TD 2004/47 - Income tax: consolidation: capital gains: does the single entity rule in section 701-1 of the Income Tax Assessment Act 1997 affect the application of the additional basic conditions in subsection 152-10(2) when a CGT event happens to a share or trust interest that is a membership interest in a subsidiary member (company or trust) of a consolidated group?

Taxation Determination

Income tax: consolidation: capital gains: does the single entity rule in section 701-1 of the *Income Tax Assessment Act 1997* affect the application of the additional basic conditions in subsection 152-10(2) when a CGT event happens to a share or trust interest that is a membership interest in a subsidiary member (company or trust) of a consolidated group?

1. No. The single entity rule in section 701-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) does not prevent recognition of the company or trust to determine if the additional basic conditions in subsection 152-10(2) of the ITAA 1997 are satisfied.

2. It is a basic condition when applying the small business concessions to a capital gain you make from a share or trust interest, that you are a CGT concession stakeholder in the company or trust or CGT concession stakeholders in the company or trust together have a small business participation percentage in you of at least 90%: subsection 152-10(2) of the ITAA 1997.

3. An individual is a CGT concession stakeholder of a company or trust at a time if the individual is a significant individual in the company or trust or a spouse of significant individual in the company or trust, if the spouse has a small business participation percentage in the company or trust at that time that is greater than zero (section 152-60 of the ITAA 1997). An individual is a significant individual in a company or a trust at a time if, at that time, the individual has a small business participation percentage in the company or trust of at least 20% (section 152-55 of the ITAA 1997). An entity's small business participation percentage in another entity at a time is the percentage that is the sum of the entity's direct small business participation percentage and indirect small business participation percentage in the other entity at that time (section 152-65 of the ITAA 1997). Accordingly, a significant individual and hence a CGT concession stakeholder can be traced indirectly through other entities.

4. The single entity rule does not prevent recognition of a subsidiary member of the group or the membership interests in it for the purpose of determining whether the additional basic conditions in subsection 152-10(2) of the ITAA 1997 are satisfied.

5. This is because although the single entity rule treats subsidiary members of a consolidated group as parts of the head company (and not separate entities) for income tax purposes, it does not apply to defeat a clearly intended outcome under provisions outside the consolidation rules (such as Parts 3-1 and 3-3 of the ITAA 1997). In such cases, intra-group interests, or legal entities that are part of the head company for consolidation purposes, require a level of recognition in applying provisions that have regard to such interests and entities (for example, in determining eligibility for a concession). Paragraphs 8(c) and 26 to 28 of Taxation Ruling TR 2004/11 explain the Commissioner's view that reading the Act as a whole achieves this outcome (and without the need to rely on section 701-85 of the ITAA 1997).

6. Therefore in relation to a capital gain from a CGT event happening to an interest in a subsidiary member of a consolidated group, it must be determined whether, just before the CGT event, the subsidiary member's CGT concession stakeholders together had a small business participation percentage in the group company that held the interest of at least 90%.

Note: We consider that the view taken in this Determination is consistent with that in TD 2004/45 or TD 2004/46. The provisions referred to in those Determinations test whether an entity that made a capital gain has a significant individual. For a consolidated group this is the head company. However, the test in subsection 152-10(2) of the ITAA 1997 involves determining whether the entity in which the membership interests are held has a significant individual and hence a CGT concession stakeholder. In a consolidated group this entity will be a subsidiary member.

Example 1

7. *All the shares in HeadCo are owned by an individual. HeadCo is the head company of a consolidated group consisting of HeadCo, SubCo 1 and SubCo 2.*

8. *HeadCo beneficially owns all the shares in SubCo 1. SubCo 1 beneficially owns all the shares in SubCo 2. SubCo 2 carries on a business.*

9. *In the 2011 income year SubCo 1 sold all its shares in SubCo 2 to a company that was not a member of the consolidated group. As a result HeadCo made a capital gain. HeadCo wishes to apply the small business 50% reduction to the capital gain.*

10. *SubCo 2 has a CGT concession stakeholder (the individual) who has a small business participation percentage in SubCo1 of at least 90% just before the CGT event. Accordingly, the additional basic conditions in subsection 152-10(2) are satisfied. HeadCo is able to claim the small business 50% reduction to reduce the amount of the capital gain made on the disposal of the shares in the subsidiary*.

Example 2

10A. *Assume the same facts as in Example 1 except that the individual owns 85% of the shares in HeadCo instead. Another individual (who was not a spouse of the first individual) owns the remaining 15%.*

10B. *Although SubCo 2 has a CGT concession stakeholder (the individual), it does not have CGT concession stakeholders who together have a small business participation percentage in SubCo1 of at least 90% just before the CGT event. Accordingly, the additional basic conditions in subsection 152-10(2) of the ITAA 1997 are not satisfied. HeadCo is not able to claim the small business 50% reduction to reduce the amount of the capital gain made on the disposal of the shares in the subsidiary.*

Date of effect

11. 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 75 and 76 of Taxation Ruling TR 2006/10).

Note: the amendments applied to this Determination on 19 December 2012 apply to CGT events happening in and after the 2006-07 income year.

Commissioner of Taxation
6 October 2004

References

Previous draft:

TD 2004/D17

Related Rulings/Determinations:

TR 2004/11; TR 2006/10; TD 2004/45; TD 2004/46

Subject references:

- CGT asset
- CGT event
- CGT exemptions
- consolidation
- consolidation – capital gains tax
- significant individual
- small business relief

Legislative references:

- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3
- ITAA 1997 152-10(2)
- ITAA 1997 152-50
- ITAA 1997 152-55
- ITAA 1997 152-60
- ITAA 1997 152-65
- ITAA 1997 701-1
- ITAA 1997 701-85
- TAA 1953

ATO references
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