% of original interests in the head entity of the demerger group are owned by:
 - (i) Australian residents; or
 - (ii) foreign residents whose new interests have the *necessary connection with Australia just after they acquire them; and
- (g) neither the original interests nor the new interests are in a trust that is a *superannuation fund; and
- (h) the requirements of subsection (2) are met.

Example: To continue the example from subsection 125-55(1), Peter owns 400 post-CGT shares in Company A. Companies A and B are both members of a demerger group. Company A is the head entity of the demerger group and Company B is a demerger subsidiary.

Company A proceeds to demerge 100% of its shares in Company B to its shareholders.

Company A enters into a proportionate capital reduction, returning 40 cents per share to its ordinary shareholders. Peter is entitled to \$160 (40c times 400 shares) under the capital reduction.

For Peter, the capital reduction amount of \$160 is compulsorily applied to acquire Company A's shares in Company B, at \$6.75 (a discount of 10% to current market value). Company A rounds up the fractional amounts in calculating the number of whole shares to be distributed to each shareholder. This gives Peter 24 shares in Company B (160 divided by 6.75, rounded up to the nearest whole number).

Note: Acquiring new interests by an owner of original interests may include the allocation of the owner's entitlement to new interests to a nominee:

- to sell on the owner's behalf; or
- to hold pending the owner being located.

- (2) Each owner (an *original owner*) of original interests in the *head entity of the *demerger group must:
- (a) *acquire, under the *demerger, the same proportion, or as nearly as practicable the same proportion, of new interests in the *demerged entity as the original owner owned in the head entity just before the demerger; and
 - (b) just after the demerger, have the same proportionate total *market value of *ownership interests in the head entity and demerged entity as the original owner owned in the head entity just before the demerger.

Note 1: There is an exception: see section 125-75.

Note 2: Dual listed company voting shares are not treated as ownership interests: see section 125-60.

Note 3: Fractional interests will generally not affect your ability to choose a roll-over.

Example: To continue the example from subsection (1), Company A concludes, given the circumstances of the demerger, that the market values of Peter's and the other shareholders' shares in A and B are expected to be in proportion with their original interests in Company A, and advises the shareholders of this position.

- (3) In working out whether an original owner complies with subsection (2):
- (a) disregard *ownership interests that are original interests the owner owns in the *demerged entity; and

- (b) an anticipated reasonable approximation of the *market value of ownership interests is sufficient.

Example: An anticipated reasonable approximation of market values of ownership interests may include:

- valuations provided to shareholders in scheme documents;
 - the price selected for use under a sale facility;
- and may be made by reference to long-term value.

Exception: off-market buy-backs

- (4) A buy-back of *shares that is an off-market purchase for the purposes of Division 16K of Part III of the *Income Tax Assessment Act 1936* is not a *demerger.

Exception: roll-over available under another provision

- (5) Circumstances where an owner of original interests can obtain a roll-over under a provision of this Act outside this Division for all of the CGT events that happened to the owner's original interests under the circumstances cannot be a **demerger**.

Note: An owner might be able to obtain a roll-over for the CGT events under Subdivision 124-E, 124-G, 124-H or 124-M.

Meaning of demerged entity

- (6) An entity that is a former member of a *demerger group is a **demerged entity** if, under a *demerger that happens to the group, *ownership interests in the entity are acquired by:
- (a) shareholders in the *head entity of the group; or
 - (b) unitholders or holders of interests in the head entity of the group.

Meaning of demerging entity

- (7) An entity that is a member of a *demerger group just before the *CGT event referred to in section 125-155 happens is a **demerging entity** if, under a *demerger that happens to the group:
- (a) the entity (either alone or together with other members of the demerger group)*dispose of at least 80% of their total *ownership interests in another member of the demerger

group to owners of original interests in the *head entity of the demerger group; or

- (b) at least 80% of the total ownership interests of that entity and of other members of the demerger group in another member of the demerger group end and new interests are issued to owners of original interests in the head entity; or

Note: CGT event C2 and CGT event C3 are the only relevant CGT events.

