TR 2004/18EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – TR 2004/18

Relying on this Compendium

This Compendium of comments provides responses to comments received on the draft update to Taxation Ruling TR 2004/18DC *Income tax: capital gains: application of CGT event K6 (about pre-CGT shares and pre-CGT trust interests) in section 104-230 of the Income Tax Assessment Act 1997*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Issue number	Issue raised	ATO response
1	**General** Having regard to original ruling TR 2004/18, we request the Commissioner reconsider the Ruling in its entirety now, having had the benefit of over 30 years of application.	The purpose of the addendum to TR 2004/18 is to: • reflect the Commissioner's revised view that only one capital gain can arise under CGT event K6, and • clarify which property is taken into account in working out the amount of the capital gain. The Commissioner's views on the other matters dealt with in TR 2004/18 have not changed. On that basis, we have not made any broader changes to the final Ruling.
2	**Where only one 75% test is satisfied** We agree with the former interpretation of subsection 104-230(6), which captures the draftsperson's intention to only tax the assets that are relevant to the 75% test that has been satisfied. The Commissioner's revised interpretation is incorrect because it is contrary to the substance of former section 160ZZT of the *Income Tax Assessment Act 1936*	We agree that section 104-230 expresses the same idea with respect to how the capital gain is to be calculated as former section 160ZZT of the ITAA 1936. However, we disagree that it follows that the revised interpretation set out in the final Ruling is contrary to that idea or to the intended purpose of former section 160ZZT. We consider that when calculating the capital gain under subsection 104-230(6), it is not relevant which 75% test has been satisfied and the capital

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	(ITAA 1936), which has been 'brought over' to subsection 104-230(6). We request further examples to provide guidance on reasonable attribution methodologies when only one of the 75% tests is satisfied.	gain is calculated by reference to all property referred to in subsection 104-230(2). Determination of what constitutes a reasonable attribution of the capital proceeds will depend on the facts of each case (and, in any given case, there may be more than one reasonable approach). For these reasons, we consider that further examples would be of limited value.
3	**Where both 75% tests are satisfied** We understand the Commissioner's approach is to capture all underlying post-CGT property in a multi-tier structure when both 75% tests are satisfied. However, we request further examples which illustrate how the capital gain is calculated in these circumstances. Example 7 of the draft update to the Ruling is insufficient to explain the principles to taxpayers.	Our approach is that regardless of whether one or both 75% tests are satisfied, consideration is given to all post-CGT property for the purposes of calculating the capital gain under subsection 104-230(6). That subsection does not prescribe a particular method for calculating the capital gain, apart from the requirement that there be a reasonable attribution of the capital proceeds. We consider that further examples would be of limited value for the reasons set out in our response to Issue 2 of this Compendium.
4	**What property is taken into account** If the pre-CGT holding company holds post-CGT shares in a lower-tier company that holds post-CGT assets, the draft update to the Ruling suggests that the calculation of the capital gain should focus on the underlying CGT assets of the lower-tier company rather than on the shares in the lower-tier company. However, if the shares in the lower-tier company were acquired at a time when it held those post-CGT assets and the purchase price paid for the shares reflects the value of those assets at that time, then it would seem both unfair and unreasonable to disregard the shares in the lower-tier company as this would mean ignoring the higher cost base of the shares.	Generally, we consider it reasonable to attribute the capital proceeds to the value of the underlying property, rather than to the value of the interests in the lower-tier entity on the basis that it would be the underlying property which is the primary contributory factor to the capital proceeds. However, there may be valid reasons to depart from the general approach in any given case. The final Ruling is not intended to prescribe a particular approach to be followed in all cases.
5	**Tracing** The final Ruling should specify a limit on how many levels of a multi-tier structure taxpayers must trace through.	As the facts and circumstances of each case will vary, and there will be a range of factors that may be relevant to determining how many tiers it is practical to trace through, we consider it would not be appropriate to specify a limit that applies in all cases.

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6	**Binding methodology** We believe that the binding section of the final Ruling should provide at least one method that would be regarded as reasonable. We believe it is possible to provide a methodology that is broadly in line with Example 7 of the draft update to the Ruling and would suggest that proposed paragraphs 35A and 35B of the final Ruling include additional information consistent with the following steps: 1. Value should not be assigned to shares in lower-tier companies. 2. A reasonable allocation should occur with respect to allocating liabilities to assets (other than shares). 3. When allocating the remaining amounts, the net value of assets in their proportion to the net value of the entity would be reasonable.	What is considered reasonable will vary according to the facts of each case (and more than one method may be reasonable in any given case). For this reason, we do not consider it appropriate to prescribe a 'one-size-fits-all' method that would be accepted without regard to the factual scenario.
7	**Example 7** It would be useful for the ATO to state that the loan of $40,000 payable by Beta Co has been allocated to the loan receivable of $40,000 from Charlie Co. We think this is important, as the loan could have been used to finance the cost of shares in Charlie Co of $10,000, which would have resulted in a different allocation.	The facts of Example 7 of the final Ruling do not specify whether Beta Co allocates the $40,000 loan it receives from the external party to finance its loan to Charlie Co (in full) or whether it instead uses part of that loan $10,000) to finance its purchase of shares in Charlie Co. This will not have any bearing on whether CGT event K6 happens, as that relies on the determination of: • the net value of Alpha Co, which will be $60,000 regardless of whether Beta Co used some of the funds it borrowed to finance its purchase of shares, and • the market value of the post-CGT property in Alpha Co (under paragraph 104-230(2)(a)) or Beta Co and Charlie Co (under paragraph 104-230(2)(b)), which will be the amount set out in paragraph 145 of the final Ruling regardless of how Beta Co used the funds it borrowed. The allocation of liabilities is, generally, a relevant consideration for the calculation of a capital gain under the 'two-step approach'. Accordingly, examples in the final Ruling which illustrate the 'two-step approach' generally

