


TD 1999/D29 - Income tax: capital gains: for the purpose of the expression 'before you acquired the share' in paragraph 110-55(7)(b) of the Income Tax Assessment Act 1997 ('the 1997 Act') does when a share was acquired include when a share is taken to have been acquired by subsection 149-30(1) or subsection 149-70(2) of Division 149 (about when an asset stops being a pre-CGT asset)?

 This cover sheet is provided for information only. It does not form part of *TD 1999/D29 - Income tax: capital gains: for the purpose of the expression 'before you acquired the share' in paragraph 110-55(7)(b) of the Income Tax Assessment Act 1997 ('the 1997 Act') does when a share was acquired include when a share is taken to have been acquired by subsection 149-30(1) or subsection 149-70(2) of Division 149 (about when an asset stops being a pre-CGT asset)?*

This document has been finalised by TD 2001/13.

Draft Taxation Determination

Income tax: capital gains: for the purpose of the expression ‘before you acquired the share’ in paragraph 110-55(7)(b) of the *Income Tax Assessment Act 1997* (‘the 1997 Act’) does when a share was *acquired* include when a share is *taken* to have been *acquired* by subsection 149-30(1) or subsection 149-70(2) of Division 149 (about when an asset stops being a pre-CGT asset)?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office (ATO). DTDs should not be relied on; only final TDs are authoritative statements of the ATO.

1. Yes.
2. Profits derived by a company before a share is *taken* to have been *acquired* under Division 149 are treated in the same way for the purposes of subsections 110-55(7) and (8) of the 1997 Act as profits derived by a company before a share is actually *acquired* (‘pre-acquisition profits’). These subsections, in certain circumstances, reduce the reduced cost base of a share if pre-acquisition profits have been distributed to the holder of the share as dividends eligible for rebate under section 46 or 46A of the *Income Tax Assessment Act 1936* (‘the 1936 Act’).
3. We take the same view under subsection 160ZK(1B) and paragraph 160ZK(5)(b) of the 1936 Act in relation to a share deemed under section 160ZZS and under Subdivision C of Division 20 of Part IIIA of the 1936 Act to be acquired on a particular date.
4. We take an equivalent view to that outlined in paragraphs 1 and 2 above, adapted as necessary, in other situations where a share is taken to be acquired at a particular time on a change of underlying ownership interests in the share (e.g., under subsections 104-175(8) and (9) of the 1997 Act or paragraphs 160ZZOA(1)(d) and (e) of the 1936 Act).

Explanation

5. 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. Subsections 149-30(1) and 149-70(2) provide that Parts 3-1 and 3-3 of the 1997 Act apply to the share as if it had been

acquired at the time it was taken to have been acquired. Subsections 110-55(7) and (8) are included in Part 3-1.

6. Paragraph 110-55(7)(b) of the 1997 Act applies to 'profits derived by the company before you acquired the share'. Because of the deeming done in Division 149, paragraph 110-55(7)(b) extends to profits derived by the company before you are taken to have acquired the share.

7. The construction adopted in paragraphs 1 and 2 of this Determination promotes the purpose or object underlying subsection 110-55(7) of the 1997 Act.

8. The purpose 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 in circumstances where the controller or associate does 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) of 1994 confirms this was the purpose of these provisions.

9. An economic loss is not suffered if amounts reflected in the cost base of a share (e.g., an amount representing pre-acquisition profits) are distributed as rebatable 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 its sale of the B Co share.

10. 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 and 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. Equally, the reduced cost base of A Co's share should not include the amount representing the \$50 profit (derived before Division 149 applied) distributed to it. If it did, A Co would again (inappropriately) make a capital loss of \$50 on its sale of the B Co share.

Example

11. *A determination by a public entity (ABC Ltd) under Division 20 shows that majority underlying interests in assets of ABC Ltd (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, so 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 20 January 1997 and that immediately before the shares were deemed to be acquired, XYZ Ltd had derived profits of \$9 million that had not been distributed.*

12. *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 subsections 110-55(7) and (8) 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.*

Your comments

13. If you wish to comment on this draft Taxation Determination, please send your comments by Friday 30 July 1999 to:

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Commissioner of Taxation

30 June 1999

Previous draft:

Not previously issued in draft form to the public

*Related Rulings/Determinations:**Subject references:*

arrangement; company; controller; dividend; dividend rebate; majority underlying interests; pre-acquisition profit; reduced cost base; share

Legislative references:

ITAA36 46; ITAA36 46A; ITAA36 160ZK(1B); ITAA36 160ZK(5); ITAA36 160ZK(5)(b); ITAA36 160ZZOA(1); ITAA36 160ZZOA(1)(d); ITAA36 160ZZOA(1)(e); ITAA36 Pt IIIA, Div 20; ITAA36 Pt IIIA, Subdiv 20C; ITAA36 160ZZS; ITAA97 Pt 3-1; ITAA97 104-175(8); ITAA97 104-175(9); ITAA97 110-55(7); ITAA97 110-55(7)(b); ITAA97 110-55(8); ITAA97 Pt 3-3; ITAA97 149; ITAA97 149-30(1); ITAA97 149-35(2); ITAA97 149-70(2); ITAA97 149-75(2); ITAA97 149-79(2)

Case references:

ATO references:

NO

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