TD 2011/8EC; TD 2011/9EC; TD 2011/10EC - Compendium

Ruling Compendium – TD 2011/8, TD 2011/9 and TD 2011/10

This is a compendium of responses to the issues raised by external parties to draft Taxation Determinations TD 2010/D4, TD 2010/D5 and TD 2010/D6

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.	Issue raised	ATO Response/Action taken
1.	Paragraph 2 of the draft Determinations states 'This draft Determination does not apply to the extent (if any) that the incidental costs mentioned in paragraph 1 of this draft Determination are remuneration to a member of the group.' We request the Australian Taxation Office (ATO) to elaborate on this statement. That is, it appears that the statement is a simple extrapolation of section 701-1 of the *Income Tax Assessment Act 1997*[1] (that is the intra-group payment would be ignored). Accordingly, the ATO should clarify if this is the case and whether the paragraph is intended to cover any other transaction that the ATO has in mind. The statement is currently misleading and not easy to understand.	This statement is made to clarify that the ATO view expressed in these tax determinations does not apply to incidental costs which are remuneration from the head company to member of the group. We agree this is an application of section 701-1, however the point is emphasised to avoid confusion rather than to mislead. For further guidance on the application of section 701-1 see Taxation Ruling TR 2004/11 Income tax: consolidation: the meaning and application of the single entity rule in Part 3-90 of the Income Tax Assessment Act 1997.
2.	The draft Determinations are limited to incidental costs under subsection 110-35(2). There seems to be no apparent reason to limit the binding status of the ruling to only those costs that fall under the first element of incidental costs. We believe that this is an oversight and that the draft Determinations should be changed so that all references are to section 110-35 throughout.	The purpose of a Determination is to publish the ATO's interpretation of a particular issue arising under the law, in the form of a short and concise answer.

[1] All references are to the *Income Tax Assessment Act 1997*.

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2. cont	For example, we are unsure why transfer costs incurred prior to the joining time on the transfer of shares (where applicable) under subsection 110-35(3) would not be capable of forming part of the draft Determination. Should the ATO disagree with the previous two points, we still believe the ATO should refer to section 110-35 throughout the draft Determination and specifically reference those provisions that the ATO does not believe have application. For example, subsection 110-35(10).	These Determinations provide specific responses to the issue of the application paragraph 40-880(5)(f) where incidental costs are incurred • to acquire membership interests in an entity prior to joining a consolidated group • to acquire membership interests after the entity becomes a member of the group, and • to dispose of membership interests of a subsidiary member after the member leaves consolidated group. While specific to incidental costs under subsection110-35(2) the principle established in the determinations could apply to other incidental costs, such as transfer costs, which are relevant to the acquisition or disposal of membership interests. Section 110-35 is not referred to generally in the context of these determinations because not all incidental costs are relevant to the acquisition or disposal of membership interests in a consolidated group. These determinations are about establishing a principle for the operation of paragraph 40-880(5)(f) and for that purpose an incidental cost under subsection 110-35(2) was chosen as an example. It is acknowledged that the request to expand the coverage of the TD to cover the range of incidental costs incurred in acquiring or disposing of shares in a subsidiary is a reasonable one. However, such an expansion of the determinations would not provide any further clarity on how the single entity rule, the cost setting rules and the CGT cost base rules interact in determining whether such expenditure could (apart from section 40-880) be taken into account in working out a capital gain or capital loss from a CGT event.

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3.	Paragraph 14 of TD 2010/D4 states that 'Paragraph 40-880(5)(f) has no regard to whether the capital expenditure is actually taken into account in working out a capital gain or capital loss from a later CGT event.' We do not agree with this statement. The cost base is used under section 705-60 and then is not to be used further due to the operation of section 701-1 and (more specifically) section 701-58. Furthermore, the Explanatory Memoranda (EM) is not clear in its operation where a section of the Act subsequently prevents the use of the cost base of an asset (that is section 701-58, together with section 701-1, prevents such future use). More specifically, the EM states that an 'amount is not taken into account in working out a capital gain or loss if the expenditure cannot be included in the cost base or reduced cost base of the asset'. It follows then that we consider the better view is that paragraph 40-880(5)(h) operates, being the more applicable paragraph in this circumstance. This is because the expenditure is expressly prevented from being used in calculating a future capital gain. As we believe that paragraph 40-880(5)(h) is the more appropriate paragraph to prevent the deduction, the ATO should consider either: (1) redrafting the question addressed by TD 2010/D4 to ask whether section 40-880 generally applies, or (2) redrafting paragraph 1 of TD 2010/D4 to state (in answer to the question posed) 'No, paragraph 40-880(5)(f) does not prevent the deduction, but paragraph 40-880(5)(h) will do so.'	The Commissioner's view is that paragraph 40-880(5)(f) is more relevant than paragraph 40-880(5)(h) in the context of TD 2010/D4. The relevant expenditure in this determination is characterised as incidental costs at the time the costs are incurred and is included in the cost base of the membership interests in the entity before joining time. It is at the time the expenditure is incurred that the expenditure is characterised when determining if one of the exclusions in subsection 40-880(5) applies, not at some future time. As the incidental costs are capable of being taken into account in working out a capital gain or loss, the exclusion in paragraph 40-880(5)(f) applies. Only one exclusion needs to apply and it is not necessary to consider if the cost bases of the membership interests are used in calculating the allocable cost amount under section 705-60 and whether a further exclusion in paragraph 40-880(5)(h) applies.

