

TD 2008/29 - Income tax: consolidation: capital gains: do the core consolidation rules in Division 701 of the Income Tax Assessment Act 1997 modify the effect of the CGT contract rules if an entity contracts to buy or sell a CGT asset and the contract settles after the entity becomes, or ceases to be, a member of a consolidated group?

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Taxation Determination

Income tax: consolidation: capital gains: do the core consolidation rules in Division 701 of the *Income Tax Assessment Act 1997* modify the effect of the CGT contract rules if an entity contracts to buy or sell a CGT asset and the contract settles after the entity becomes, or ceases to be, a member of a consolidated group?

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Ruling

1. Yes, but only in the two cases set out in paragraph 3 of this Determination.
2. Once there has been a change of ownership of a CGT asset, CGT event A1 generally happens to the entity that owned the asset and entered into the contract to dispose of it: subsections 104-10(1) and (2) of the *Income Tax Assessment Act 1997* (ITAA 1997). That event happens at the time that entity entered into the contract: paragraph 104-10(3)(a) of the ITAA 1997. Similarly, the contract time is when the CGT asset is taken to have been disposed of by the entity which owned it, and when it is taken to be acquired by the entity which becomes its owner (see subsection 109-5(2) of the ITAA 1997). These are the 'CGT contract rules'.

3. There are two cases where the core consolidation rules in Division 701 of the ITAA 1997 (such as the single entity, entry history and exit history rules) produce a different outcome. They are where:

- a contract to buy a CGT asset is entered into by an entity before it becomes a subsidiary member of a consolidated group and the contract settles after that time – in that case, the head company of the consolidated group (not the subsidiary) is taken to have acquired the asset at the contract time (entry-buy case); and
- a contract to sell a CGT asset is entered into by a subsidiary member of a consolidated group and the contract settles after the subsidiary has left the group – in that case, CGT event A1 is taken to have happened to the head company (not the subsidiary) of the consolidated group at the contract time (exit-sell case).

4. If the head company of a consolidated group makes a capital gain on the disposal of a CGT asset in an exit-sell case, such a gain may be duplicated on the disposal of interests in the subsidiary. For example, it may be duplicated in a capital gain made by the head company (or a former subsidiary member of the group) on the disposal of membership interests, which are a direct or indirect membership interest, in the subsidiary member that entered into the contract to sell the asset. In such a case, the Commissioner would not disturb a taxpayer's approach of calculating its net capital gain or net capital loss by disregarding a capital gain made on the disposal of the membership interests to the extent it represents a duplication of the gain made by the head company on the disposal of the asset. The Commissioner views this approach as being open and consistent with the scheme of the Act.

5. To the extent that the approach in this Determination regarding the CGT contract rules discussed in paragraph 2 of this Determination (about CGT event A1) is relevant for other CGT events with a contract rule (for example, CGT event D1 – subsection 104-35(2) of the ITAA 1997), the approach should be taken to apply with such modifications as necessary.

Note: The timing of when certain CGT events are taken to have occurred has been amended by the *Tax Laws Amendment (2010 Measures No. 1) Act 2010*. The Commissioner's view contained in this Taxation Determination is broadly that where a CGT event arises in relation to a CGT asset because a contract or agreement has been entered into, the CGT event is taken to have occurred at the earlier time when the contract was entered into.

Section 716-860 of the ITAA 1997 introduced by *Tax Laws Amendment (2010 Measures No. 1) Act 2010* modifies the CGT timing rules when an entity joins or leaves a consolidated group and the CGT event straddles the joining or leaving time. For contracts entered into after 8 May 2007, the time of the CGT event happening to the joining entity is not taken to be the time the contract was entered into but the time when the circumstances that gave rise to the CGT event first existed. That is when the change of beneficial ownership occurs.

To the extent that section 716-860 of the ITAA 1997 does not affect matters covered in this Taxation Determination, the Commissioner's view will continue to apply.

Application

6. This Determination does not apply if the entities entering into the contract are members of the same consolidated group at either the contract time or the time just after the contract is completed.

Examples

7. The following examples demonstrate the interaction between the CGT and consolidation rules in a number of straddle contract scenarios.

8. Examples 1 and 2 deal with contracts made by an entity before it joins a consolidated group that settle after joining where the entity was not a member of a consolidated group at the contract time (entry cases).

9. Examples 3 to 5 deal with contracts made by an entity while it is a subsidiary member of a consolidated group that settle after the entity has left the group where the entity was not a member of any other consolidated group at the settlement time (exit cases).

