

TD 95/54 - Income tax: capital gains: does a person who acquires the benefit of a restrictive covenant incur a capital loss on the expiry of that covenant?

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! This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in [TR 2006/10](#) provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

! This document has changed over time. This is a consolidated version of the ruling which was published on *29 November 2006*



This Determination, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the *Taxation Administration Act 1953*, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Determination is a public ruling and how it is binding on the Commissioner. Unless otherwise stated, 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 a settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Taxation Determination

Income tax: capital gains: does a person who acquires the benefit of a restrictive covenant incur a capital loss on the expiry of that covenant?

1. Yes, provided that the benefit of the restrictive covenant does not form part of goodwill on the sale of a business.
2. Subsection 160M(6B) of the *Income Tax Assessment Act 1936* applies to deem the person who acquires the restrictive covenant to do so when the covenant is granted.
3. The reduced cost base under subsection 160ZH(3) is the amount paid for the restrictive covenant.
4. On expiry of the restrictive covenant, a change in ownership is taken to have occurred (paragraph 160M(3)(b)), resulting in a disposal for nil consideration. On expiry the covenant, no longer being enforceable, has nil market value for the purposes of the deemed market value rules. This results in a capital loss equal to the amount paid for the restrictive covenant. The capital loss is incurred on the change in the ownership of the benefit (subsection 160U(4)), i.e., when the covenant expires.

Note 1: If the restrictive covenant is considered to be part of the goodwill of a business there are no capital gains tax consequences until the disposal of that goodwill.

Note 2: On the creation of a restrictive covenant, it is vested in terms of paragraph 160M(6)(b) in the person who acquires the benefit of it. By paragraph 160M(6B)(a), that person is taken to have acquired the restrictive covenant at the time applicable under subparagraphs 160U(6)(a)(i) or 160U(6)(b)(i). For a restrictive covenant, that time, we consider, is when the covenant is granted. If the restrictive covenant is created under a contract, the covenant is granted on the making of the contract (subparagraph 160U(6)(a)(i)). If the restrictive covenant is not created under a contract, the covenant is granted when it is vested in the person who acquires the benefit of it (subparagraph 160U(6)(b)(i)).

Note 3: The usual clause for restrictive covenants operates for a specified time, e.g., three (3) years and for a specified geographical area, e.g., 50 km from the City GPO. We would regard the restrictive covenant in this example as expiring at the end of the three (3) year period.

Note 4: The capital gains tax implications of consideration received in respect of restrictive covenants and trade ties are dealt with in Taxation Ruling TR 95/3.

Commissioner of Taxation

27/9/95

FOI INDEX DETAIL: Reference No. I 1014637 Previously issued as Draft TD 95/D4

Related Determinations:

Related Rulings: TR 95/3

Subject Ref: capital loss; expiry; goodwill; restrictive covenant

Legislative Ref: ITAA 160M(3)(b); ITAA 160M(6)(b); ITAA 160M(6B); ITAA 160M(6B)(a); ITAA 160U(4);
ITAA 160U(6)(a)(i); ITAA 160U(6)(b)(i); ITAA 160ZH(3)

ATO Ref: 95/2836-9

ISSN 1038 - 8982