# *TD 2005/D48 - Income tax: capital gains: can money paid for the purposes of the first element of cost base in subsection 110-25(2) of the Income Tax Assessment Act 1997 and reduced cost base under section 110-55 of the Income Tax Assessment Act 1997 include the amount of a liability extinguished under the doctrine of set-off?*

# Draft Taxation Determination

## Income tax: capital gains: can money paid for the purposes of the first element of cost base in subsection 110-25(2) of the *Income Tax Assessment Act 1997* and reduced cost base under section 110-55 of the *Income Tax Assessment Act 1997* include the amount of a liability extinguished under the doctrine of set-off?

***Preamble***

*This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the* ***Taxation Administration Act 1953****. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. Yes. If an amount is owed in respect of the acquisition of a CGT asset, the set-off of all or part of that liability constitutes money paid in respect of the acquisition of the asset for the purposes of the first element of cost base in subsection 110-25(2) of the *Income Tax Assessment Act 1997* (ITAA 1997) and reduced cost base under section 110-55 of the ITAA 1997.

2. A set-off occurs if there are presently due mutual liabilities of sums certain owing between the same parties which they agree to set-off in equal amounts against each other.

3. The doctrine of set-off was considered in *re Harmony and Montague Tin and Copper Mining Company* (1872-73) 8 LR Ch App 407 (known commonly as *Spargo's Case)* where Mellish LJ said at 414:

> Nothing is clearer than that if parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side on that account, and those accounts are settled by both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law, that in every case where a transaction resolves itself into paying money by A. to B., and then handing it back again by B. to A., if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards.

4. In *FC of T v. Steeves Agnew & Co (Vic) Pty Ltd* (1951) 82 CLR 408 Dixon J in approving the doctrine of set-off established in *Spargo's Case* said at 420:

> If cross-liabilities in sums certain of equal amounts immediately payable are mutually extinguished by an agreed set-off, that amounts to payment for most common-law and statutory purposes.

5. The doctrine of set-off also includes a set-off of equal amounts where unequal sums are owed by the parties if payment of the residue is effected by other means: *FC of T v. Steeves Agnew & Co (Vic) Pty Ltd* (1951) 82 CLR 408 per Dixon J at 421.

6. Therefore, if one of the amounts due in a set-off is in respect of the acquisition of an asset, the amount set-off constitutes money paid in respect of the acquisition of the asset for the purposes of the first element of cost base in subsection 110-25(2) of the ITAA 1997 and reduced cost base in section 110-55 of the ITAA 1997.

### *Example*

7. *Company X advertises for sale a CGT asset for $120,000. Company Y, a trade creditor of Company X sees the advertisement and enters into an unconditional contract to purchase the asset for that amount. By the time Company Y is to due to settle the contract its finance department notes that there are presently due mutual liabilities, with Company Y having a debt due to it from Company X of $50,000 for services provided. Contact is made with Company X and it is agreed that the $50,000 debt owing to Company Y for the provision of services be set-off against the amount due for the acquisition of the CGT asset and the remaining $70,000 be paid in cash. The first element of the cost base of the CGT asset is the money paid of $120,000.*

### Date of effect

8. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of 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).

### Your comments

9. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

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**Commissioner of Taxation**
19 October 2005

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 92/20

*Subject references:*

- asset
- acquisition
- capital gains
- CGT asset
- first element
- money
- pay

*Legislative references:*

- TAA 1953 Pt IVAAA
- ITAA 1997 110-25(2)
- ITAA 1997 110-55

*Case references:*

- FC of T v. Steeves Agnew & Co (Vic) Pty Ltd (1951) 82 CLR 408
- re Harmony and Montague Tin and Copper Mining Company (1872-73) 8 LR Ch App 407

ATO references

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