

***TD 2001/27 - Income tax: capital gains: how do Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997 ('ITAA 1997') treat:(a) a final liquidation distribution, including where all or part of it is deemed by subsection 47(1) of the Income Tax Assessment Act 1936 ('ITAA 1936') to be a dividend; and (b) an interim liquidation distribution to the extent it is not deemed to be a dividend by subsection 47(1)?***

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# Taxation Determination

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

- (a) a final liquidation distribution, including where all or part of it is deemed by subsection 47(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936') to be a dividend; and**
- (b) an interim liquidation distribution to the extent it is not deemed to be a dividend by subsection 47(1)?**

***Preamble***

*The number, subject heading, date of effect and paragraphs 1 to 19 of the 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. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

***Date of Effect***

*This Determination applies to 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).*

**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 ending of the shareholder's shares in the company for the purposes of capital gains or capital losses made on the happening of CGT event C2 (about cancellation, surrender and similar endings) in section 104-25 of the ITAA 1997. After the winding-up of a company, CGT event C2 happens to the shares when the company ceases to exist in accordance with the *Corporations Act 2001* (see Taxation Determination TD 2000/7 paragraphs 3 and 4).

***Alternative view***

2. An alternative view that a final distribution represents proceeds from the winding-up of the company - and not from the ending 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 subsection 47(1) 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 ITAA 1936 to be a dividend paid out of profits, and to be assessable income of a shareholder in the company under subsection 44(1), 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 ITAA 1997 does not apply. The capital proceeds for the ending of the shares are not limited to the portion of the distribution that is not assessable under subsection 44(1).

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

#### **Non-assessable part of interim liquidation distribution**

6. CGT event G1 (about capital payments for shares) in subsection 104-135(1) of the ITAA 1997 may result in capital gains being made and (or) the need for cost base and reduced cost base reductions in respect of shares in a company in liquidation. However, it may do so only to the extent that the interim distribution made by the company's liquidator is not an amount that is deemed to be a dividend under subsection 47(1) of the ITAA 1936 (referred to in section 104-135 and in this Taxation Determination as the 'non-assessable part') and the company does not cease to exist within 18 months of the distribution being paid. For the purposes of CGT event G1, a 'payment' can include the giving of property. (Note also that any capital gain that would be made on a pre-CGT share is disregarded: see subsection 104-135(5) of the ITAA 1997).

7. If the company ceases to exist within 18 months of the payment of the distribution, subsection 104-135(6) ensures that the non-assessable part is disregarded for the purposes of section 104-135. The non-assessable part is treated as part of the capital proceeds for the happening of CGT event C2 when the share ends. Note that it is the company's ceasing to exist, not the final distribution, that must happen within 18 months of the payment for this outcome to occur.

8. 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, the shareholder is unlikely to know whether the company will cease to exist within 18 months of payment of the distribution. There are two courses of action open to the shareholder in such a case:

- (a) to assume (this includes a case where the shareholder anticipates) that the company will cease to exist within 18 months; or
- (b) to apply CGT event G1 on the assumption that the company will not cease to exist within the 18 month period.

9. Only if the shareholder is advised in writing by the liquidator that the company will not cease to exist within 18 months of payment of the non-assessable part of the distribution must the shareholder initially apply CGT event G1.

10. In relation to each course of action covered by paragraph 8, further action may be required depending on whether the company ceases to exist within the 18 month period.

*Shareholder assumes the company will cease to exist within 18 months but it does not cease to exist*

11. In the absence of written advice from the liquidator that the company will not cease to exist within 18 months of payment of the interim distribution, a shareholder may assume that the company will cease to exist within 18 months.

12. The shareholder may therefore initially apply subsection 104-135(6) to disregard the non-assessable part for the purposes of CGT event G1 and this amount will be part of their capital proceeds for the happening of CGT event C2 when their shares end. Any capital gains 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 end.

13. If the company does not cease to exist within 18 months of the payment of the interim liquidation distribution, subsection 104-135(6) does not apply and CGT event G1 can have effect.

14. The effect of CGT event G1 in relation to the non-assessable part 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-assessable part of the interim distribution and, if the non-assessable part of the distribution is greater than the cost base (the difference being 'the excess'), the shareholder makes a capital gain equal to the excess at the time of the payment. The shareholder would take that capital gain into account in calculating their net capital gain or net capital loss for the income year in which the payment is made.

15. The shareholder may need to have their assessment amended for the income year in which the payment was made. An amendment would only be necessary to take a capital gain into account if one was made when CGT event G1 happened and it causes to arise, or it causes an increase in, a net capital gain in respect of that income year. Any cost base or reduced cost base reduction would be required to be made as at the time of the payment.

16. If a shareholder's assessment is amended to include, or increase, a net capital gain as a result of the happening of CGT event G1 and a liability to pay the general interest charge arises, the remission of the general interest charge will be dealt with in each case on its own merits.

