TD 2001/13 - Income tax: capital gains: for the purpose of the expression 'acquired the share' in paragraph 110-55(7)(b) of the Income Tax Assessment Act 1997 ('the 1997 act') does acquired include a case where you are taken to have acquired the share for an acquisition cost equal to its market value?

This document has changed over time. This is a consolidated version of the ruling which was published on *13 June 2001*

Taxation Determination

Income tax: capital gains: for the purpose of the expression 'acquired the share' in paragraph 110-55(7)(b) of the *Income Tax Assessment Act 1997* ('the 1997 Act') does *acquired* include a case where you are *taken* to have *acquired* the share for an acquisition cost equal to its market value?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 5 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

Date of Effect

This Determination applies to years commencing both before and after its date of issue. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

1. Yes. 'Acquired' in its context in paragraph 110-55(7)(b) of the 1997 Act, in relation to a share, includes a case where you are deemed to have acquired the share for a market value acquisition cost.

2. The effect is that profits derived before the time of such a deemed acquisition come within the scope of subsection 110-55(7) if the other requirements of that subsection are met.

3. Examples where such a deemed acquisition occurs in the 1997 Act are in subsections 149-30(1) and 149-35(2) or subsections 149-70(2) and 149-75(2) of Division 149 (about when an asset stops being a pre-CGT asset), subsections 104-175(8) and 104-175(9) (about a company ceasing to be a member of a wholly-owned group after roll-over) and subsections 136-40(2) and 136-40(3) (about an individual or company, which may include a shareholder, becoming an Australian resident).

4. We take the same view in relation to the corresponding provisions dealing with a partnership's share in a company (subsections 110-60(5) and 110-60(6)) and references in this Taxation Determination to subsections 110-55(7) and 110-55(8) should be read as including references to subsections 110-60(5) and 110-60(6) adapted as necessary.

5. We also take the same view under subsection 160ZK(1B) or 160ZK(3B) and paragraph 160ZK(5)(b) of the *Income Tax Assessment Act 1936* ('the 1936 Act') in relation to the provisions corresponding to those above (namely section 160ZZS and Subdivision C of Division 20 of Part IIIA, paragraphs 160ZZOA(1)(d) and 160ZZOA(1)(e) and subsection 160M(12) of the 1936 Act).

Explanation

6. One requirement for subsection 110-55(7) to apply to reduce the reduced cost base of a share you own in a company is that an amount representing (in whole or in part) a distribution under an arrangement is reasonably attributable to profits derived by the company before you *acquired* the share. The subsection applies not only to an actual acquisition of a share but also if you are taken by the 1997 Act to have acquired a share for an acquisition cost equal to its market value.

7. The rationale behind the approach taken to deemed acquisitions for market value can be explained by examining Division 149 of the 1997 Act as an example.

8. Division 149 of the 1997 Act applies to make a pre-CGT share a post-CGT share if majority underlying interests in the share have not been maintained. Under subsections 149-30(1) and 149-70(2), Parts 3-1 and 3-3 of the 1997 Act apply to the share as if it had been acquired at the time it is taken to have become a post-CGT share and the first element of its reduced cost base is the asset's market value at that time: subsections 149-35(2) and 149-75(2). Subsections 110-55(7) and 110-55(8) are in Part 3-1.

9. Paragraph 110-55(7)(b) of the 1997 Act applies to 'profits derived by the company before you acquired the share'. Because of the operation of Division 149, paragraph 110-55(7)(b) extends to profits derived by the company before you are taken by subsection 149-30(1) or 149-70(2) to have acquired the share.

10. The purpose or object of subsection 160ZK(1B), when read with subsection 160ZK(5) of the 1936 Act (rewritten as subsection 110-55(7) of the 1997 Act), was to prevent a controller of a company or an associate of a controller from being able to generate a capital loss on the disposal of shares in the company if the controller or associate did not suffer an economic loss to the extent of that capital loss. Paragraph 4.2 of the explanatory memorandum to Taxation Laws Amendment Bill (No 2) 1994 confirms this was the purpose or object of these provisions.

