TD 2001/14 - Income tax: capital gains: how is a distribution of the 'exempt' 50% component of a capital gain attributable to goodwill (as worked out in accordance with paragraph 47(1A)(b) of the Income Tax Assessment Act 1936 ('the 1936 Act')) treated for the purposes of:(a) sections 47 and 44 of the 1936 Act; and (b) the capital gains provisions in the Income Tax Assessment Act 1997 ('the 1997 Act'); when a company's business ends and the capital gain is distributed to shareholders by a liquidator in the course of winding up the company?

Taxation Determination

Income tax: capital gains: how is a distribution of the 'exempt' 50% component of a capital gain attributable to goodwill (as worked out in accordance with paragraph 47(1A)(b) of the *Income Tax Assessment Act 1936* ('the 1936 Act')) treated for the purposes of:

(a) sections 47 and 44 of the 1936 Act; and

(b) the capital gains provisions in the *Income Tax Assessment Act 1997* ('the 1997 Act');

when a company's business ends and the capital gain is distributed to shareholders by a liquidator in the course of winding up the company?

Preamble.
The number, subject heading, date of effect and paragraphs 1 to 5 and 15 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Determination is a public ruling and how it is legally binding on the Commissioner.*

Date of Effect
This Determination applies to income years commencing both before and after its date of issue. However, the Determination 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).

1. A distribution by a liquidator of the 'exempt' 50% component of a capital gain attributable to goodwill (as worked out in accordance with paragraph 47(1A)(b) of the 1936 Act, that is, disregarding indexation) is not deemed to be a dividend under subsection 47(1). [A reference in this Determination to 'the "exempt" 50% component', in relation to a capital gain attributable to goodwill, refers to that part of the capital gain which, for the purposes of paragraph 47(1A)(b) of the 1936 Act, is disregarded by subsection 118-250(1) of the 1997 Act or which is subject to a small business 50% reduction under section 152-205 in Subdivision 152-C of the 1997 Act].

2. The 'exempt' 50% component is not 'income derived by the company' according to ordinary concepts for the purposes of subsection 47(1) of the 1936 Act. Nor is it 'income derived

by the company' under the extended definition of that expression in subsection 47(1A) of the 1936 Act.

3. The 'exempt' 50% component does not come within the extended definition of 'income derived by a company' in subsection 47(1A) of the 1936 Act because it is a 'capital gain that is disregarded' within the meaning of that expression in Step 1 of the method statement in paragraph 47(1A)(b). Specifically, this is because:

- if section 118-250 applies - subsection 118-250(1) disregards half of the capital gain; or
- if, from 21 September 1999 (see Note 2), section 152-205 applies - a capital gain attributable to goodwill is reduced by 50% in accordance with Step 4 in the method statement in subsection 102-5(1) of the 1997 Act. The amount by which the capital gain is reduced is appropriately treated as a capital gain that is 'disregarded' for the purposes of subsection 47(1A).

4. Being a capital gain disregarded under Step 1 of the method statement in paragraph 47(1A)(b), the 'exempt' 50% component is not included in the net capital gain of the company under Step 2 of that method statement.

5. For the capital gains provisions in the 1997 Act, the distribution by the liquidator of the 'exempt' 50% component represents capital proceeds for the cancellation of the shares (CGT event C2: section 104-25) in the case of a final distribution or an interim distribution which is followed within 18 months by the dissolution of the company: see section 104-25 and subsection 104-230(6). It is an amount to which CGT event G1 (about capital payments for shares) in section 104-135 of the 1997 Act applies in the case of other interim liquidation distributions in respect of post-CGT shares.

