


TD 94/D44 - Income tax: does subsection 70B(4) operate to reduce the amount of a deduction under subsection 70B(2) for a loss on the disposal of a traditional security where the disposal occurs as a result of the liquidation of the issuer of the security?

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Draft Taxation Determination

Income tax: does subsection 70B(4) operate to reduce the amount of a deduction under subsection 70B(2) for a loss on the disposal of a traditional security where the disposal occurs as a result of the liquidation of the issuer of the security?

1. Yes. Subsection 70B(2) allows a deduction for the amount of any loss on the disposal or redemption of a traditional security. If an insolvent company is being or has been wound up, and the liquidator has made a **final** payment to the holders of traditional securities issued by the company, we will accept that the securities have been disposed of at that time. Alternatively, if there is to be no distribution and the liquidator officially notifies holders that this is the case, we will accept that the official notification constitutes a disposal of the security for the purposes of section 70B. (See paragraphs 59 and 60 of Draft Taxation Ruling TR93/D43.)

2. Where a traditional security is disposed of on or after 1 July 1992, subsection 70B(4) may operate, in certain circumstances, to deny a deduction under subsection 70B(2) in respect of so much of the amount of the loss as is a loss of capital or is a loss of a capital nature.

3. One of the requirements of subsection 70B(4), contained in paragraph 70B(4)(e), is the need to draw the conclusion that, having regard to:

- (i) the financial position of the issuer of the security;
- (ii) perceptions of the financial position of the issuer; and
- (iii) other relevant matters,

the disposal or redemption took place for the reason, or for reasons that included the reason, that there was an apprehension or belief that the issuer was, or would be likely to be, unable or unwilling to discharge all liability to pay amounts under the security.

4. It has been suggested that where a disposal occurs in the circumstances mentioned in paragraph 1 above, it would not necessarily be concluded that the holder of the security had the required apprehension or belief to enable subsection 70B(4) to apply.

5. We do not accept that subsection 70B(4) necessarily requires the holder, in a subjective sense, to have the requisite apprehension or belief. In our view the test is an objective test. In the circumstances outlined we believe that the test is satisfied. When an insolvent company is being, or has been wound up, we think that if regard is had to its financial position, ie, that it is unable to pay amounts due to its creditors, it would be concluded that the disposal occurred for the reason, or reasons which included the reason, that the company would be unable to pay amounts due to holders of its securities. Accordingly, the deductible loss (if any) on the disposal or redemption of such securities cannot include an amount of capital or of a capital nature.

Example:

The XYZ Company Pty Ltd, the issuer of a number of traditional securities, is placed into liquidation. Prior to the company being dissolved, a holder of some of the securities is notified by the liquidator that because of insufficient funds, holders of securities will not receive a distribution upon liquidation.

The securities, which are not 'marketable securities', cost the holder \$1000. In the year of income ended 30 June 1993 the holder claimed a deduction under subsection 70B(2) for \$1000, being the amount of the loss on the disposal of the securities. The holder argued that the disposal did not occur because of the holder's view as to the financial state of the issuer. Rather, the disposal occurred because of the actions of the liquidator in winding up the company. Consequently subsection 70B(4) did not apply to reduce the amount of the deduction.

We think that in these circumstances, so much of the loss that is capital or of a capital nature is not an allowable deduction under subsection 70B(2) because of the operation of subsection 70B(4).

Commissioner of Taxation

5/5/94

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