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TD 04/13 history

7 April 2004 **Original ruling**

You are here → 11 January 2006 **Consolidated ruling** Addendum



Taxation Determination

Income tax: capital gains: can CGT event E1 in section 104-55 of the *Income Tax Assessment Act 1997* happen to a shareholder in a company in voluntary administration under Part 5.3A of the *Corporations Act 2001* who declares a trust over their shares?

Preamble

The number, subject heading, date of effect and paragraphs 1 to paragraphs 14 of this document are a 'public ruling' for the purposes of Part IVAAA of the Taxation Administration Act 1953 and are legally binding on the Commissioner.

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

1. Yes. CGT event E1 in section 104-55 of the *Income Tax Assessment Act 1997* (ITAA 1997) can happen in these circumstances. The creation of the trust is not rendered illegal by the scheme of the *Corporations Act 2001* (Corporations Act).
2. CGT event E1 will not happen if a mere contract to transfer the shares was entered into, as this conduct would not, of itself, establish a certainty of intention to create a trust over the shares.
3. Subject to the qualifications in paragraph 4, a shareholder will make a capital loss on the share, for the income year in which the trust is created, if, at the time when the trust is created, the market value of the share is less than its reduced cost base.
4. A shareholder will not make a capital loss on the happening of CGT event E1 if the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) apply to the arrangement, or if the shareholder is a company and the capital loss is deferred under Subdivision 170-D of the ITAA 1997 (about deferring capital losses and deductions from transactions entered into by a company that is a member of a linked group).

Explanation

5. When a company enters voluntary administration under Part 5.3A of the Corporations Act, shareholders became subject to restrictions including a restriction on their ability to transfer their shares. Section 437F of the Corporations Act states that 'A transfer of shares in a company, or an alteration in the status of members of a company, that

is made during the administration of the company is void except so far as the Court otherwise orders'. In circumstances where a Court order has not been obtained, shareholders cannot effect a change of ownership of their shares for the purposes of CGT event A1 in section 104-10 of the ITAA 1997.

Circumstances where a trust is taken to be created by declaration or settlement

6. There is no particular form of words that a shareholder needs to use in order to create a trust. However, the form of words used must identify the elements that must exist for a trust to come into existence. These are certainty of intention to create a trust, terms, subject matter (the shares) and objects (the person to benefit).

7. There are circumstances where a trust cannot be created. Courts will refuse to enforce legal or equitable rights that arise out of an illegal purpose. Examples are listed in the decision of McHugh J in *Nelson v. Nelson* (1995) 184 CLR 538 at 613:

- where a statute discloses an intention that the rights should be unenforceable in all circumstances; or
- where the sanction of refusing those rights is not disproportionate to the seriousness of the unlawful conduct, the imposition of the sanction is necessary to protect the object and policies of the statute and the statute does not disclose an intention that the remedies contained in the statute are the only legal consequences for the breach of the statute or the frustration of its policies.

8. The creation of a trust over shares in a company in administration is not one of these circumstances. Section 437F does not absolutely prohibit dealings in, or the creation of rights in respect of, shares in a company in administration. The object of the provision is not frustrated by a declaration of trust, as the legal owner of the shares (as trustee) remains principally liable in respect of the liabilities that attach to the shares. In *Keay*, A 1999, *Mcperson's Law of Company Liquidation*, 4th ed, LBC, Sydney, it is pointed out at page 239 that the object of comparable liquidation provisions in subsections 468(1) and 493(2) of the Corporations Act is:

'...to prevent a shareholder from evading liability as a contributory by transferring shares to some impecunious person after winding up has commenced, but this policy is sufficiently served by avoiding only the transfer itself. A mere contract to transfer shares is not rendered illegal or void by the statute so that, as between the parties themselves, the purchaser would be entitled to any dividends declared, and bound to pay calls made upon those shares after the contract was entered into'.

Application of Part IVA of the ITAA 1936

9. The application of the anti-avoidance provisions in Part IVA of the ITAA 1936 would depend on the facts of any particular case. Arrangements entered into between related parties such as family members are not necessarily precluded from the possible application of the anti-avoidance provisions.

10. However, subject to these reservations the creation of a trust over shares in a company in administration would not, as a general rule, attract the application of Part IVA where:

- the shareholder's intention to hold the relevant shares as trustee on trust for another person is specified in writing; and
- there is no intention, arrangement or understanding at any time that any beneficial interest in the shares is to be reacquired by the trustee shareholder.

Example

11. *Horace owns a share in Pasminco Limited, a company that entered voluntary administration on 19 September 2001. On 4 September, 2003, Horace signs an agreement accepting an offer from Value Co (the purchaser), an entity that offers to purchase shares in companies in administration for a commercial fee. Under the terms of the agreement, Horace will hold the share on trust for the purchaser until that purchaser can obtain registration of the transfer.*

12. *As no Court Order has been made to allow the registration of the transfer of Pasminco shares, CGT event E1 happens at the time Horace signs the agreement. Based on the terms of the written agreement, there is certainty of intention to create a trust, terms, subject matter (the Pasminco share) and object (the purchaser).*

13. *Horace will make a capital loss equal to the difference between the reduced cost base of the share, and its market value at the time of the creation of the trust.*

Note 1: The scope of CGT event G3 in section 104-145 of the ITAA 1997 was extended with effect from 22 March 2005. The event now happens if a liquidator or administrator makes an appropriate written declaration in respect of valueless shares or financial instruments. Accordingly, a shareholder in a company in administration may be able to choose to make a capital loss from that event happening in respect of their shares (rather than by creating a trust over them).

Note 2: written declaration by administrator of Pasminco Limited

The example in paragraphs 11 – 13 refers to Pasminco Limited.

On 31 March 2005, the administrator of Pasminco Limited declared in writing that they have reasonable grounds to believe there is no likelihood the shareholders will receive any further distribution for their shares.

Accordingly, shareholders can now choose to make a capital loss from their Pasminco Limited shares as a result of CGT event G3. The capital loss will be equal to the reduced cost base of the shares as at 31 March 2005 and is made for the income year that includes that date.

Date of effect

14. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms

of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Note: The Addendum to this Determination that issued on 11 January 2006 applies on and from 22 March 2005.

Commissioner of Taxation

7 April 2004

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

TR 92/20; TR 92/1; TR 97/16

Subject references:

- administrator
- capital loss
- CGT event
- company
- cost base
- loss
- reduced cost base
- share
- worthless shares

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 Pt IVA
- ITAA 1936 177D
- ITAA 1997 104-10
- ITAA 1997 104-55
- ITAA 1997 subsec 104-55(2)
- ITAA 1997 subdiv 170-D
- Corporations Act 2001 5.3A
- Corporations Act 2001 437F
- Corporations Act 2001 subsec 468(1)
- Corporations Act 2001 subsec 493(2)

Case references:

- Nelson v. Nelson (1995) 184 CLR 538

Other references:

- Keay, A 1999, *Mcperson's Law of Company Liquidation*, 4th ed, LBC, Sydney.

ATO references

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