- (c) the demerged entity issues sufficient new ownership interests in itself with the result that owners of original interests in the head entity own at least 80% of the total ownership interests in the demerged entity; or
- (d) some combination of the processes referred to in paragraphs (a), (b) and (c) happens with the effect that members of the demerger group stop owning at least 80% of the total ownership interests owned by members of the demerger group in another member of the group.

125-75 Exceptions to subsection 125-70(2)

Employee share schemes

- (1) In working out whether the requirements in subsection 125-70(2) are met, disregard each of the *ownership interests described in subsections (2) and (3) if, just before the *demerger, those interests (taking into account either or both of their number and value) represented not more than 3% of the total *ownership interests in the entity.
- (2) An *ownership interest in a company that is owned by an entity is disregarded under subsection (1) if the ownership interest:
- (a) is:
- (i) a *qualifying share or a *qualifying right *acquired under an *employee share scheme; or
- (ii) a *share acquired under a *scheme to which section 26AAC of the *Income Tax Assessment Act 1936* applies; and
- (b) is not a fully-paid ordinary share.

- (3) An *ownership interest in a trust that is owned by an entity is disregarded under subsection (1) if the ownership interest:
- (a) would be a *qualifying share or a *qualifying right *acquired under an *employee share scheme if Division 13A of Part III of the *Income Tax Assessment Act 1936* applied to ownership interests in a trust; and
 - (b) is not a fully-paid unit.

Adjusting instruments

- (4) In working out whether the requirements in subsection 125-70(2) are met, disregard each of the *ownership interests described in subsection (5) (*adjusting instruments*) if, just before the *demerger, those interests represented not more than 10%, or such greater percentage (not exceeding 17%) as is prescribed, of the ownership interests in the entity.
- (5) An *ownership interest in a *listed public company or a *listed widely held trust that is the *head entity of a *demerger group is disregarded under subsection (4) if:
- (a) the adjusting instrument was issued on terms that ensure that its value is not adversely affected by an *arrangement undertaken by the company or trust in relation to other ownership interests in the company or trust; and
 - (b) if the adjusting instrument can be converted into an ordinary *share in the company or an ordinary unit in the trust, any conversion will occur on a basis:
 - (i) that is set out in the terms of the issue of the instrument; and
 - (ii) that is adjusted to take into account a capital reduction or a capital reconstruction; and
 - (c) before conversion, the owner of the adjusting instrument does not have a right to participate in distributions of profit or capital except as set out in the terms of the issue of the instrument; and
 - (d) the adjusting instrument deals with the effect of a *demerger that happens to the demerger group on the value of the instrument.

Example: Some examples of adjusting instruments are:

- convertible preference shares, including reset preference shares;
- convertible notes;
- partly paid shares where the paid-up amount is adjusted to reflect a capital reduction.

Additional exceptions

- (6) The regulations may provide that, in working out whether the requirements in subsection 125-70(2) are met, other *ownership interests of a kind specified in the regulations are to be disregarded if, just before the *demerger, those interests represented not more than a prescribed percentage of the ownership interests in the entity.
- (7) However, the total percentage of *ownership interests to be disregarded under this section must not exceed 20% of the ownership interests in the entity.

125-80 What is the roll-over?

- (1) If you choose the roll-over, a *capital gain or *capital loss you make from a *CGT event happening under the *demerger to an original interest you own is disregarded.
- (2) If you choose the roll-over, the first element of the *cost base and *reduced cost base of:
- (a) each new interest that you are not taken to have *acquired before 20 September 1985; and
 - (b) if not all of your original interests ended under the *demerger—each of your remaining original interests that you acquired on or after 20 September 1985;
- is such proportion of the sum of the cost bases of all your original interests that you acquired on or after 20 September 1985 (worked out just before the demerger) as is reasonable having regard to the matters specified in subsection (3).

Note 1: These rules replace the cost base and reduced cost base adjustments in CGT event E4 and CGT event G1.

