TD 2008/29EC - Compendium

Ruling Compendium – TD 2008/29

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D9 – Income tax: consolidation: capital gains: do the core consolidation rules in Division 701 of the *Income Tax Assessment Act 1997* modify the effect of the CGT contract rules if an entity contracts to buy or sell a CGT asset and the contract settles after the entity becomes, or ceases to be, a member of a consolidated group?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Entity/ies commenting	Issue raised	Tax Office Response/Action taken
1	1	***Framing the Determination question*** The question that the draft Determination addresses would have been better formulated in terms of the two cases where the core consolidation rules do modify the effect of the CGT contract rules (as set out in paragraph 3).	The Tax Office understands the comment to suggest that the Determination should deal only with the two cases where the core consolidation rules modify the effect of the CGT contract rules. However, the draft and final Determinations provide a view on the broader issue of whether the consolidation rules modify the CGT contract rules and identify exceptions to the general case. That is, the Determination has broader application than in just the two cases identified in paragraph 3. For this reason, the Tax Office prefers the approach taken in the Determination.
2	2,3,4 and 5	***Exit sell: legally binding advice*** Paragraph 4 of the draft Determination allows taxpayers to calculate their net capital gain or loss in a way that ensures the capital gain made on the disposal of the CGT asset in an exit-sell case is not taxed again on the sale of the membership interests in the leaving entity. There is a concern that the approach in paragraph 4 is not legally binding on the Commissioner and that	The Determination sets out the Commissioner's views on the way the core consolidation rules interact with the CGT contract timing rules. The views expressed on the operation of these provisions are legally binding on the Commissioner and may be relied on by anyone to whom the ruling applies. Paragraph 4 of the Determination provides that the Tax Office would not disturb the relevant assessment which does not include what would otherwise be the assessable capital gain on the disposal of the membership interests that represents a duplication

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		taxpayers are therefore unable to rely on the statement. The issue would be more appropriately addressed by way of a legislative amendment to protect the tax positions adopted by taxpayers in the past once the Tax Office's views have been finalised.	of the gain made by the head company on the disposal of the asset. Without this approach, the consolidation rules may result in tax being paid twice in respect of the same economic gain. The Tax Office has adopted this approach to produce a sensible tax outcome which, in its view, is consistent with the scheme of the Act. Insofar as the comment relates to legislative design issues, these are outside the scope of the Determination and are matters more appropriate for Treasury to consider. To that end, the Tax Office has provided Treasury with a copy of these comments.
3	2	***Exit sell: removal of gain duplication*** To provide taxpayers with greater certainty, the Tax Office should adopt one of the following technical arguments in alleviating the duplicated gain: (i) Change paragraph 4 of the draft Determination to allow taxpayers to apply subsection 104-10(4) of the ITAA 1997 to the capital gain or loss made on the disposal of the membership interests in a manner that reduces the capital proceeds by that part of the capital gain made on the disposal of the CGT asset that is the subject of the straddle contract. (ii) Subsection 6-25(1) of the ITAA 1997 refers to an 'amount' being included in your assessable income twice. It is possible to interpret 'amount' to include an amount attributable to the same economic gain. Where two amounts are included in section 102-5 of the ITAA 1997, it is possible for the ATO to apply subsection 6-25(1) in the limited scenario of a straddle exit-sell case.	The Tax Office considers that there is no legislative support for the interpretative approaches suggested. *Adjust capital proceeds*: There is nothing within Division 116 of the ITAA 1997, nor subsection 104-10(4), that allows the head company to calculate its capital proceeds from the disposal of the membership interests in the leaving entity by ignoring the part of the capital gain that has already been taken into account on the sale of the CGT asset. *Subsection 6-25(1)*: The gain duplication that arises in an exit-sell case does not result from two income tax provisions including the same amount in the head company's assessable income. The requirements in subsection 6-25(1) therefore would not be met. *Market value cost base for straddle contract*: In calculating the cost base of a CGT asset that is contractual rights, the Tax Office thinks the better view of subsection 110-25(2)(b) of the ITAA 1997 is that the property given by the vendor to acquire the asset is the contractual rights created in the purchaser to have the CGT asset transferred at the contract price (that is not the CGT asset itself). The market value of the rights created would generally be nil. *Changing the time of the CGT event*: see below.