10. Examples 6 and 7 deal with contracts entered into by a member of a consolidated group where that entity is a member of another consolidated group at the settlement time (group to group cases).

Example 1: Entry-buy

11. *On 16 June 2004, X Co entered into a contract to purchase shares (60%) in B Co. On 1 July 2004, all of the shares in X Co were purchased by the head company of a consolidated group and, as a result, X Co joined the group. No other member of the group held shares in B Co.*

12. *On settlement of the contract on 16 August 2004, when X Co was a subsidiary member of the group, X Co became the owner of the shares in B Co.*

13. *The group's head company is taken to have acquired the shares in B Co on 16 June 2004 (that is, the date X Co entered into the contract).*

Example 2: Entry-sell

14. *On 22 June 2004, X Co entered into a contract to sell all its shares in B Co (40%) to Y Co.*

15. *On 10 July 2004, Head Co acquired all of the shares in X Co which caused X Co to become a member of Head Co's consolidated group. Y Co is not a member of the group.*

16. *On 30 July 2004, the contract settled and X Co ceased to be the owner of the shares in B Co.*

17. *CGT event A1 happens to X Co on 22 June 2004 when it entered into the contract.*

Example 3: Exit-buy

18. *On 12 May 2006, M Co, a subsidiary member of a consolidated group, entered into a contract to purchase land from Y Co who is not a member of the group.*

19. On 20 June 2006, the head company of the group sold all of the shares in M Co. As a result, M Co leaves the group.
20. On settlement of the land contract on 12 July 2006, when M Co was not a member of the group, M Co became the owner of the land.
21. M Co is taken to have acquired the land on 12 May 2006 (that is, the date that M Co entered into the contract).

Example 4: Exit-sell

22. X Co is a subsidiary member of a consolidated group and the owner of land. Under the single entity rule, the land is an asset of the group's head company, Head Co.
23. On 16 June 2006, X Co entered into a contract to sell the land.
24. X Co leaves the group on 30 June 2006 as a result of Head Co selling all of its shares in X Co to an individual.
25. The land contract settled in August 2006.
26. CGT event A1 happens to Head Co on 16 June 2006 (the contract time).

Example 5: Exit-sell: avoidance of double taxation

27. S Co is a subsidiary member of a consolidated group and the owner of land. Under the single entity rule, the land is an asset of the group's head company, Head Co. The land has a cost base of \$2 million.
28. On 1 July 2005, S Co entered into a contract to sell the land for \$3.5 million and received a deposit of \$500,000.
29. All of the shares in S Co are sold to a non-resident on 21 August 2005 and, as a result, S Co leaves the group.
30. The land contract settles on 30 September 2005 and S Co receives the remainder of the purchase price being \$3 million. CGT event A1 happens to Head Co on 1 July 2005 and Head Co makes a capital gain of \$1.5 million which it must take into account in working out its net capital gain or net capital loss for the income year in which the CGT event is taken to have happened.
31. The land is also recognised as an asset of S Co that it takes with it when it leaves the group (see Taxation Determination TD 2008/31). Head Co uses the cost base of the land at S Co's leaving time as its terminating value for the purposes of working out the cost base of the membership interests in S Co. Assuming S Co holds no other assets, a capital gain of \$1.5 million will arise on the sale of the group's membership interests in S Co which duplicates the capital gain made by Head Co on the land. An approach by Head Co to disregard the \$1.5 million capital gain on the disposal of the relevant interests when calculating its net capital gain or net capital loss for the income year would not be disturbed.

Example 6: Group to group – buy

32. On 25 March 2005, M Co, a subsidiary member of a consolidated group (the 'target group'), entered into a contract to purchase land.

33. On 20 April 2005, all of the shares in the head company of the target group were acquired by Z Co, the head company of another consolidated group (the 'bidder group'). As a result, all of the members of the target group became members of the bidder group.
34. On settlement of the land contract on 12 May 2005 M Co became the owner of the land.
35. Z Co, the head company of the bidder group, is taken to have acquired the land on 25 March 2005 (that is, the date that M Co entered into the contract).
36. The outcome would be the same if Z Co had instead acquired all the shares in M Co so that only M Co became a member of Z Co's bidder group.