Note 2: The head entity or the demerging entity may advise you of the proportions.

- (3) The matters are:

- (a) the *market values of your remaining original interests just after the *demerger, or an anticipated reasonable approximation of those market values; and
- (b) the market values of your new interests just after the demerger, or an anticipated reasonable approximation of those market values.

Example: To continue the example from subsection 125-70(2), Company A advises its shareholders that Company B at that time represents 5% of the market value of the group as a whole. Peter's cost base for each of his shares in A is \$4.60, and Peter recalculates his cost base as follows:

Total cost base = $\$1840 \times 4.60 \times 400$ shares
to be spread over 400 shares in A and 24 shares in B.

5% of 1840 = 92

$92 \div 24$ shares = \$3.83 per B share

$1840 - 92 = 1748$

$1748 \div 400 = \$4.37$ per A share

Pre-CGT interests

- (4) The following subsections apply if you choose the roll-over and you *acquired some or all of your original interests before 20 September 1985.
- (5) If you *acquired all of your original interests before 20 September 1985, you are taken to have acquired all of your new interests before that day.
- (6) If you *acquired some of your original interests before 20 September 1985, you are taken to have acquired a reasonable whole number of your new interests before that day having regard to:
 - (a) the *market values of your original interests and your remaining original interests just after the *demerger, or an anticipated reasonable approximation of those market values; and

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- (b) the market values of your new interests just after the demerger, or an anticipated reasonable approximation of those market values.
- (7) If a proportion, but not all of, your original interests ends under the *demerger and you *acquired some of your original interests before 20 September 1985, that same proportion of those interests you acquired before that day ends.
- Note: CGT event K6 may be relevant if you later dispose your interests that are treated as being pre-CGT.
- Example: Bert owned 100 shares in a company of which 50 were acquired pre-CGT. Under a demerger 20 of Bert's 100 shares were cancelled in exchange for new interests. As 20% of his shares were cancelled, 10 of his pre-CGT shares are taken to have been cancelled.
- (8) If you choose a roll-over for some but not all of your original interests, you apply the rules in this section as if your original interests for which you chose the roll-over were your only original interests.

125-85 Cost base adjustments where CGT event happens but no roll-over chosen

- (1) You must adjust the *cost base and *reduced cost base of an *ownership interest you own in a company or trust if:
- (a) a *demerger happens to a *demerger group of which the company or trust is a member; and
 - (b) you owned an original interest in the *head entity of the demerger group just before the demerger; and
 - (c) a *CGT event happens to the original interest and you *acquire a new interest under the demerger; and
 - (d) you do not choose a roll-over under this Subdivision for the original interest.
- (2) The adjustments you must make are the same as the adjustments you would have to make under section 125-80 for the *cost bases and *reduced cost bases of the remaining original interests and new interests just after the *CGT event if you could have chosen a roll-over under this Subdivision for the *demerger and you had done so.

125-90 Cost base adjustments where no CGT event

- (1) You must adjust the *cost base and *reduced cost base of an *ownership interest you own in a company or trust if:
 - (a) a *demerger happens to a *demerger group of which the company or trust is a member; and
 - (b) you owned an original interest in the *head entity of the demerger group just before the demerger; and
 - (c) no *CGT event happens to the original interest, but you *acquire a new interest under the demerger.
- (2) The adjustments you must make are the same as the adjustments you would have to make under section 125-80 if you could have chosen a roll-over under this Subdivision for the *demerger and you had done so.

125-95 No other cost base adjustment after demerger

If you have to make adjustments to the *cost base and *reduced cost base of your *ownership interests under section 125-80, 125-85 or 125-90 because of a *demerger, no other adjustment can be made under this Act to those cost bases and reduced cost bases because of something that happens under the demerger.

Note: Those sections deal with any value shift that might occur under the demerger and avoid the need for the general value shifting regime to apply.

