TD 2001/D2 - Income tax: capital gains: how do Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997 ('the 1997 Act') treat:(a) a final liquidation distribution; and (b) an interim liquidation distribution? and what are the capital gains consequences if all or part of a final liquidation distribution is deemed by subsection 47(1) of the Income Tax Assessment Act 1936 ('the 1936 Act') to be a dividend paid out of profits and therefore assessable income of a shareholder under subsection 44(1) of the 1936 Act?

This cover sheet is provided for information only. It does not form part of *TD 2001/D2 - Income tax: capital gains: how do Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997 ('the 1997 Act') treat:(a) a final liquidation distribution; and (b) an interim liquidation distribution? and what are the capital gains consequences if all or part of a final liquidation distribution is deemed by subsection 47(1) of the Income Tax Assessment Act 1936 ('the 1936 Act') to be a dividend paid out of profits and therefore assessable income of a shareholder under subsection 44(1) of the 1936 Act?*

This document has been finalised by TD 2001/27.

Draft Taxation Determination

Income tax: capital gains: how do Parts 3-1 and 3-3 of the *Income Tax Assessment Act 1997* ('the 1997 Act') treat:

(a) a final liquidation distribution; and

(b) an interim liquidation distribution?

and what are the capital gains consequences if all or part of a final liquidation distribution is deemed by subsection 47(1) of the *Income Tax Assessment Act 1936* ('the 1936 Act') to be a dividend paid out of profits and therefore assessable income of a shareholder under subsection 44(1) of the 1936 Act?

Preamble

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

Final liquidation distribution

1. The full amount of a final distribution made by a liquidator on the winding up of a company constitutes capital proceeds from the cancellation of the shareholder's shares in the company for the purposes of a capital gain or capital loss made on the happening of CGT event C2 (about cancellation, surrender and similar endings) in section 104-25 of the 1997 Act. In a winding-up of a company, CGT event C2 happens because the shares in the company end on their cancellation.

Alternative view

2. An alternative view that a final distribution represents proceeds from the winding up of the company - and not from the cancellation of the company's shares - is one with which we disagree. It does not accord with the decision of the High Court of Australia in *C of T (NSW) v Stevenson* (1937) 59 CLR 80; 4 ATD 415 where Rich, Dixon and McTiernan JJ said at CLR 99; ATD 424: 'In the liquidation the excess of [the company's] assets over its liabilities is distributed among the shareholders **in extinguishment of their shares**' (emphasis added). And later, their Honours said on the same page, 'The shareholder simply receives his proper proportion of a total net fund … and he receives it **in replacement for his share**' (emphasis added).

Final liquidation distribution and deemed dividend

3. If all or part of a final distribution made by a liquidator of a company is deemed by subsection 47(1) of the 1936 Act to be a dividend paid out of profits, and it is therefore assessable income of a shareholder in the company, this does not alter the position stated in paragraph 1 of this Taxation Determination.

4. The apportionment rule in subsection 116-40(2) of the 1997 Act does not restrict the capital proceeds for the cancellation of the shares to any portion of the distribution not assessed as a dividend.

5. However, subsection 118-20(1), when read with subsection 118-20(1A) of the 1997 Act, ensures that no part of the final liquidator's distribution is taxed both as a dividend and as a capital gain.

Interim liquidation distribution

6. CGT event G1 (about capital payments for shares) in subsection 104-135(1) of the 1997 Act happens if an interim distribution is made by a liquidator of a company (to the extent the distribution is not a dividend) in respect of post-CGT shares if the company is dissolved more than 18 months after payment of the distribution. If the company is dissolved within 18 months of the payment of the interim distribution, the payment will form part of the shareholder's capital proceeds for CGT event C2 happening when their shares end.

7. At the time a shareholder is paid an interim liquidation distribution, or when the time comes for lodging a tax return for the year of income in which the distribution was made, shareholders are unlikely to know whether the company will be dissolved within 18 months of the distribution. There are two courses of action open to the shareholder in such a case:

(a) to anticipate that the company will be dissolved within 18 months; or

(b) to apply CGT event G1 to the interim distribution on the basis that the company will not be dissolved within the 18 month period.

Only if the shareholder is advised in writing by the liquidator that the company will not be dissolved within 18 months of the distribution, must the shareholder initially apply CGT event G1 to the interim distribution.

8. In each case covered by paragraph 7, further action may be required depending on whether the company is in fact dissolved within the 18 month period.

Shareholder assumes dissolution within 18 months

9. In the absence of written advice from the liquidator that the company will not be dissolved within 18 months of the distribution, a shareholder may assume that the company will be dissolved within 18 months.

10. The shareholder may therefore initially apply subsection 104-135(6) to disregard the application of CGT event G1 and the payment will be part of their capital proceeds for CGT event C2 happening when their shares end. Any capital gain the shareholder makes when CGT event C2 happens to their shares would be relevant in calculating the shareholder's net capital gain and assessable income in the income year in which their shares are cancelled.

11. If the company is **not** dissolved within 18 months of the interim liquidation payment, subsection 104-135(6) does not apply. In this case, CGT event G1 rather than CGT event C2 applies to the payment (CGT event C2 will still apply on cancellation of the shares, but the capital proceeds for it will not include the interim distribution).

12. The effect of CGT event G1 happening is to reduce the cost base and reduced cost base of the shareholder's share as at the time of the payment. The reduction amount is the non-dividend part of the interim distribution and, if the non-dividend part of the distribution is greater than the cost base ('the excess'), the shareholder makes a capital gain equal to the excess at the time of payment. The shareholder would include that capital gain in their assessable income for the income year in which the payment is made.

13. The shareholder may need to have their assessment amended for the income year in which the payment was made. The amendment would only be necessary to include a capital gain in their assessable income if one was made when CGT event G1 happened. Any cost base or reduced cost base reductions would be required as at the time of the payment.

