TA 2009/12 - Re-characterising capital losses as revenue losses

Australian Government
Australian Taxation Office

Taxpayer Alert

TA 2009/12

FOI status: may be released

Taxpayer Alerts are intended to be an 'early warning' of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officers named in the Taxpayer Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

Title **Re-characterising capital losses as revenue losses**

This Taxpayer Alert describes an arrangement whereby taxpayers seek to re-characterise their shareholding status from that of a long term capital investor to a trader in shares. Taxpayers involved have claimed the capital gains tax (CGT) discount on previous receipts, but are now realising losses which they seek to claim as tax deductions against ordinary income (as opposed to capital losses which are only able to be offset against capital gains).

Description

This taxpayer alert is intended to apply to arrangements having features that are substantially equivalent to the following:

1. The taxpayer is an individual investor who holds shares.

2. The taxpayer has previously disposed of shares realising a profit, and treated that profit as a capital gain.

   This is done on the basis that the shares were held with the intention of benefiting from a long term increase in capital value and/or the receipt of dividend income during the holding period. The taxpayer's records are maintained on this basis.

3. As the taxpayer is an individual and had held the shares for more than 12 months, the taxpayer claimed the 50% CGT discount in their income tax return for each of the relevant financial years.

4. The value of shares still held by the taxpayer decreases as a result of market conditions and the taxpayer has an unrealised loss in respect of those shares.

5. The taxpayer may receive advice from a tax professional or financial advisor regarding the deductibility of losses incurred on the sale of shares for the current income year, including the benefits of being regarded as holding shares as a share trader when making such a loss.

6. Without changing the economic substance of their shareholdings, the taxpayer decides to arbitrarily re-characterise their shareholding in order to claim the net loss from their sale as a revenue deduction pursuant to section 8-1 of the *Income Tax Assessment Act* 1997 (ITAA).

   This is done on the basis that the taxpayer is now carrying on a business of share trading (as opposed to carrying forward capital losses indefinitely to be offset against any future capital gains, as would be the case for an investor).

7. To support a contention that the taxpayer is carrying on a business of share trading, the taxpayer may artificially adopt specific practices to present a pretence of being a share trader, but with no objective, material change in either the nature of investments held (or sold) or their holding activities. Some of these practices (which in the relevant circumstances a reasonable person would regard as artificial and contrived) may include:

   a) Purchasing or selling shares on a more regular basis (often with small net volumes). This is often called "window dressing";

   b) Creating a trading plan for their share transaction activities with a newly stated goal of maximising profit - even though the shares sold will generate a loss, rather than a profit;

   c) Increasing recording of time spent per week on the investment process (without any significant change in the total value of transactions); and

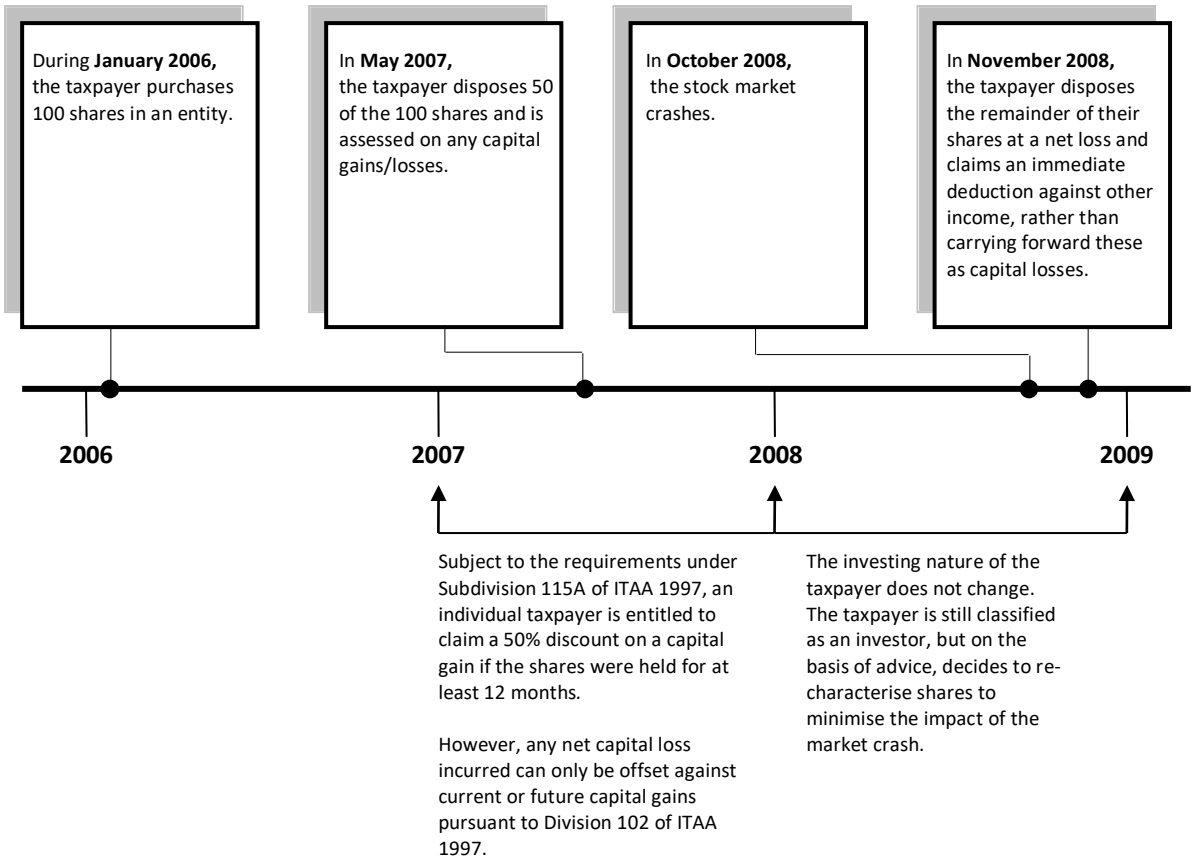
   d) Maintaining additional records to evidence share transactions including additional reliance on guidance from others (without any significant change in the total value of transactions).