125-100 No further demerger relief in some cases

This Division does not apply to the remaining *ownership interests in a *demerged entity if one or more members of the *demerger group *disposed of or cancelled less than 100% of the total ownership interests of that group in the demerged entity.

Note: After the demerger, a former member of the demerger group can undertake a further demerger to which this Division can apply.

Subdivision 125-C—Consequences for members of demerger group

Guide to Subdivision 125-C

125-150 Guide to Subdivision 125-C

Certain capital gains and capital losses that members of a demerger group make under a demerger are disregarded.

Certain capital losses made under a demerger are reduced where the demerger results in a value shift.

Table of sections

Operative provisions

- 125-155 Certain capital gains or losses disregarded for demerging entity
- 125-160 No CGT event J1
- 125-165 Adjusted capital loss for value shift under a demerger
- 125-170 Reduced cost base reduction if demerger asset subject to roll-over

[This is the end of the Guide.]

Operative provisions

125-155 Certain capital gains or losses disregarded for demerging entity

Any *capital gain or *capital loss a *demerging entity makes from *CGT event A1, *CGT event C2, *CGT event C3 or *CGT event K6 happening to its *ownership interests in a *demerged entity under a *demerger is disregarded.

Note 1: The full list of CGT events is in section 104-5.

Note 2: This section will not apply if section 125-100 applies.

125-160 No CGT event J1

*CGT event J1 does not happen to a *demerged entity or a member of a *demerger group under a *demerger.

125-165 Adjusted capital loss for value shift under a demerger

A *capital loss made by an entity that was a member of a *demerger group from a *CGT event happening to a *CGT asset under a *demerger or after a demerger is reduced to the extent that the capital loss is reasonably attributable to a reduction in the *market value of the asset because of the demerger.

Example: The market value of equity or loan interests in the demerging entity may be reduced by the disposal, for inadequate value, of ownership interests of another member of the demerger group to owners of original interests in the head entity of the group.

125-170 Reduced cost base reduction if demerger asset subject to roll-over

- (1) The *reduced cost base of a *CGT asset is reduced if:
 - (a) the *market value of the asset is reduced because of a *demerger; and
 - (b) after the demerger the asset is *acquired by an entity from another entity (the *transferor*) in a situation where the transferor obtained a roll-over for the disposal; and
 - (c) the reduction occurred when the transferor owned the asset.
- (2) The *reduced cost base of the asset as determined under the roll-over is reduced just after the roll-over to the extent of the reduction in *market value caused by the *demerger.

Note: The rules in section 125-165 and this section deal with any value shift that might occur under the demerger and avoid the need for the general value shifting regime to apply.

- (3) If the *reduced cost base of a *CGT asset is reduced under this section because of a *demerger, no other adjustment can be made under this Act to that reduced cost base because of something that happens under the demerger.

Subdivision 125-D—Corporate unit trusts and public trading trusts

Guide to Subdivision 125-D

125-225 Guide to Subdivision 125-D

| |
|--|
| <p>This Division applies to corporate unit trusts and public trading trusts as if they were companies.</p> |
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Table of sections

Operative provisions

125-230 Application of Division to corporate unit trusts and public trading trusts

[This is the end of the Guide.]

Operative provisions

125-230 Application of Division to corporate unit trusts and public trading trusts

This Division applies to a trust to which section 102K or 102S of the *Income Tax Assessment Act 1936* applies for an income year in which a *demerger happens as if:

- (a) the trust were a company; and
- (b) *ownership interests in it were interests in a company.

Part 2—Dividend relief

Income Tax Assessment Act 1936

2 Subsection 6(1)

Insert:

demerged entity has the meaning given by section 125-70 of the *Income Tax Assessment Act 1997*.

3 Subsection 6(1)

Insert:

demerger has the meaning given by section 125-70 of the *Income Tax Assessment Act 1997*.