Example 7: Group to group – sell

37. Assume the facts in Example 6, except that M Co (already the owner of the land) entered into a contract to sell the land.
38. CGT event A1 happens to the head company of the target group on 25 March 2005 (that is, the date M Co entered into the contract of sale).
39. The CGT event does not happen to Z Co, the head company of the bidder group, because M Co was not a subsidiary member of the bidder group at the contract time.

Date of effect

40. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation17 December 2008

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Explanation

41. Under the ordinary operation of the CGT contract rules, a CGT asset is taken to be acquired or disposed of at the contract time by the entity that entered into the contract. However, when the contract settles after an entity that is a party to the contract becomes, or ceases to be, a subsidiary member of a consolidated group (referred to as a 'straddle contract'), the core rules in Division 701 of the ITAA 1997 must also be considered.

42. The core consolidation rules in Division 701 of the ITAA 1997 (such as the single entity, entry history and exit history rules) do not operate in contract cases to change the usual CGT outcome in terms of whether there has been an acquisition or disposal of an asset and **the timing** of the CGT event. That is, for CGT purposes, there will be taken to be an acquisition or disposal at the contract time.

43. However, there are two cases where the core consolidation rules do change the identity of **the entity** that is taken to acquire or dispose of the asset. These are the cases set out in paragraph 3 of this Determination.

Entry-buy case

44. The first case is where an entity enters into a contract to buy a CGT asset before it becomes a member of a consolidated group and the contract settles after the entity has become such a member of the group. Normally (that is, outside consolidation) the entity would be taken to have acquired the asset at the contract time. However, as a result of the single entity rule and entry history rule, the head company is taken to have acquired the asset at the contract time (see Example 1). This will be the outcome even if the entity was a member of another consolidated group at the contract time (see Example 6).

Exit-sell case

45. The second case is where a subsidiary member of a consolidated group enters into a contract to sell a CGT asset and the contract settles after the subsidiary has left the group. Normally (that is, outside consolidation) CGT event A1 would be taken to have happened to the subsidiary at the time it entered into the contract. However, as the subsidiary was a member of a consolidated group at that time, the event is taken to have happened to the group's head company: refer to the single entity rule in section 701-1 of the ITAA 1997 (see Example 4). This will be the outcome even if the subsidiary is a member of another consolidated group at the settlement time (see Example 7).

46. If CGT event A1 was taken to have happened to the subsidiary at the contract date it would not be possible to tax the subsidiary on any resulting capital gain and the subsidiary may lose the benefit of any resulting capital loss. This is because a subsidiary's taxable income is worked out under section 701-30 of the ITAA 1997 by reference only to assessable income and deductions that arise in periods during which the entity is not a member of a consolidated group in an income year. The CGT event happens when it is a member.

47. As discussed in paragraph 4 of this Determination, where a head company makes a capital gain in an exit-sell case, that gain may be duplicated, in whole or in part, when membership interests in the contracting entity are disposed of. Gain duplication may occur because the terminating value of the asset is used for the purpose of working out the cost base of membership interests under the tax cost setting rules of Division 711 of the ITAA 1997. As a result, a further capital gain may be made by the head company or a former subsidiary member on the disposal of membership interests, that are direct or indirect membership interests, in the subsidiary member that entered into the contract. In such a case, having regard to the scheme of the Act, the Commissioner would not disturb a taxpayer's approach of calculating its net capital gain or net capital loss by disregarding a capital gain made on the disposal of the membership interests to the extent it represents a duplication of the gain made by the head company on the disposal of the asset (see Example 5).

References

Previous draft:

TD 2008/D9

Related Rulings/Determinations:

TD 2008/30; TD 2008/31; TR 2006/10

Subject references:

- acquisition of CGT assets
- capital gains tax
- CGT assets
- CGT event A1-disposal of a CGT asset
- CGT events
- consolidation
- consolidation – capital gains tax
- consolidation - tax liabilities
- head company
- joining entity
- leaving entity
- single entity rule

- time of CGT event

Legislative references:

- ITAA 1997 104-10(1)
- ITAA 1997 104-10(2)
- ITAA 1997 104-10(3)(a)
- ITAA 1997 104-35(2)
- ITAA 1997 109-5(2)
- ITAA 1997 Div 701
- ITAA 1997 701-1
- ITAA 1997 701-30
- ITAA 1997 716-860
- ITAA 1997 Div 711
- TAA 1953
- Tax Laws Amendment (2010 Measures No. 1) Act 2010

Other references:

- Consolidation Reference Manual
-

ATO references

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