

TD 2008/31 - Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the Income Tax Assessment Act 1997, is the CGT asset that an entity has contracted to sell to another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

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! This document has changed over time. This is a consolidated version of the ruling which was published on *30 May 2012*



Taxation Determination

Income tax: consolidation: capital gains: for the purposes of Part 3-90 of the *Income Tax Assessment Act 1997*, is the CGT asset that an entity has contracted to sell to another taxpayer an asset of the entity at a time it joins or leaves a consolidated group, if the contract is not completed at that time?

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

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[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

Ruling

1. Yes. The CGT asset, the subject of the contract, is an asset of the entity at the time it joins or leaves a consolidated group for the purposes of the consolidated group rules in Part 3-90 of the *Income Tax Assessment Act 1997* (ITAA 1997).

2. In general, no other asset arising under the contractual arrangements would be recognised separately as an asset of the entity at the joining time or the leaving time. Exceptions to this would be if the entity has had some separate dealings in respect of such an asset or if such an asset is recognised in commerce and business as having economic value to the entity at the joining time or the leaving time for which a purchaser of its membership interests would be willing to pay.

Note: The timing of when certain CGT events are taken to have occurred has been amended by the *Tax Laws Amendment (2010 Measures No. 1) Act 2010*. The

Commissioner's view contained in this Taxation Determination is broadly that where a CGT event arises in relation to a CGT asset because a contract or agreement has been entered into, the CGT event is taken to have occurred at the earlier time when the contract was entered into.

Section 716-860 of the *Income Tax Assessment Act 1997* introduced by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* modifies the CGT timing rules when an entity joins or leaves a consolidated group and the CGT event straddles the joining or leaving time. For contracts entered into after 8 May 2007, the time of the CGT event happening to the joining entity is not taken to be the time the contract was entered into but the time when the circumstances that gave rise to the CGT event first existed. That is when the change of beneficial ownership occurs.

To the extent that section 716-860 of the *Income Tax Assessment Act 1997* does not affect matters covered in this Taxation Determination, the Commissioner's view will continue to apply.

Application

3. This Determination does not apply if the entities entering into the contract are members of the same consolidated group at either the contract time or the time just after the contract is completed. Nor does it apply to assets that are subject to a finance lease.

Example 1 – entry sell case

4. On 22 June 2004, X Co entered into a contract to sell all of its shares in B Co (40%) to Y Co.
5. On 10 July 2004, Head Co acquired all of the shares in X Co which caused X Co to become a member of Head Co's consolidated group.
6. Head Co must allocate the group's allocable cost amount (ACA) for X Co's shares to the assets of X Co when it becomes a subsidiary member. In relation to the contract, the relevant asset recognised for tax cost setting purposes are the shares in B Co.
7. In this example, no asset that X Co may hold at its joining time arising under the contractual arrangement would be recognised separately by Head Co as an asset of X Co.

Example 2 – exit sell case

8. X Co is a subsidiary member of a consolidated group and the owner of land. Under the single entity rule, the land is an asset of the group's head company, Head Co.
9. On 16 June 2006, X Co entered into a contract to sell the land.
10. X Co leaves the group on 30 June 2006 as a result of Head Co selling all of its shares in X Co to an individual.
11. At the leaving time, Head Co must identify the assets X Co takes out of the group in calculating the tax cost of the group's membership interests in X Co. In applying section 711-25 of the ITAA 1997, the land is recognised as an asset that the head company holds at the leaving time (because of the single entity rule applying to X Co).

Date of effect

12. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation17 December 2008

Appendix 1 – Explanation

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

Background

13. When an entity joins a consolidated group it is necessary to identify each asset that it brings with it into the group. This is because section 701-10 and Division 705 of the ITAA 1997 seek to align the assets' cost for income tax purposes with the group's cost of acquiring the entity (referred to as the allocable cost amount or ACA).

14. Similarly, when an entity ceases to be a subsidiary member of a consolidated group, it is necessary to identify the assets taken from the group when it leaves. This is because the assets' cost is used in working out the cost base of the group's membership interests in the leaving entity under Division 711 of the ITAA 1997.