14. If a shareholder's assessment is amended to include a capital gain as a result of CGT event G1 happening and a liability to pay the general interest charge arises under subsection 204(3) of the 1936 Act (or under subsection 170AA(1) of the 1936 Act if the amendment related to the 1999-2000 year of income or an earlier year of income), the remission of the general interest charge will be dealt with in each case on its own merits.

15. We would expect, however, that the discretion in section 8AAG of the *Taxation Administration Act 1953* would ordinarily be exercised to remit the general interest charge in full where requests for amendment are lodged and, where relevant, self-amendments are made, within a reasonable time after the end of the 18 month period. In most cases, we would consider a period of one month after that time to be a reasonable period but there may be circumstances where a shareholder can establish that a longer period is reasonable.

Shareholder is told by liquidator that company will not be dissolved with 18 months or assumes that outcome

16. If the shareholder is told by the liquidator that the company will not be dissolved within 18 months of the distribution, or chooses to assume that outcome, CGT event G1 happens in respect of the payment.

17. If, contrary to the liquidator's advice or the shareholder's assumption, the company is in fact dissolved within 18 months of the payment, the shareholder would request an amended assessment to remove any CGT event G1 capital gain from their assessable income in the income year of the payment. They would be entitled to receive interest for the overpayment. The interim liquidation distribution would form part of their capital proceeds for CGT event C2 happening when their shares end. No cost base or reduced cost base reductions are taken to have been required by CGT event G1 in respect of the interim distribution.

Example 1

18. *Bill acquired 100 shares in XYZ Pty Ltd in 1987. The shares have a cost base of $10,000 at the time they are cancelled following the winding-up of the company in September 1999. Bill receives a final distribution on 1 July 1998 (the company is dissolved within 18 months of the distribution) of $18,000 of which $7,000 is deemed to be a dividend by subsection 47(1) of the 1936 Act. Bill makes an assessable capital gain in the year ended 30 June 2000 of $1,000 (that is, $8,000 [$18,000 - $10,000] less the amount of $7,000 assessed as a dividend under subsection 44(1) of the 1936 Act).*

19. *If the subsection 47(1) deemed dividend had been $9,000, Bill would have made no capital gain or capital loss on the cancellation of his shares.*

Example 2

20. *On 12 March 2001, Brett, who has no capital losses or tax losses, is paid an interim liquidation distribution of $50,000 in respect of his shares in Desert Co, which are held on capital account. The company began operations pre-CGT and has several pre-CGT gains on capital account that are undistributed. An amount of $8,000 of the interim distribution is deemed to be a dividend under section 47 for the purposes of section 44 of the 1936 Act. The shares were acquired by Brett in October 2000 for $25,000.*

21. *Assuming that the liquidator of Desert Co does not advise Brett in writing that Desert Co will not be dissolved within 18 months of the 12 March 2001 distribution, Brett may assume that Desert Co will be so dissolved and not initially apply CGT event G1 in relation to the distribution. (On the facts given, there would be a capital gain of $17,000 under event G1 were it to apply.)*

22. *If Desert Co is not dissolved within the 18 month period, Brett should request an amendment to include the capital gain of $17,000 in his assessable income for the year of income in which the distribution was made. If the company is dissolved within that period, Brett should include the full $50,000 distributed as capital proceeds for cancellation of the shares under CGT event C2 (Other amounts distributed, including a final distribution, may also form part of the capital proceeds.) Subsection 118-20(1), when read with subsection 118-20(1A) of the 1997 Act, will ensure that no part of the $8,000 dividend component of the $50,000 is taxed both as a dividend and as a capital gain.*

Note 1:

23. If a liquidator of a company makes a final distribution, we expect that they would clearly identify it is a final distribution so that shareholders in the company will know that it is a final distribution, not an interim distribution.

Note 2:

24. This Taxation Determination when issued as a final will rewrite and replace Taxation Determination TD 95/13. When this draft Taxation Determination is issued as a final Taxation Determination TD 95/13 and Taxation Determination TD 95/12 will be withdrawn.

Note 3:

25. This Determination reflects changes in the law effected by *Tax Law Improvement Act (No 1) 1998*. One change aligns the treatment of interim liquidation distributions with that of final distributions if the company is dissolved within 18 months from the interim payment. The other change extends the anti-overlap provisions of 118-20(1) of the 1997 Act to ensure that a capital gain is reduced by an amount included in assessable income or exempt income if the amount would also have been taken into account in calculating the capital gain.

Your comments

26. We invite you to comment on this Draft Taxation Determination. This Draft Taxation Determination was previously released as TD 1999/D24. We are allowing 3 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

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Commissioner of Taxation

11 April 2001

Previous TD:
Previously issued as TD 95/12, TD 95/13 and TD 1999/D24

Related Rulings/Determinations:
TD 95/10; TD 95/11; TD 95/14; TD 95/15

Subject references:
- assessable income
- cancellation
- capital gain
- capital proceeds
- company
- disposal
- distribution
- dividend
- interim distribution
- liquidation
- liquidator
- shareholder
- shares

Legislative references:
- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 47
- ITAA 1936 47(1)
- ITAA 1936 170AA(1)
- ITAA 1936 204(3)
- ITAA 1997 Pt 3-1
- ITAA 1997 104-25
- ITAA 1997 104-135(1)
- ITAA 1997 104-135(6)
- ITAA 1997 116-40(2)
- ITAA 1997 118-20(1)
- ITAA 1997 188-20(1A)
- ITAA 1997 Pt 3-3
- TAA 8AAG

Case references:
- C of T (NSW) v Stevenson (1937) 59 CLR 80; 4 ATD 415

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