
Taxation Determination

Income tax: capital gains: if a gain company pays a loss company an amount (a subvention payment) equal to the tax benefit of a net capital loss transferred under Subdivision 170-B of the *Income Tax Assessment Act 1997*, does this ensure that no cost base and reduced cost base reductions are required to direct and indirect interests in the loss company under section 170-175?

Preamble

*The number, subject heading, date of effect and paragraphs 1 to 4 and 6 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the *Taxation Administration Act 1953* and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

Date of Effect

This Determination applies only to net capital losses transferred before 22 February 1999 but may have implications for years commencing both before and after its date of issue. However, this Determination 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).

1. No.
2. Appropriate reductions must be made under section 170-175 in Subdivision 170-B of the *Income Tax Assessment Act 1997* ('the 1997 Act') to the cost base and reduced cost base (both referred to as 'relevant cost base' in this Determination) of a share or debt interest in the loss company to prevent a capital loss, or a reduced capital gain, on an interest that duplicates the loss transferred under Subdivision 170-B (see **Note 1** below).
3. A subvention payment for the transferred loss may impact on the extent of the relevant cost base reduction necessary to prevent the duplication. However, a subvention payment does not of itself obviate any requirement to make relevant cost base reductions for interests in the loss company (see **Note 2** below).
4. We take the same view as set out above in relation to the application of subsection 160ZP(13) of the *Income Tax Assessment Act 1936* ('the 1936 Act') – which was rewritten as section 170-175 of the 1997 Act.

Note 1:

5. Sections 170-175 and 170-180 applied to transfers of net capital losses within wholly-owned groups of companies before 22 February 1999. These provisions have been repealed

and do not apply to net capital losses transferred on or after that date. Subdivision 170-C applies to transfers of tax losses and to transfers of net capital losses within wholly-owned groups of companies from 22 February 1999. Reference should be made to the specific provisions of that Subdivision for the adjustment rules that apply in relation to losses transferred from 22 February 1999.

Note 2:

6. Where paragraphs 170-175(1)(e) and 170-175(2)(f) refer to ‘any consideration received by the loss company for the transferred amount’, we take the view that they refer to an amount equal to or less than the tax benefit of the transferred loss (that is, the amount of loss transferred multiplied by the relevant corporate tax rate). If, on transferring a net capital loss, a loss company receives a payment greater than the value of the tax benefit of that loss, in our opinion the excess is not consideration for ‘the transferred amount’. A gain company could not obtain a greater advantage from the transferred loss than its tax benefit. Thus, if a subvention payment is made that is equal to the amount of the loss transferred (rather than the value of its tax benefit), regard can only be had, in making relevant cost base reductions under section 170-175 for interests in the loss company, to the extent that it represents the tax benefit. In other words, we take the view that the legislation does not allow relevant cost base reductions to be avoided by making an excessive payment for a transferred loss. We hold this view even though the excessive payment may restore some or all of the lost value represented by the loss transferred.

Explanation

7. Section 170-175 of the 1997 Act, before its repeal, required an appropriate reduction to the relevant cost base of a share or debt interest in a loss company following a transfer of a net capital loss under Subdivision 170-B. In determining the appropriate amount of the reduction under subsection 170-175(1) or 170-175(2), regard must be had to the group company’s direct or indirect interest in the loss company (paragraphs 170-175(1)(f) and 170-175(2)(g)) and to any consideration received by the loss company for the transferred loss (paragraphs 170-175(1)(e) and 170-175(2)(f)).

8. If a subvention payment is made equal to the tax benefit of a net capital loss transferred (for example, 36% of the net capital loss where the applicable company tax rate is 36%), it has been argued that, on a literal construction of section 170-175 and the factors specified therein, no relevant cost base reduction is appropriate. This is because no value is shifted by the transfer of the tax benefit of the loss in return for the subvention payment. On this construction, section 170-175 would require a relevant cost base reduction only for any value shifted by the actual transfer of the net capital loss (that is, because the subvention payment is less than the tax benefit of the loss). We do not agree with this interpretation.

9. In determining an ‘appropriate’ amount in terms of subsection 170-175(1) or 170-175(2) to reduce the relevant cost base of the share or debt interest, the purpose or object for which the provision was enacted and its legislative history must be considered. It is only in this way that, in determining what adjustment may be appropriate under the provision, the significance of the amount of the subvention payment can be determined.

10. Section 170-175 (and subsection 160ZP(13) before it) was intended to address the ‘duplication’ of a transferred capital loss (‘loss duplication’ in this Determination refers to a capital loss or reduced capital gain on a group company’s interest in the loss company that is attributable to the transferred loss). This is clear from the Treasurer’s Press Release Number 74 of 1989 and the notes on clause 23 in the explanatory memorandum to Taxation Laws Amendment Bill 1990.

