


TD 2004/48 - Income tax: consolidation: capital gains: for the purposes of Subdivision 125-C of the Income Tax Assessment Act 1997 , can the head company of a consolidated group meet the requirements of a demerging entity in subsection 125-70(7) where a subsidiary member is demerged from the group?

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Taxation Determination

Income tax: consolidation: capital gains: for the purposes of Subdivision 125-C of the *Income Tax Assessment Act 1997*, can the head company of a consolidated group meet the requirements of a *demerging entity* in subsection 125-70(7) where a subsidiary member is demerged from the group?

Preamble

*The number, subject heading, date of effect and paragraphs 1 to 6 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. Yes. The head company of the consolidated group can satisfy the requirements of a *demerging entity* in subsection 125-70(7) of the *Income Tax Assessment Act 1997* (ITAA 1997).
2. Section 125-155 of the ITAA 1997 disregards any capital gains or capital losses made by demerging entities when certain CGT events happen to their ownership interests in the entity being demerged (the 'demerged entity').
3. To be a demerging entity, an entity must satisfy the requirements contained in subsection 125-70(7) of the ITAA 1997. One of the conditions is that the entity is a member of a demerger group *just before* (emphasis added) the relevant CGT event happens to its ownership interests in the demerged entity. Under subsection 125-65(1) of the ITAA 1997, the membership of a demerger group is made up of a head entity and one or more demerger subsidiaries.
4. When a demerged entity is a member of a consolidated group, consideration needs to be given to the interaction of the demerger provisions with the single entity rule in section 701-1 of the ITAA 1997. Under the single entity rule, the subsidiary members of a consolidated group are treated as parts of the head company (and not separate entities) for the group's income tax purposes.
5. However, the single entity rule 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. In our view, the single entity rule does not prevent recognition of the demerged entity, and the group's membership interests in the demerged entity, just before the relevant CGT event happens. The head company can meet the requirements of a demerging entity in subsection 125-70(7) of the ITAA 1997. That is, the demerger group consists of the head company and the demerged subsidiary, even if there are other interposed subsidiary members. This is consistent with CGT events in relation to the demerger happening to the head company under the single entity rule.

Note: The single entity rule has no application in determining the eligibility of *non-group members* (for example, shareholders of the head company) for demerger relief.

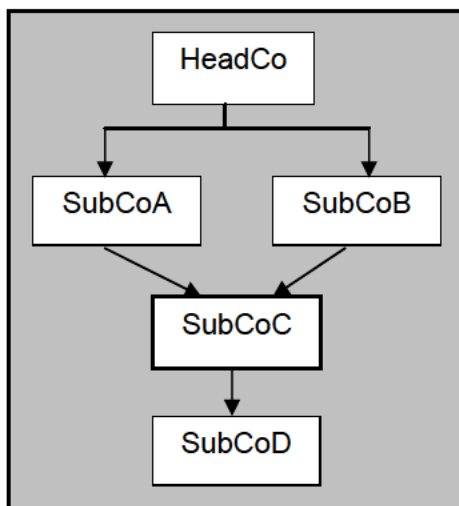
Example

7. *HeadCo is the head company of a consolidated group. The subsidiary members of the consolidated group include two Australian resident companies, SubCoA and SubCoB, each of which is wholly-owned by HeadCo. SubCoA and SubCoB also own, in equal proportions, all of the shares in SubCoC. SubCoC owns all of the ownership interests in SubCoD.*

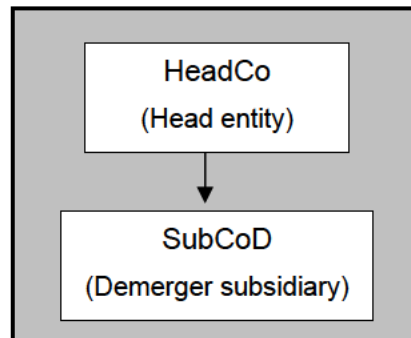
8. *In December 2003, SubCoC demerges all of its interests in SubCoD. Under the restructure, SubCoC's ownership interests in SubCoD are transferred to HeadCo's shareholders, in proportion to their existing shareholding in the head company.*

9. *The relevant consolidated group and demerger group is shown below:*

Consolidated group



Demerger group



10. *In this example, there is a demerger group consisting of HeadCo and SubCoD (the single entity rule does not apply to this extent). HeadCo is the head entity as no other member of the demerger group owns ownership interests in it: subsection 125-65(3) of the ITAA 1997. SubCoD is a demerger subsidiary because, by virtue of the single entity rule, HeadCo has the right to receive more than 20% of any distribution of income or capital by SubCoD: subsection 125-65(6) of the ITAA 1997.*

11. *HeadCo would also meet the requirements of a demerging entity under subsection 125-70(7) of the ITAA 1997 as:*

- *it is a member of a demerger group just before the relevant CGT event happens to the ownership interests in SubCoD; and*
- *by virtue of the single entity rule, HeadCo is taken to have disposed of at least 80% of its ownership interests in SubCoD to its own shareholders under the demerger.*

12. *As HeadCo is a demerging entity, and the restructure of SubCoD satisfies the requirements of a demerger, a capital gain or capital loss made by HeadCo from CGT event A1 happening on the transfer of interests held in SubCoD is disregarded under section 125-155 of the ITAA 1997.*

Date of effect

13. 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/D18

- single entity rule

Related Rulings/Determinations:

TR 92/20; TR 2004/11

Legislative references:

- TAA 1953 Pt IVA
- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3
- ITAA 1997 125-65(1)
- ITAA 1997 125-65(3)
- ITAA 1997 125-65(6)
- ITAA 1997 125-70(7)
- ITAA 1997 Subdiv 125-C
- ITAA 1997 125-155
- ITAA 1997 701-1
- ITAA 1997 701-85

Subject references:

- capital gains tax
 - CGT exemptions
 - consolidation
 - consolidation – capital gains tax
 - demerger
 - demerger group
 - demerger subsidiary
 - head entity
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ATO references

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