TAX TALKS

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299 | Pre-CGT Shares and Company Assets

The CGT treatment of pre-CGT shares and company assets keeps causing confusion, so here is a handy overview.

Pre-CGT Shares and Company Assets

Pre-CGT shares and company assets will not stay pre-CGT forever. At some stage they change to post-CGT. When depends on the CGT event.

In this episode Geoff Stein of Brown Wright Stein Lawyers will give you a handy overview.

Here is what we learned but please listen in as Geoff explains all this much better than we ever could.

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Pre-CGT Shares and Company Assets

To show you how and when pre-CGT shares and company assets change to post-CGT, let’s go through four different scenarios.

Let’s use the example of companies A, B, C and D. All were established before 20 September 1985 by separate individual shareholders. All four companies hold one company asset each, a building, each purchased in August 1985 for $100k from share capital.

So on 20 September 1985 the shares and company assets in all four companies are pre-CGT. But now, after 20 September 1985 the following happens:

Company A – Change in Majority Shareholding

Upon a change in majority shareholding, the shares and company assets (building) all lose pre-CGT status, all now post-CGT.

The shares become a post-CGT asset in the hands of the new shareholder with market value as cost base.

All company assets become post-CGT assets with market value as their cost base as well.

Example Company A

Let’s say the new shareholder pays $5m for the shares and the company sells the building for $6m a year later.

Original shareholder: Makes a $4.9m capital gain ($5m less $100k cost base) which is CGT-free.

Company: Revalues the asset to $5m against capital profits reserve ($4.9m). When selling the building for $6m, the company makes a $1m taxable capital gain ($6m less $5m cost base), no 50% CGT discount.

New shareholder: Nothing happens until they withdraw the $6m.

The first $1m comes out as a fully franked dividend. The $100k share capital comes out as a capital distribution upon liquidation of the company or through a share capital reduction, reducing the shares' cost base from $5m to $4.9m.

The $4.9m comes out in one of two ways: as an unfranked dividend or as a capital distribution upon liquidation of the company. As an unfranked dividend it gets taxed at the new shareholder's marginal tax rate. As a capital distribution it goes against the remaining share cost base of $4.9m without any CGT.

Company B – Capital Improvements

Capital improvements to a pre-CGT asset are treated as post-CGT per Subdivision 108-D. Everything else (shares + original building) remains pre-CGT. Upon sale, a portion of the purchase price is allocated to the post-CGT capital improvement, giving rise to a taxable CGT. Look out for depreciation. The rest is booked against capital profits reserve.

Company C – 75% of Net Value

When a pre-CGT company's net value consists of more than 75% of post-CGT asset, then the shares' CGT status is apportioned between pre- and post-CGT accordingly.

Example Company C

The first building is worth $5m. The original shareholder buys another building worth $15m. So 75% of the company's net value is now post-CGT. Shares are pro-rata pre and post-CGT upon purchase (25% pre-CGT, 75% post-CGT). The first building remains pre-CGT. The new building is post-CGT.

Company D – Death of Original Shareholder

Upon death of the original shareholder the shares change to post-CGT with market value at time of death as cost base.

The company assets remain pre-CGT as the new shareholder slips into the shoes of the original shareholder as per s149-30 (3) ITAA97, so doesn't trigger a change in majority shareholding.

So for company assets the new shareholder slips into the shoes of the original shareholder. But not for the shares themselves.

Example Company D

When we go through this example, three things happen: 1 – The death of the shareholder, 2 – The sale of the building and then 3 – The payout of the proceeds from the sale of the building.

1 – Death of the Original Shareholder

Let's say that at the time the original shareholder dies the building (original cost $100k) is worth $5m.

New Shareholder: Since the shares were pre-CGT, the new shareholder receives the shares with the market value at time of death as cost base*, so $5m. And the shares are now post-CGT.

*If the shares had been post-CGT before death, the new shareholder would have received the original shareholder's cost base.

Company: No CGT Event, no change to cost base or CGT status. The company assets stay pre-CGT.

2 – Sale of Building

The company sells the building for $6m.

New Shareholder: No CGT event

Company: CGT event A1 – the capital gain is $5.9m ($6m less $100k cost base). However, no taxable capital gain since the building is pre-CGT. So the company books the $5.9m capital gain against capital profits reserve.

3 – Withdraw of Money

The company pays the $6m to the new shareholder.

New shareholder:

The $100k share capital comes out as a capital distribution upon liquidation of the company or through a share capital reduction, reducing the shares' cost base from $5m to $4.9m.

The $4.9m comes out in one of two ways: as an unfranked dividend or as a capital distribution upon liquidation of the company. As an unfranked dividend it gets taxed at the new shareholder's marginal tax rate. As a capital distribution it goes against the remaining share cost base of $4.9m without any CGT.

The remaining $1m ($6m less the $5m cost base) comes out as an unfranked dividend – no CGT event – taxed at the marginal tax rate.

Discretionary Trust

The same would have applied if the shares had been held by a unit or discretionary trust as long as the beneficiaries haven't changed since 1985 as per IT 2340 and ID 2003/778. But would not apply to a testamentary trust.

So these are the four most common scenarios in which pre-CGT shares and company assets change to post-CGT at some stage. But this is just a rough overview. Please listen in as Geoff explains this much better than we ever could.

Please also listen to [ep 253 Pre-CGT company assets after death].

MORE

[Home-Based Business CGT]

[Small Business CGT Concession Overview]

[Pre-CGT Company Assets After Death]

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