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		(iii) It is arguable that the contractual rights that the leaving entity acquired on entering into the sale contract have a cost base equal to the market value of the land under subsection 110-25(2)(b) of the ITAA 1997. This is because the leaving entity will have agreed to give property (the land) in respect of the acquisition of the right to receive the purchase price. Subsection 110-25(2)(b) is wide enough to encapsulate the value of property that the person is 'required to give' at a future time. (iv) Change the time of CGT event A1 to when the change of ownership occurs (discussed below)	
4	2	***Entry and exit-sell: time of CGT event A1 is when change of ownership happens*** The Determination should address the alternative view that, in an exit-sell case, CGT event A1 only 'happens' to the tax entity that owns the CGT asset at the time when there is a change in both the legal and beneficial ownership of the asset. This interpretation would result in the same economic gain being assessed once in an exit-sell case. It would also avoid any practical issues for the head company of the old group in terms of monitoring whether the sale has been completed and other relevant events that occur after the member has left the consolidated group.	The comment suggests that the time of the CGT event, and any tax liability, is when the change of ownership occurs. This view would require the asset's disposal to be treated as if it did not happen under a contract such that paragraph 104-10(3)(a) of the ITAA 1997, rather than paragraph 104-10(3)(b), sets the time when CGT event A1 happens. The Tax Office does not consider the consolidation rules operate to ignore the contractual basis of the asset's disposal. The rules therefore do not change the timing of the CGT event (see paragraph 42 of the Determination). The announced legislative changes, which seek to change the time of the CGT event to the time the change of ownership happens, lend further support to the view that the existing law cannot be interpreted in the way suggested. [Further details on the announced measure are available in the (former) Assistant Treasurer's Press Release No. 050 of 2007 and the Treasurer's and Assistant Treasurer's Joint Press Release No. 053 of 2008].

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		The ATO should acknowledge this alternative position in the Determination and also provide that such an interpretation is reasonably tenable (even if not the preferred ATO view).	The Tax Office acknowledges that the exit-sell position in the Determination raises practical issues for the head company in obtaining information from the subsidiary member that is relevant to calculating its capital gain or loss. However external advisors (for the head company) have indicated that contracts for the sale of a subsidiary include indemnities for tax and other tax related clauses. The exchange of information to enable the head company to comply with its tax obligations could be incorporated into such contracts.
5	2	***Exit-sell: loss on membership interests*** The approach in paragraph 4 of the draft Determination does not apply if the disposal of the membership interests results in a capital loss. If, in Example 5, there was another asset (not being sold under a straddle contract) which had a tax cost of $2m and a market value of $100,000 at the leaving time, this would result in a capital loss on the disposal of the membership interests of $400,000. The result is inequitable as it duplicates the capital gain on the asset's disposal by virtue of a reduced capital loss on the shares in S Co.	Paragraph 4 of the Determination addresses the general case of when gain duplication may arise. The approach that the Commissioner would take where the head company makes a capital loss on the disposal of the membership interests would need to be considered on a case by case basis.
6	3	***Exit sell: loss duplication on CGT asset and membership interests*** Would 'double losses' made by a taxpayer on the disposal of equity interests in a subsidiary in an exit sell scenario also be expected to be disregarded? What legislative mechanism would enable the Commissioner to strike down such transactions?	If the head company makes a capital loss on the disposal of the CGT asset that is the subject of the straddle contract, consideration would need to be given to the operation of Subdivisions 165-CD and 715-B of the ITAA 1997 in removing any loss duplication at the level of the group's membership interests in the leaving entity.

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7	3	***Exit sell: approach where other unintended consequences arise under consolidation*** Would the Commissioner adopt the same approach in paragraph 4 of the draft Determination in the context of other unintended tax consequences that arise under the operation of the consolidation provisions?	This issue is beyond the scope of the Determination. Paragraph 4 of the Determination applies specifically to taxpayers whose circumstances fall within the terms of the ruling. Whether a similar approach could be adopted in a different set of circumstances would need to be considered on a case by case basis.
8	1	***Intra-group dealings*** Reissuing TD 2005/D27 (as draft TD 2008/D9) without explaining the position on intra-group transactions is less than ideal. The positions in TD 2005/D27 have some attraction from a pragmatic point of view but the logic leading to the positions is unclear.	The Tax Office is taking a holistic approach in considering what constitutes an intra-group dealing and the appropriate tax treatment in these cases. The consequences for straddle contracts will be considered as part of this broader review.
9	2	***Intra-group dealings*** The principles in the draft Determination are equally applicable to straddle contracts between group members. CGT event A1 should be taken to happen at the contract time with any resulting capital gain or loss ignored under the single entity rule (being a CGT event that happens at the time the two entities are members of the same tax consolidated group.) *Example* B Co and C Co are subsidiary members of the same tax consolidated group and B Co owns land with a market value of $3.5m and a cost base of $2m. If B Co contracts to sell the asset to C Co and C Co leaves the consolidated group before the contract settles, there should be no consequences under CGT event A1 as it happens at the time the two entities are members of the same group.	The exclusion in paragraph 6 of the draft Determination (or paragraph 3 of draft TDs 2008/D10 and 2008/D11) requires the CGT asset being acquired or disposed of under the contract to be an asset of the same consolidated group at **both** the contract time and settlement time. It therefore would not apply to the example provided because the CGT asset is not an asset of the old consolidated group at settlement. However, the example highlights a number of interaction issues which the Tax Office thinks would benefit from further consultation with stakeholders. As a result, the types of intra-group dealings in CGT assets to which the final 3 Determinations do not apply now also include contracts where the purchaser and seller were members of the same consolidated group at **either** contract or settlement. These scenarios will be considered as part of the Tax Office's broader review of intra-group transactions.

