# PART A About capital gains tax

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**SIGN POST**

## CHECK THIS SIGNPOST BEFORE YOU READ PART A OF THIS GUIDE

**Do you understand the three methods of calculating a capital gain?**
If you don't, read **part A chapter 2**, starting on page 14.

**Have you received a distribution of a capital gain from a managed fund or other unit trusts in 2002–03?**
If yes, read **part A chapter 4**, starting on page 23.

**Have you sold shares or units in a unit trust in 2002–03?**
If yes, read **part A chapter 5**, starting on page 27.

**Did you sell real estate or your home (main residence) in 2002–03?**
If yes, read **part A chapter 6**, starting on page 45.

**Do you need help completing the capital gains item on your individual tax return?**
If yes, read the relevant chapters in **part A**, then work through **part B**.

**Do you need help completing the capital gains item on your entity's tax return?**
If yes, read the relevant chapters in **part A**, then work through **part C**.

# CHAPTER 1 DOES CAPITAL GAINS TAX APPLY TO YOU?

This chapter provides general background information about capital gains tax and how it applies to you.

## What is capital gains tax and what rate of tax do you pay?

**Capital gains tax** (CGT) is the tax you pay on any capital gain you make and include on your annual income tax return. There is no separate tax on capital gains, it is merely a component of your income tax. You are taxed on your net capital gain at your marginal tax rate.

Your **net capital gain** is:

- your total capital gains for the year
  *minus*
- your total capital losses (including any net capital losses from previous years)
  *minus*
- any **CGT discount** and CGT small business concessions to which you are entitled.

You make a capital gain or capital loss if a CGT event happens. You can also make a capital gain if a **managed fund** or other trust distributes a capital gain to you.

For most CGT events, your capital gain is the difference between your capital proceeds and the cost base of your **CGT asset**—for example, if you received more for an asset than you paid for it. You make a capital loss if your **reduced cost base** is greater than your capital proceeds. (The terms in **bold** are explained in more detail in this chapter.)

Generally, you can disregard any capital gain or capital loss you make on an asset you acquired before 20 September 1985 (pre-CGT). For details of some other exemptions, see **Exemptions and roll-overs** on page 10.

There are special rules that apply when working out gains and losses from depreciating assets. To the extent that a depreciating asset is used for a taxable purpose (for example, in a business) any gain is treated as ordinary income and any loss as a deduction. A capital gain or capital loss may arise only to the extent that a depreciating asset has been used for a non-taxable purpose (for example, used privately). For details on the CGT treatment of depreciating assets, see **CGT and depreciating assets** on page 11.

To work out whether you have to pay tax on your capital gains, you need to know:

- whether a CGT event has happened
- the time of the CGT event
- how to calculate the capital gain or capital loss
- whether there is any exemption or **roll-over** that allows you to reduce or disregard the capital gain or capital loss
- how to apply any capital losses
- whether the CGT discount applies, and
- whether you are entitled to any of the CGT concessions for small business.

## What is a CGT event?

CGT events are the different types of transactions or events that may result in a capital gain or capital loss. Many CGT events involve a CGT asset while other CGT events relate directly to capital receipts (capital proceeds).

To work out your capital gain or capital loss, you need to know which CGT event applies. The type of CGT event affects when you include the capital gain or capital loss in your net capital gain or net capital loss and how you calculate the capital gain or capital loss.

There is a wide range of CGT events. Some happen often and affect many different people while others are rare and affect only a few people. There is a summary of CGT events A1 to L7 at appendix 1 on page 98.

The most common CGT event happens if you dispose of an asset to someone else—for example, if you sell or give away an asset. Subdividing land does not result in a CGT event if you retain ownership of the subdivided blocks. Therefore, you do not make a capital gain or a capital loss at the time of the subdivision.

Some other CGT events from which you may make a capital gain or capital loss include when:

- an asset you own is lost or destroyed (the destruction may be voluntary or involuntary)
- shares you own are cancelled, surrendered or redeemed
- you enter into an agreement not to work in a particular industry for a set period of time
- a trustee makes a **non-assessable payment** to you from a managed fund or other unit trusts

- a company makes a payment (not a dividend) to you as a shareholder
- a liquidator declares that shares you own are worthless
- you receive an amount from a local council for disruption to your business assets by roadworks
- you stop being an Australian resident
- you enter into a conservation covenant, or
- you dispose of a depreciating asset that you used for private purposes.

Australian residents make a capital gain or capital loss if a CGT event happens to any of their assets anywhere in the world. As a general rule, non-residents make a capital gain or capital loss only if a CGT event happens to a CGT asset that has a necessary connection with Australia.

Non-Australian residents may also make a capital gain or capital loss where CGT events create:

- contractual or other rights (CGT event D1), or
- a trust over future property (CGT event E9).

### Order in which CGT events apply

If more than one CGT event could apply to your transaction or circumstances, the most relevant CGT event applies.

### Time of the CGT event

The timing of a CGT event is important because it tells you in which income year a capital gain or capital loss from the event affects your income tax.

If you dispose of a CGT asset to someone else, the CGT event happens when you enter into the contract for disposal. If there is no contract, the CGT event generally happens when you stop being the asset's owner.

**Example**

**Contract**

In June 2003, Sue enters into a contract to sell land. The contract is settled in October 2003.

Sue makes the capital gain in the 2002–03 income year when she enters into the contract and not the 2003—04 income year when settlement takes place.

If a CGT asset you own is lost or destroyed, the CGT event happens when you first receive compensation for the loss or destruction. If you do not receive any compensation, the CGT event happens when the loss is discovered or the destruction occurred.

**Example**

**Insurance policy**

Laurie owned a rental property that was destroyed by fire in June 2002. He received a payment under an insurance policy in October 2002. The CGT event happened in October 2002.

The CGT events relating to shares and units, and the times of the events, are dealt with in chapter 5.

## What is a CGT asset?

Many CGT assets are easily recognisable—for example, land, shares in a company and units in a unit trust. Other CGT assets are not so well understood—for example, contractual rights, options, foreign currency and goodwill. All assets are subject to the CGT rules unless they are specifically excluded.

CGT assets fall into three categories:

- collectables
- personal use assets, and
- other assets.

### Collectables

Collectables include the following items that are used or kept mainly for the personal use or enjoyment of you or your associate(s):

- paintings, sculptures, drawings, engravings or photographs; reproductions of these items or property of a similar description or use
- jewellery
- antiques
- coins or medallions
- rare folios, manuscripts or books, and
- postage stamps or first day covers.

A collectable is also:

- an interest in any of those items
- a debt that arises from any of those items, or
- an option or right to acquire any of those items.

Any capital gain or capital loss you make from a collectable acquired for $500 or less is disregarded. A capital gain or capital loss you make from an interest in a collectable is disregarded if the market value of the collectable when you acquired the interest was $500 or less. However, if you acquired the interest for $500 or less before 16 December 1995, a capital gain or capital loss is disregarded.

If you dispose of collectables individually that you would usually dispose of as a set, you are exempt from paying CGT only if you acquired the set for

$500 or less. This does not apply to collectables you acquired before 16 December 1995.

Capital losses from collectables can only be used to reduce capital gains (including future capital gains) from collectables.

### Personal use assets

A personal use asset is:

- a CGT asset, other than a collectable, that is used or kept mainly for the personal use or enjoyment of you or your associate(s)
- an option or a right to acquire a personal use asset
- a debt resulting from a CGT event involving a CGT asset kept mainly for your personal use and enjoyment, or
- a debt resulting from your doing something other than gaining or producing your **assessable income** or carrying on a business.

Personal use assets include such items as boats, furniture, electrical goods and household items. Land and buildings are not personal use assets. Any capital loss you make from a personal use asset is disregarded.

If a CGT event happened to a personal use asset during or after the 1998–99 income year, any capital gain you make from the asset or part of the asset is disregarded if you acquired the asset for $10,000 or less. If you dispose of personal use assets individually that would usually be sold as a set, you get the exemption only if you acquired the set for $10,000 or less.

### Other assets

Assets that are not collectables or personal use assets include:

- land
- shares in a company
- rights and options
- leases
- units in a unit trust
- goodwill
- licences
- convertible notes
- your home (see **Exemptions** on page 10)
- contractual rights
- foreign currency, and
- any major **capital improvement** made to certain land or pre-CGT assets.

### Partnerships

It is the individual partners who make a capital gain or capital loss from a CGT event, not the partnership itself. For CGT purposes, each partner owns a proportionate share of each CGT asset.

### Joint tenants

For CGT purposes, individuals who own an asset as joint tenants are each treated as if they own an equal interest in the asset as a tenant in common (see page 78 for more information).

### Separate assets

For CGT purposes, there are exceptions to the rule that what is attached to the land is part of the land. In some circumstances, a building or structure is considered to be a separate CGT asset from the land.

Other improvements to an asset (including land) acquired before 20 September 1985 may also be treated as a separate CGT asset.

*Buildings, structures and other improvements to land you acquired on or after 20 September 1985*

A building, structure or other capital improvement on land that you acquired on or after 20 September 1985 will be a separate CGT asset from the land if a balancing adjustment provision applies to it. For example, a timber mill building is subject to a balancing adjustment if it is sold or destroyed, so it is treated as a separate asset from the land.

*Buildings and structures on land acquired before 20 September 1985*

A building or structure on land that you acquired before 20 September 1985 will be a separate asset if:

- you entered into a contract for the construction of the building or structure after that date, or
- construction began on or after that date.

*Other capital improvements to pre-CGT assets*

If you make a capital improvement to a CGT asset you acquired before 20 September 1985, this improvement will be treated as a separate asset and be subject to CGT if certain conditions are met. These conditions relate to the improvement thresholds in the table below.

If these conditions are met, when a CGT event happens to the original asset, the cost base of the capital improvement must be:

- more than the improvement threshold for the year in which the event happens, and
- more than 5% of the amount of money and property you receive from the event.

If there is more than one capital improvement and they are related to each other, they are treated as one separate CGT asset if the total of their cost bases is more than the threshold.

The improvement threshold is changed to take account of inflation. The thresholds for 1985–86 to 2002–03 are shown in the following table.

**Improvement thresholds for 1985–86 to 2002–03**

| *Income year* | *Threshold ($)* | *Income year* | *Threshold ($)* |
|---|---|---|---|
| 1985–86 | 50,000 | 1994–95 | 82,290 |
| 1986–87 | 53,950 | 1995–96 | 84,347 |
| 1987–88 | 58,859 | 1996–97 | 88,227 |
| 1988–89 | 63,450 | 1997–98 | 89,992 |
| 1989–90 | 68,018 | 1998–99 | 89,992 |
| 1990–91 | 73,459 | 1999–2000 | 91,072 |
| 1991–92 | 78,160 | 2000–01 | 92,802 |
| 1992–93 | 80,036 | 2001–02 | 97,721 |
| 1993–94 | 80,756 | 2002–03 | 101,239 |

**Example**

**Adjacent land**

On 1 April 1984, Dani bought a block of land. On 1 June 2003, she bought another block adjacent to the first one. Dani amalgamated the titles to the two blocks into one title.

The second block is treated as a separate CGT asset acquired on or after 20 September 1985 and is therefore subject to CGT.

## What are capital proceeds?

Capital proceeds is the term used to describe what you receive from a CGT event. This is usually an amount of money or the value of any property you receive (or are entitled to receive) as a result of a CGT event.

In some cases, if you receive nothing in exchange for a CGT asset (for example, if you give the CGT asset as a gift) you are taken to have received the market value of the asset at the time of the CGT event. You may also be taken to have received the market value if:

- your capital proceeds are more or less than the market value of the CGT asset, and
- you and the purchaser were not dealing with each other at arm's length in connection with the event.

You are said to be dealing at arm's length with someone if each party acts independently and neither party exercises influence or control over the other in connection with the transaction. The law looks at not only the relationship between the parties but also the quality of the bargaining between them.

Capital proceeds from a CGT event are reduced if:

- you are not likely to receive some or all of those proceeds
- the non-receipt is not due to anything you have done or failed to do, and
- you took all reasonable steps to get payment.

Provided you are not entitled to a tax deduction for the amount you repaid, capital proceeds are reduced by:

- any part of the proceeds that you repay, or
- any compensation you pay that can reasonably be regarded as a repayment of the proceeds.

If you are registered for goods and services tax (GST) and you receive payment when you dispose of a CGT asset, any GST payable is not part of the capital proceeds.

There are special rules for calculating the proceeds from a depreciating asset. A depreciating asset is a tangible asset (other than land or trading stock) that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Certain intangible assets are also depreciating assets.

For more information, see **CGT and depreciating assets** on page 11 and the *Guide to depreciating assets*.

## What is the cost base?

For most CGT events, the cost base of a CGT asset is important in working out if you have made a capital gain. For working out the amount of a capital loss for these events, the reduced cost base of a CGT asset is relevant.

For some CGT events, the cost base is not relevant. In these cases, the CGT event explains the amounts to use to work out your capital gain. Columns 3 and 4 in appendix 1 indicate when the cost base or reduced cost base of an asset is relevant. For example, if you enter into an agreement not to work in a particular industry for a set period of time, CGT event D1 specifies that you make a capital gain or capital loss by comparing the capital proceeds with the incidental costs. Also the cost base of an asset that is a depreciating asset is not relevant in working out a capital gain from that asset.

There are special rules for calculating the cost of a depreciating asset. For details, see **CGT and depreciating assets** on page 11 and the *Guide to depreciating assets*.

## Elements of the cost base

The cost base of a CGT asset is made up of five elements. You need to add together all these elements to work out your cost base for each CGT asset.

If you are registered for GST, the elements of the cost base are reduced by the amount of any GST input tax credits included in the cost.