Example

Company's position

6. *X Pty Ltd, a resident company, was incorporated and acquired a business after 19 September 1985. The business was acquired for $1,100,000 and of that amount its goodwill was acquired for $100,000. The business was sold and the goodwill disposed of for $200,000 in the company's 1998-99 year of income.*

7. *Assuming the cost base of the goodwill after indexation was $110,000, the company made a capital gain of $90,000 of which $45,000 was exempt under section 118-250. The company paid tax of $16,200 on the gain (that is 36% x $45,000).*

8. *The company transferred the after-tax amount of $83,800 to its capital profits reserve.*

9. *The company was placed in liquidation. The liquidator distributed $83,800 appropriated from the capital profits reserve.*

Shareholder's position

10. *Subsection 47(1), read with subsection 47(1A), deems a shareholder to have received a dividend to the extent that an amount would have been a capital gain to the company disregarding indexation.*

11. *In this particular case, the capital gain to the company (disregarding indexation, as subsection 47(1A) requires) would have been $100,000. Fifty percent ($50,000) would have qualified for exemption under section 118-250. The balance of the distribution ($33,800 -that is $50,000 less $16,200 tax paid) is deemed by subsection 47(1) to be a dividend.*

12. *If the distribution is a final distribution or an interim distribution followed within 18 months by the dissolution of the company, the full amount of $83,800 would represent capital proceeds for the cancellation of the shares and would need to be taken into account in calculating*

the extent of any capital gain or loss in respect of the cancellation. Subsection 118-20(1) would operate to ensure an appropriate reduction is made to any capital gain that would otherwise arise to the extent of the $33,800 deemed dividend.

13. *If the distribution is an interim distribution not followed within 18 months by the dissolution of the company, the application of section 104-135 would need to be considered in relation to the amount of the distribution that is not deemed to be a dividend (that is $50,000 [$83,800 - $33,800]).*

Note 1:

14. This Determination rewrites and replaces Taxation Determination TD 95/14 which is now withdrawn.

Note 2:

15. Section 118-250 has been repealed. Division 152 of the 1997 Act (about small business relief) has now been inserted and applies to assessments for the income year including 21 September 1999 and all later income years, if a CGT event happens after 11.45 am, by legal time in the Australian Capital Territory, on 21 September 1999: item 61 in Schedule 1 to the *New Business Tax System (Capital Gains Tax) Act 1999*. Division 152, among other small business relief, replaces the former 50% goodwill exemption with a 50% active asset reduction for all businesses with net assets of $5 million or less. Goodwill is an active asset for the purposes of Division 152: subsection 152-40(1) of the 1997 Act. A capital gain attributable to goodwill may be reduced by section 152-205 of the 1997 Act by 50% - in accordance with Step 4 in the method statement in subsection 102-5(1) of the 1997 Act. To the extent the liquidation distribution represents the amount of the reduction, it will not be taken to be a dividend - under the extended definition in subsection 47(1) of the 1936 Act - for the purposes of section 44 of the 1936 Act. The same applies to reductions of capital gains on active assets other than goodwill.

Commissioner of Taxation
13 June 2001

Previously released:
Previously issued in final form as TD 95/14 and in draft form as TD 1999/D25

Subject references:
- active asset
- assessable income
- business
- capital gain
- capital loss
- cancellation
- capital proceeds
- company
- deemed dividend
- disposal
- disregarded
- distribution
- dividend
- exempt 50% component
- exemption
- goodwill
- income
- indexation

- liquidation
- liquidator
- reduction
- shares
- small business
- winding up

Legislative references:

- ITAA 1936 44
- ITAA 1936 47
- ITAA 1936 47(1)
- ITAA 1936 47(1A)
- ITAA 1936 47(1A)(b)
- ITAA 1997 102-5(1)
- ITAA 1997 104-25
- ITAA 1997 104 –135
- ITAA 1997 104-230(6)
- ITAA 1997 118-20(1)
- ITAA 1997 118-250
- ITAA 1997 118-250(1)
- ITAA 1997 152-40(1)
- ITAA 1997 152-205
- ITAA 1997 Division 152
- ITAA 1997 Subdivision 152-C
- New Business Tax System (Capital Gains Tax) Act 1999 Item 61 Sch 1

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