


TD 95/D4 - 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 document has been finalised by TD 95/54.

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Draft 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 cost base under subsection 160ZH(3) is the amount paid for the restrictive covenant.
4. On expiry, the restrictive covenant is disposed of in terms of subsection 160M(3)(b) for nil consideration. 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 (see subsection 160U(4)) i.e. when the covenant expired.

(**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: The usual clause for restrictive covenants operates for a specified time, e.g. 3 years and a specified geographical area, e.g. 50 km from the City GPO. At the end of the 3 year period we would regard the restrictive covenant as having expired.)

Commissioner of Taxation

4/5/95

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