*First element: money paid for the asset*
This element includes money paid (or required to be paid) for the asset and the market value of property given (or required to be given) to acquire the asset.

*Second element: incidental costs of the CGT event or of acquiring the CGT asset*
Examples of these incidental costs include agents commission, the cost of advertising to find a seller or buyer, stamp duty and fees paid for professional services (for example, to an accountant, professional tax adviser, valuer or lawyer).

You can include expenditure for advice concerning the operation of the tax law as an incidental cost only if it was provided by a recognised professional tax adviser and you incurred the expenditure after 30 June 1989.

Do not include expenditure for which you have or may have a deduction for income tax purposes in any year.

*Third element: non-capital costs associated with owning the asset*
Examples of these non-capital costs include rates, land taxes, repairs and insurance premiums. They also include non-deductible interest on borrowings to finance a loan used to acquire a CGT asset and on loans used to finance capital expenditure you incur to increase an asset's value.

You can include non-capital costs of ownership only in the cost base of assets acquired on or after 21 August 1991. You cannot include these non-capital costs in the cost base of any collectables or personal use assets.

These costs cannot be indexed or used to work out a capital loss. Do not include expenditure for which you have or may have a deduction for income tax purposes in any year.

*Fourth element: capital costs associated with increasing the value of your asset*
This element is relevant only if the expenditure was incurred to increase the asset's value and is reflected in the state or nature of the asset at the time of the CGT event—for example, if you paid for a car port to be built on your rental investment property.

*Fifth element: capital costs to preserve or defend your title or rights to your asset*
This element includes capital expenditure you incur to preserve or defend your title or rights to the asset—for example, if you paid a call on shares.

**Assets acquired after 13 May 1997**

If you acquired a CGT asset after 13 May 1997, the cost base of the asset does not include:

- any expenditure on the asset that has been (or can be) allowed as an income tax deduction; this applies to all elements of the cost base, or
- heritage conservation expenditure and landcare and water facilities expenditure incurred after 12 November 1998 that give rise to a tax offset.

This also applies to certain assets—such as buildings or major capital improvements—that are treated as separate assets from the land because they were constructed or made on or after 20 September 1985 on land acquired before 20 September 1985. If those assets were constructed or made after 13 May 1997, the cost base does not include the above expenditure.

**NOTE** **Special rules for land**

If you acquired land on or before 13 May 1997 but incurred expenditure on a building or major capital improvement that is not treated as a separate asset from the land (because the land was acquired on or after 20 September 1985) and the expenditure was incurred after 30 June 1999, the cost base of the property does not include any income tax deductions you can claim for the expenditure.

**Example**

**Special building write-off deduction**

Zoran acquired a rental property on 1 July 1997 for $200,000. Before disposing of the property on 30 June 2003, he had claimed $10,000 in special building write-off deductions.

At the time of disposal, the cost base of the property was $210,250. Zoran must reduce the cost base of the property by $10,000 to $200,250.

### Reversal of deduction: effect on cost base

In some cases, a deduction you have claimed on a CGT asset can be partly or wholly 'reversed'; that is, the value of part or all of the deduction may be declared as income in the year the CGT event happens. In this case, the capital gains cost base of the CGT asset is increased by the amount you have to include in your assessable income.

### Indexation of the cost base

If a CGT event happened in relation to a CGT asset you acquired before 11.45am (by legal time in the ACT) on 21 September 1999 and owned for at least 12 months, you may be able to use either the **indexation method** or the **discount method** to calculate your capital gain.

If you use the indexation method, some of the cost base expenditure you incurred up to 11.45am (by legal time in the ACT) on 21 September 1999 may be indexed to account for inflation up to the September 1999 quarter. Only expenditure incurred before 11.45am (by legal time in the ACT) on 21 September 1999 may be indexed because changes to the law mean indexation was frozen at that date. Refer to chapter 2 page 14 for more information.

## Elements of the reduced cost base

The reduced cost base is the amount you take into account when you are working out whether you have made a capital loss when a CGT event happens to a CGT asset. Remember that a capital loss can only be used to reduce a capital gain—it cannot be used to reduce other income.

The reduced cost base of a CGT asset has the same five elements as the cost base (see previous page), except for the third element. The third element of the reduced cost base of an asset is any amount that is assessable because of a balancing adjustment for the asset or that would be assessable if certain balancing adjustment relief were not available. These elements are not indexed. Also, if you are registered for GST, the elements do not include the amount of any GST input tax credits. You need to add together all these elements for a CGT asset to find out your reduced cost base for the relevant CGT asset.

The reduced cost base does not include any of those costs that have been (or can be) allowed as deductions—for example, write-off deductions for capital expenditure.

**Example**

**Write-off deduction**

Danuta acquired a new income-producing asset on 28 September 1994 for $100,000. She sold it for $90,000 in November 2002. During the period she owned it she was allowed write-off deductions of $7,500. Her capital loss is worked out as follows:

| | |
|---|---|
| Cost base | $100,000 |
| less write-off deduction | $7,500 |
| **Reduced cost base** | **$92,500** |
| less capital proceeds | $90,000 |
| **Capital loss** | **$2,500** |

### Modifications to the cost base and reduced cost base

In some cases, the general rules for calculating the cost base and reduced cost base have to be modified. For example, the market value may be substituted for the first element of the cost base or reduced cost base if:

- you did not incur expenditure to acquire the asset
- some or all of the expenditure you incurred cannot be valued, or
- you did not deal at arm's length with the vendor in acquiring the asset.

Any expenditure you recoup does not form part of the cost base or reduced cost of a CGT asset except if the recouped amount is included in your assessable income. This might include an insurance pay-out you receive or an amount paid for by someone else, unless those amounts are included in your assessable income.

**Example**

**Recouped expenditure**

John bought a building in 2000 for $200,000 and incurred $10,000 in legal costs associated with the purchase. As part of a settlement, the vendor agreed to pay $4,000 of the legal costs. John did not claim as a tax deduction any part of the $6,000 he paid in legal costs.

He later sells the building. As he received reimbursement of $4,000 of the legal costs, in working out his capital gain he includes only $6,000 in the cost base.

If you acquire a CGT asset or incur expenditure and only part of the expenditure you incur relates to the CGT asset, only that part of the expenditure that is reasonably attributable to the asset can be included in its cost base or reduced cost base.

Similarly, if a CGT event happens only to part of a CGT asset, the cost base or reduced cost base of the asset is generally apportioned to work out the capital gain or capital loss from the CGT event.

### Consolidated groups

For modifications to cost bases for consolidated groups refer to the *Consolidation reference manual*. To get this manual and other consolidation products, phone the Business tax reform infoline on **13 24 78** or visit the Business tax reform section of **www.ato.gov.au**

### Special rules for the cost base and reduced cost base

There are other rules that may affect the cost base or reduced cost base of an asset. For example, they are calculated differently:

- when you first use your **main residence** to produce income after 20 August 1996 (see chapter 6)
- for an asset that you receive as a beneficiary or as the legal personal representative of a deceased estate (see chapter 9)
- for **bonus shares** or units, rights and options and convertible notes (see chapter 5), and
- under a demerger for owners of the head entity (see chapter 5) and the demerged entity and for entities within the demerger group.

### Debt forgiveness

A debt is forgiven if you are freed from the obligation to pay it. Commercial **debt forgiveness** rules apply to debts forgiven after 27 June 1996. A debt is a commercial debt if part or all of the interest payable on the debt is, or would be, an allowable deduction.

Under the commercial debt forgiveness rules, a forgiven amount may reduce (in the following order) your:

- prior year revenue losses
- prior year net capital losses
- deductible expenditure
- cost base and reduced cost base of assets.

These rules do not apply if the debt is forgiven as a result of:

- an action under bankruptcy law
- a deceased person's will, or
- reasons of natural love and affection.

**Example**

**Debt forgiveness**

On 1 July 2002, Josef had available net capital losses of $9,000. On 1 January 2003, he sold shares he had owned for more than 12 months for $20,000. They had a cost base (no indexation) of $7,500. On 1 April 2003, a commercial debt of $15,000 that Josef owed to AZC Pty Ltd was forgiven. Josef had no prior year revenue losses and no deductible capital expenditure.

Josef would work out what net capital gain to include in his assessable income as follows:

| | |
|---|---|
| Available net capital losses | $9,000 |
| less debt forgiveness adjustment | $9,000 |
| Adjusted net capital loss | Nil |
| Cost base of shares (no indexation) | $7,500 |
| less debt forgiveness adjustment | $6,000 |
| Adjusted cost base | $1,500 |
| Calculation of net capital gain | |
| Sale of shares | $20,000 |
| Adjusted cost base (no indexation) | $1,500 |
| less carried forward loss | Nil |
| Capital gain (eligible for discount) | $18,500 |
| less discount percentage (50%) | $9,250 |
| Net capital gain | $9,250 |

## Acquiring CGT assets

Generally, you acquire a CGT asset when you become its owner. You may acquire a CGT asset as a result of:

- a CGT event happening (for example, the transfer of land under a contract of sale)
- other events or transactions happening (for example, a company issuing shares, where their issue is not a CGT event), or
- applying specific rules (for example, if a CGT asset passes to you as a beneficiary when someone dies).

### Time of acquisition

The time a CGT asset is acquired is important for four reasons:

- CGT generally does not apply to pre-CGT assets, that is, assets acquired before 20 September 1985
- different cost base rules apply to assets acquired at different times—for example, non-capital costs are not included in the cost base of an asset acquired before 21 August 1991

- the time of acquisition determines whether the cost base of a CGT asset is indexed to take account of inflation and the extent of that indexation (see chapter 2 page 15), and
- the time of acquisition also determines whether you are eligible for the CGT discount—for example, one requirement is that you need to have owned a CGT asset for at least 12 months (see chapter 2 page 14).

If you acquire a CGT asset as a result of a CGT event, certain rules determine when you are taken to have acquired the asset. These rules depend on which CGT event is involved. For example, if you enter into a contract to purchase a CGT asset, the time of acquisition is when you enter into the contract. If someone disposes of an asset to you without entering into a contract, you acquire the asset when you start being the asset's owner. If a CGT asset passes to you as a beneficiary of someone who has died, you acquire the asset on the date of his or her death.

If you acquire a CGT asset without a CGT event happening, different rules apply to determine when you acquire the asset. If, for example, a company issues or allots shares to you, you acquire the shares when you enter into a contract to acquire them, or if there is no contract, at the time of their issue or allotment.

## Becoming a resident and ceasing to be a resident

There are special CGT rules that apply when you become a resident or stop being a resident of Australia for tax purposes. They do not affect assets you acquired before 20 September 1985.

### Becoming a resident

When you become a resident you are taken to have acquired certain assets at the time you became a resident for their market value at that time.

This rule only applies to assets that you acquired that did not have a necessary connection with Australia (see below).

The general cost base rules apply to an asset that had a necessary connection with Australia (for example, land in Australia) when you became a resident.

### Ceasing to be a resident

If you stop being an Australian resident for tax purposes, you are taken to have disposed of assets that don't have the necessary connection with Australia (see below). You are taken to have disposed of them for their market value on the day you stopped being a resident.

*Exception*

There is an exception. If you are an individual and you were an Australian resident for less than five years during the 10 years before you stopped being one, you can choose to disregard any capital gain or capital loss you make if:

- you owned the asset before last becoming an Australian resident, or
- you inherited the asset after last becoming an Australian resident.

If you make this choice, no capital gain or capital loss will arise in relation to the asset until the earlier of:

- a CGT event happening to the asset (for example, its sale or disposal),
- you becoming an Australian resident again.

### Necessary connection with Australia

Assets that have a necessary connection with Australia include:

- land or a building in Australia (or an interest in land or a building)
- a CGT asset that you have used in carrying on a business through a permanent establishment in Australia
- a share in a private company that is an Australian resident company for the income year in which the CGT event happens
- a share, or an interest in a share, in a public company that is an Australian resident company and in which you and your associates own at least 10% of the value of the shares at any time during the five years before the CGT event happens
- a unit in a unit trust that is a resident trust and in which you and your associates own at least 10% of the issued units at any time during the five years before the CGT event happens
- a unit or other interest in a trust that is a resident trust for CGT purposes for the income year in which the CGT event happens, and
- an option or right to acquire a CGT asset listed above.

Assets that do not fall within one of these categories—for example, land or a building overseas or shares in a foreign company— do not have the necessary connection with Australia.

### Proposed concessions for temporary residents

The Government has announced changes to the tax treatment of individuals who are first time

temporary residents of Australia. Under the proposed amendments any capital gains or capital losses made by such persons on the disposal of assets that do not have the necessary connection with Australia (except for the disposal of portfolio interests in publicly listed companies and resident unit trusts) will be disregarded if the CGT event happens on or after 1 July 2002. To date the legislation for this measure has not been passed by parliament.

## Choices

In some cases you are given a choice as to how the CGT rules apply to you. As a general rule, if you wish to make a choice you must make it by the day you lodge your tax return. The way you prepare your tax return is sufficient evidence of your choice.

However, there are some exceptions:
- some replacement asset roll-overs for companies must be made earlier
- choices relating to the small business retirement exemption must be made in writing, and
- a longer period is allowed to choose the small business roll-over.

## Exemptions and roll-overs

There may be exemptions or roll-overs that allow you to reduce, defer or disregard your capital gain or capital loss. The most common exemption is if you dispose of an asset you acquired before 20 September 1985.

### Exemptions

The exemptions listed below allow you to reduce or disregard a capital gain or capital loss you make from certain CGT events.

