

TD 1999/D32 - Income tax: capital gains: does paying a loss company for the transfer of a net capital loss under Division 170 of the Income Tax Assessment Act 1997 ('the 1997 Act') (where the payment is equal to the tax benefit of the loss) mean that it is not appropriate to reduce the cost base and reduced cost base of direct and indirect interests in the loss company under section 170-175?

 This cover sheet is provided for information only. It does not form part of *TD 1999/D32 - Income tax: capital gains: does paying a loss company for the transfer of a net capital loss under Division 170 of the Income Tax Assessment Act 1997 ('the 1997 Act') (where the payment is equal to the tax benefit of the loss) mean that it is not appropriate to reduce the cost base and reduced cost base of direct and indirect interests in the loss company under section 170-175?*

This document has been finalised by TD 2001/16.

Draft Taxation Determination

Income tax: capital gains: does paying a loss company for the transfer of a net capital loss under Division 170 of the *Income Tax Assessment Act 1997* ('the 1997 Act') (where the payment is equal to the tax benefit of the loss) mean that it is not appropriate to reduce the cost base and reduced cost base of direct and indirect interests in the loss company under section 170-175?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office (ATO). DTDs should not be relied on; only final TDs are authoritative statements of the ATO.

1. No.
2. It is appropriate to reduce the cost base and reduced cost base ('RCB') of share or debt interests in the loss company to prevent a capital loss (or reduced capital gain) on an interest that reflects (and duplicates) the loss transferred under Division 170.
3. We take the same view 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).

Explanation

4. Section 170-175 requires appropriate reductions to the cost base and RCB of share or debt interests in a loss company following a transfer of a net capital loss under Division 170. In determining the appropriate **amount** of the reduction, regard must be had to the group company's direct or indirect interest in the loss company (paragraph 170-175(1)(f)) and any consideration received by the loss company for the transferred loss (paragraph 170-175(1)(e)).

5. If a subvention payment (in this case, a sum paid by a transferee company to a transferor company as consideration for the transferred loss) is made equal to the tax benefit of a net capital loss transferred (e.g., 36% of the net capital loss), it has been argued that, on a literal construction of section 170-175 and the factors specified therein, no cost base reductions are 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 cost base reductions only for any value shifted by the actual transfer of the net capital loss (i.e., because the subvention payment is less than the tax benefit of the loss). We do not agree with this interpretation.

6. In determining an 'appropriate' amount to reduce the cost base and RCB of the share or debt, the purpose for which the provision was enacted and its legislative history cannot be ignored. 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.

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

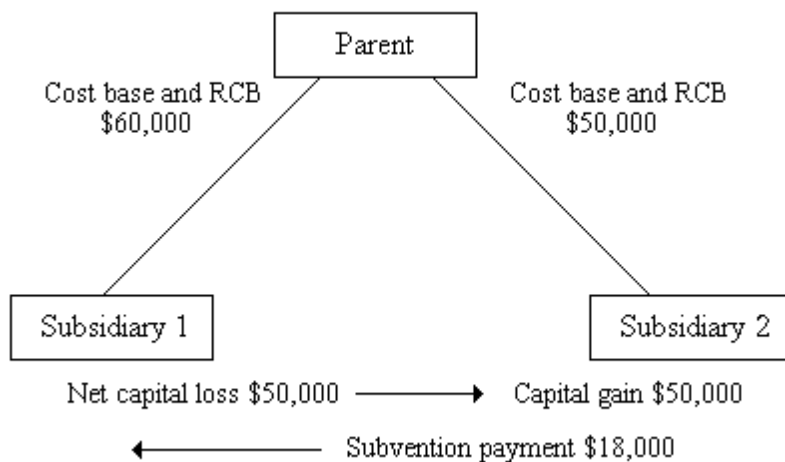
8. The purpose of the amendment to subsection 160ZP(13) made by Taxation Laws Amendment Bill No 2 of 1994 was to include the amount of any subvention payment as a relevant factor in determining the quantum of the reduction in cost base and RCB necessary to prevent loss duplication: see clauses 9.1, 9.5,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

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

10. It was clearly recognised the subvention payment may have increased, and been reflected in, the value of a group company's interests in the loss company at the time of their sale, so that a cost base and RCB 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 was, therefore, not to supplant the original purpose of preventing the duplication of transferred capital losses, but to ensure adjustments took account of the impact of a subvention payment.

11. 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 (i.e., to prevent loss duplication) whereas the alternative view 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 object or purpose of the provision.

Example



12. **Facts:** 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 that 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 in return for a subvention payment of \$18,000. As subsection 160ZP(13) stood before the 1994 amendment took effect, a \$50,000 reduction of cost base and RCB of Parent's shares in Subsidiary 1 was required even though, after the subvention payment, their value was not \$10,000 but \$28,000 (i.e., cash proceeds from sale of asset \$10,000 plus subvention payment of \$18,000). If the shares had then been sold, an (inappropriate) capital gain of \$18,000 would have arisen. 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 (i.e., \$50,000 less \$18,000) is required. This prevents loss duplication or inappropriate gain reduction. If the shares are then sold, their cost base and RCB is \$28,000 and their value is \$28,000, so no inappropriate capital gain or capital loss arises. If no cost base and RCB reduction were made, a capital loss could arise on the sale of Parent's shares in Subsidiary 1 of \$32,000 (i.e., \$60,000 less \$28,000). That loss duplicates \$32,000 of the \$50,000 already transferred and utilised within the group. It is, therefore, appropriate for a cost base and RCB reduction of \$32,000 to be made in this case even though a subvention payment has been made equal to the tax benefit of the loss transferred.

Your comments

13. If you wish to comment on this draft Taxation Determination, please send your comments by Friday 6 August 1999 to:

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Commissioner of Taxation

7 July 1999

Previous draft:

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Related Rulings/Determinations:

TD 1999/D33

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cost base reduction; net capital loss transfer; reduced cost base reduction; subvention payment

Legislative references:

ITAA97 170; ITAA97 170-175; ITAA97 170-175(1)(e); ITAA97 170-175(1)(f); ITAA36 160ZP(13); AIA 15AA

Case references:

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