8. The taxpayer subsequently decides to dispose of the shares to realise the net loss.

9. The change in approach is applied on a prospective basis only, such that only future transactions are affected, even though there has been no substantive change in objective facts between the current year and previous years.

Example of an arrangement

A taxpayer with some or all of the above features enters into the following situation:



Features which concern us

Depending upon the individual facts and circumstances, the ATO considers that arrangements of this type may give rise to taxation issues including whether:

(a) any transactions from the taxpayer's activity are covered by the capital loss provisions under Part 3-1 of the ITAA 1997;

(b) any losses incurred from the disposal may be allowed as a deduction under section 8-1 of the ITAA 1997;

(c) any transactions from the taxpayer's activity are covered by the trading stock rules under Division 70 of the ITAA 1997;

(d) any losses incurred are able to be substantiated by evidence necessary to determine/support the intention of the acquisition as explained in TD 2007/2. In particular, whether records have been retained until the later of:

   i. the end of the statutory record of retention period, e.g. s.262A(4) of the *Income Tax Assessment Act 1936* (ITAA 1936), or

ii. the end of the statutory period of review for an assessment for the year of income when the tax loss is fully deducted or the net capital loss is fully applied;

(e) the general anti-avoidance rule contained in Part IVA of the ITAA 1936 may be applied to cancel any tax benefit under all, or some part, of the arrangement; and

(f) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953).

The ATO is currently reviewing these arrangements.

Further information on share trading can be found on **www.ato.gov.au** under **'Carrying on a business of share trading'** and in ATO ID 2001/745.

***Note 1**: You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling. If you have received a private ruling in respect of your arrangement, you can rely on that private ruling. A private ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the private ruling is later found to be incorrect. However, a private ruling only applies to the particular entity identified and the particular scheme described in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the private ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity.*

***Note 2**: If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the Income Tax Assessment Act 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

***Note 3**: Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false and misleading statement to the Commissioner. Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the ATO. If you have any information about the current arrangement, phone us on 1800 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 68 (Fast Key Code **3 4**).*

***Note 4**: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

***Note 5**: Where appropriate, section 167 of the Income Tax Assessment Act 1936 (ITAA 1936) may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PSLA 2007/7 and PSLA 2007/24.*

***Note 6**: A registered tax agent may have their registration cancelled or suspended by the Tax*

Agents' Board under section 251K of the Income Tax Assessment Act 1936 if they are guilty of misconduct as a tax agent or are not considered a fit and proper person to prepare income tax returns. A person under a sentence of imprisonment for a serious taxation offence is not a fit and proper person.

Amendment history

Date	Comment
19 January 2024	Updated ATO tip-off hotline numbers

Subject References:
Aggressive tax planning
Part IVA
Capital losses
Capital gain
Revenue account
Share trading
Promoters

Legislative References:
Income Tax Assessment Act 1997
Section 8-1
Division 35
Division 70
Division 102
Subdivision 115A
Part 3-1

Income Tax Assessment Act 1936
Part IVA
Section 167
Section 251K
Section 262A(4)

Tax Administration Act 1953
Schedule 1 Div 290

Case law
Sun Newspapers Ltd v FCT (1938) 61 CLR 337
Ferguson v FCT (1979) 37 FLR 310; 79 ATC 4261; (1979) 9 ATR 873
Case X86 90 ATC 621
FC of T v Radnor Pty Ltd 91 ATC 4689
Shields v DC of T (Cth); Case [1999] AATA 4

Related Practice Statements:
PS LA 2007/7
PS LA 2007/24
PS LA 2008/15

Related Rulings/Determinations/Interpretative Decisions:
ATO ID 2001/745
TD 2007/2

Authorised by:	**Stephanie Martin**
Contact Officer:	**Bruce Collins**
Business Line:	**Aggressive Tax Planning**
Section:	**Technical & Case Leadership**
Phone:	**(02) 621 62710**