*General exemptions*

A capital gain or capital loss you make from any of the following is disregarded:
- a car (that is, a motor vehicle designed to carry a load of less than one tonne and fewer than nine passengers) or motor cycle or similar vehicle
- a decoration awarded for valour or brave conduct unless you paid money or gave any other property for it
- collectables acquired for $500 or less
- a capital gain from a personal use asset acquired for $10,000 or less
- any capital loss from a personal use asset
- CGT assets used solely to produce exempt income
- shares in a pooled development fund
- compensation or damages you receive for any wrong or injury you suffer in your occupation
- compensation or damages you receive for any wrong, injury or illness you or your relatives suffer
- compensation you receive under the firearms surrender arrangements
- winnings or losses from gambling, a game or a competition with prizes
- an amount you receive as reimbursement or payment of your expenses under the General Practice Rural Incentives Program or the Sydney Aircraft Noise Insulation Project
- a CGT asset that is your trading stock at the time of a CGT event
- a re-establishment grant made under section 52A of the *Farm Household Support Act 1992*
- a dairy exit payment under the *Farm Household Support Act 1992*
- a reimbursement or payment made under the M4/M5 Cashback Scheme
- all payments made under the German Forced Labour Compensation Programme (GFLCP)—including to a relative or heir of the victim (refer Class Ruling CR 2002/59 *Income tax: compensation payments for Holocaust survivors and their relatives—remembrance, responsibility and future foundation*)
- some types of testamentary gifts
- any capital gain or capital loss that would otherwise arise from the assignment of a right in relation to a general insurance policy held with an HIH company to the Commonwealth, the trustee of the HIH trust or a prescribed entity, or
- in certain circumstances, a general insurance policy, a life insurance policy or an annuity instrument.

*Other exemptions*

Any capital gain you make may be reduced if, because of a CGT event, an amount has been included in your assessable income other than as a capital gain.

Any capital loss you make from the following is disregarded:
- the expiry, forfeiture, surrender or assignment of a lease if the lease is not used solely or mainly for the purpose of producing assessable income
- a payment to an entity of personal services income that is included in an individual's assessable income (or any other amount attributable to that income).

A capital loss made by an exempt entity is also disregarded.

*Specific exemption—main residence*

You can ignore a capital gain or capital loss you make from a CGT event relating to a **dwelling** that was your main residence. This can change, however, depending on how you came to own the dwelling and what you have done with it—for example, if you rented it out (see chapter 6 for more information).

*Specific exemption—small business concessions*

There are a range of concessions that allow you to disregard in whole or in part a capital gain from an active asset that you use in your small business. For more information on these concessions see the publication *Capital gains tax concessions for small business*.

### Roll-overs

Roll-over allows a capital gain or capital loss to be deferred or disregarded until a later CGT event happens. The types of roll-over available are listed in the next column; however, only the following four types are covered in this guide. If you would like information on the other roll-overs, please contact the Australian Taxation Office.

*Marriage breakdown*

In certain cases where an asset is transferred from one spouse to another after their marriage breakdown, any CGT is deferred until a later CGT event happens (for example, when the former spouse sells the asset to someone else). For more examples of how CGT obligations are affected by marriage breakdown, see chapter 8.

*Loss, destruction or compulsory acquisition of an asset*

You may defer a capital gain in some cases where a CGT asset has been lost or destroyed or is compulsorily acquired (see chapter 7).

*Scrip-for-scrip*

You may also be able to defer a capital gain if you dispose of your shares in a company or interest in a trust as a result of a takeover (see chapter 5 page 29).

*Demergers*

You may also be able to defer a capital gain or capital loss if a CGT event happens to your shares in a company or interest in a trust as a result of a demerger (see chapter 5 page 31).

### Other replacement asset roll-overs

- Disposal or creation of assets by individual or trustee to a wholly-owned company
- Disposal or creation of assets by partners to a wholly-owned company
- CGT event happens to small business assets and you acquire replacement assets
- Renewal or extension of a statutory licence—Strata title conversion
- Exchange of shares in the same company or units in the same unit trust
- Exchange of rights or options to acquire shares in a company or units in a unit trust
- Exchange of shares in one company for shares in an interposed company
- Exchange of units in a unit trust for shares in a company
- Body is converted to an incorporated company
- Crown leases
- Depreciating assets
- Prospecting and mining entitlements
- Disposal of a security under a securities lending arrangement
- Ending of ownership of units or interests ends under a trust restructure.

### Other same asset roll-overs

- Transfer of a CGT asset to a wholly owned company
- Transfer of a CGT asset of a partnership to a wholly owned company
- Transfer of a CGT asset between related companies
- Disposal of assets by a trust to a company under a trust restructure.

## CGT and depreciating assets

The uniform capital allowance system (UCA) applies from 1 July 2001. Unlike the previous capital allowance regime for plant which operated prior to 1 July 2001, a capital gain or capital loss from the disposal of a depreciating asset will only arise to the extent that a depreciating asset has been used for a non-taxable purpose (for example, used privately).

A capital gain or capital loss is calculated using the UCA concepts of cost and termination value and not those found in the CGT provisions (capital proceeds and cost base).

A CGT event (CGT event K7) happens if a balancing adjustment event occurs for a depreciating asset you held, and at some time during the period you held it, you used it for a non-taxable purpose.

A balancing adjustment event most commonly occurs for a depreciating asset if you stop holding it (for example, you sell, lose or destroy it) or stop using it.

### Calculating a capital gain or capital loss for a depreciating asset that is not a pooled asset

You make a capital gain if a depreciating asset's termination value is more than its cost. A capital gain from a depreciating asset is calculated as follows:

$$(\text{Termination value} - \text{cost}) \times \frac{\text{sum of reductions}}{\text{total decline}}$$

- 'Sum of reductions' – is the sum of the reductions in your deductions for the asset's decline in value that is attributable to your use of the asset, or having it installed ready for use, for a non-taxable purpose.
- 'Total decline' – is the decline in value of the depreciating asset since you started to hold it.

You make a capital loss if the depreciating asset's cost is more than its termination value. A capital loss from a depreciating asset is calculated as follows:

$$(\text{Cost} - \text{termination value}) \times \frac{\text{sum of reductions}}{\text{total decline}}$$

**Example**

**Capital gain on depreciating asset**

Larry purchased a truck in August 2002 for $5,000. He used the truck 10% for private purposes. The decline in value of the truck up to the date of sale was $2,000. Therefore, the sum of his reductions is $200 (10% of $2,000). Larry disposes of the truck in July 2004 for $7,000. Larry calculates his capital gain from CGT event K7 as follows:

$$(\$7{,}000 - \$5{,}000) \times \frac{200}{2000}$$

Capital gain from CGT event K7 = $200

### Calculating a capital gain or capital loss for a depreciating asset in a low-value pool

There are separate rules for depreciating assets that have been allocated to a low-value pool.

You make a capital gain if the depreciating asset's termination value is more than its cost. The amount of the capital gain is calculated as:

$$(\text{Termination value} - \text{cost}) \times (1 - \text{taxable use fraction})$$

- 'taxable use fraction' – the percentage of the asset's use that is for producing your assessable income, expressed as a fraction. This is the percentage you reasonably estimate at the time the asset is allocated to the low-value pool.

You make a capital loss if the depreciating asset's cost is more than its termination value. The amount of the capital loss is calculated as:

$$(\text{Cost} - \text{termination value}) \times (1 - \text{taxable use fraction})$$

### Application of CGT concessions

A capital gain from disposal of a depreciating asset may qualify for the CGT discount if conditions for the CGT discount are satisfied. If the CGT discount applies, there is no reduction of the capital gain under the indexation method, as detailed in chapter 2.

The small business CGT concessions do not apply to a capital gain made from the disposal of a depreciating asset as any capital gain only arises in respect of the use of the depreciating asset for a non-taxable purpose (for example, to the extent it is used for private purposes).

### Do any CGT exemptions apply to a depreciating asset?

The following exemptions may apply to a capital gain or capital loss made from the disposal of a depreciating asset:

- Pre-CGT assets—A capital gain or capital loss from a depreciating asset is disregarded if the asset was acquired before 20 September 1985.
- Simplified Tax System (STS) assets—A capital gain or capital loss from a depreciating asset is disregarded if you have elected to become an STS taxpayer and you can deduct an amount for the depreciating asset's decline in value under the STS provisions for the income year in which the balancing adjustment event occurred.
- Personal use asset—If a depreciating asset is a personal use asset (that is, one used or kept mainly for personal use and enjoyment), any capital loss from CGT event K7 is disregarded. A capital gain under CGT event K7 from a personal use asset costing $10,000 or less is also disregarded.
- Collectables—A capital gain or a capital loss from a depreciating asset that is a collectable costing $500 or less is disregarded.
- Balancing adjustment event and CGT event—A balancing adjustment event that gives rise to a capital gain or capital loss is only included under CGT event K7. However, capital proceeds received under other CGT events—for example, CGT event D1—may still be relevant for a depreciating asset as CGT events are not the equivalent of balancing adjustment events.

### Changed treatment of intellectual property

Intellectual property is a depreciating asset for the purposes of the UCA. Under this system, the former special treatment for partial realisations of intellectual property no longer applies.

If you grant or assign an interest in an item of intellectual property, you are treated as if you had stopped holding part of the item. You are also treated as if, just before you stop holding that part, you had split the original item of intellectual property into two parts, the part you stopped holding and the rest of the original item. You determine a first element of the cost for each part.

This treatment applies if a licence is granted over an item of intellectual property. To this extent, the treatment of intellectual property is different from other depreciating assets. The grant of a licence in respect of other depreciating assets would result in CGT event D1 (about creating contractual rights) happening.

### Need more information?

For more information about depreciating assets, see the *Guide to depreciating assets* and *Uniform capital allowance system: low-value pools*.

## Where to now?

Chapter 2 in **part A** explains how to calculate a capital gain using one of the three methods (indexation, discount or 'other').

Chapter 4 in **part A** explains how to calculate your capital gain if a managed fund or trust has distributed a capital gain to you. Capital gains included in trust distributions must be taken into account in working out your net capital gain or capital loss.

For more specific directions on how to complete your income tax return, please go to:

- **part B** for individuals
- **part C** for companies, trusts and funds.

# CHAPTER 2 HOW TO WORK OUT YOUR CAPITAL GAIN OR CAPITAL LOSS

This chapter explains how to work out your capital gain or capital loss. There are three methods that you can use to work out your capital gain. There is only one way to work out your capital loss.

The **Capital gain or capital loss worksheet** provided at the back of this guide shows the three methods of calculating a capital gain: the indexation method, the discount method and the 'other' method. You are not obliged to use this worksheet but you may find it helps you calculate your capital gain or capital loss for each CGT event.

**NOTE** **New terms**

If there are terms in this chapter that are not familiar to you, refer to **Explanation of terms** at the back of this guide.

## Three methods of calculating capital gain

The three methods of calculating capital gains are summarised and compared in the following table. They are explained in more detail in the following pages. In some cases you may be able to choose either the discount method or the indexation method to calculate your capital gain. In this case you use the method that gives you the better result.

## The 'other' method

This is the simplest of the three methods. You must use the **'other' method** to calculate your capital gain if you have bought and sold your asset within 12 months or generally for CGT events that do not involve an asset. In these cases, the indexation and discount methods do not apply.

Generally, to use the 'other' method, you simply subtract your cost base (what the asset cost you) from your capital proceeds (how much you sold it for). The amount of proceeds left is your capital gain. For some types of CGT events, a cost base is not relevant. In these cases, the particular CGT event explains the amounts to use.

**Capital gain calculation methods**

| | Indexation method | Discount method | 'Other' method |
|---|---|---|---|
| **Description of method** | Allows you to increase the cost base by applying an **indexation factor** based on CPI up to September 1999 | Allows you to discount your capital gain | Basic method of subtracting the cost base from the capital proceeds |
| **When to use the method** | Use for an asset owned for 12 months or more if it produces a better result than the discount method. Use only for assets acquired before 11.45am (by legal time in the ACT) on 21 September 1999. | Use for an asset owned for 12 months or more if it produces a better result than the indexation method. | Use when the indexation and discount methods do not apply (for example, if you have bought and sold an asset within 12 months). |
| **How to calculate your capital gain using the method** | Apply the relevant indexation factor (see CPI table at appendix 2 on page 103), then subtract the indexed cost base from the capital proceeds (see worked example for Val on page 17). | Subtract the cost base from the capital proceeds, deduct any capital losses, then reduce by the relevant discount percentage (see worked example for Val on page 17). | Subtract the cost base (or the amount specified by the relevant CGT event) from the capital proceeds (see worked example for Marie-Anne on page 15). |

**Example**

### Calculating a capital gain using the 'other' method

Marie-Anne bought a property for $150,000 under a contract dated 24 June 2002. The contract provided for the payment of a deposit of $15,000 on that date, with the balance of $135,000 to be paid on settlement on 5 August 2002.

Marie-Anne paid stamp duty of $5,000 on 20 July 2002. On 5 August 2002, she received an account for solicitors fees of $2,000 which she paid as part of the settlement process.

Contracts for the sale of the property for $215,000 were exchanged on 15 October 2002. Marie-Anne incurred costs of $1,500 in solicitors fees and $4,000 in agents commission.

As she bought and sold her property within 12 months, Marie-Anne must use the 'other' method to calculate her capital gain.

| | |
|---|---|
| Deposit | $15,000 |
| Balance | $135,000 |
| Stamp duty | $5,000 |
| Solicitors fees for purchase of property | $2,000 |
| Solicitors fees for sale of property | $1,500 |
| Agents commission | $4,000 |
| **Cost base (total)** | **$162,500** |

Marie-Anne works out her capital gain as follows:

| | |
|---|---|
| Capital proceeds | $215,000 |
| less cost base | $162,500 |
| **Capital gain calculated using the 'other' method** | **$52,500** |

Assuming Marie-Anne has not made any other capital losses or capital gains in the 2002–03 income year and does not have any prior year net capital losses, the net capital gain to be included at item **17** on her tax return is $52,500 (item **9** if she uses the tax return for retirees).

