TR 93/15 - Income tax: capital gains tax consequences of consideration comprising a lump sum plus a right to a contingent and unascertainable amount

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Income tax: capital gains tax consequences of consideration comprising a lump sum plus a right to a contingent and unascertainable amount

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This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part . Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is 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.]

What this Ruling is about

1. This Ruling is concerned with the capital gains tax consequences under Part IIIA of the *Income Tax Assessment Act 1936* of the sale of an asset for a lump sum plus a right to a contingent and unascertainable amount. An amount is contingent if the event giving rise to its payment may or may not occur, and unascertainable if it can be calculated only when the event occurs.

2. The Ruling explains:

(a) the capital gains tax consequences for the seller;

(b) the capital gains tax consequences for the buyer; and

(c) the particular capital gains tax consequences of the transaction on the sale of an asset acquired before 20 September 1985.

3. This Ruling is not concerned with a lump sum paid in instalments. Nor does it consider whether the consideration is assessable or deductible under other provisions of the income tax law.

Ruling

The seller

4. If the consideration received under a contract of sale is a lump sum plus a right to a contingent and unascertainable amount, the lump sum is treated as a sum of money and the right is treated as property other than money (paragraph 160ZD(1)(c)).

5. The right is also an asset under section 160A and payment of an amount in satisfaction of the right is a disposal of that asset under paragraph 160M(3)(b).

The buyer

6. If consideration given under a contract of purchase is a lump sum plus a contingent obligation to pay an unascertainable amount, the consideration given at the time of purchase is an amount of money only (paragraph 160ZH(4)(a)).

7. The payment of a further amount to satisfy the contingent obligations is also an amount of money, but only at the time of the payment (paragraph 160ZH(4)(a)).

8. A contingent obligation to pay an amount in respect of the right is not property in the hands of the buyer.

Assets acquired before 20 September 1985

9. A right received as part of the consideration on the disposal of an asset acquired before 20 September 1985 is itself subject to the capital gains tax provisions if the original asset is disposed of after 19 September 1985. The right is therefore not regarded as having been acquired before 20 September 1985.

Date of effect

10. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Background

11. There is concern over the lack of symmetry between the seller's and the buyer's capital gains tax position in that the seller is taken to have received money and property as consideration while the buyer is taken to have paid only money as consideration. It is not a prerequisite to the operation of the capital gains tax provisions that there be symmetry of treatment between different taxpayers. The provisions must operate according to the particular taxpayer's circumstances and perspective.

12. The lack of symmetry arises because a right may be property while an obligation is not.

13. The *CCH Macquarie Concise Dictionary of Modern Law* defines 'property' as:

> "1. ownership. 2. any thing capable of being owned"

The courts have also defined the term 'property' very widely to include not only an asset but the rights in an asset (*Jones v Skinner*(1836) 5 LJ Ch 90; *McCaughey v Commr of Stamp Duties*(1945) 46 SR (NSW) 192; *Minister of State for the Army v Dalziel* (1944) 68 CLR 261).

Illustration

14. An illustration of the type of transaction considered in this Ruling follows:

. A seller wishes to dispose of a business.

. The seller believes the income earning ability of the business makes it worth $500,000.

. A buyer knows it is worth at least $400,00 but is unsure of precisely how much.

. The seller and the buyer agree to a sale of the business for $400,000 plus a further amount if the business continues to be successful

. They decide that if the gross business sales for the next year exceed $250,000 an amount calculated at 50% of the excess will be paid by the buyer to the seller.

. A written contract is entered into with these conditions and the business changes hands.

. All of these events occur after 20 September 1985.

The seller

Is the consideration received money only?

15. At the time of sale the consideration receivable of $400,000 in the illustration above, is an entitlement to money in respect of the disposal of the business. The agreement that the seller will receive a further amount of money if and when the gross sales exceed $250,000 is not an entitlement to money either immediately or in the future (*Marren v Ingles*[1980] 3 All ER 95). The seller only has a right to a contingent and unascertainable amount. A debt has not been created as the buyer only has a contingent liability to pay. There may never be an amount receivable by the seller. If the occurrence of an event takes place and the amount can be calculated, the contingent right at that time becomes an actual entitlement to money. Consequently the seller has not received, nor is he entitled, at the time of the sale of the business, to receive that further amount of money.

