

# ***TA 2008/7 - Application of Part IVA of the Income Tax Assessment Act 1936 to 'wash sale' arrangements***

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! The ATO view on the arrangement described in TA 2008/7 is set out in TR 2008/1.

! This document has changed over time. This version was published on *18 April 2008*



# Taxpayer Alert

TA 2008/7

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**FOI status: may be released**

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*Taxpayer Alerts are intended to be an "early warning" of significant new and emerging tax planning issues or arrangements that the ATO has under risk assessment.*

*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 ATO officers of new and emerging 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.*

*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 the ATO considers give rise to taxation issues. These issues will generally require more detailed analysis to provide an ATO view to taxpayers.*

*The developers and marketers of an arrangement which is the subject of a Taxpayer Alert should provide the full facts of the arrangement to the ATO to enable the ATO to finalise its view.*

*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. Such taxpayers might obtain their own advice and/or contact the ATO officer named in the Alert.*

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

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## **TITLE: Application of Part IVA of the *Income Tax Assessment Act 1936* to 'wash sale' arrangements**

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1. This Taxpayer Alert describes an arrangement called a 'wash sale' where an asset is disposed of, but there is no substantial change in economic interest in the asset.

### **DESCRIPTION**

2. The type of wash sale arrangement this alert covers is where a taxpayer disposes of, or otherwise deals with a capital gains tax (CGT) asset to generate a capital or revenue loss, but where in substance, there is no significant change in the

taxpayer's economic exposure in the asset. This may occur where the interest in the asset is in some way reinstated by the taxpayer, in order to apply a resulting capital loss or allowable deduction against a capital gain or assessable income already derived or expected to be derived.

3. Reinstatement of the taxpayer's interest is commonly achieved by a taxpayer selling a CGT asset and creating a trust over the asset or transferring an asset to a trust. We are concerned where this is done with the sole or dominant purpose of generating a capital or revenue loss to offset against a capital gain or assessable income when in substance there is an intention to acquire the same or substantially the same asset or the taxpayer still benefits from the asset.

4. Examples of mechanisms to carry out wash sale arrangements covered by this Taxpayer Alert and where Part IVA might be relevant are those discussed in paragraph 4 of TR 2008/1 which sets out the ATO view in relation to wash sales. These examples apply where the taxpayer disposes of, or otherwise deals with, an asset and there is an arrangement to acquire the same or substantially the same asset, or otherwise continue to benefit from the asset.

### **Example: 24 hours between disposal and acquisition**

This example corresponds with Example 2 in TR 2008/1.

#### **Step 1**

1. Kelly maintains a large share portfolio. She sells a parcel of Alpha shares from her portfolio on 20 March 2007 and makes a capital gain of \$62,000 in the year ended 30 June 2007.

#### **Step 2**

2. On 5 June 2007, Kelly receives a financial booklet discussing various end of year income tax saving strategies. As a result of what she reads, she reviews her share portfolio and notes that her shares in Echo Ltd (Echo) are currently trading at \$1.20 per share. Kelly's reduced cost base for her Echo shares is \$2.42 per share. Acting on one of the strategies outlined in the booklet she devises a plan which would allow her to crystallise the unrealised loss and maintain her interest in Echo. In view of this she contacts Bruce, her broker, on the same day to obtain information on the market and the current expectations as to the price of the Echo shares. Bruce assures her that there have been no relevant market announcements and that he expects, based on the information available to him, that there will be no significant movements in the price of the Echo shares over the next couple of days.

#### **Step 3**

3. Acting on Bruce's advice she places with him a sell order for 50,000 Echo shares at \$1.20 per share.
4. Kelly's capital proceeds from the sale transaction are \$60,000, and her reduced cost base is \$122,000 (including the \$1,000 transaction costs see Step 4), giving her a capital loss of \$62,000.

#### **Step 4**

5. The next day (6 June 2007), Kelly instructs Bruce to buy 50,000 Echo shares. The price of the stock has now moved up to \$1.21 per share.
6. Bruce charges Kelly \$1,000 for transaction costs associated with the sell and buy orders.

#### **Outcome**

7. Kelly offsets the \$62,000 capital loss against the \$62,000 capital gain when preparing her income tax return for the year ended 30 June 2007.
8. The scheme, for the purposes of subsection 177A(1), includes all the steps leading to, the entering into and the implementation of the planned sell and buy transactions, the incurrance of a \$62,000 capital loss and the offsetting of that capital loss against the \$62,000 capital gain by Kelly. The facts surrounding the entry into the scheme, including the adoption of the strategy in the financial booklet and the advice received on the expectations as to price, suggest that Kelly planned to purchase back the same number of Echo shares shortly after she sold them. Accordingly, the disposal and acquisition of the shares 24 hours later constitute a scheme within the meaning of subsection 177A(1).
9. Upon weighing up the eight factors in section 177D (ITAA 1936) (see example 2 in TR 2008/1 for the full analysis), it would be concluded that the dominant purpose of Kelly in entering into and carrying out the scheme was to obtain a tax benefit in the form of a capital loss. In particular the manner, form and substance, timing, tax effects and financial consequences for Kelly arising from the scheme support this conclusion. Accordingly, the Commissioner may make a determination under section 177F to cancel the tax benefit.

#### **FEATURES WHICH CONCERN US**

5. Depending upon the individual facts and circumstances, the Tax Office considers that wash sale arrangements that have the above features may give rise to taxation issues including whether:
  1. the general anti-avoidance provisions in Part IVA of the ITAA 1936 should be applied to cancel all or part of a relevant capital loss or allowable deduction from the wash sale arrangement where the taxpayer disposes of the assets with every intention of acquiring the same or substantially the same assets, or otherwise continue to benefit from the asset.
  2. any entity involved in the arrangement is a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the *Taxation Administration Act 1953*.

*The Australian Taxation Office has examined these wash sale arrangements and a view as to the application of Part IVA has been provided in TR 2008/1.*

*Note 1: Penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Reductions in base penalty may be available if the taxpayer makes a voluntary disclosure to the Tax Office. 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 the tax agent integrity service on 1800 639 745.*

*Note 2: 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.*

**Subject references:**

Aggressive tax planning  
Wash sales  
Capital gain tax  
Capital losses  
Deductions  
Arrangement  
Promoters

**Legislative references:**

*Income Tax Assessment Act 1936 Part IVA*  
*Taxation Administration Act 1953 Schedule 1 Div 290*

**Related Practice Statements:**

PS LA 2005/13

**Related Rulings/Determinations:**

TR 2008/1  
TD 2004/13

*file references:*

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