TD 2004/35 - Income tax: consolidation and capital gains tax: does section 104-10 (CGT event A1) of the Income Tax Assessment Act 1997 apply to the head company of a consolidated group where a licence granted within the consolidated group is later transferred to a non-group entity for no capital proceeds?

Taxation Determination

Income tax: consolidation and capital gains tax: does section 104-10 (CGT event A1) *of the Income Tax Assessment Act 1997* apply to the head company of a consolidated group where a licence granted within the consolidated group is later transferred to a non-group entity for no capital proceeds?

Preamble

The number, subject heading, date of effect and paragraphs 1 to paragraphs 6 of this document are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

1. Yes, section 104-10 (CGT event A1 about the disposal of a CGT asset) of the *Income Tax Assessment Act 1997* (ITAA 1997) will happen to the head company where the head company of a consolidated group transfers the licence or where the licence is transferred by a subsidiary member of that consolidated group. The capital proceeds are deemed to be the market value of the licence at the time of the CGT event under the market value substitution rule in section 116-30 of the ITAA 1997.

2. When a member of a consolidated group is granted a licence by another member, there are no income tax consequences for the head company because of the single entity rule (SER) in section 701-1 of the ITAA 1997.

3. However, when the licence is transferred from the consolidated group to a non-group entity, CGT event A1 happens to the head company because of the change of ownership from the group to the non-group entity. For instance, where the transfer of the licence is by a subsidiary member of the group, the SER takes the transfer to have been by the head company.

4. CGT event A1 happens 'if ***you*** dispose of a CGT asset'. In this case '***you***' is taken to be the head company and the CGT asset is the licence. The head company is recognised as disposing of the licence to the non-group entity.

5. The cost base of a CGT asset consists of 5 elements (see subsection 110-25(1) of the ITAA 1997). Those elements are the various amounts of money or property '***you***' paid, gave, incurred or are required to pay or give. Again, in this case, '***you***' is the head company of the group. As intra-group expenditures and transfers are taken to be the actions of the head company during the period of consolidation and are not recognised for income tax purposes they cannot be included in an element of the cost base of the licence.

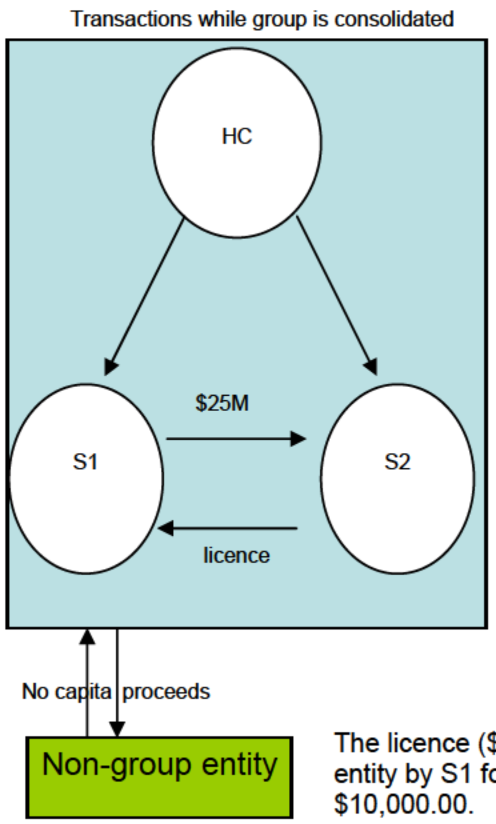
Only incidental costs incurred by the group to non-group entities relating to the transfer are included in the cost base.

6. On CGT event A1 happening to the head company, the head company is taken to have received capital proceeds equal to the licence's market value at the time of the event (see section 116-30 of the ITAA 1997).

Example

7. *HC is the head company of a consolidated group with S1 and S2 being subsidiary members of the consolidated group. While consolidated, S1 pays $25 million to S2 for the grant of a licence. S1 subsequently assigns the licence to a non-group entity for no capital proceeds even though it has a market value of $25 million. S1 incurs incidental costs of $10,000.00 on the transfer of the licence. The incidental costs are in respect of legal services provided by a third party.*

8. *<u>The diagram below shows the above transactions.</u>*



The licence ($25 million market value) is assigned to the non-group entity by S1 for no capital proceeds incurring incidental costs of $10,000.00.

9. *In the above example, there are no income tax consequences from S2 creating a licence in S1 for $25 million.*

10. *CGT event A1 happens to HC because the SER treats the change of ownership of the licence from S1 to the non-group entity as a change of ownership from HC to that entity.*

11. *Equally the SER will treat HC as having received capital proceeds of $25 million for the licence under the market value substitution rule. HC is also taken to have a cost base being incidental costs of $10,000.00. This results in the HC making a capital gain of $24,990,000.00.*

Date of Effect

12. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation
22 September 2004

Previous draft:
TD 2004/D42

Related Rulings/Determinations:
TR 92/20; TR 2004/11

Legislative references:
- TAA 1953 Pt IVAAA
- ITAA 1997 104-10
- ITAA 1997 110-25(1)
- ITAA 1997 116-30
- ITAA 1997 701-1

ATO references
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