Meaning of 'asset'

15. The meaning of an 'asset' for the purposes of applying the tax cost setting rules in Divisions 705 and 711 is not defined in the ITAA 1997.

16. The Commissioner takes the view in Taxation Ruling TR 2004/13¹ that an asset, for the purposes of the cost setting rules in Part 3-90 of the ITAA 1997, is 'anything recognised in commerce and business as having economic value to the joining entity at the joining time for which a purchaser of its membership interests would be willing to pay'. The same criteria would apply in identifying an asset a leaving entity takes with it on exiting the group.

17. As explained in paragraph 26 of TR 2004/13, the extent and degree to which the assets of the entity should be separately identified or treated as composite items will depend on the nature of the asset, the business being carried on by the entity and the circumstances of the particular case.

Identifying the relevant asset in a straddle contract

18. If the transfer of ownership of the asset has yet to be completed when the entity joins or leaves a consolidated group, the relevant assets for cost setting purposes must be identified.

19. When an entity enters into a contract to sell a CGT asset, its ownership of that asset continues to be recognised at law, until such time as ownership passes to another party.

20. Although entering into the contract to sell the asset will result in the seller acquiring legal or equitable rights (for example, to receive the purchase price, or balance of the purchase price on settlement), this will normally be accompanied by obligations, (for example, to deliver up the asset on completion). Ordinarily, these rights and obligations will offset in value terms such that there will be no asset arising out of the contractual arrangements that is 'recognised in commerce and business as having economic value to the joining entity at the joining time for which a purchaser of its membership interests would be willing to pay.' In these circumstances, it is appropriate to recognise only the underlying asset for tax cost setting purposes.

¹ Taxation Ruling TR 2004/13 *Income tax: the meaning of an asset for the purposes of Part 3-90 of the Income Tax Assessment Act 1997.*

21. However, if, for example, the entity has dealt with an asset arising under the contract separately, it may be separately recognised as an asset of the entity where it is held at the joining or leaving time. Equally, if an asset arising under the contractual arrangement has economic value (separate from the value of the CGT asset that is the subject of the contract), it may be recognised as a commercial or business asset of the entity at the joining time or the leaving time. This could occur where, in the absence of other factors to the contrary, the market value of the CGT asset being sold at the joining or leaving time is less than its contract price.

22. Recognising the underlying CGT asset as the most relevant asset of the joining or leaving entity also achieves more appropriate cost setting outcomes. If an asset arising under the contract were recognised instead:

- in an entry-sell case, there would be an over-allocation of ACA to other reset cost base assets of the joining entity because the asset arising under the contract would have a lower market value relative to the entity's other assets; and
- in an exit sell case, the cost base for the group's membership interests in the leaving entity would be understated because the asset arising under the contract would have a terminating value of nil.

23. This approach is consistent with paragraph 26 of TR 2004/13 where it refers to CGT assets being identified consistently with the approach in Taxation Ruling TR 95/35² and Taxation Determination TD 93/86.³

² Taxation Ruling TR 95/35 *Income tax: capital gains: treatment of compensation receipts.*

³ Taxation Determination TD 93/86 *Income tax: capital gains: are the totality of rights under a contract considered to be the one asset, or is each right considered to be a separate asset for CGT purposes?*

References

Previous draft:

TD 2008/D11

- joining time
- leaving entity
- leaving time
- tax cost setting rules

Related Rulings/Determinations:

TD 93/86; TD 2008/29; TD 2008/30;
TR 95/35; TR 2004/13; TR 2006/10

Legislative references:

- ITAA 1997 Pt 3-90
- ITAA 1997 701-10
- ITAA 1997 Div 705
- ITAA 1997 Div 711
- ITAA 1997 711-25
- ITAA 1997 716-860
- TAA 1953
- Tax Laws Amendment (2010 Measures No. 1) Act 2010

Subject references:

- assets
- consolidation
- consolidation – assets
- consolidation – capital gains tax
- consolidation – exiting
- consolidation – joining
- cost of membership interests
- cost setting rules
- head company
- joining entity

Other references:

- Consolidation Reference Manual
-

ATO references

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