


IT 2589 - Income tax: capital gains - application of section 51AAA

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TAXATION RULING NO. IT 2589

INCOME TAX: CAPITAL GAINS - APPLICATION OF
SECTION 51AAA

F.O.I. EMBARGO: May be released

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PREAMBLE Section 160ZO of Part IIIA of the Income Tax Assessment Act 1936 (the Act) includes net capital gains in the assessable income of a taxpayer. In so far as it includes net amounts in assessable income, it departs from the broad statutory scheme of the Act explained by Mason J in FCT v. Whitfords Beach Pty Ltd 82 ATC 4031 at p.4040, (1982) 12 ATR 692 at p.702 in the following terms:

'In the United Kingdom the legislation taxes the net profits or gains of a business. Our Act proceeds by an entirely different method - taking the taxpayer's gross income (sec 25(1)), adding to it other receipts of which sec.26(a) is an a typical example (because it catches net profit), thereby arriving at his assessable income from which are subtracted allowable deductions where appropriate (sec. 48) resulting in the ascertainment of his taxable income'.

2. Section 51AAA of the Act, introduced at the same time as Part IIIA, provides that:

"Where -

- (a) an amount is included in the assessable income of a taxpayer under section 160ZO;
- (b) a deduction would, but for this section, be allowable under this subdivision to the taxpayer; and
- (c) if the amount had not been included in the assessable income the deduction would not be allowable,

the deduction is not allowable."

3. Concern has been expressed that if paragraph 51AAA(c) were construed literally it would have an unintended effect of precluding certain deductions. Such deductions include tax-related expenses (section 69), gifts (section 78), income losses (section 80) and income losses transferred within a

company group (section 80G). A literal construction of paragraph 51AAA(c) might suggest that these deductions would not be allowable where a taxpayer's only assessable income in the relevant year of income was a net capital gain.

RULING

4. The words of any statutory provision must be first read in the context provided by the statute as a whole (K & S Lake City Freighters Pty Ltd v. Gordon & Gotch Ltd (1985) 60 ALR 509 at 512, 514, 517 and 519).

5. When considering section 51AAA in the context of the Act, regard must be had to the capital gains tax scheme of Part IIIA which includes any net capital gains in the assessable income of the taxpayer and to other income provisions of the Act which are concerned primarily with the inclusion of gross income in a taxpayer's assessable income (see FCT v. Whitfords Beach Pty Ltd, supra).

6. When considered in that context it is clear that section 51AAA was enacted to ensure that expenses incurred in relation to an asset may be taken into account only to ascertain the net capital gain arising on disposal of the asset. Such expenses reduce the capital gain to the extent they are allowable under section 160ZH of the Act for the purpose of calculating the cost base of the relevant asset. Section 51AAA provides that expenses associated with an asset are not allowable deductions in terms of section 48 of the Act as a result of the inclusion of the net capital gain in the assessable income.

7. The purpose and effect of section 51AAA can be illustrated by the taxation treatment of interest expenses incurred on money borrowed to purchase a non-income producing asset. The interest expenses are not included in the cost base of the asset because they are not of a capital nature and therefore do not satisfy the terms of section 160ZH. Section 51AAA puts beyond doubt that the interest expenses are not deductible under subsection 51(1) or any other provision of the Act by reason of the inclusion of a net capital gain arising from the disposal of the asset in the assessable income.

8. It follows from the general scheme of the Act that section 51AAA operates in the manner described in paragraph 6 and should not be read as denying deductions of the kind referred to in paragraph 3 of this Ruling.

9. This interpretation of section 51AAA is also consistent with the statement in the Explanatory Memorandum that accompanied the Income Tax Assessment Amendment (Capital Gains) Act 1986 (Act No. 52 of 1986) - which inserted Part 111A in the Act - that "ordinary income tax deductible losses will also be able to be offset against realised capital gains".

COMMISSIONER OF TAXATION
31 May 1990