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4.	Paragraph 13 of TD 2010/D5 states 'A consequence of the SER is that when an entity becomes a subsidiary member of a consolidated group the membership interests in the entity held by the group are ignored for those purposes. This means that while the SER applies, the incidental costs cannot be included in the cost base or reduced cost base of the shares.' Furthermore, paragraph 15 states 'Since there is no other way in which the incidental costs could be taken into account in working out a capital gain or capital loss from a CGT event, paragraph 40-880(5)(f) does not prevent an amount being deducted for the incidental costs under section 40-880.' We highlight that paragraph 13 could imply that the head company now 'holds' the underlying assets. Furthermore, subsection 701-55(2), (5A) and (5B) specifically state that the head company is taken to acquire the relevant assets. We request the ATO to more formally state and conclude that the head company **is not taken** to incur such incidental costs in acquiring the underlying assets.	In the context of TD 2010/D5, once the subsidiary member has joined the group, the membership interests are ignored under the single entity rule (SER). When the incidental costs are incurred in acquiring the membership interests there is no cost base or reduced cost base to which the incidental costs can be attached. It is at the time the expenditure is incurred that the expenditure is characterised when determining if one of the exclusions in subsection 40-880(5) applies. The Explanatory Memorandum to Tax Laws Amendment (2006 Measures No. 1) Bill 2006 at paragraph 2.87 and 2.88 is very clear on this principle. The head company is taken to hold the underlying assets of the subsidiary members however neither the operation of the SER nor subsections 701-55(2), (5A) and (5B) result in the incidental costs being taken to be incurred in acquiring the underlying assets. There is no support in the law for the proposition that the incidental costs could be re-characterised as incidental costs of acquiring the underlying assets. Therefore, it is considered unnecessary to address such a possibility. This issue was addressed previously in the Compendium to Taxation Determination TD 2010/1, TD 2010/1EC.

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5.	Paragraph 15 of TD 2010/D5 states 'However, it does not follow that the incidental costs are deductible under section 40-880: that will depend on the facts of each case and whether the other requirements under that section are met.' In our view, this is an unsatisfactory conclusion for the draft Determination as it leaves a taxpayer with uncertainty as to the application of section 40-880 in a vanilla case. That is, we understand that each case is fact specific and that an amount of the deduction may be denied by the operation of another provision (for example subsection 40-880(3)). However, this conclusion leaves one to question whether a deduction is **at all** available and whether a taxpayer is missing a fundamental issue the ATO has with any of the other provisions of section 40-880. We believe it is only appropriate to provide appropriate guidance to taxpayers with a vanilla example (as taxpayers will be uncertain whether the ATO has a concern with any other provisions of section 40-880). For example, we request the ATO to conclude the example contained in paragraphs 3 to 5 by stating: For the purpose of the example, it is assumed that the business of Aco and Bco is operated solely for a taxable purpose. In this example, a deduction would be allowed for the $10,000 under section 40-880 over five years.	TD 2010/D5 provides the ATO view of the operation of the exclusion under paragraph 40-8805(f) not on the wider issue of deductibility under section 40-880. The conclusion at the end of paragraph 15 is appropriate because all of the requirements of section 40-880 must be considered before an amount is deductible under this section. Draft Taxation Ruling TR 2010/D7 Income tax: business related capital expenditure – section 40-880 of the *Income Tax Assessment Act 1997* core issues provides guidance on all aspects of the provision.
6.	In draft Determination TD 2010/D6, the ATO should consider linking the operation of subsection 701-55(5) to section 112-15, which deems the tax cost setting amount to be an 'amount paid' by the head company for the membership interests. The operation of this provision would support the ATO's conclusion contained in paragraph 13.	Paragraph 13 of TD 2010/D6 explains the operation of subsection 701-55(5) where a subsidiary member leaves the group and no further support is considered necessary as it is a restatement of the law. The application of section112-15 is not relevant to the issue addressed and is beyond the scope of this determination.