## The indexation method

You can use the indexation method to calculate your capital gain if:

- a CGT event happens to an asset you acquired before 11.45am (by legal time in the ACT) on 21 September 1999, and
- you owned the asset for 12 months or more.

Under this method, you increase each amount included in an element of the cost base (other than those in the third element—non-capital costs of ownership) by an indexation factor.

The indexation factor is worked out using the Consumer Price Index (CPI) at appendix 2 on page 103.

If the CGT event happened on or after 11.45am (by legal time in the ACT) on 21 September 1999 you can only index the elements of your cost base up to 30 September 1999. You use this formula:

$$\text{Indexation factor} = \frac{\text{CPI for quarter ending 30.9.99 (123.4)}}{\text{CPI for quarter in which expenditure was incurred}}$$

If the CGT event happened before 11.45am (by legal time in the ACT) on 21 September 1999, you use this formula:

$$\text{Indexation factor} = \frac{\text{CPI for quarter when CGT event happened}}{\text{CPI for quarter in which expenditure was incurred}}$$

Work out the indexation factor to three decimal places, rounding up if the fourth decimal place is five or more.

For most assets, you index expenditure from the date you incur it, even if you do not pay some of the expenditure until a later time. However, there is an exception for partly paid shares or units acquired on or after 16 August 1989. If the company or trust later makes a call on the shares or units, you use the CPI for the quarter in which you made that later payment.

There are some exceptions to the requirement that you must have owned an asset for at least 12 months for indexation to apply. For example, you can use the indexation method:

- if you acquire a CGT asset as a legal personal representative or a beneficiary of a deceased estate. The 12-month requirement is satisfied if the deceased acquired the asset 12 months (or more) before you disposed of it, or
- if you acquired an asset as the result of a marriage breakdown. You will satisfy the 12-month requirement if the period your spouse owned the asset and the period you have owned the asset are in total equal to or greater than 12 months.

## The discount method

You can use the discount method to calculate your capital gain if:

- you are an individual, a trust or a complying superannuation entity
- a CGT event happens in relation to an asset you own
- the CGT event happened after 11.45am (by legal time in the ACT) on 21 September 1999

- you acquired the asset at least 12 months before the CGT event, and
- you did not choose to use the indexation method.

Generally the discount method does not apply to companies, although it can apply in relation to a limited number of capital gains made by life insurance companies.

In determining whether you acquired the CGT asset at least 12 months before the CGT event, both the day of acquisition and the day of the CGT event are excluded.

**Example**

**CGT discount method**

Sally acquired a CGT asset on 2 February 2002. Sally is entitled to apply the CGT discount if a CGT event happens in relation to that asset on or after 3 February 2003.

In certain circumstances, you may be eligible for the CGT discount even if you have not owned the asset for at least 12 months. For example:

- if you acquire a CGT asset as a legal personal representative or as a beneficiary of a deceased estate. The 12-month requirement is satisfied if the asset was acquired by the deceased
  - before 20 September 1985 and you disposed of it 12 months or more after they died, or
  - on or after 20 September 1985 and you disposed of it 12 months or more after they acquired it
- if you acquired an asset as a result of a marriage breakdown, you will satisfy the 12-month requirement if the period your spouse owned the asset and the period you have owned the asset are in total equal to or greater than 12 months, or
- if a CGT asset is compulsorily acquired, lost or destroyed and you acquire a roll-over replacement asset, you will satisfy the 12-month requirement for the replacement asset if the period of ownership of the original asset and the replacement asset is at least 12 months.

### Certain capital gains are excluded

The CGT discount does not apply to capital gains from certain CGT events. The full list of CGT events is shown in the summary at appendix 1 on page 98. The CGT discount does not apply to CGT events D1, D2, D3, E9, F1, F2, F5, H2, J2 or J3.

If you make a capital gain from a CGT event that creates a new asset—for example, receiving a payment for agreeing not to do something (entering into a restrictive covenant), you cannot satisfy the 12-month ownership rule so your CGT event does not qualify for the CGT discount.

The CGT discount may be denied:

- if the CGT event that gave rise to the capital gain occurred under an agreement that was made within 12 months of the acquisition of the asset (section 115-30)
- on the disposal of certain shares or trust interests in non-widely held companies and trusts, that is, those with fewer than 300 members, or
- if an arrangement was entered into for the purposes of claiming the CGT discount under which an 'income' asset was converted into a 'capital' asset (conversion of income to capital) (Part IVA of the *Income Tax Assessment Act 1936*).

### Discount percentage

The discount percentage is the percentage by which you reduce your capital gain. You can reduce the capital gain only after you have applied all available capital losses.

The discount percentage is 50% for individuals and trusts, and $33\frac{1}{3}$% for complying superannuation entities and eligible life insurance companies.

## Choosing the indexation or discount method

For assets you have held for 12 months or more, you may choose to use the indexation method or the discount method to calculate your capital gain. There is no one factor you can use as a basis to select the better option as it depends on the type of asset you own, how long you have owned it, the dates you owned it and the past rates of inflation. Because capital losses must be offset against capital gains before the discount is applied, your choice may also depend on the amount of capital losses that you have available.

For example, Justin sold some land and has a $10,000 capital gain under the discount method (before applying the CGT discount) or a $7,000 capital gain under the indexation method. If Justin has no capital losses the discount method will produce the smaller capital gain (that is, $5,000).

However Justin also made a capital loss of $5,000 on the sale of some shares. He will be better off to use the indexation method to work out the capital gain from the sale of his land. Under this method his net capital gain is $2,000 ($7,000 – $5,000). If he used the discount method his net capital gain would be $2,500 [($10,000 – $5,000) × 50%].

It is probably best to calculate your capital gain using both methods to find out which gives you the better result. This is shown for Val in the worked example on the next page and the completed **Capital gain or capital loss worksheet** on the following page.

**Example**

### Choosing the indexation or discount method

Val bought a property for $150,000 under a contract dated 24 June 1991. The contract provided for the payment of a deposit of $15,000 on that date, with the balance of $135,000 to be paid on settlement on 5 August 1991.

She paid stamp duty of $5,000 on 20 July 1991. On 5 August 1991, she received an account for solicitors fees of $2,000, which she paid as part of the settlement process.

She sold the property on 15 October 2002 (the day the contracts were exchanged) for $215,000. She incurred costs of $1,500 in solicitors fees and $4,000 in agents commission.

***Val's capital gain calculated using the indexation method***

| | |
|---|---|
| Deposit × indexation factor<br>$15,000 × (123.4 ÷ 106.0 = 1.164) | $17,460 |
| Balance × indexation factor<br>$135,000 × (123.4 ÷ 106.0 = 1.164) | $157,140 |
| Stamp duty × indexation factor<br>$5,000 × (123.4 ÷ 106.6 = 1.158) | $5,790 |
| Solicitors fees for purchase of property × indexation factor<br>$2,000 × (123.4 ÷ 106.6 = 1.158) | $2,316 |
| Solicitors fees for sale of property<br>(indexation does not apply) | $1,500 |
| Agents commission<br>(indexation does not apply) | $4,000 |
| **Cost base (total)** | **$188,206** |

Val works out her capital gain as follows:

| | |
|---|---|
| Capital proceeds | $215,000 |
| less cost base | $188,206 |
| **Capital gain**<br>(Val's total current year capital gain using this method) | **$26,794** |

Assuming Val has not made any other capital losses or capital gains in the 2002–03 income year and does not have any prior year net capital losses, her net capital gain using the indexation method is $26,794.

***Val's capital gain calculated using the discount method***

| | |
|---|---|
| Deposit | $15,000 |
| Balance | $135,000 |
| Stamp duty | $5,000 |
| Solicitors fees for purchase of property | $2,000 |
| Solicitors fees for sale of property | $1,500 |
| Agents commission | $4,000 |
| **Cost base (total)** | **$162,500** |

Val works out her capital gain as follows:

| | |
|---|---|
| Capital proceeds | $215,000 |
| less cost base | $162,500 |
| Capital gain before applying discount<br>(Val's total current year capital gain using this method) | $52,500 |
| **less 50% discount**<br>(as Val has no capital losses) | **$26,250** |
| **Net capital gain** | **$26,250** |

As the discount method provides Val with the better result, she will show the amount worked out using the discount method on her tax return rather than the amount worked out using the indexation method.

The worksheet example on the next page shows how Val might complete the **Capital gain or capital loss worksheet** using both methods.

## Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

**CGT asset type or CGT event**

Shares and units (in unit trusts) ☐ Other CGT assts and any other CGT events[4] ☐
Real estate ☒ Collectables[5] ☐

**Description of CGT asset or CGT event** Val's property at 15 Smith St, Oldtown

**Date of acquisition** 24/6/1991 **Date of CGT event** 15/10/2002

**Elements of the cost base or reduced cost base**

| | 1 Amount | 2 Amounts to be deducted for cost base[9] | 3 Cost base (1 – 2) | 4 Amounts to be deducted for reduced cost base[9] | 5 Reduced cost base[9] (1 – 4) | 6 Indexation factor[10] | 7 Cost base indexed (3 × 6) |
|---|---|---|---|---|---|---|---|
| Acquisition or purchase cost of the CGT asset[6] | 15 000 | | 15 000 | 0 | 15 000 | 123.4 ÷ 106.0 | 17 460 |
| | 135 000 | | 135 000 | 0 | 135 000 | 123.4 ÷ 106.0 | 157 140 |
| Incidental costs to acquire the CGT asset | 7 000 | | 7 000 | 0 | 7 000 | 123.4 ÷ 106.6 | 8 106 |
| Incidental costs that relate to the CGT event[7] | 5 500 | | 5 500 | 0 | 5 500 | 1 (no indexation) | 5 500 |
| Non-capital costs of ownership of the CGT asset[8] | | | | | | | |
| Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event | | | | | | | |
| Capital costs to establish, preserve or defend title to, or a right over, the CGT asset | | | | | | | |
| | **Cost base unindexed** | | $ 162 500 | | | | |
| | | | **Reduced cost base** | | $ 162 500 | | |
| | | | | | **Cost base indexed** | | $ 188 206 |

### Capital gain calculation

| **Indexation method** | | **Discount method** | | **'Other' method** (CGT asset held less than 12 months) | |
|---|---|---|---|---|---|
| Capital proceeds[11] | $ 215 000 | Capital proceeds[11] | $ 215 000 | Capital proceeds[11] | $ |
| *Less:* cost base indexed | $ 188 206 | *Less:* cost base unindexed | $ 162 500 | *Less:* cost base unindexed | $ |
| **Capital gain (a)** | **$** 26 794 | **Capital gain (b)*** | **$** 52 500 | **Capital gain** | **$** |

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

### Capital loss calculation

| **Capital loss** | |
|---|---|
| Reduced cost base | $ |
| *Less:* capital proceeds[11] | $ |
| **Capital loss**[12] | **$** |

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

## How to calculate a capital loss

Generally, you make a capital loss if your reduced cost base is greater than your capital proceeds. The excess is your capital loss.

**Example**

### Write-off deduction

Antonio acquired a new income-producing asset on 28 September 1999 for $100,000. He sold it for $90,000 in November 2002. During the period he owned it, he was allowed write-off deductions of $7,500. Antonio works out his capital loss as follows.

| | |
|---|---|
| Cost base | $100,000 |
| less write-off deduction | $7,500 |
| Reduced cost base | $92,500 |
| less capital proceeds | $90,000 |
| Capital loss | $2,500 |

**Example**

### Capital loss (reduced cost base greater than capital proceeds)

In July 1996, Chandra bought 800 shares at $3 per share. He incurred brokerage and stamp duty of $100. In December 2002, Chandra sold all 800 shares for $2.50 per share. He incurred brokerage of $75. He made a capital loss, calculated as follows.

***Calculation of reduced cost base***

| *Date expense incurred* | *Description of expense* | *Expense* |
|---|---|---|
| July 1996 | Purchase price | $2,400 |
| July 1996 | Brokers fees and stamp duty | $100 |
| December 2002 | Brokers fees | $75 |
| Reduced cost base | | $2,575 |

***Calculation of capital loss***

| | |
|---|---|
| Reduced cost base | $2,575 |
| Capital proceeds 800 × $2.50 | $2,000 |
| Capital loss | $575 |

However, the reduced cost base is not relevant for some types of CGT events. In these cases, the particular CGT event explains the amounts to use (see appendix 1: Summary of CGT events on page 98).

**NOTE** **Reduced cost base**

You cannot index a reduced cost base.

# CHAPTER 3 KEEPING RECORDS

You must keep records of everything that affects your capital gains and capital losses. There are penalties if you do not keep the records for at least five years after the last relevant capital gains tax (CGT) event. If you make a net capital loss, you may need to keep your records for a longer period—for five years after any CGT event where you make a capital gain that you reduce by applying your net capital loss.

Keeping adequate records of all expenditure will help you correctly work out the amount of capital gain or capital loss you have made when a CGT event happens. It will also help make sure you do not pay more CGT than is necessary.

Keeping good records can help your beneficiaries reduce the impact of CGT after you die. If you leave an asset to another person, the asset may be subject to CGT when a CGT event happens to that asset in the future—for example, if your daughter (the beneficiary) sells the house (the asset) you have left her in your will.

## What records do you need to keep?

You must keep records of every act, transaction, event or circumstance that may be relevant to working out whether you have made a capital gain or capital loss from a CGT event. It does not matter whether the CGT event has already happened or whether it may happen in the future.