3A Subsection 6(1)

Insert:

demerger allocation means:

- (a) the total market value of the allocation represented by the ownership interests issued by the demerged entity in itself under a demerger to the owners of ownership interests in the head entity of the demerger group; or
- (b) the total market value of the allocation represented by the ownership interests disposed of by a member of a demerger group under a demerger to the owners of ownership interests in the head entity; or
- (c) the total of both of those market values.

4 Subsection 6(1)

Insert:

demerger dividend means that part of a demerger allocation that is assessable as a dividend under subsection 44(1) or that would be so assessable apart from subsections 44(3) and (4).

5 Subsection 6(1)

Insert:

demerger group has the meaning given by section 125-65 of the *Income Tax Assessment Act 1997*.

6 Subsection 6(1)

Insert:

demerger subsidiary has the meaning given by section 125-65 of the *Income Tax Assessment Act 1997*.

7 Subsection 6(1)

Insert:

demerging entity has the meaning given by section 125-70 of the *Income Tax Assessment Act 1997*.

8 Subsection 6(1)

Insert:

head entity of a demerger group has the meaning given by section 125-65 of the *Income Tax Assessment Act 1997*.

9 Subsection 6(1)

Insert:

ownership interest has the meaning given by section 125-60 of the *Income Tax Assessment Act 1997*.

10 At the end of section 44

Add:

- (2) Subsections (3) and (4) apply to a demerger dividend unless the head entity elects in writing, within one month after it decides which of its shareholders will receive ownership interests in the demerged entity under the demerger, that those subsections do not apply to the total demerger dividend for all shareholders.
- (3) This section applies to the demerger dividend as if it had not been paid out of profits.

- (4) A demerger dividend is not assessable income or exempt income.
- (5) However, subsections (3) and (4) do not apply to a demerger dividend unless, just after the demerger, CGT assets owned by the demerged entity or a demerger subsidiary representing at least 50% by market value of all the CGT assets (or a reasonable approximation of market value) owned by the demerged entity and its demerger subsidiaries are used, directly or indirectly, in one or more businesses carried on by one or more of those entities.
- (6) In applying subsection (5), disregard any assets that are ownership interests in a demerger subsidiary unless they are used in a business referred to in that subsection.

11 Section 45B

Repeal the section, substitute:

45B Schemes to provide certain benefits

Purpose of section

- (1) The purpose of this section is to ensure that relevant amounts are treated as dividends for taxation purposes if:
 - (a) components of a demerger allocation as between capital and profit do not reflect the circumstances of a demerger; or
 - (b) certain payments, allocations and distributions are made in substitution for dividends.

Application of section

- (2) This section applies if:
 - (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company; and
 - (b) under the scheme, a taxpayer (the *relevant taxpayer*), who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit; and
 - (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant

purpose but not including an incidental purpose) of enabling a taxpayer (the *relevant taxpayer*) to obtain a tax benefit.

Commissioner to determine that section 45BA or 45C applies

- (3) The Commissioner may make, in writing, a determination that:
- (a) section 45BA applies in relation to the whole, or a part, of the demerger benefit; or
 - (b) section 45C applies in relation to the whole, or a part, of the capital benefit.

A determination does not form part of an assessment.

Note: If section 45BA applies in relation to the whole, or a part, of a demerger benefit, this benefit may be a capital benefit.

Meaning of provided with a demerger benefit

- (4) A person is *provided with a demerger benefit* if in relation to a demerger:
- (a) a company provides the person with ownership interests in that or another company; or
 - (b) something is done in relation to an ownership interest owned by the person that has the effect of increasing the value of an ownership interest (which may or may not be the same ownership interest) owned by the person.

Meaning of provided with a capital benefit

- (5) A reference to a person being *provided with a capital benefit* is a reference to any of the following:
- (a) the provision of ownership interests in a company to the person;
 - (b) the distribution to the person of share capital or share premium;
 - (c) something that is done in relation to an ownership interest that has the effect of increasing the value of an ownership interest (which may or may not be the same interest) that is held by the person.
- (6) However, a person is not *provided with a capital benefit* to the extent that the provision of interests, the distribution or the thing

done referred to in subsection (5) involves the person receiving a demerger dividend.