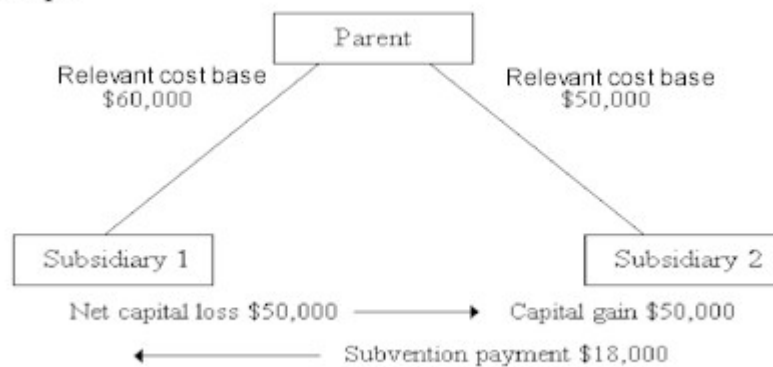
11. The purpose of the amendment to subsection 160ZP(13) made by Taxation Laws Amendment Bill (No 2) 1994 was to include the amount of a subvention payment for the transferred loss as a relevant factor in determining the quantum of the reduction in the relevant cost base necessary to prevent loss duplication: see paragraphs 9.1, 9.5, 9.7 and 9.13 of the explanatory memorandum to the Bill.

12. In particular, the explanatory memorandum reconfirmed that the purpose of the subsection 160ZP(13) relevant cost base reduction was to prevent 'a capital loss being incurred on ... shares or debts which is attributable to the loss which has been transferred' (paragraph 9.5, page 92).

13. It was clearly recognised that the subvention payment may have increased, and been reflected in, the value of a group company's interest in the loss company at the time of its sale. So, a relevant cost base reduction based solely on the amount of loss transferred and the interest held may have been greater than necessary to prevent loss duplication and inappropriate gain reduction. The purpose of the 1994 amendment, therefore, was not to supplant the original purpose or object of preventing the duplication of transferred capital losses, but to ensure reductions took account of the impact of a subvention payment if one was made.

14. The interpretation adopted above is supported by section 15AA of the *Acts Interpretation Act 1901 (Cth)*. In terms of section 15AA, the interpretation promotes the purpose or object of the statutory provision (that is, to prevent loss duplication) whereas the alternative view (in paragraph 8 of this Determination) does not. The legislative history of the provision and extrinsic materials (including the explanatory memoranda to the 1990 and 1994 legislation) are relevant in determining the purpose or object of the provision.

Example



15. After 19 September 1985, Parent capitalised Subsidiary 1 with \$60,000 and Subsidiary 2 with \$50,000. Subsidiary 1 purchased an asset for \$60,000, which later declined in value and was sold for its market value of \$10,000. Subsidiary 1 had a net capital loss of \$50,000 for the 1997-98 year of income. During that year, Subsidiary 2 made a capital gain of \$50,000 on the sale of an asset, and an agreement was made whereby Subsidiary 1 transferred the net capital loss of \$50,000 to Subsidiary 2 under Subdivision 170-B in return for a subvention payment of \$18,000. Parent later sold Subsidiary 1 for \$28,000. Under section 170-175 a reduction of \$32,000 would be appropriate to the relevant cost bases of Parent's shares in Subsidiary 1. This prevents Parent from duplicating the net capital loss transferred to the extent of \$32,000.

16. If no relevant cost base reduction were made, a capital loss of \$32,000 would have arisen on the sale (that is, \$60,000 less \$28,000). That loss duplicates \$32,000 of the \$50,000 transferred and utilised within the group. It is therefore appropriate for a relevant cost base reduction of \$32,000 to be made in this case even though a subvention payment had been made equal to the tax benefit of the loss transferred.

Note 3:

17. The same result would have been obtained had the net capital loss been transferred under section 160ZP of the 1936 Act after the amendment was made to allow a subvention payment to be taken into account in determining the quantum of a relevant cost base reduction.

18. As subsection 160ZP(13) stood before the 1994 amendment took effect, a \$50,000 reduction of the relevant cost base of Parent's shares in Subsidiary 1 would arguably have been required even though, after the subvention payment, their value was not \$10,000 but \$28,000 (that is, cash proceeds from sale of asset \$10,000 plus subvention payment \$18,000). An (inappropriate) capital gain (ignoring indexation) of \$18,000 would have arisen on the sale of the shares.

19. The effect of the 1994 amendment is that the subvention payment of \$18,000 is taken into account in making the adjustment so that only a (net) reduction of \$32,000 (that is, \$50,000 less \$18,000) is required. This prevents loss duplication or inappropriate gain reduction. If the shares are then sold, their relevant cost base is \$28,000 and their value is \$28,000, so no inappropriate capital gain or capital loss arises.

Commissioner of Taxation4 July 2001

Previously released:

Previously released as TD 1999/D30 (withdrawn on 2 July 1999) and TD 1999/D32

Related Rulings/Determinations:

TD 2001/17

Subject references:

- appropriate
- company
- cost base
- cost base reduction
- direct interest
- group company
- indirect interest
- interest
- loss
- loss company
- loss duplication
- net capital loss
- net capital loss transfer
- reduced cost base
- subvention payment
- tax benefit

Legislative references:

- ITAA 1997 Division 170
- ITAA 1997 170-175
- ITAA 1997 170-175(1)(e)
- ITAA 1997 170-175(1)(f)
- ITAA 1997 170-175(2)(f)
- ITAA 1997 170-175(2)(g)
- ITAA 1997 Subdiv 170-B
- ITAA 1997 Subdiv 170-C
- ITAA 1936 160ZP(13)
- Acts Interpretation Act 15AA

ATO references:

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