17. We would expect, however, that the discretion to remit the general interest charge in full would ordinarily be exercised if a shareholder seeks an amendment within a reasonable time after the end of the 18 month period. In most cases, we would consider a period of one month after the end of the 18 month period 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 the liquidator that the company will not cease to exist within 18 months or assumes that outcome but it does cease to exist within that period*

18. If the shareholder is told by the liquidator that the company will not cease to exist within 18 months of the payment of the interim distribution, or the shareholder chooses to assume that outcome, CGT event G1 must be applied in respect of the non-assessable part of the payment.

19. If, contrary to the liquidator's advice or the shareholder's assumption, the company in fact ceases to exist within 18 months of the payment, the shareholder may need to seek an amendment to remove any CGT event G1 capital gains from any net capital gain in their assessable income in the income year of the payment. They would be entitled to receive interest for the overpayment. The non-assessable part of the interim liquidation distribution would form part of the capital proceeds for the happening of CGT event C2 when their shares end. No cost base or reduced cost base

reductions would be taken to have been required by CGT event G1 in respect of the interim distribution.

*Example 1: final liquidation distribution with a deemed subsection 47(1) dividend component*

20. Bill acquired 100 shares in XYZ Pty Ltd in 1987. XYZ Pty Ltd went into liquidation. Bill's shares have cost bases totalling \$10,000 at the time they end on the company's ceasing to exist in September 1999. Bill receives a final liquidation distribution on 1 July 1998 of \$18,000 of which \$7,000 is deemed to be a dividend by subsection 47(1) of the ITAA 1936. Bill makes capital gains in the income 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 ITAA 1936).

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

*Example 2: interim and final liquidation distributions*

22. On 12 March 2001 Brett, who has no capital losses, net 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. No part of the interim distribution is deemed to be a dividend under subsection 47(1) for the purposes of subsection 44(1) of the ITAA 1936. The shares were acquired by Brett in October 2000 for \$48,000.

23. If the liquidator of Desert Co does not advise Brett in writing that Desert Co will not cease to exist within 18 months of the 12 March 2001 distribution, Brett may assume that Desert Co will cease to exist within that period and may decide initially not to apply CGT event G1 in relation to the distribution. As a result, there would be no capital gains or cost base (or reduced cost base) reductions to the shares at this stage. (On the facts given, there would be capital gains of \$2,000 under CGT event G1 were it to apply and the cost bases and reduced cost bases of the shares would be reduced to nil).

24. If Desert Co does not cease to exist within the 18 month period, Brett should, as soon as practicable after the end of the 18 month period, seek an amendment to his income tax assessment for the year of income in which the interim distribution was made to include the capital gains of \$2,000 in his assessable income. If, on the other hand, the company does cease to exist within the 18 month period, Brett need not seek an amendment. Instead, he should include the \$50,000 distributed as capital proceeds for the ending of the shares under CGT event C2. (Note that if Brett had initially assumed that the company would not cease to exist within the 18 month period, but it did, he would need to seek an amendment to exclude the effect of the capital gain of \$2,000 under CGT event G1). Assuming that a final liquidation distribution of \$15,000 is also made (of which no part is deemed by subsection 47(1) to be a dividend paid out of profits for the purposes of subsection 44(1)) and there are no other distributions, Brett would make capital gains of \$17,000 (that is \$65,000 less \$48,000) in respect of the CGT event C2 that happens when the shares end on the company's ceasing to exist. If Brett acquired his shares at least 12 months before CGT event C2 happens to the shares, he may be entitled to treat the gains as discount capital gains.

**Note 1:**

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

**Note 2:**

26. This Taxation Determination rewrites and replaces Taxation Determinations TD 95/12 and TD 95/13. Taxation Determinations TD 95/12 and TD 95/13 are withdrawn.

**Note 3:**

27. 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 ITAA 1997 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.

**Note 4:**

28. This Determination does not address the consequences under Parts 3-1 and 3-3 of the ITAA 1997 of an interim liquidation distribution to the extent it is deemed by subsection 47(1) of the ITAA 1936 to be a dividend.

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**Commissioner of Taxation**

7 November 2001

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*Previous draft:*

Previously released in draft form as TD 1999/D24 and TD 2001/D2

*Previous rulings:*

Previously released as TD 95/12; TD 95/13

*Related rulings:*

TD 95/10; TD 95/15; TD 2000/5; TD 2000/7; TD 2001/14

*Subject references:*

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

*Legislative references:*

- TAA 1953 Part IVAAA
- ITAA 1936 44(1)
- ITAA 1936 47(1)
- ITAA 1997 104-25
- ITAA 1997 104-135
- ITAA 1997 104-135(1)
- ITAA 1997 104-135(5)
- ITAA 1997 104-135(6)
- ITAA 1997 116-40(2)

- ITAA 1997 118-20(1)
- ITAA 1997 118-20(1A)
- ITAA 1997 Pt 3-1
- ITAA 1997 Pt 3-3

*Case references:*

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

NO: T98/6900-0

ISSN: 1038-8982