11. An economic loss is not suffered if value reflected in the amount of reduced cost base of a share (for example an amount representing pre-acquisition profits) is distributed as a rebatable dividend or dividends and the share is then sold for its ex-dividend value. For example, assume A Co acquires a post-CGT share in B Co for $100 of which $50 represents pre-acquisition profits. B Co distributes the $50 to A Co as a rebatable dividend and A Co then sells the share for $50. As a result, A Co receives back a total of $100 for its $100 outlay. A Co suffers no economic loss. The reduced cost base of A Co's share should not include the amount representing the $50 pre-acquisition profit distributed to it. If it did A Co would inappropriately make a capital loss of $50 (reduced cost base $100 less capital proceeds $50) on the sale of its share.

12. If A Co's share had been a pre-CGT share and Division 149 had applied - because majority underlying interests in it were no longer maintained - the share would be taken to be a post-CGT asset. The *first* element of the share's reduced cost base would be taken to be its market value at the time (assumed to be $100). A Co could get the same $50 tax-free (rebatable) dividend and $50 from selling its share for the ex-dividend value. A Co would recover the value of its pre-CGT share of $100 and again would suffer no economic loss. Therefore, if the $50 profit derived before Division 149 applied to A Co's share is distributed, the reduced cost base of the share should not include an amount representing that profit. If it did A Co would again inappropriately make a capital loss of $50 on the sale of its share.

Example

13. *A determination by a public entity (ABC Ltd) under Division 20 of Part IIIA of the 1936 Act shows that majority underlying interests in its assets (being pre-CGT acquired shares in a wholly-owned subsidiary XYZ Ltd) had not been maintained at 20 January 1997. There was no requirement for ABC Ltd to test before that date. Therefore, its shares in XYZ Ltd are deemed to be acquired post-CGT for their market value on 20 January 1997. It is assumed that their market*

value is $10 million on that day and that before the shares were taken to be acquired XYZ Ltd had derived profits of $9 million that had not been distributed.

14. *On 16 October 1997 the $9 million profit of XYZ Ltd is distributed to ABC Ltd as a rebatable dividend. On 1 July 1998 ABC Ltd sells the shares for $1 million. Assuming all the requirements of subsection 110-55(7) are satisfied, the reduced cost base of the shares is $1 million and, as a result, ABC Ltd makes no capital loss on their disposal. ABC Ltd has not suffered a $9 million economic loss because it has previously received the $9 million value in tax-free form.*

Commissioner of Taxation
13 June 2001

Previously released:
Previously issued in draft form as TD 1999/D29

Related Rulings/Determinations:
TR 92/1; TR 97/16; TR 92/20

Subject references:
- acquired
- arrangement
- company
- controller
- deemed acquisition
- dividend
- dividend rebate
- majority underlying interests
- partnership
- pre-acquisition profit
- pre-CGT asset
- profit
- reasonably attributable
- rebatable dividend
- reduced cost base
- share

Legislative references:
- ITAA 1936 160M(12)
- ITAA 1936 160ZK(1B)
- ITAA 1936 160ZK(3B)
- ITAA 1936 160ZK(5)
- ITAA 1936 160ZK(5)(b)
- ITAA 1936 160ZZOA(1)(d)
- ITAA 1936 160ZZOA(1)(e)
- ITAA 1936 Part IIIA Division 20 Subdivision C
- ITAA 1936 160ZZS
- ITAA 1997 Pt 3-1
- ITAA 1997 104-175(8)
- ITAA 1997 104-175(9)
- ITAA 1997 110-55(7)
- ITAA 1997 110-55(7)(b)
- ITAA 1997 110-55(8)
- ITAA 1997 110-60(5)
- ITAA 1997 110-60(6)
- ITAA 1997 Pt 3-3
- ITAA 1997 136-40(2)
- ITAA 1997 136-40(3)
- ITAA 1997 Division 149
- ITAA 1997 149-30(1)

- ITAA 1997 149-35(2)
- ITAA 1997 149-70(2)
- ITAA 1997 149-75(2)

ATO references:
NO: 99/8920-0
FOI: I 1024260
ISSN: 1038-8982