

ATO ID 2004-668 (Capital Gains Tax – Buy/Sell Agreement - Time of CGT Event A1)

ATO ID 2004/668

Income tax

Capital gains tax : buy-sell agreement - time of CGT event A1

FOI status: may be released

Status of this decision: Decision Current



CAUTION: This is an edited and summarised record of a Tax Office decision. This record is not published as a form of advice. It is being made available for your inspection to meet FOI requirements, because it may be used by an officer in making another decision.

This ATOID provides you with the following level of protection:

If you reasonably apply this decision in good faith to your own circumstances (which are not materially different from those described in the decision), and the decision is later found to be incorrect you will not be liable to pay any penalty or interest. However, you will be required to pay any underpaid tax (or repay any over-claimed credit, grant or benefit), provided the time limits under the law allow it. If you do intend to apply this decision to your own circumstances, you will need to ensure that the relevant provisions referred to in the decision have not been amended or repealed. You may wish to obtain further advice from the Tax Office or from a professional adviser.

Issue

Is a buy-sell agreement 'entered into' for the purposes of paragraph 104-10(3)(a) of the *Income Tax Assessment Act 1997* (ITAA 1997) before a condition precedent to its formation is fulfilled?

Decision

No. The buy-sell agreement is not entered into for the purposes of paragraph 104-10(3)(a) of the ITAA 1997 until the condition precedent to its formation is met.

Facts

A buy-sell agreement was signed between a private limited company and its shareholders.

It was a condition precedent to the formation of the agreement that one of the shareholders die.

If any shareholder died, their interests in the company were to be transferred to each of the other shareholders.

Reasons for Decision

Buy-sell agreements are used in business succession planning. If a business proprietor is unable to continue in business in circumstances contemplated by the agreement (such as death or disablement), the agreement ensures that the business is preserved for the remaining proprietors. The outgoing proprietor (or their estate) receives an amount equivalent to the worth of their equity in the business. The ultimate transfer of business interests is funded by insurance proceeds.

Subsection 104-10(1) of the ITAA 1997 provides that CGT event A1 happens on the disposal of a CGT asset. A CGT asset is disposed of if there is a change in its ownership from one entity to another.

The agreement in this case provided for the disposal of shares in a company carrying on a business if a shareholder died.

Subsection 104-10(3) ITAA 1997 provides that CGT event A1 happens when you enter into the contract for the disposal or, if there is no contract, when the change of ownership occurs.

The time when a contract is entered into is the time when it comes into existence for general law purposes.

If a contract is subject to a condition, an issue arises whether the condition is a condition precedent to its formation or whether it is a condition precedent to performance of the contract. In the first case, the contract does not come into existence until the condition is met. In the second case, the condition does not prevent the creation of the contract - non-fulfilment of the condition merely entitles a party to terminate the contract: see *Perri v. Coolangatta Investments Pty Ltd* (1982) 149 CLR 537.

In this case, the language used to describe the condition evidenced the parties' intention not to be bound by it from the date it was signed. That is, it was a condition precedent to the formation of the agreement. Accordingly, no agreement will be entered into for the purposes of CGT event A1 until the death of a party to the contract. When a party to the agreement dies there will only be a contract in respect of the assets being disposed of by that party. Subsequent contracts will be made when other parties die.

Date of decision: 23 July 2004

Year of income: Year ended 30 June 2004

Legislative References:

Income Tax Assessment Act 1997

[subsection 104-10\(1\)](#)

[subsection 104-10\(3\)](#)

[paragraph 104-10\(3\)\(a\)](#)

Case References:

Perri v. Coolangatta Investments Pty Ltd

[\(1982\) 149 CLR 537](#)

Related ATO Interpretative Decisions

[ATO ID 2003/1190](#)

Keywords

capital gains tax

CGT event A1-disposal of a CGT asset

deaths
private companies
shareholder payments
shareholders

Date of publication: 13 August 2004

ISSN: 1445-2782