- (7) For the purposes of this section, a non-share distribution to an equity holder is taken to be the distribution to the equity holder of share capital to the extent to which it is a non-share capital return.

Meaning of relevant circumstances of scheme

- (8) The *relevant circumstances* of a scheme include:
- (a) the extent to which the demerger benefit or capital benefit is attributable to capital or the extent to which the demerger benefit or capital benefit is attributable to profits (realised and unrealised) of the company or of an associate (within the meaning in section 318) of the company;
 - (b) the pattern of distributions of dividends, bonus shares and returns of capital or share premium by the company or by an associate (within the meaning in section 318) of the company;
 - (c) whether the relevant taxpayer has capital losses that, apart from the scheme, would be carried forward to a later year of income;
 - (d) whether some or all of the ownership interests in the company or in an associate (within the meaning in section 318) of the company held by the relevant taxpayer were acquired, or are taken to have been acquired, by the relevant taxpayer before 20 September 1985;
 - (e) whether the relevant taxpayer is a non-resident;
 - (f) whether the cost base (for the purposes of the *Income Tax Assessment Act 1997*) of the relevant ownership interest is not substantially less than the value of the applicable demerger benefit or capital benefit;
 - (g) whether the relevant taxpayer or an associate (within the meaning in section 318) of the taxpayer is a private company that would not have been entitled to a rebate under section 46F if the taxpayer had been paid an equivalent dividend instead of the demerger benefit or capital benefit;
 - (h) if the scheme involves the distribution of share capital or share premium—whether the interest held by the relevant taxpayer after the distribution is the same as the interest
-

would have been if an equivalent dividend had been paid instead of the distribution of share capital or share premium;

- (i) if the scheme involves the provision of ownership interests and the later disposal of those interests, or an increase in the value of ownership interests and the later disposal of those interests:
 - (i) the period for which the ownership interests are held by the holder of the interests; and
 - (ii) when the arrangement for the disposal of the ownership interests was entered into;
- (j) for a demerger only:
 - (i) whether the profits of the demerging entity and demerged entity are attributable to transactions between the entity and an associate (within the meaning in section 318) of the entity; and
 - (ii) whether the assets of the demerging entity and demerged entity were acquired under transactions between the entity and an associate (within the meaning in section 318) of the entity;
- (k) any of the matters referred to in subparagraphs 177D(b)(i) to (viii).

*Meaning of **obtaining a tax benefit***

- (9) A relevant taxpayer **obtains a tax benefit** if an amount of tax payable, or any other amount payable under this Act, by the relevant taxpayer would, apart from this section, be less than the amount that would have been payable, or would be payable at a later time than it would have been payable, if the demerger benefit had been an assessable dividend or the capital benefit had been a dividend.

Expressions to have same meanings as in Part IIIAA

- (10) Expressions used in this section that are defined in Part IIIAA have the same meanings as in that Part.

45BA Effect of determinations under section 45B for demerger benefits

- (1) If the Commissioner makes a determination under subsection 45B(3), the amount of the demerger benefit, or the part of the benefit, is taken not to be a demerger dividend for the purposes of this Act for the owner of the ownership interest or the relevant taxpayer at the time when the owner or relevant taxpayer is provided with the demerger benefit.
- (2) The amount of the demerger benefit is:
 - (a) if the benefit is the provision of an ownership interest—the market value of the interest at the time that it is provided; or
 - (b) if the benefit is an increase in the value of an ownership interest—the increase in the market value of the interest as a result of the change; or
 - (c) if the benefit is a distribution to the shareholder of share capital or share premium—the amount debited to the share capital account or share premium account of the company in connection with the provision of the benefit.

12 Section 45C (heading)

Repeal the heading, substitute:

45C Effect of determinations under sections 45A and 45B for capital benefits

13 Subsection 45C(4)

Before “value” (wherever occurring), insert “market”.

14 Paragraphs 45C(4)(a) and (b)

Omit “a share”, substitute “an ownership interest”.

