TD 1999/D88 - Income tax: capital gains: does the word 'expiring' in paragraph 104-25(1)(c) and the expression 'expiry of a CGT asset' in subparagraph 116-30(3)(a)(i) of the Income Tax Assessment Act 1997 include voluntary terminations?

This cover sheet is provided for information only. It does not form part of *TD 1999/D88 - Income tax: capital gains: does the word 'expiring' in paragraph 104-25(1)(c) and the expression 'expiry of a CGT asset' in subparagraph 116-30(3)(a)(i) of the Income Tax Assessment Act 1997 include voluntary terminations?*

This document has been finalised by TD 1999/76.

Draft Taxation Determination

Income tax: capital gains: does the word 'expiring' in paragraph 104-25(1)(c) and the expression 'expiry of a CGT asset' in subparagraph 116-30(3)(a)(i) of the *Income Tax Assessment Act 1997* include voluntary terminations?

Preamble

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

1. No.

2. The word 'expiring' in paragraph 104-25(1)(c) of the *Income Tax Assessment Act 1997* and the expression 'expiry of a CGT asset' in the market value substitution rule in subparagraph 116-30(3)(a)(i) are limited to an expiry by an effluxion or lapse of time, for example, when the specified time period of a lease expires.

3. Subsection 116-30(1) substitutes market value if no capital proceeds are received from a CGT event. The purpose of subsection 116-30(1) is to prevent an inappropriate capital loss arising if a CGT asset is given up for no capital proceeds. The market value substitution rule ensures that if no capital proceeds are received by the taxpayer, the taxpayer is deemed to have received the market value of the asset as capital proceeds.

4. The expiry of a CGT asset in terms of CGT event C2 (about the cancellation, surrender and similar endings of intangible CGT assets) in section 104-25 is excluded from the market value substitution rule by subparagraph 116-30(3)(a)(i). The purpose of subparagraph 116-30(3)(a)(i) is to prevent the market value substitution rule from applying when the value of an asset has diminished through the normal course of events to the point where the market value is nil, for example, on the expiry of a lease agreement. When a lease expires, it has no value. Substituting a market value at the time the asset ends, as if the lease had not expired, would give an inappropriate result.

5. However, before a lease expires it has a value that reflects the remaining term of the lease. If the lease is voluntarily terminated before it expires, it is appropriate to substitute a market value on termination. Whether the market value is a positive amount or nil depends on the facts of each case.

6. The cancellation of a statutory licence is also excluded from the market value substitution rule by subparagraph 116-30(3)(a)(ii). If the word ‘expiry’ included voluntary terminations, subparagraph 116-30(3)(a)(i) would encompass the cancellation of a statutory licence and subparagraph 116-30(3)(a)(ii) would be redundant.

Example 1

7. An option to acquire shares has a value of $100 before it expires (ie the exercise price of the option is $500 whereas the market value of the shares is $600). If you allow the option to expire, you receive no capital proceeds for the expired option and subparagraph 116-30(3)(a)(i) ensures that there is no market value substitution. However, if, before the option expires, you give up your rights under the option and receive no capital proceeds, you are deemed to have received the market value of $100.

Example 2

8. George has a 5 year lease over an office building for which he paid a premium of $10,000. George decides to retire early from business and surrenders the lease to the lessor 4 years into the term. As the lease did not expire, but was surrendered, the normal market value substitution rule applies to the capital proceeds from the CGT event that happens when the lease ends (CGT event C2), and George is treated as having received the market value of the unexpired term (1 year) of the lease. If that market value was $2,000, George would make a capital loss of $8,000 ($10,000 cost base of the lease less the $2,000 capital proceeds). If the lease had expired at the end of its term, George would not be treated as having received any capital proceeds and George would make a $10,000 capital loss.

Your comments

9. We invite you to comment on this Draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date:	**24 September 1999**
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25 August 1999

Previous draft:

Not previously released in draft form

Related Rulings/Determinations:

Subject references:

capital gains; capital losses; capital proceeds; CGT asset; CGT event; CGT event C2; expiring; expiry; lease; market value; option

Legislative references:

ITAA 1997 104-25; ITAA 1997 104-25(1)(c); ITAA 1997 116-30(1); ITAA 1997 116-30(3)(a)(i); ITAA 1997; 116-30(3)(a)(ii)

Case references:

ATO references:
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