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		Further consideration would be required on identifying the assets of C Co at its leaving time and whether an appropriate gain or loss is calculated on the group's membership interests in C Co. Based on draft TD 2008/D10, the CGT asset being acquired would not be an asset of C Co with the possibility of double tax if C Co is required to recognise a liability at step 4 of the allocable cost amount (ACA) calculations on exit.	
10	1	***Examples*** The assets in Examples 1 and 2 (shares) are different from the assets used in draft TD 2005/D27 (land). It is not clear why the changes were made. Similarly, Examples 3 and 4 no longer include dollar amounts or commentary on cost base impacts and incidental costs of disposal after exit. Again, it is not clear why these changes were made.	Examples 1 and 2 were changed in the draft and final Determinations so that the CGT asset in each example matches the asset used in the corresponding exit or entry example in the related Determinations on asset recognition. Examples 3 and 4 were modified so that they address only the issue that is the subject of the Determination. Related issues, such as the cost base impacts for the CGT asset being acquired under the contract, will be clarified in the *Consolidation Reference Manual*.
11	2	***Exit-sell examples*** Further examples are needed, in addition to Example 5, to cover the scenario of: • a tax consolidated group acquiring the leaving entity, and • a multiple entry consolidated (MEC) group acquiring the leaving entity as a new eligible tier-1 (ET-1) company.	Example 7 of both the draft and final Determinations addresses the case where the leaving entity is a member of a different consolidated group at the time of settlement of the straddle contract. The Tax Office considers that the principles in the Determination, together with the existing examples, make clear which tax entity makes the capital gain or loss on the disposal of a CGT asset in an exit-sell case (that is the head company of the old consolidated group).

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12	6	***Exit-sell example: leaving entity's obligations under tax funding arrangement*** In Example 5 of the draft Determination, no account is taken of the liability for tax on the capital gain of $1.5M on disposal of the land by S Co. In most corporate groups, a tax contribution deed would be in place, requiring S Co to compensate the head company for the tax the consolidated group will pay on S Co's share of the group income. It is therefore likely that S Co would have a liability of $450,000 due to the head company representing the amount of tax payable on the capital gain. This is the result of the application of the accounting principles in Urgent Issues Group UIG Interpretation 1052. The amount the purchaser would be willing to pay for the company would also be affected by this.	Example 5 of the Determination is intended to illustrate generally the approach the Commissioner will accept in disregarding the capital gain on the asset sale that may potentially be duplicated in calculating the head company's capital gain on the membership interests. The implications of tax funding agreements are outside the scope of the Determination.
13	2	***Announced legislative changes*** The issue of gain duplication in Example 5 will still arise under the proposed legislative changes – the leaving entity will make a capital gain under CGT event A1 on the asset's disposal and the head company is taxed on the gain via the sale of membership interests in the leaving entity. Example 5 is similar to an example where the leaving entity joins a MEC group as an eligible ET-1 company. In this case, the ET-1 company does not perform a Division 705 calculation in relation to its CGT assets. The announcement would therefore result in a capital gain to the old group on a disposal of the leaving entity, and a capital gain to the new group on settlement of the straddle contract.	This issue is outside the scope of the Determination. The Tax Office understands that Treasury intends to consult with relevant stakeholders on the legislative design of this measure. There will be an opportunity to raise this issue, and any others, directly with Treasury as part of these discussions. The Tax Office has provided the comments to Treasury for their consideration.

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		We request that the ATO liaise with Treasury to ensure that Example 5 does not result in double tax under the amended legislation.	
14	2	The Tax Office's view on the interaction of the consolidation provisions and straddle contracts are in 3 draft Determinations, a Discussion Paper and section C2-1-070 of the *Consolidation Reference Manual* which makes it difficult for taxpayers to form a comprehensive view of the income tax consequences for straddle contracts. We ask that the Tax Office give some consideration to how these documents interact and provide textual linkages between the documents.	The Tax Office acknowledges the comment. To further assist taxpayers, worked examples setting out the income tax consequences for straddle contacts will be included in the *Consolidation Reference Manual*.