16. The statement in subsection 160K(3) that:

> "A reference in this Part to a person being entitled to receive money ... includes a reference to a person being entitled to receive money ... either immediately or at a future date, ... either in a lump sum or by instalments."

does not change the requirement that the entitlement to the amount of money must exist at the time of the disposal of the asset, though the time for payment may be in the future.

Is the consideration received money and property other than money?

17. The seller has received a lump sum and a right to be paid a further amount of money on an event occurring. The right is a contractual promise that has been obtained for value and is capable of being assigned. It is a right of a proprietary nature. The seller receives or becomes entitled to receive that right at the time of the disposal of the asset. Accordingly, the seller has received both an amount of money and property other than money (paragraph 160ZD(1(c); *Marren v Ingles*[1980] 3 All ER 95).

18. The amount of consideration received for the original asset is the lump sum and the market value of the right at the time of its acquisition (paragraph 160ZD(1)(c)).

How is the right treated?

19. The right is an asset for capital gains tax purposes (section 160A).

20. If the right is acquired after 19 September 1985, it is subject to the capital gains tax provisions. Its date of acquisition is the date of the contract under which it is acquired. As the right is acquired under the contract disposing of the original asset, the date of making that contract is the acquisition date of the right (subsection 160U(3)).

21. The cost base of the right is the market value at the time of acquisition plus any other relevant amounts under section 160ZH.

22. The market value of the right may be dependent on a number of factors including the risk, the likelihood of the event occurring and the variables on which the amount, if and when payable, is to be calculated. If it is a high risk business or calculated in a market of highly speculative and variable prices, it may be accepted that the market value is low or even, in some circumstances, nil. However, in a stable market where the risk is low, only small changes in prices occur and there is a strong likelihood that the event giving rise to a payment will occur, it is expected that the market value of the right will closely reflect the amount of money likely to become payable.

23. The receipt or non-receipt of the further amount in satisfaction of, or on the expiry of, the right is a disposal of the right (paragraph 160M(3)(b)).

24. If the seller becomes entitled to more than one possible capital payment (e.g. 50% of the excess of sales over 250,000 to be paid each year for the next two years), then whether it is one right to several possible payments or several rights (one for each possible payment) will depend on the contract in each case. Generally, the initial approach will be to regard the totality of rights under the contract as one asset for the purposes of Part IIIA (TD 93/86). A part disposal of that asset occurs at the time each of the possible payments arises.

The buyer

25. The time to consider what the buyer has given as consideration for the asset is, as the provisions in Part IIIA apply on disposal of an asset, when the buyer in turn disposes of the asset.

26. The question at that time is whether the buyer has given only money as consideration or a combination of money and property other than money (subsection 160ZH(4)).

Is the obligation property?

27. If the buyer agrees to pay a contingent and unascertainable amount, a proprietary right is created in the seller by the buyer. The buyer creates an obligation contingent on the happening of an event. The buyer does not give the seller any property that was previously owned by the buyer, even though what is given becomes the property of the seller. The buyer simply has no property to dispose of and nothing can be transferred or conveyed from the the buyer. It has been judicially decided that property can be acquired by one person without there being a corresponding disposition of that property by another person. Consequently, the buyer has not given property as part of the consideration (subsection 160ZH(4)) *(Commissioner of Taxes (Q) v. Camphin* (1937) 57 CLR 127; (1937) 4 ATD 315; *Ord Forrest Pty Ltd v. FC of T* 74 ATC 4034; (1974) 4 ATR 230; *Allina Pty Ltd v. FC of T* 91 ATC 4195; (1991) 21 ATR 1320).

How is the obligation treated?

28. Any further amount of money paid under the obligation is part of the amounts of money paid to acquire the asset, in our illustration the business. The consideration consisting of a lump sum plus any later payment made if and when the contingent obligation becomes an actual obligation is an amount of money paid or required to be paid by the buyer in respect of the acquisition of the asset (paragraph 160ZH(4)(a)). Indexation is available on any further amount paid from the date of the payment (subsection 160ZJ(3A)).

29. If the buyer sells the original asset before the contingent obligation under the contract has become an actual obligation, any amount paid in settlement of the contingent obligation is an incidental cost of disposal and is included in the cost base of the original asset.

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case references
- Allina Pty Ltd v. FC of T 91 ATC 4195; (1991) ATR 1320
- C of T v. Camphin (1937) 57 CLR 127
- Jones v Skinner (1836) 5 LJ Ch 127
- McCaughey v Commr of Stamp Duties 1945 46 SR (NSW) 192
- Marren v. Ingles [1980] All ER 95
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