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Anti-Avoidance and Share “Wash Sale” Arrangements

With the recent volatility in the share market, no doubt many investors have been considering disposing some of their share investments to mitigate their losses and perhaps offset these against previous realised gains.

Some investors may even be considering reacquiring such shares immediately on the same day or soon thereafter.

The Commissioner recently released a Public Ruling on the application of the Part IVA general anti-avoidance rules to such “wash sale” arrangements.

The term “wash sale” is a commercial concept that is broadly used to describe an arrangement resulting in the sale and repurchase of the same, or substantially the same, asset within a short period of time of each other. The arrangement is such that there is effectively no change in the taxpayer’s economic exposure to, or interest in, the asset.

The ruling is concerned with schemes where an asset is disposed of, or otherwise dealt with, for the purpose of crystallising a capital loss or realising an allowable deduction. Where that dealing results in no change to the beneficial ownership of the asset, or where that ownership is immediately reinstated by the taxpayer, the commercial incentive for the transaction will need to be identified.

The Ruling lists nine types of transactions as examples of wash sales where Part IVA might be in question. The examples include:

- The taxpayer disposes of the asset and at the same time, or shortly after, acquires the same asset (or vice versa);
- The taxpayer disposes of an asset and shortly before, after, or at the same time as the disposal, enters into an arrangement to acquire the same asset in the future for the same price as the proceeds received on the asset’s disposal;
- The taxpayer disposes of an asset and shortly before, after, or at the same time as the disposal, the taxpayer enters into an arrangement which entitles the taxpayer to future income produced by the asset and/or any capital appreciation in the asset;
- The taxpayer disposes of the asset to a company which the taxpayer is a member of, or which the taxpayer controls under a trust arrangement;
- The taxpayer disposes of the asset to a company which the taxpayer controls and the company (or trustee) disposes of the asset to the taxpayer, or enters into arrangements to provide the financial benefits of the asset to the taxpayer;
- The taxpayer disposes of the asset in circumstances where there is a significant overlap in the individuals who had direct or indirect

interests in the asset before and after the disposal (eg. From one wholly owned company to another, or between two trusts with the same trustee and class of beneficiaries or objects); and

- The taxpayer disposes of the asset to family members and there is an arrangement/understanding that the asset will be re-acquired by the taxpayer, the future income produced by the asset and/or any capital appreciation will be provided to the taxpayer, or there is otherwise no change in how the financial benefits produced by the asset are utilized by the taxpayer when compared to what occurred prior to the disposal.

When will Part IVA apply?

Firstly, there must be a scheme. The Ruling states a scheme would consist of the steps taken to effect the wash sale such as those to:

- Dispose of or deal with the asset so that a capital loss or allowable deduction is incurred;
- Continue the taxpayer's economic exposure to, or interest in, the asset, or substantially the same asset, or enable the taxpayer to reinstate that exposure or interest; and
- Apply the capital loss or allowable deduction against a capital gain or assessable income, whether in that income year or a subsequent income year.

Secondly, there must be a tax benefit in connection with the scheme. In the examples provided, the capital loss or allowable deduction is the tax benefit.

Were Part IVA to apply – what are the consequences?

If Part IVA applies to a wash sale, the Commissioner may make a determination to cancel all or some of the tax benefits (capital loss or deductions) obtained in connection with it.

For more information on any aspect of the above, please contact Michelle Saunders on (08) 6311 6911 or Marissa Bechta on (08) 6311 6933.

The Ruling contains 6 examples to illustrate what the Commissioner will conclude Part IVA should apply. The examples include specific scenarios where investors holding onto unrealised losses sell those shares, realise their loss and then buy back in that specific stock shortly after at minimal economic difference. The above were transacted to offset previous realised capital gains. The Commissioner was of the view that Part IVA applied in these situations.

General Comment

Part IVA is capable of applying to the sale and repurchase of the same or similar asset even if the transactions convey beneficial ownership and are done at an arm's length price between unrelated parties when the tax benefit appears to outweigh any commercial advantage or not be referable to the bestowing of a family benefit. This is so even though at the time of the transactions the loss was real although, but for the transaction, unrealised.

Needless to say, the question of whether a sale and repurchase of an asset constitutes a scheme to which Part IVA applies will require a close examination of the circumstances in which those transactions occurred. The onus of establishing the dominant purpose of the arrangements remain with the taxpayer. Whether there is a significant risk of the asset price changing within a period of 24 hours or one month or one year will depend on the evidence available to support the taxpayers assessment of that risk. Unfortunately, taxpayers all too often do not document the basis of their assessment (at least contemporaneously), and the Commissioner is left to judge the dominant purpose without evidence and with the benefit of hindsight.

The most important factor is whether there has been a transfer of risk for a period which is long enough for one to be able to objectively conclude that the dominant purpose for entering into the transaction was to remove the exposure to an appreciable movement in the asset price or change that exposure to cash (or other asset) for that period.

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