The records must be in English (or be readily accessible or convertible to English) and must show:

- the nature of the act, transaction, event or circumstance
- the day it happened
- who did the act or who were the parties to the transaction, and
- how the act, transaction, event or circumstance is relevant to working out the capital gain or capital loss.

The following are examples of records you may need to keep:

- receipts of purchase or transfer
- details of interest on money you borrowed relating to this asset
- records of agent, accountant, legal and advertising costs
- receipts for insurance costs and land rates or taxes
- any market valuations
- receipts for the cost of maintenance, repairs or modifications, and
- accounts showing brokerage on shares.

You should also keep records to establish whether you have claimed an income tax deduction for an item of expenditure. In many cases if you have claimed a deduction for an amount it cannot be taken into account for CGT purposes.

### Records relating to real estate

Real estate can include the family home, vacant blocks of land, business premises, rental properties, holiday houses and hobby farms.

Even though your family home is usually exempt, if you acquired it on or after 20 September 1985 it is advisable to keep all records relating to the home, just as you would for other items of real estate. If the home ceases to be fully exempt at some time in the future, you will need to know the full cost of the home so that you do not pay more CGT than necessary. If you do not have sufficient records, reconstructing them later could be difficult. See chapter 6 page 45 for details of when your home may not be fully exempt.

You will need to keep a copy of the purchase contract and all receipts for expenses relating to the purchase of the property—for example, stamp duty, legal fees, survey and valuation fees. You will also need to keep all records relating to the CGT event and all relevant expenses—for example, the sale contract and records of legal fees and stamp duty.

Keep a record of capital expenditure on improvements, non-capital costs and capital expenditure on maintaining title or right to the asset that you incurred during your period of ownership. These costs may form part of the cost base in working out whether you have made a capital gain or capital loss at the time the CGT event happens.

Capital expenditure on improvements may include building an extension, addition or improvement, including initial repairs.

Examples of non-capital costs of real estate include interest, rates and land taxes, insurance premiums and cost of repairs—for example, replacing broken items. You may include only non-capital costs incurred on ownership of a CGT asset acquired on or after 21 August 1991 and only if you are not entitled to a tax deduction for them.

If the property is your home and you use it to produce income (for example, by renting out part or all of it), you will need to keep records of the period the home is producing income and the proportion of the home you have used to produce income.

If, after 20 August 1996, you use your home for income-producing purposes for the first time, you will be taken to have acquired your home at that time for its market value. You will use this as your acquisition cost to calculate a capital gain or capital loss at the time the CGT event happens. You will still need to keep details of expenses relating to your home after the date that it started producing income.

**Records relating to shares in companies and units in unit trusts**

Most of the records you need to keep to work out your CGT when you dispose of shares in companies or units in unit trusts (including managed funds) will be given to you by the company, the unit trust manager or your stockbroker. It is important for you to keep everything they give you in relation to your shares and units.

These records will generally provide the following important information:

- the date of purchase of the shares or units
- the amount paid to purchase the shares or units
- details of any non-assessable payments made to you during the time you owned the shares or units
- the date and amount of any calls if shares were partly paid
- the sale price if you sell them, and
- any commissions paid to brokers when you buy or sell them.

There are special CGT rules for certain shares and units which may affect the records you keep—for example, bonus shares and units, rights and options, and employee shares. See chapter 5 for more information.

**Records relating to bonus shares**

To be safe, if you have received any bonus shares on or after 20 September 1985, keep all the documents the company gives you.

For any bonus shares issued before 1 July 1987, you need to know when the original shares were acquired. If you acquired them on or after 20 September 1985, you will also need to know what they cost. Flowchart 1 appendix 3 on page 104 summarises the different rules applying to the treatment of bonus shares.

Keep a record of any amounts you paid to acquire the bonus shares and any amounts taxed as a dividend when they were issued.

**Records relating to inheriting an asset**

You must keep special records when you inherit an asset as a beneficiary of the estate of a person who died on or after 20 September 1985. If the asset was acquired by the deceased person before 20 September 1985, you need to know the market value of the asset at the date of the person's death and the amount of any relevant costs incurred by the executor or trustee. This is the amount that the asset is taken to have cost you. If the executor or trustee has a valuation of the asset, get a copy of that valuation report. Otherwise you will need to get your own valuation.

If the asset you inherit was acquired by the deceased person on or after 20 September 1985, you need to know full details of all relevant costs incurred by the deceased person and by the executor or trustee. Get those details from the executor or trustee. Even if you inherit a house that was the family home of the deceased person, you need to keep records of costs paid by the deceased person in case you are not able to claim a full exemption for the house after you inherit it.

If, after 20 August 1996, you inherit a house that was the family home of the deceased and it was not regarded as being used to produce income at the time of death, you will be taken to have acquired the house at its market value at the date of death. If the executor or trustee has a valuation of the asset, get a copy of that valuation report. Otherwise you will need to get your own valuation. Make sure you keep details of any other costs you have paid out for the asset since the date you inherited it.

## Asset registers

You can choose to enter information from your CGT records into an asset register. Keeping an asset register may enable you to discard records that you might otherwise be required to keep for long periods of time.

If you choose to keep an asset register, transfer the following information to it from the normal records you need to keep for CGT purposes:

- the date of acquisition of an asset
- the cost of the asset
- a description, amount and date for each cost associated with the purchase of the asset (for example, stamp duty and legal fees)—other information contained in a record that may be relevant in calculating your CGT obligation
- the date the CGT event happened to the asset, and

- the capital proceeds received when the CGT event happened.

This information must be certified by a registered tax agent or a person approved by the Commissioner of Taxation.

If you use an asset register, you must keep the documents from which you have transferred the information for five years from the date the asset register entry in question has been certified. You must keep the asset register entries for five years from the date the related CGT event happens or after you have applied any capital loss against capital gains.

For more information about asset registers, see *Taxation Ruling TR 2002/10—Income tax: capital gains tax: asset register* which is available on our website at **www.ato.gov.au**

## Exceptions

You do not need to keep records if, for any CGT event, a capital gain or capital loss is disregarded. For example, you do not need to keep records for a motor vehicle as it is an exempt asset.

## It is never too late

If you have acquired assets on or after 20 September 1985 and have not kept records, or your records have inadvertently been destroyed, you can still do something about it.

If you have bought real estate, your solicitor or real estate agent may have copies of most of the records you need. You should be able to get copies if you ask for them.

If you have made improvements to an investment property—for example, if you built an extension, you can ask for a copy of the builder's receipt for payment.

If you have bought shares in a company or units in a unit trust, your stockbroker or investment adviser may be able to supply you with the information you need.

If you receive an asset as a gift and you did not get a market valuation at the time, a professional valuer can tell you what its market value was at the relevant date.

The main thing is to get as many details as possible so you can reconstruct your records. You should make sure you keep sufficient records in the future.

# CHAPTER 4 TRUST DISTRIBUTIONS

This chapter explains how distributions from trusts (including managed funds) can affect your capital gains tax (CGT) position. Managed funds include property trusts, share trusts, equity trusts, growth trusts, imputation trusts and balanced trusts.

Distributions from trusts can include different amounts but the following two types of amounts are relevant for CGT purposes:

- capital gains, and
- non-assessable payments.

Distributions of trust capital gains are treated as capital gains that you have made.

Non-assessable payments mostly affect the cost base of units in a unit trust (including managed funds) but can in some cases create a capital gain. Non-assessable payments do not affect beneficiaries of a discretionary trust.

**NOTE New terms**

There may be terms in this chapter that are not familiar to you. Refer to **chapter 1** in **part A** for more information or to **Explanation of terms** at the back of this guide.

Trustees, including fund managers, may use different terms to describe the methods of calculation and other terms used in this guide. For example, they may use the term ‘non-discount gains’ when they refer to capital gains worked out using the indexation and ‘other’ methods.

## Capital gains made by trust

### STEP 1 EXCLUDE NET CAPITAL GAINS FROM TRUST INCOME ITEM

If you are a beneficiary of a trust, you may be entitled to (or may have received) a share of the net income of the trust which includes some of the trust’s net capital gain. In this case, you do not include your share of the trust’s net capital gain at item **12 Partnerships and trusts** on your tax return. Instead, you are treated as having a capital gain (or capital gains) worked out, as explained in step 2.

**NOTE Item 12 on tax return for individuals**

Question **12** in *TaxPack 2003* asks you to exclude net capital gains from the amount of trust income shown at **U** item **12** on your tax return. In your distribution statement, the trust should state the amount(s) of capital gain in your trust distribution.

However, if your statement shows that your share of the trust’s net capital gain is more than the overall net amount of your share of the trust’s net income, do not exclude the whole capital gain component when you complete item **12** on your tax return. In this situation, you exclude instead only the overall net amount of your share of trust income. You also use only this lesser amount in working out your capital gains.

**Example**

**Capital gain greater than share of trust net income**

Debra’s trust distribution shows that she received $2,000 as her share of the net income of a trust.

This is made up of a primary production loss of $5,000, non-primary production income of $2,000 and a net capital gain of $5,000.

At item **12** on her tax return, Debra will show $5,000 loss from primary production at **L** and $5,000 non-primary production income at **U**.

She excludes only $2,000 from item **12** because her share of the net income of the trust ($2,000) is less than her share of the net capital gain. The $2,000 is the amount Debra uses in working out her net capital gain at **A** item **17** on her tax return.

### STEP 2 CAPITAL GAIN YOU ARE TAKEN TO HAVE MADE

If you are a beneficiary who is entitled to a share of a trust net capital gain you are taken to have made the following extra capital gains in addition to those you have made from CGT events.

You may be a beneficiary who is entitled to a share of the income of a trust that includes a capital gain reduced by the CGT discount or the small business 50% active asset reduction. In this case, you need to **gross up** the capital gain by multiplying it by two. This grossed-up amount is an extra capital gain.

You multiply by four your share of any part of the net capital gain from a trust that the trust has reduced by both the CGT discount and the small business 50% active asset reduction. This grossed-up amount is an extra capital gain.

If you are entitled to any part of the net capital gain from a trust that the trust has not reduced by one of these concessions, then that amount is an extra capital gain.

**NOTE** **No double taxation**

You are not taxed twice on these extra capital gains because you did not include your capital gains from the trust at item **12** on your tax return. You can apply the CGT discount to trust gains calculated using the discount method after you have applied your capital losses.

These extra capital gains are taken into account in working out your net capital gain for the income year. You include them at step 2 in part B or part C.

**Example**

**Distribution where the trust claimed concessions**

Serge is a beneficiary in the Shadows Unit Trust. He receives a distribution of $2,000 from the trust. This distribution includes $250 of net income remaining after a $1,000 capital gain made by the trustee was reduced by the CGT discount and the small business 50% active asset reduction.

Serge has also made a capital loss of $100 from the sale of shares.

He calculates his net capital gain as follows:

| | |
|---|---|
| Gross up the share of trust net capital gain ($250) by multiplying by 4 | $1,000 |
| Deduct capital losses | $100 |
| | $900 |
| Apply the CGT discount of 50% | $450 |
| | $450 |
| Apply the 50% active asset reduction | $225 |
| **Net capital gain** | **$225** |

Serge will show $1,000 at H item **17** on his tax return, which is his total current year capital gain. His net capital gain to be shown at A item **17** on his tax return is $225. He will show a trust distribution of $1,750 ($2,000 – $250) at U item **12** on his tax return.

**NOTE** **Applying the concessions**

Remember that you must use the same method as the trust to calculate your capital gain.

This means you cannot apply the CGT discount to capital gains distributed to you from the trust calculated using the indexation method or 'other' method.

Also, you can only apply the small business 50% active asset reduction to grossed-up capital gains to which the trust applied that concession.

## Non-assessable payments from a trust

It is quite common for a trust to make non-assessable payments to beneficiaries.

If a profit made by the trust is not assessable, any part of that profit distributed to a beneficiary will also be non-assessable in most cases—for example, a share of a profit made on the sale of property acquired by the trust before 20 September 1985.

However, if you receive non-assessable payments from a trust, you need to make cost base adjustments to your units or trust interest. Those adjustments will affect the amount of any capital gain or capital loss you make on the unit or interest (for example, when you sell it). If certain amounts exceed your cost base, you may also make a capital gain equal to that excess in the year it is paid to you.

**NOTE** **Non-assessable payments under a demerger**

If non-assessable payments are made under a demerger, no adjustment is required to the cost base and the reduced cost base of your new interests for the payments unless they are more than the cost base or reduced cost base. Similarly, no capital gain arises in respect of these payments except in these circumstances. You may be able to choose CGT roll-over for a capital gain you make. For more information about demergers, see chapter 5 page 32.

**NOTE** **Capital loss**

You cannot make a capital loss from a non-assessable payment.

If relevant to you, non-assessable payments may be shown on your distribution statement as:

- **tax-free amounts** (where certain tax concessions allowed to the trust means it can pay greater distributions to its unit holders)
- **CGT-concession amounts** (the trust's CGT discount and capital losses components of any actual distribution)
- **tax-exempted amounts** (generally made up of exempt income of the trust, amounts on which the trust has already paid tax or income you had to repay to the trust), or
- **tax-deferred amounts** (other non-assessable payments, including indexation allowed to the trust on its capital gains and accounting differences in income).

Before 1 July 2001, a payment of an amount associated with building allowances was treated as a tax-free amount. Payments on or after that date are treated as tax-deferred amounts.

A CGT-concession amount received before 1 July 2001 was treated in the same way as a tax-deferred amount. From this date, CGT-concession amounts no longer require a cost base or reduced cost base adjustment.

Tax-exempted amounts do not affect your cost base or reduced cost base.

However, if your statement shows any tax-deferred or tax-free amounts, you adjust the cost base and reduced cost base as follows:

- cost base—deduct the tax-deferred amounts from the cost base
- reduced cost base—deduct both the tax-deferred amounts and the tax-free amounts.