15 Paragraphs 45C(4)(a) and (b)

Omit “the share”, substitute “the interest”.

16 Subsection 45D(1)

Repeal the subsection, substitute:

Notice by Commissioner of determination

- (1) If the Commissioner makes a determination under section 45A, 45B or 45C, the Commissioner must give a copy of the determination to the company concerned (which, in the case of a demerger benefit referred to in section 45B, is the head entity of the demerger group). The notice may be included in a notice of assessment.

Notice by company of determination

- (1A) That company must, in the case of a determination under section 45A or 45B, give a copy of the notice to:
- (a) the advantaged shareholder referred to in section 45A; or
 - (b) the relevant taxpayer referred to in section 45B.

17 Section 109B

After “(See Subdivisions C and D.)”, insert “Also, this Division does not apply to demerger dividends. (See Subdivision DA.)”.

18 After Subdivision D of Division 7A of Part III

Insert:

Subdivision DA—Demerger dividends not treated as dividends

109RA Demerger dividends not treated as dividends

This Division does not apply to a demerger dividend to which section 45B does not apply.

19 Subsection 128B(1)

Omit “and (3A)”, substitute “, (3A) and (3D)”.

20 After subsection 128B(3C)

Insert:

- (3D) This section does not apply to a demerger dividend to which section 45B does not apply.

Part 3—Consequential amendments

Income Tax Assessment Act 1997

21 At the end of section 102-20

Add:

Note 4: The capital loss may be affected if the CGT asset was owned by a member of a demerger group just before a demerger: see section 125-170.

22 At the end of subsection 104-10(5)

Add:

Note 3: A capital gain or loss made by a demerging entity from CGT event A1 happening as a result of a demerger is also disregarded: see section 125-155.

23 At the end of subsection 104-25(5)

Add:

Note 5: Cost base adjustments are made only under Subdivision 125-B if there is a roll-over under that Subdivision for CGT event C2 happening as a result of a demerger.

Note 6: A capital gain or loss made by a demerging entity from CGT event C2 happening as a result of a demerger is also disregarded: see section 125-155.

24 At the end of subsection 104-70(6)

Add:

Note: Cost base adjustments are made only under Subdivision 125-B if there is a roll-over under that Subdivision for CGT event E4 happening as a result of a demerger.

25 At the end of subsection 104-135(4)

Add:

Note: Cost base adjustments are made only under Subdivision 125-B if there is a roll-over under that Subdivision for CGT event G1 happening as a result of a demerger.

26 At the end of subsection 104-155(5)

Add:

; or (g) a company or a trust that is a member of a *demerger group issues new *ownership interests under a *demerger.

Note: For demergers, see Division 125.

27 At the end of subsection 104-175(7)

Add:

Note: CGT event J1 does not happen to a demerged entity or a member of a demerger group if CGT event A1 or C2 happens to a demerging entity under a demerger: see section 125-160.

28 At the end of section 104-230

Add:

Note: A capital gain or loss made by a demerging entity from CGT event K6 happening as a result of a demerger is also disregarded: see section 125-155.

29 After section 112-53

Insert:

112-54 Demergers

| Demergers | | | |
|------------------|--|--|---------------------|
| Item | In this situation: | Element affected: | See section: |
| 1 | There is a roll-over under Subdivision 125-B after a demerger | First element of cost base and reduced cost base of new interests and remaining original interests | 125-80 |
| 2 | There is a CGT event under a demerger but no roll-over under Subdivision 125-B | First element of cost base and reduced cost base of new interests and remaining original interests | 125-85 |

| Demergers | | | |
|------------------|---|--|---------------------|
| Item | In this situation: | Element affected: | See section: |
| 3 | There is a cost base adjustment under Subdivision 125-B but no CGT event under a demerger | First element of cost base and reduced cost base of new interests and remaining original interests | 125-90 |

30 Subsection 112-105(3)

Repeal the subsection, substitute:

- (3) All replacement-asset roll-overs are set out in the table in section 112-115.