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		contain facts that relate to the allocation of liabilities. See, for instance, paragraph 139 of Example 6 of the final Ruling. However, in the context of Example 7 of the final Ruling (which involves a head company, Alpha Co, which has no liabilities and which holds post-CGT property only), it is not necessary to include any additional facts relating to allocation of liabilities of Beta Co. The calculation will be the same regardless of whether Beta Co's liability is allocated exclusively to its loan to Charlie Co or partly to its purchase of shares in Charlie Co. Under either option: • $20,000 of the capital proceeds will relate to the land held by Charlie Co (paragraph 148D of the final Ruling), and • one-sixth of this $20,000 amount will be attributable to the gain in value of the land, while the remaining five-sixths will be attributable to the cost base.
8	**Transitional approach** Consideration should be given to limiting the application of the final Ruling so that it only applies on a prospective basis, unless there is a benefit for taxpayers.	Prior to 23 July 2025, taxpayers may choose to rely on either the original version of the Ruling or the revised version of the Ruling. See paragraphs 9 and 10 of the final Ruling.
9	**The terms 'property', 'assets' and 'CGT asset'** The Ruling considers the meaning of the terms 'property' and 'assets', and distinguishes those terms from the term 'CGT asset'. However, many taxpayers do not appreciate the practical impact of these differences on the application of subsections 104-230(2) and (6). We request further guidance which clearly articulates those differences. In particular, when calculating the capital gain, should taxpayers reduce the capital proceeds by any amount which is attributable to the value of non-property items?	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.
10	**Accounting standards and the measurement of assets** For tax purposes, should the following assets be measured at their gross value or net value: • a receivable for which a doubtful debt provision has been made	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.

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	• a lease that is recognised as a right-of-use asset with a corresponding liability?	
11	**Liabilities and provisions** The definition of 'liabilities' in paragraph 21 of the Ruling requires substantial elaboration and should address: • matters relevant to the recognition and measurement of liabilities • the treatment of specific types of liabilities and provisions. For example, see the discussion: • of the term 'liabilities' in Taxation Determination TD 2007/14 *Income tax: capital gains: small business concessions: what 'liabilities' are included in the calculation of the 'net value of the CGT assets' of an entity in the context of subsection 152-20(1) of the Income Tax Assessment Act 1997?* in the context of subsection 152-20(1), and • of 'tax-related liabilities' in Taxation Determinations TD 2007/28 *Income tax: what is a 'present legal obligation' of a private company for the purposes of subsection 109Y(2) of Division 7A of Part III of the Income Tax Assessment Act 1936?* and TD 2012/10 *Income tax: when is income tax of a private company a 'present legal obligation' for the purposes of the distributable surplus calculation under subsection 109Y(2) of Division 7A of Part III of the Income Tax Assessment Act 1936?* for the purpose of applying section 109Y.	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.

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12	**Consolidation** We seek clarification on the interaction between CGT event K6 and the consolidation regime. Specifically, are intra-group transactions recognised for the purpose of applying section 104-230?	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.
13	**International tax – Subdivision 768-G** We request that the final Ruling consider the interaction between Subdivision 768-G and CGT event K6 where a corporate shareholder holds pre-CGT shares in a multi-tier structure that has one or more foreign lower-tier companies. Specifically, if Subdivision 768-G would have applied to a direct disposal of the shares in a foreign lower-tier company, then the value of that company's active business should be excluded from the calculation of the capital gain under CGT event K6. To do otherwise would be inconsistent with the policy intent of Subdivision 768-G.	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.
14	**International tax – Part X** We request that the final Ruling consider the interaction between Part X of the ITAA 1936 and CGT event K6. For example, where a shareholder owns pre-CGT shares in a foreign company that has generated attributable income, the amount of any income that has previously been attributed should be excluded when calculating the capital gain under CGT event K6. Also, to the extent that an Australian company is interposed between the Australian shareholder and the foreign company, the calculation of the capital gain under CGT event K6 should focus on underlying capital gains rather than attributed income.	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.

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15	**Uncompleted agreements** The private company (or private trust or a lower-tier entity) might be the vendor under an uncompleted agreement for the sale of property at the time of the other CGT event. The final Ruling should address the impact of an uncompleted agreement for sale on the 75% tests in subsection 104-230(2) and the calculation of the capital gain under subsection 104-230(6).	We consider this to be outside the scope of the addendum – see our response to Issue 1 of this Compendium.