Generally, you make any adjustment to the cost base or reduced cost base of your unit or trust interest at the end of the income year. However, if some other CGT event happens to the unit or trust interest during the year (for example, you sell your units) you must adjust the cost base or reduced cost base just before the time of that CGT event. The amount of the adjustment is based on the amount of non-assessable payments paid to you up to the date of sale. You use the adjusted cost base or reduced cost base to work out your capital gain or capital loss (see chapter 2 page 14 for more information).

The cost base and reduced cost base adjustments are more complex if you deducted capital losses from a grossed-up capital gain where a capital gain made by the trust was reduced by the small business 50% active asset reduction. If this applies to you, you may need to seek advice from the Australian Taxation Office on how to make the adjustments.

If the tax-deferred amount is greater than the cost base of your unit or trust interest, you include the excess as a capital gain. You can use the indexation method if you bought your units or trust interest before 11.45am (by legal time in the ACT) on 21 September 1999. However, if you do so, you cannot use the discount method to work out your capital gain when you later sell the units or trust interest.

**Example**

### Bob has received a non-assessable amount.

Bob owns units in OZ Investments Fund which distributed income to him for the year ending 30 June 2003. The fund gave him a statement showing his distribution included the following capital gains:

- $100 calculated using the discount method (grossed-up amount $200)
- $75 calculated using the indexation method, and
- $28 calculated using the 'other' method.

These capital gains add up to $203.

The statement shows Bob's distribution did not include a tax-free amount but it did include:

- $105 tax-deferred amount.

From his records, Bob knows that the cost base and reduced cost base of his units are $1,200 and $1,050 respectively.

Bob has no other capital gains or capital losses for the 2002–03 income year.

Bob follows these steps to work out the amounts to show on his tax return.

As Bob has a capital gain which the fund reduced under the CGT discount of 50% ($100), he includes the grossed-up amount ($200) in his total current year capital gain.

Bob adds the grossed-up amount to his capital gains calculated using the indexed method and 'other' method to work out his total current year capital gains:

$200 + $75 + $28 = $303

As Bob has no other capital gains or capital losses, and he must use the discount method in relation to the capital gains calculated using the discount method from the trust, his net capital gain is equal to the amount of capital gain included in his distribution from the fund ($203).

Bob completes item **17** on his tax return as follows:

**17 Capital gains**

Did you have a capital gains tax event during the year? G NO YES X

You must also print X in the YES box at G if you received a distribution of a capital gain from a trust.

Net capital gain A 203.00

Total current year capital gains H 303.00

Net capital losses carried forward to later income years V .00

***Records Bob needs to keep***

The tax-deferred amount Bob received is not included in his income or his capital gains but it affects the cost base and reduced cost base of his units in OZ Investments Fund for future income years.

Bob deducts the tax-deferred amount from both the cost base and reduced cost base of his units as follows:

| | |
|---|---|
| Cost base | $1,200 |
| less tax-deferred amount | $105 |
| **New cost base** | **$1,095** |
| Reduced cost base | $1,050 |
| less tax-deferred amount | $105 |
| **New reduced cost base** | **$945** |

**Example**

### Ilena's capital loss is greater than her non-discounted capital gain.

Ilena invested in XYZ Managed Fund. The fund made a distribution to Ilena for the year ending 30 June 2003 and provided her with a statement that shows her distribution included:

- $65 **discounted capital gain**, and
- $90 non-discounted capital gain.

The statement shows Ilena's distribution also included:

- $30 tax-deferred amount, and
- $35 tax-free amount.

Ilena has no other capital gains but made a capital loss of $100 on some shares she sold during the year.

From her records, Ilena knows the cost base and reduced cost base of her units are $5,000 and $4,700 respectively.

Ilena has to treat the capital gain component of her fund distribution as if she made the capital gain. To complete her tax return, Ilena must identify the capital gain component of her fund distribution and work out her net capital gain.

Ilena follows these steps to work out the amount to show at **H** item **17** on her tax return.

As Ilena has a $65 capital gain which the fund reduced by the CGT discount of 50%, she must gross up the capital gain. She does this by multiplying the amount of the discounted capital gain by two:

$65 × 2 = $130

Ilena adds her grossed-up and non-discounted capital gains to work out her total current year capital gains:

$130 + $90 = $220

She shows her total current year capital gains ($220) at **H** item **17** on her tax return.

After Ilena has grossed up the discounted capital gain received from the fund, she subtracts her capital losses from her capital gains.

Ilena can choose which capital gains she subtracts the capital losses from first. In her case, she gets the better result if she:

1. subtracts as much as possible of her capital losses (which were $100) from her non-discounted capital gains ($90).

   $90 – $90 = $0 (non-discounted capital gains)

2. subtracts her remaining capital losses after step 1 ($10) from her discounted capital gains ($130).

   $130 – $10 = $120 (discounted capital gains)

3. applies the CGT discount to her remaining discounted capital gains:

   ($120 × 50%) = $60 (discounted capital gains)

Finally, Ilena adds up the capital gains remaining to arrive at her net capital gain:

$0 (non-discounted) + $60 (discounted)
= $60 net capital gain.

Ilena completes item **17** on her tax return follows:

**17 Capital gains**

Did you have a capital gains tax event during the year? **G** NO YES X
You must also print **X** in the **YES** box at **G** if you received a distribution of a capital gain from a trust.

Net capital gain **A** 60.00

Total current year capital gains **H** 220.00

Net capital losses carried forward to later income years **V** .00

***Records Ilena needs to keep***

The tax-deferred and tax-free amounts Ilena received are not included in her income or her capital gain but the tax-deferred amount affects the cost base and reduced cost base of her units in XYZ Managed Fund for future income years. The tax-free amount affects her reduced cost base.

Ilena reduces the cost base and reduced cost base of her units as follows:

| | |
|---|---:|
| Cost base | $5,000 |
| less tax-deferred amount | $30 |
| **New cost base** | **$4,970** |

| | |
|---|---:|
| Reduced cost base | $4,700 |
| less (tax-deferred amount + tax-free amount) ($30 + $35) | $65 |
| **New reduced cost base** | **$4,635** |

# CHAPTER 5 INVESTMENT IN SHARES AND UNITS

This chapter explains your capital gains tax (CGT) obligations if you sold or otherwise disposed of any shares or units in a unit trust (including a managed fund) in 2002–03. It also explains what happens when you have a CGT event under a demerger. For information about distributions from a unit trust (other than under a demerger) in 2002–03, see chapter 4.

**NOTE Managed fund**

A managed fund is a unit trust. Where we refer to a unit trust in this guide we are also referring to a managed fund.

**NOTE Recent share transactions**

You may find the information about recent share transactions in **appendix 4** on page 108 useful when completing your income tax return.

## How capital gains tax affects shares and units

For CGT purposes, shares in a company or units in a unit trust are treated in the same way as any other assets.

As a general rule, if you acquire any shares or units on or after 20 September 1985, you may have to pay tax on any capital gain you make when a CGT event happens to them. This would usually be when you sell or otherwise dispose of them. In this case, CGT event A1 would happen. You will find a list of all CGT events at appendix 1 on page 98.

**NOTE New terms**

There may be terms in this chapter that are not familiar to you. Refer to **chapter 1** in **part A** for more information or to **Explanation of terms** at the back of this guide.

A CGT event might happen to shares even if a change in their ownership is involuntary—for example, if the company in which you hold shares is taken over or merges with another company. This may result in a capital gain or capital loss.

This chapter also deals with the receipt of non-assessable payments from a company (CGT event G1) while chapter 4 deals with non-assessable payments from a trust (CGT event E4). If you own shares in a company that has been placed in liquidation, CGT event G3 explains how you can choose to make a capital loss when the liquidator declares the shares worthless.

There are a number of special CGT rules if you receive such things as bonus shares, **bonus units**, rights, options or non-assessable payments from a company or trust. Special rules also apply if you buy convertible notes or participate in an **employee share scheme** or a dividend reinvestment plan.

The rest of this chapter explains these rules and contains examples showing how they work in practice. The flowcharts at **appendix 3** on page 104 will also help you work out whether the special rules apply to you.

If you need more information about how other income tax provisions affect your share investments, get the publication *You and your shares* from the sources listed at the back of this guide.

## Identifying shares or units sold

Sometimes taxpayers own shares or units that they may have acquired at different times. This can happen as people decide to increase their investment in a particular company or unit trust. A common question people ask when they dispose of only part of their investment is how to identify the particular shares or units they have disposed of.

This can be very important because shares or units bought at different times may have different amounts included in their cost. In calculating the capital gain or capital loss when disposing of only part of an investment, you need to be able to identify which ones you have disposed of. Also, when you dispose of any shares or units you acquired before 20 September 1985, any capital gain or capital loss you make is generally disregarded.

If you have the relevant records (for example, share certificates), you may be able to identify which particular shares or units you have disposed of. In other cases, the Commissioner will accept your selection of the identity of shares disposed of.

Alternatively, you may wish to use a 'first in, first out' basis where you treat the first shares or units you bought as being the first you disposed of.

In limited circumstances, the Australian Taxation Office (ATO) will also accept an average cost method to determine the cost of the shares disposed of. This average cost method can be used only when:

- the shares are in the same company
- the shares are acquired on the same day

- the shares have identical rights and obligations, and
- you are not required to use market value for cost base purposes.

**Example**

**Identifying when shares or units were acquired**

Boris bought 1,000 shares in WOA Ltd on 1 July 1997. He bought another 3,000 shares in the company on 1 July 2002.

In December 2002, WOA Ltd issued Boris with a CHESS statement for his 4,000 shares. When he sold 1,500 of the shares on 1 January 2003, he was not sure whether they were the shares he bought in 2002 or whether they included the shares bought in 1997.

Because Boris could not identify when he bought the particular shares he sold, he decided to use the 'first in, first out' method and nominated the 1,000 shares bought in 1997 plus 500 of the shares bought in 2002.

## Demutualisation of insurance companies

If you hold a policy in an insurance company that **demutualises**, you may be subject to CGT either at the time of the demutualisation or when you sell your shares. A company demutualises when it changes its membership interests to shares (for example, the NRMA). There are similar rules if you are a member of a non-insurance organisation which demutualises.

The insurance company may give you an option either to keep your share entitlement or to take cash by selling the shares under contract through an entity set up by the company.

If it is an Australian insurance company and you choose to keep the shares, you will not be subject to CGT until you eventually sell them. However, if you elect to sell your share entitlement and take cash, you need to include any capital gain on your tax return in the income year in which you entered into the contract to sell the shares, even though you may not receive the cash until a later income year.

The demutualising company will write to all potential 'shareholders' and advise them of the acquisition cost in each instance, sometimes referred to as the 'embedded value'. Even though you did not pay anything to acquire the shares, they have a value that is used for CGT purposes.

If you hold a policy in an overseas insurance company that demutualises, you may be subject to CGT at the time of the demutualisation. You should contact the ATO for advice if this applies to you.

## Share buy-backs

As a shareholder, you may have received an offer from the company to buy back some or all of your shares in the company. If you disposed of shares back to the company under a buy-back arrangement, you may have made a capital gain or capital loss from that CGT event.

Some of the buy-back price may also be treated as a dividend for tax purposes. The time you make the capital gain or capital loss will depend on the conditions of the particular buy-back offer. It may be the time you lodge your application to participate in the buy-back, or if it is a conditional offer of buy-back, the time the offer is accepted.

**Example**

**Buy-back offer**

Sam bought 4,500 shares in Company A in January 1994 at a cost of $5 per share. In February 2003, Sam applied to participate in a buy-back offer to dispose of 675 shares (15%). Company A approved a buy-back of 10% (450) of the shares on 15 June 2003. The company sent Sam a cheque on 5 July 2003 for $4,050 (450 shares x $9). No part of the distribution is a dividend.

Sam works out his capital gain for 2002–03 as follows.

**If he chooses to use the indexation method:**

| | |
|---|---|
| Capital proceeds | $4,050 |
| Cost base 450 shares × $5 ($2,250 × 1.118 including indexation) | $2,515 |
| Capital gain | $1,535 |

**If he chooses to use the discount method:**

| | |
|---|---|
| Capital proceeds | $4,050 |
| Cost base | $2,250 |
| Capital gain (before applying any discount) | $1,800 |

Sam has no capital losses to apply against this capital gain and decides that the discount method will provide him with the better result. He will include $900 ($1,800 × 50%) in his assessable income.

## Shares in a company in liquidation

Where a company is placed in liquidation, company law restricts the transfer of shares in the company. This means that, in the absence of special CGT rules, you may not be able to realise a capital loss on shares that have become worthless.

In certain circumstances, you can choose to realise a capital loss on worthless shares prior to dissolution (if you had acquired the shares on or after 20 September 1985). This applies if you own shares in a company and the liquidator declares in writing that there is no likelihood you will receive any further distribution in the course of winding up the company. The liquidator's declaration can still be made after you receive a distribution during the winding-up.

If you make this choice, you will make a capital loss equal to the reduced cost base of the shares at the time of the liquidator's declaration. The cost base and reduced cost base of the shares are reduced to nil just after the liquidator makes the declaration.

These rules do not apply:

- where a company is placed in receivership or is de-listed, or
- to units in unit trusts.

**Example**

**Liquidator's declaration that shares are worthless**

The liquidators of HIH Insurance Ltd made a written declaration on 10 October 2001 that they had reasonable grounds to believe that there was no likelihood that the shareholders of HIH Insurance Ltd would receive any distribution in the course of the winding up.

Hillary purchased shares in HIH Insurance Ltd on 1 August 1999. CGT event G3 happened in relation to her shares on 10 October 2001 when the liquidator made the declaration. Hillary chose to make capital losses equal to the reduced cost bases of her shares as at 10 October 2001. She claimed the capital losses in her 2001–02 tax return.