31 At the end of section 112-110

Add:

- Note 3: The reduced cost base may be further modified if the replacement asset roll-over happens after a demerger: see section 125-175.

32 Section 112-115 (before table item 15)

Insert:

14C Demergers

Division 125

33 Section 112-140

Omit the third sentence, substitute “All same-asset roll-overs are set out in the table in section 112-150”.

34 Section 112-145 (note)

Omit “Note”, substitute “Note 1”.

35 At the end of section 112-145

Add:

- Note 2: The reduced cost base may be further modified if the same asset roll-over happens after a demerger: see section 125-175.

36 Subsection 122-70(2) (note)

Omit “Note”, substitute “Note 1”.

37 At the end of subsection 122-70(2)

Add:

Note 2: The reduced cost base may be modified for a roll-over happening after a demerger: see section 125-175.

38 Subsection 122-200(1) (note)

Omit “Note”, substitute “Note 1”.

39 At the end of subsection 122-200(1)

Add:

Note 2: The reduced cost base (as determined under this section) may be modified for a roll-over happening after a demerger: see section 125-175.

40 At the end of subsection 124-10(3)

Add:

Note 5: The reduced cost base may be modified for a roll-over happening after a demerger: see section 125-175.

41 At the end of section 126-15

Add:

Note: The reduced cost base may be modified for a roll-over happening after a demerger: see section 125-175.

42 Subsection 126-60(2) (note)

Omit “Note”, substitute “Note 1”.

43 At the end of subsection 126-60(2)

Add:

Note 2: The reduced cost base may be modified for a roll-over happening after a demerger: see section 125-175.

43A At the end of section 202-45

Add:

; (i) a *demerger dividend.

43B At the end of section 975-150

Add:

- (3) However, the right, power or option of an owner of *ownership interests in the *head entity of a *demerger group to *acquire, under a *demerger, ownership interests in the *demerged entity is not a right, power or option covered by subsection (1).

44 Subsection 995-1(1)

Insert:

demerged entity has the meaning given by section 125-70.

45 Subsection 995-1(1)

Insert:

demerger has the meaning given by section 125-70.

46 Subsection 995-1(1)

Insert:

demerger dividend has the meaning given by subsection 6(1) of the *Income Tax Assessment Act 1936*.

47 Subsection 995-1(1)

Insert:

demerger group has the meaning given by section 125-65.

48 Subsection 995-1(1)

Insert:

demerger subsidiary has the meaning given by section 125-65.

49 Subsection 995-1(1)

Insert:

demerging entity has the meaning given by section 125-70.

50 Subsection 995-1(1)

Insert:

dual listed company arrangement has the meaning given by section 125-60.

51 Subsection 995-1(1)

Insert:

dual listed company voting share has the meaning given by section 125-60.

52 Subsection 995-1(1)

Insert:

head entity of a demerger group has the meaning given by section 125-65.

53 Subsection 995-1(1) (definition of ownership interest)

Repeal the definition, substitute:

ownership interest: an *ownership interest*:

- (a) in land or a *dwelling—has the meaning given by section 118-130; and
- (b) in a company or trust—has the meaning given by section 125-60.

Part 4—Transitional

54 Transitional

A company that makes payments in respect of shares in the company under a demerger that happens on or after 1 July 2002 and before this Act receives the Royal Assent can choose to apply section 45B of the *Income Tax Assessment Act 1936* as that section existed before the amendments made by this Act to the demerger rather than that section as amended by this Act if:

- (a) the head entity of the demerger group is a listed public company; and
- (b) the only CGT events (if any) that happen under the demerger to all original interests in that head entity are CGT event A1, CGT event C2 or CGT event G1.

Part 5—Application

55 Application

The amendments made by this Schedule apply to demergers happening on or after 1 July 2002.

*[Minister's second reading speech made in—
House of Representatives on 27 June 2002
Senate on 16 September 2002]*

(164/02)
