


TD 2022/14EC - Compendium

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Public advice and guidance compendium – TD 2022/14

1 Relying on this Compendium

This Compendium of comments provides responses to comments received on Draft Taxation Determination TD 2019/D11 *Income tax: where a liability is assumed on acquisition of a CGT asset, is the assumed liability excluded from the cost base of the asset if expenditure on discharge of the liability is deductible?*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
All legislative references in this Compendium are to the <i>Income Tax Assessment Act 1997</i> .		
1	An assumption of a liability is not expenditure, and therefore subsection 110-45(2) cannot apply. The expenditure to discharge a liability is not expenditure in respect of the acquisition of an asset.	The final Determination has been amended to clarify its intended application. It provides that a non-contingent liability to pay a specified amount that is deductible will be excluded from the first element of cost base pursuant to subsection 110-45(2). We consider that a taxpayer who has incurred a non-contingent liability of a pecuniary character, and is entitled to claim a deduction in respect of it, has deductible expenditure (even if the liability is yet to be discharged by way of payment).
2	The ATO's view means a taxpayer would be required to track the liability until it is discharged and then adjust the cost base depending on the actual amount paid. Where the assumed liability changes over time, the ATO's view may result in the cost base increasing or decreasing if the amount paid on discharge is different to the value of the liability on the date of acquisition of the asset.	The final Determination clarifies its application to non-contingent liabilities to pay a specified amount. It is the amount of the non-contingent liability incurred which is the subject of the deduction.

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3	The draft Determination position will result in double taxation for retirement village operators in certain circumstances; this being where a lease premium resident contract with an outgoing village resident is replaced with another lease premium resident contract with an incoming resident.	The final Determination has been amended to clarify its intended application. The hypothetical circumstances which are asserted to give rise to double taxation for retirement village operators, assuming they are correct, are not expected to arise in applying the final Determination.
4	The draft Determination position will result in different tax outcomes between a direct asset acquisition compared to an entity acquisition. In particular, retirement village operators are excluded from the deductible liabilities rule in the tax consolidation cost setting rules. Adopting the draft Determination view will create artificial bias towards an entity acquisition, which is contrary to policy intention that similar outcomes should arise between asset and entity acquisitions.	Any policy issues regarding asserted different tax outcomes between asset and entity acquisitions are outside the scope of this Determination.
5	The draft Determination is contrary to the Commissioner's published views outlined in Taxation Ruling TR 2002/14 <i>Income tax: taxation of retirement village operators</i> . If finalised in its current form, the Determination represents a U-turn by the ATO.	We consider there is no inconsistency between the final Determination and TR 2002/14.
6	The approach endorsed in the draft Determination is akin to the 'look through' approach in the context of earnout arrangements which was rejected by the Commissioner in Draft Taxation Ruling TR 2007/D10 <i>Income tax: capital gains: capital gains tax consequences of earnout arrangements</i> .	We consider there is no inconsistency between the final Determination and TR 2007/D10 (withdrawn).
7	<p>Amounts paid in discharge of liabilities to which an asset is subject would likely be better characterised as costs of owning the asset and not as costs of acquiring the asset.</p> <p>Merely discharging the liability does not improve or perfect the acquisition as the acquisition is already complete.</p> <p>But for deductibility, these outgoings would form part of the third element (not the first element) of cost base. Hence, they would be excluded from the third element of cost base by subsection 110-45(1B) and not under subsection 110-45(2).</p>	<p>The final Determination has been amended to clarify its intended application. It provides that a non-contingent liability to pay a specified amount that is deductible will be excluded from the first element of cost base pursuant to subsection 110-45(2).</p> <p>In this scenario, it is the liability incurred which is the subject of the application of subsection 110-45(2). The discharge of the liability is not relevant to this exercise.</p>

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8	<p>Paragraph 6 of the draft Determination states:</p> <p>In principle, an item of expenditure should either be deductible for income tax purposes or included in the cost base of an underlying asset for CGT purposes, but not both.</p> <p>As a general and high-level description of the legislation, it is not a substitute for identifying a specific legislative basis for including or excluding particular amounts from cost base in particular cases.</p> <p>The amount of a liability assumed and an amount paid later in discharge of it are not the same 'item' of expenditure.</p> <p>Subsection 110-45(2) allows only what has been deducted to be excluded from cost base; not some distinct item that is thought to be related to or connected with what has been deducted.</p>	<p>The final Determination has been amended to clarify its intended application.</p> <p>A taxpayer who has incurred a non-contingent liability of a pecuniary character, and is entitled to claim a deduction in respect of it, has deductible 'expenditure' even though the liability may yet be discharged by way of payment.</p> <p>'Expenditure' for subsection 110-45(2) purposes must include a liability that is deductible even though the liability has yet to be discharged. This is necessarily so, in order for the provision to operate in the context of precluding 'expenditure' in cost base to the extent that such 'expenditure' is deductible.</p>
9	<p>In respect of section 112-35, the legislative intention was to include the full amount of the liability in cost base with its later discharge to be ignored.</p> <p>Former paragraph 160S(2)(a) (the predecessor provision to section 112-35) provided that the asset acquired is treated as if it is free of any 'right by way of security', with former paragraph 160S(2)(b) specifying that it is the full amount of the liability that forms part of cost base. The subsequent satisfaction of the liability was irrelevant. If the asset is treated as acquired free of any security, the actual discharge of this 'non-existent security' can have no effect. It cannot be said that discharge of the debt occurs to acquire the asset in a regime in which the debt is not considered to exist for the purposes of applying the capital gains tax provisions.</p> <p>Consequently, the reference to the 'latest representation of the same liability' in the draft Determination is incorrect. It is open to criticism as being unsupported or without legal precedent.</p>	<p>The final Determination no longer makes the point regarding expenditure in discharging the liability being the latest representation of the same liability referred to in section 112-35.</p> <p>The relevant expenditure is that constituted by the non-contingent liability to pay a specified amount that is initially included in the cost base of an asset.</p>
10	<p>There is no discussion of the impact on the vendor's capital proceeds.</p>	<p>The impact on the vendor's capital proceeds is outside the scope of this Determination.</p>

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11	<p>The draft Determination noted that in the absence of an assumed liability encumbrance, the cash consideration paid by a purchaser would have been higher. Although this is likely to hold as a general proposition, it cannot necessarily be assumed that the cash consideration would be reduced by the full face value of the assumed liability. There are a range of arm's-length circumstances that may affect the cash consideration for the sale of an asset, including the fact that the purchase price may take into account the after-tax cost to a purchaser of paying out an assumed liability.</p>	The final Determination has been amended to omit this point.
12	<p>Further guidance is required in the following situations if the interpretation in the draft Determination is to be finalised:</p> <ul style="list-style-type: none">• What happens if the liability is subject to a deduction because of the application of the taxation of financial arrangements?• What happens if the liability is in a foreign currency and is subject to a deductible foreign exchange loss?• How would the Determination apply to a debt defeasance arrangement which replaces one liability with another?• The tax treatment of a liability to rehabilitate a mine which has not arisen (but is inherent in the asset), and where the liability has arisen.• Interactions with the consolidation regime and ACA calculations under subsection 705-70(1AC).	Guidance on these situations is outside the scope of this Determination.