If CGT event G3 has not happened or you have not chosen for it to apply, you may make a capital loss on shares when a court order is given to dissolve the company. Also, if a company is wound up voluntarily, shareholders may realise a capital loss either three months after a liquidator lodges a tax return showing that the final meeting of the company has been held, or on another date declared by a court. The cancellation of shares as a result of the dissolution of the company is an example of CGT event C2.

## Takeovers and mergers

If a company in which you own shares is taken over or merges with another company, you may have a CGT obligation if you are required to dispose of your existing shares or they are cancelled.

In certain circumstances, if you acquire new shares in the takeover or merged company, you may be able to defer paying CGT until a later CGT event happens. For more information, see **Scrip-for-scrip roll-over** on page 30.

Some takeover or merger arrangements involve an exchange of shares. In these cases, when you calculate your capital gain or capital loss, your capital proceeds will be the market value of the shares received in the takeover or merged company at the time of disposal of your original shares.

If you receive a combination of money and shares in the takeover or merged company, your capital proceeds are the total of the money and the market value of the shares you received at the time of disposal of the shares.

The cost of acquiring the shares in the takeover or merged company is the market value of your original shares at the time you acquire the other shares, reduced by any cash proceeds.

To correctly calculate the capital gain or capital loss for your original shares, you will need to keep records (in addition to the usual records) showing the parties to the arrangement, the conditions of the arrangement and the capital proceeds.

As each takeover or merger arrangement will vary according to its own particular circumstances, you need to get full details of the arrangement from the parties involved.

**Example**

**Takeover**

We are assuming with this example that **scrip-for-scrip roll-over** does not apply (see below).

Desiree owns 500 shares in ABC Ltd. These shares are currently worth $2 each. Their cost base, with indexation, is $1.50.

XYZ Ltd offers to acquire each share in ABC Ltd for one share in XYZ Ltd and 75 cents cash. The shares in XYZ Ltd are valued at $1.25 each. Accepting the offer, Desiree receives 500 shares in XYZ Ltd and $375 cash.

The capital proceeds received for each share in ABC Ltd is $2 ($1.25 market value of each XYZ Ltd share plus 75 cents cash). Therefore, as the cost base of each ABC Ltd share is $1.50, Desiree will make a capital gain of 50 cents ($2 – $1.50) on each share, a total of $250.

The cost base of the newly acquired XYZ Ltd shares is the market value of the shares in ABC Ltd ($2) less the cash amount received ($0.75), that is, $1.25 each or a total of $625 (500 × $1.25).

## Scrip-for-scrip roll-over

If a company in which you owned shares was taken over and you received new shares in the takeover company, you may be entitled to scrip-for-scrip roll-over. You may also be eligible for this roll-over if you exchange a unit or other interest in a fixed trust, for a similar interest in another fixed trust.

Scrip-for-scrip roll-over is not available if a share is exchanged for a unit or other interest in a fixed trust, or if a unit or other interest in a fixed trust is exchanged for a share.

You can only choose the roll-over if you have made a capital gain from such an exchange on or after 10 December 1999. Roll-over does not apply to a capital loss.

Roll-over is only available if the exchange is in consequence of an arrangement that results in the acquiring entity (or the wholly owned group of which it is a member) becoming the owner of 80% or more of the original company or trust.

For companies, the arrangement must be one in which all owners of voting shares in the original entity can participate. For trusts, this means all owners of trust voting interests in the original entity or, where there are no voting interests, all owners of units or other fixed interests can participate.

There are special rules if a company or trust has a small number of shareholders or beneficiaries or there is a significant common stakeholder. You will need to seek information from the company or trust about whether the conditions have been satisfied.

The roll-over allows you to disregard the capital gain made from the original shares, units or other interest. You are taken to have acquired the replacement shares, units or other interest for the cost base of the original interest.

You can apply the CGT discount when you dispose of new shares providing the combined period that you owned the original shares and the new shares is at least 12 months. The same applies to units in a trust. Note that you have to deduct any capital losses (including capital losses from earlier years) from your capital gains before applying the CGT discount.

You may only be eligible for partial roll-over if you exchange shares, units or interests for similar interests in another entity (replacement interest) plus something else, usually cash.

This is because roll-over applies only to the replacement interest. You will need to apportion the cost base of the original interest between the replacement interest and the cash (or other proceeds not eligible for roll-over).

If your original shares, units or other interests were acquired before 20 September 1985 (pre-CGT), you are not eligible for scrip-for-scrip roll-over. Instead, you acquire the replacement interest at the time of the exchange and the replacement interest is no longer a pre-CGT asset. However if the arrangement is one that would otherwise qualify for scrip-for-scrip roll-over, the cost base of the replacement interest is its market value just after the acquisition.

**Example**

### Partial scrip-for-scrip roll-over

Gunther owns 100 shares in Windsor Ltd, each with a cost base of $9. He accepts a takeover offer from Regal Ltd which provides for Gunther to receive one Regal share plus $10 cash for each share in Windsor. Gunther receives 100 shares in Regal and $1,000 cash. Just after Gunther is issued shares in Regal, each share is worth $20.

Gunther has received $10 cash for each of his Windsor shares and so has $1,000 to which roll-over does not apply.

In this case, it is reasonable to allocate a portion of the cost base of the original shares having regard to the proportion that the cash bears to the total proceeds. That is:

$1,000 ÷ 3,000 × $900 = $300

Gunther’s capital gain is as follows:

| $1,000 (Cash) | – | $300 cost base | = | $700 capital gain |
|---|---|---|---|---|

Gunther calculates the cost base of each of his Regal shares as follows:

$900 — $300 ÷ 100 = $6

**Example**

**Scrip-for-scrip roll-over**

Stephanie owns ordinary shares in Reef Ltd. On 28 February 2003, she accepted a takeover offer from Starfish Ltd under which she received one ordinary share and one preference share for each Reef share. The market value of the Starfish shares just after Stephanie acquired them was $20 for each ordinary share and $10 for each preference share.

The cost base of each Reef share just before Stephanie ceased to own them was $15.

The offer made by Starfish Ltd satisfied all the requirements for scrip-for-scrip roll-over.

If roll-over did not apply, Stephanie would have made a capital gain per share of:

| $30 | – | $15 | = | $15 |
|---|---|---|---|---|
| Capital proceeds | | cost base | | capital gain |

Scrip-for-scrip roll-over allows Stephanie to disregard the capital gain. The cost base of the Starfish shares is the cost base of the Reef Ltd shares.

**NOTE** **Apportioning the cost base**

As the exchange is one share in Reef Ltd for two shares in Starfish Ltd, the cost base of the Reef Ltd share needs to be apportioned between the ordinary share and the preference share.

Cost base of ordinary share:
$20 ÷ 30 × $15 = $10

Cost base of preference share:
$10 ÷ 30 × $15 = $5

## Demergers

A demerger involves the restructuring of a corporate or trust group by splitting its operations into two or more entities or groups. Under a demerger the owners of the head entity of the group acquire a direct interest in an entity (demerged entity) that was formerly part of the group.

**Example**

**Demerger**

Peter owns shares (his original interest) in Company A. Company B is a wholly owned subsidiary of Company A. Company A undertakes a demerger by transferring all of its shares in Company B to its shareholders. Following the demerger all of the shareholders in Company A, including Peter, will own all of the shares in Company B (their new interests) in the same proportion as they hold their shares in Company A.

If you owned interests in a company or a fixed trust that is the head entity of a demerger group and you received new interests in the demerged entity, you will need to be aware of the CGT consequences. These are:

- you may be entitled to choose roll-over for any capital gain or capital loss you make under a demerger, and
- you are required to determine your cost base and reduced cost base for your post-CGT interests in the head entity and your new post-CGT interests in the demerged entity. You must do this whether or not you choose roll-over or whether there has been a CGT event under the demerger.

*When is roll-over available*

For the roll-over to apply, certain general demerger tests must be satisfied. Generally the head entity undertaking the demerger will advise owners whether these tests have been satisfied but you should seek our advice if you are in any doubt. The ATO may have provided advice in the form of a class ruling specific to the demerger, confirming that the tests are satisfied.

The general demerger tests are as follows:

- the demerger must happen on or after 1 July 2002
- the demerger group must own more than 20% of the entity being demerged
- the owners of the head entity must become the owners of at least 80% of the demerger group's interest in the demerged entity
- the entity being demerged must be a company if the head entity is a company or a trust if the head entity is a trust
- the owners of the head entity must have the same proportional ownership of new interests in the demerged entity as they had in the head entity just before the demerger. They must also maintain their proportional share of the market value of the group, and
- just before the demerger more than 50% of interests in the head entity of the demerger group must be owned by Australian residents or by non-residents whose new interests have the necessary connection with Australia.

If the general demerger tests are satisfied and a CGT event happened to your interest in the head entity, you will generally be entitled to choose CGT roll-over. Non-residents will only be entitled to choose roll-over if their interest in the entity that was demerged had the necessary connection to Australia.

*Consequences of choosing roll-over*

If you choose roll-over relief the consequences are as follows:

- you disregard any capital gain or capital loss made from the original shares, units or other interest
- if a proportion of your original shares, units or other interests were acquired before 20 September 1985 (pre-CGT), the same proportion of your new interests are also treated as pre-CGT assets.

*Other requirements: cost base calculations*

When a demerger takes place you are required to adjust the cost bases of your original interests in the head entity and your new interests in the demerged entity. You are required to make these adjustments irrespective of whether you chose roll-over and even if no CGT event happened to your original interests.

You work out the cost bases of your new and original interests by apportioning or 'spreading' the sum of the cost bases of your original interests between your remaining original post-CGT interests and your new interests. The apportionment is based on the relative market values of the new and original interests. The head entity should advise you of the appropriate percentage to use in setting your cost bases.

For the purposes of working out whether you can use the **CGT discount method** when a CGT event happens to your new interests, the minimum 12-month period is worked out from the date you acquired your original interests providing a CGT event happened to your original interests at the time of the demerger.

**Example**

### Demerger roll-over—BHP

As a result of the BHP demerger, BHP shareholders received one BHP Steel Ltd share for every five BHP Billiton shares they held. Immediately after the demerger BHP Steel represented 5.063% of the market value of the group as a whole.

Tom had 400 BHP Billiton shares (120 pre-CGT and 280 post-CGT) just before the demerger. As part of the demerger Tom received 80 BHP Steel shares.

### Cost base of BHP Billiton shares

Tom works out the cost bases of his post-CGT BHP Billiton shares as follows:

| Shares held before demerger | Cost base just before demerger* | | Reduction | | Cost base after demerger |
|---|---|---|---|---|---|
| 280 Post-CGT | $1,250 | X | (100% – 5.063%) | = | $1,186.71 |

*This is the cost base of the BHP Billiton shares ignoring indexation. If the indexation method is chosen when the shares are later disposed of, the cost base of the shares can be indexed up until 30 September 1999.

This means immediately after the demerger each of Tom's 280 post-CGT BHP Billiton shares has a cost base of $4.24.

The cost base adjustments are made irrespective of whether he chooses roll-over.

### Cost base of BHP Steel shares if roll-over chosen

Tom chooses roll-over. Therefore, at the time of the demerger he is taken to have acquired the same proportion of pre-CGT BHP Steel shares as pre-CGT BHP Billiton shares he owned.

The proportion of Tom's BHP Steel shares that are treated as pre-CGT is:

$$\frac{\text{Number of pre-CGT BHP Billiton shares he held} \quad 120}{\text{Total number of BHP Billiton shares he held} \quad 400} = 30\%$$

The number of BHP Steel shares Tom is taken to have acquired pre-CGT is:

Total number of BHP Steel shares received:
80 X 30% = 24

The cost base of Tom's remaining BHP Steel shares are as follows:

| Cost base of BHP Billiton shares before demerger | | Proportion | | Cost base of BHP Steel shares after demerger |
|---|---|---|---|---|
| $1,250 | X | 5.063% | = | $63.29 |

This means immediately after the demerger each of Tom's 56 post-CGT BHP Steel shares has a cost base of $1.13.

### Cost base of BHP Steel shares if roll-over not chosen

Tom does not choose roll-over.

All of his 80 BHP Steel shares are post-CGT and their cost base is $63.29 (as above).

This means immediately after the demerger each of Tom's 80 BHP Steel shares has a cost base of $0.79.

## Dividend reinvestment plans

Some companies ask their shareholders whether they would like to participate in a **dividend reinvestment plan**. Under these plans, shareholders can choose to use their dividend to acquire additional shares in the company instead of receiving a cash payment. These shares are usually issued at a discount on the current market price of the shares in the company.

For CGT purposes, if you participate in a dividend reinvestment plan you are treated as if you had received a cash dividend and then used the cash to buy additional shares.

Each share (or parcel of shares) acquired in this way—on or after 20 September 1985—is subject to CGT. The cost base of the new shares includes the price you paid to acquire them, that is, the amount of the dividend.

**Example**

**Dividend reinvestment plans**

Natalie owns 1,440 shares in PHB Ltd. The shares are currently worth $8 each. In November 2002, the company declared a dividend of 25 cents per share.

Natalie could either take the $360 dividend as cash (1,440 x 25 cents) or receive 45 additional shares in the company (360 ÷ 8).

Natalie decided to participate in the dividend reinvestment plan and received 45 new shares on 20 December 2002. She included the $360 dividend in her 2002–03 taxable income.

For CGT purposes, she acquired the 45 new shares for $360 on 20 December 2002.

## Bonus shares

Bonus shares are additional shares a shareholder receives wholly or partly as a dividend. You may also pay an amount to get them.

