TD 2004/45 - Income tax: consolidation: capital gains: how does the controlling individual condition in paragraph 152-110(1)(c) of the Income Tax Assessment Act 1997 (one of the conditions for the small business 15 year exemption in Subdivision 152-B) apply to the head company of a consolidated group in respect of the sale of an asset brought into the group by a subsidiary member?

Taxation Determination

Income tax: consolidation: capital gains: how does the controlling individual condition in paragraph 152-110(1)(c) of the *Income Tax Assessment Act 1997* (one of the conditions for the small business 15 year exemption in Subdivision 152-B) apply to the head company of a consolidated group in respect of the sale of an asset brought into the group by a subsidiary member?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 4 of this document and the note are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner.*

1. Under the single entity rule in section 701-1 of the *Income Tax Assessment Act 1997* (ITAA 1997) the controlling individual condition in paragraph 152-110(1)(c) of the ITAA 1997 is applied to the head company of the consolidated group.

2. However, the condition must be met for the whole of the time the asset was owned by the subsidiary before it became a subsidiary member of the group, and the whole of the time it was owned by the subsidiary or other group members after the subsidiary became a member.

3. Under the entry history rule in section 701-5 of the ITAA 1997, the head company inherits the subsidiary's history in respect of the controlling individual condition for the period before the subsidiary became a member of the group. Therefore, the head company will be taken to meet the condition for the subsidiary's pre-consolidation ownership period if the subsidiary met it for that period. The head company will not meet the condition for that period if the subsidiary did not meet it.

4. For the period after the subsidiary became a group member, the condition is applied directly to the head company.

Note: This Determination does not apply to intra-group assets including membership interests.

Explanation

5. Under the single entity rule, a CGT event from the sale of an asset by a subsidiary member is taken to happen to the head company of the consolidated group. Any resulting capital gain or loss is therefore made by the head company.

6. Accordingly, it is the head company that must satisfy the controlling individual condition in paragraph 152-110(1)(c) of the ITAA 1997 if it wishes to use the small business 15 year exemption to reduce a capital gain from the sale of an active asset.

7. That condition requires that the entity have a controlling individual at all times when it owned the asset (even if it was not the same controlling individual throughout that period).

8. An individual is a controlling individual of a company at a time if the individual holds the legal and equitable interest in shares, other than redeemable shares, that carry the right to exercise at least 50% of the voting power in the company and receive at least 50% of any dividend and 50% of any distribution of capital the company may pay [subsection 152-55(1) of the ITAA 1997].

9. While under the entry history rule the head company inherits the subsidiary's ownership period for the asset, it also inherits the subsidiary's history in respect of the controlling individual condition. Therefore, whether or not the subsidiary has met the condition pre-consolidation is relevant to determining whether the head company has met the condition.

10. For the period after becoming a group member, the subsidiary's circumstances are irrelevant and the condition is applied directly to the head company.

Example 1

11. *X Co acquired an active asset in January 1989. X Co had a controlling individual from January 1989 until January 2003.*

12. *In January 2003, X Co became a member of a consolidated group when the head company of the group (H Co) acquired all of the shares in it.*

13. *H Co had a controlling individual from January 2000 until June 2004.*

14. *The active asset was sold in January 2004 which resulted in a capital gain. H Co sought to disregard it under the small business 15 year exemption.*

15. *The controlling individual test is effectively applied to X Co for the period before it joined the consolidated group and to H Co after that time. As X Co had a controlling individual from 1989 until it joined the group and H Co had a controlling individual from that time until the asset was sold, H Co may claim the 15 year exemption if all of the other conditions for the exemption are satisfied.*

Example 2

16. *X Co was incorporated in 1985 and its shares have been owned since that time by a controlling individual.*

17. *In 1986, X Co incorporated Y Co and since that time X Co has been its sole shareholder.*

18. *In 1987, Y Co purchased an active asset.*

19. *In June 2003, X Co elected to form a consolidated group with Y Co.*

20. *In June 2004, the active asset was sold by Y Co and a capital gain resulted.*

21. *The effect of the single entity rule is that the sale is taken to happen to X Co and the capital gain is made by X Co.*

22. *Even though X Co has had a controlling individual for its entire existence and it is now, because of the single entity rule and the entry history rule, taken to have owned the active asset for the 15 year period prior to its disposal, it is not entitled to apply the 15 year exemption in section 152-110 of the ITAA 1997. This is because the controlling individual test in paragraph 152-110(1)(c) of the ITAA 1997 is effectively applied to Y Co before the formation of the consolidated group. Y Co did not have a controlling individual before that time as all its shares were owned by X Co.*

Date of effect

23. 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
6 October 2004

Previous draft:

TD 2004/D16

Related Rulings/Determinations:

TR 92/20

Subject references:

- capital gains tax
- CGT event
- consolidated group
- controlling individual
- entry history rule
- head company
- single entity rule
- small business relief
- small business 15 year exemption
- subsidiary member

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 152-55(1)
- ITAA 1997 152-110
- ITAA 1997 152-110(1)(c)
- ITAA 1997 Subdiv 152-B
- ITAA 1997 701-1
- ITAA 1997 701-5

ATO references
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