If you receive bonus shares on or after 20 September 1985, you may have to pay CGT if you dispose of them. You may have to modify the cost base and the reduced cost base of bonus shares if they are taxed as a dividend.

The table that follows explains how the timing of your bonus shares affects your CGT.

As a result of changes to the company law and taxation laws, the paid-up value of bonus shares is now generally not taxed as a dividend. An exception to this rule is where you have the choice of being paid a cash dividend or of being issued shares under a dividend reinvestment plan. These shares are treated as dividends and the amount of the dividend is included in your assessable income.

| Date | CGT implications of timing of bonus shares |
|---|---|
| From 20 Sep. 1985 to 30 Jun. 1987 incl. | Many bonus shares issued were paid out of a company's non-taxable capital profits, accumulated in an asset revaluation reserve from a share premium account. These bonus shares are not usually treated as taxable dividends. |
| From 1 Jul. 1987 to 30 Jun. 1998 incl. | The paid-up value of bonus shares issued is taxed as a dividend unless paid from a share premium account. |
| From 1 Jul. 1998 | The paid-up value of bonus shares issued is not taxed as a dividend unless part of the dividend was paid in cash or paid as part of a dividend reinvestment plan. |

There are other, less common circumstances where bonus shares will be taxed as a dividend—for example, where:

- the bonus shares are being substituted for a dividend to give a tax advantage, or
- the company directs bonus shares to some shareholders and dividends to others to give them a tax benefit.

Flowchart 1 in appendix 3 on page 104 summarises the different rules applying to different bonus shares issued on or after 20 September 1985.

For more information about bonus shares, refer to the sources of further information listed at the back of this guide.

### Bonus shares issued where no amount is taxed as a dividend

If you acquired the original shares on or after 20 September 1985, the acquisition date of bonus shares is the date you acquired the original shares. If an issue of bonus shares relates to both the original shares and the bonus shares, the acquisition date of the additional bonus shares is the date the original shares were issued. The cost of your original shares now covers your bonus shares as well.

The cost base or reduced cost base of the bonus shares is calculated by apportioning the amounts paid for the original shares between the original shares and the bonus shares. Effectively, this results in a reduction of the cost base of the original shares.

For original shares acquired before 20 September 1985, your CGT obligations depend on whether your shares are fully paid or partly paid. Any calls paid on partly paid bonus shares are also included in the cost base or reduced cost base of the bonus shares.

**Example**

### Fully paid bonus shares

Chris bought 100 shares in MAC Ltd for $1 each on 1 June 1985. He bought 300 more shares for $1 each on 27 May 1986. On 15 November 1986, MAC Ltd issued Chris with 400 bonus shares from its capital profits reserve, fully paid to $1. Chris did not pay anything to acquire the bonus shares and no part of the value of the bonus shares was taxed as a dividend.

For CGT purposes, the acquisition date of 100 of the bonus shares is 1 June 1985 (pre-CGT). Therefore, the bonus shares are not subject to CGT.

The acquisition date of the other 300 bonus shares is 27 May 1986. Their cost base is worked out by spreading the cost of the 300 shares Chris bought on that date over both those shares and the remaining 300 bonus shares. As the 300 original shares cost $300, the cost base of each share will now be 50 cents.

**Example**

### Partly paid bonus shares

Klaus owns 200 shares in MAC Ltd which he bought on 31 October 1984 and 200 shares in PUP Ltd bought on 31 January 1985.

On 1 January 1987, both MAC Ltd and PUP Ltd made their shareholders a one-for-one bonus share offer of $1 shares partly paid to 50 cents. Klaus elected to accept the offer and acquired 200 new partly paid shares in each company. No part of the value of the bonus shares was taxed as a dividend.

On 1 April 1989, PUP Ltd made a call for the balance of 50 cents outstanding on the partly paid shares, payable on 30 June 1989. Klaus paid the call payment on that date. MAC Ltd has not yet made any calls on its partly paid shares.

For CGT purposes, Klaus is treated as having acquired the bonus shares on the date he became liable to pay the call (1 April 1989). The cost base of the bonus shares includes the amount of the call payment (50 cents) plus the market value of the shares immediately before the call was made.

The MAC Ltd bonus shares will continue to have the same acquisition date as the original shares (31 October 1984) and are therefore not subject to CGT. However, this will not be the case if Klaus makes any further payments to the company on calls made by the company for any part of the unpaid amount on the bonus shares. In this case, the acquisition date of the bonus shares will be when the liability to pay the call arises and the bonus shares will then be subject to CGT.

### Bonus shares issued where the paid-up value is taxed as a dividend

Where the paid-up value of bonus shares is taxed as a dividend, you may have to pay CGT when you dispose of the bonus shares, regardless of when you acquired the original shares. The acquisition date of the bonus shares is the date they were issued. Their cost base is the amount of the dividend, plus any call payments you made to the company if they were only partly paid.

The exception to this rule is where you received the bonus shares before 1 July 1987. Their cost base is calculated as if the amount was not taxed as a dividend (see **Bonus shares issued where no amount is taxed as a dividend** on the previous page).

**Example**

### Cost base of bonus shares

Mark owns 1000 shares in RIM Ltd, which he bought on 30 September 1984 for $1 each.

On 1 February 1997, the company issued him with 500 bonus shares partly paid to 50 cents. The paid-up value of bonus shares ($250) is a taxable dividend to Mark.

On 1 May 1997, the company made a call for the 50 cents outstanding on each bonus share, which Mark paid on 1 July 1997.

The total cost base of the bonus shares is $500, consisting of the $250 dividend received on the issue of the bonus shares on 1 February 1997 plus the $250 call payment made on 1 July 1997.

The bonus shares have an acquisition date of 1 February 1997. If Mark holds the bonus shares for 12 months from that date, when he sells them he can use the indexation method to calculate his capital gain. Indexation for amounts payable to a company on shares in the company can be indexed only from the date of actual payment. In Mark's case, the $250 call payment can be indexed only from the date it was paid (1 July 1997).

However, indexation on the $250 dividend included in his taxable income on the issue of the bonus shares was available from 1 February 1997. This is different from the indexation treatment of amounts paid to acquire assets in other circumstances where indexation is available from the time the liability to make the payment arises. The indexation rules are explained in more detail in chapter 2.

If Mark disposes of the shares after 11.45am (by legal time in the ACT) on 21 September 1999, he can calculate his capital gain using either the indexation method or the discount method.

## Bonus units

If you have received bonus units on or after 20 September 1985, you may have to pay CGT if you make a capital gain when you dispose of them.

The CGT rules for bonus units are very similar to those for bonus shares. However, these rules do not apply if the bonus units are issued by a corporate unit trust or a public trading trust.

When the unit trust issues the bonus units, they will generally tell you what amount (if any) you have to include in your assessable income. You need to keep a record of that information to work out your CGT obligation when you dispose of them.

Flowchart 2 in appendix 3 on page 105 summarises the rules applying to bonus units issued on or after 20 September 1985.

### Bonus units issued where no amount is included in assessable income

If you did not include any amount in your assessable income for the issue of bonus units, the acquisition date of the bonus units is the date you acquired the original units to which they relate.

This table explains your CGT obligation in these cases.

| Original shares acquired before 20 Sep. 1985 | CGT implications of fully paid versus partly paid bonus shares |
|---|---|
| Fully paid shares | If the bonus shares are fully paid, the acquisition date of the bonus shares is the date you acquired the original shares. Therefore, if you acquired the original shares before 20 September 1985, any capital gain or capital loss you make from the sale of the bonus shares is disregarded. |
| Partly paid shares | With certain exceptions, if the bonus shares were partly paid and you have made a call payment, the acquisition date for the bonus shares is the date when the liability to pay the amount arose. The cost of acquiring them includes their market value just before that date. A copy of a newspaper's stock market listing for that day is an appropriate record. Exceptions—For pre-10 December 1986 partly paid up bonus shares, the date of acquisition is the date you acquired the original shares. For post-10 December 1986 partly paid up bonus shares, the date of acquisition is also the date you acquired the original shares, provided you have not paid any amount subsequently (otherwise it becomes the date the liability to pay the amount arose). |

**Example**

**Unit trusts**

Sarah is a unit holder in the CPA Unit Trust. She bought 1,000 units on 1 September 1985 for $1 each and 1,000 units on 1 July 1996 for $2 each. On 1 March 1997, the unit trust made a one-for-one bonus unit issue to all unit holders. Sarah received 2,000 new units. She did not include any amount in her assessable income as a result.

The 1,000 new units issued for the original units she acquired on 1 September 1985 are also treated as having been acquired on that date and are therefore not subject to CGT.

However, the 1,000 new units issued for the original units she acquired on 1 July 1996 are subject to CGT. Their cost base is worked out by spreading the cost of the original units ($2,000) acquired on that date over both the original units and the bonus units. Each of the units therefore has a cost base of $1.

### Bonus units issued where an amount is included in assessable income

If you include any amount in your assessable income as a result of the issue of bonus units, their acquisition date is the date they were issued, regardless of when you acquired the original units. The cost base of bonus units is the amount included in your assessable income as a result of the issue of those units, plus any calls you made if they were only partly paid.

## Rights or options to acquire shares or units

### Acquisition of rights or options and their cost base

If you own shares or units, you may be issued rights or options to acquire additional shares or units at a specified price.

If the rights and options are offered at no cost, you are taken to have acquired them at the same time as you acquired the original shares or units. Therefore, if you acquired the original shares or units before 20 September 1985, any capital gain or capital loss you make from the sale of the rights or options is disregarded.

If you acquired your original shares or units (or rights or options from another entity) on or after 20 September 1985, they are treated much like any other CGT asset and are subject to CGT. This is also the case if you paid the company or trust for them.

### Cost base after exercising rights or options to acquire shares or units

Many people decide to exercise their rights or options to acquire new shares or units rather than sell them. In this case, no CGT is payable at the time you exercise the rights or options.

### Exercising rights or options on or after 20 September 1985

If you exercise them on or after 20 September 1985, some special rules apply for calculating the cost base for shares or units acquired as a result.

You may be in a situation where:

- a company in which you are a shareholder issues you with rights or options to acquire shares, or
- after 28 January 1988, a unit trust in which you are a unit holder issues you with rights or options to acquire units.

If you pay nothing in these situations, the amount included in the cost base or reduced cost base of the shares or units you acquire depends on when you acquired your original shares or units.

### Where original shares or units were acquired before 20 September 1985

You may have acquired the original shares or units before 20 September 1985 and paid nothing for the issue of the rights or options. In this case, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is the sum of the market value of the rights or options at the time you exercise them and the amount you pay for the shares or units.

### Where original shares were acquired on or after 20 September 1985

The situation is different if you acquired the original shares or units on or after 20 September 1985 and paid nothing for the issue of the rights or options. In this case, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is simply the amount you pay for the shares or units.

You may be in a situation where:

- a company in which you are a shareholder issues you with rights or options to acquire shares, or
- after 28 January 1988, a unit trust in which you are a unit holder issues you with rights or options to acquire units.

If you make a payment in one of these situations, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is the sum of the amount you paid for the rights or options and the amount you pay for the shares or units on exercising the rights or options.

If the original shares or units were acquired before 20 September 1985, the rights or options are taken to have been acquired before that date. This means the first element of the cost base for the shares or units is the sum of the market value of the rights or options at the time you exercise them and the amount you paid for the shares or units. This is the case whether or not you make a payment to the company for the issue of the rights or options.

Different rules again apply if you acquired the rights or options to acquire shares or units from an entity other than the company or unit trust which issued the rights or options—for example, from a shareholder of the company.

If you did not pay anything to acquire the rights or options from another entity, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising them is simply the amount you paid for the shares or units.

If you did pay to acquire the rights or options, the first element of the cost base or reduced cost base of the shares or units you acquire on exercising them is the sum of the amount you actually paid for the rights or options and the amount you paid for the shares or units.

Flowcharts 3 and 4 in appendix 3 on page 106–7 summarise the different rules applying to the treatment of rights or options to acquire shares or units.

**Example**

**Sale of rights**

Shanti owns 2,000 shares in ZAC Ltd. She bought 1000 shares on 1 June 1985 and 1000 shares on 1 December 1996.

On 1 July 1998, ZAC Ltd offered each of its shareholders one right for each four shares owned to acquire shares in the company for $1.80 each. Shanti therefore received 500 rights in total. At that time, shares in ZAC Ltd were worth $2. Each right was therefore worth 20 cents.

Shanti decided that she did not wish to buy any more shares in ZAC Ltd, so she sold all her rights for 20 cents each—a total amount of $100. Only those rights issued for the shares she bought on 1 December 1996 are subject to CGT. As Shanti did not pay anything for the rights, she has made a $50 taxable capital gain on their sale.

The $50 Shanti received on the sale of her rights for the shares she bought on 1 June 1985 is not subject to CGT as those rights are taken to have been acquired at the same time as the shares, that is, before 20 September 1985.

**Example**

**Rights exercised**

Assume that, in the above example, Shanti wished to acquire more shares in ZAC Ltd. She therefore exercised all 500 rights on 1 August 1998 when they were still worth 20 cents each.

There are no CGT consequences arising from the exercise of the rights.

However, the 500 shares Shanti acquired on 1 August 1998 when she exercised the rights are subject to CGT and are acquired at the time of the exercise.

When Shanti exercised the rights issued for the shares she bought on 1 December 1996, the cost base of the 250 shares Shanti acquired is the amount she paid to exercise each right, that is, $1.80 for each share.

When she exercised the rights for the shares she bought before 20 September 1985, Shanti's cost base for each of the 250 shares she acquired includes not only the exercise price of the right ($1.80) but also the market value of the right at that time, that is, 20 cents. The cost base of each share is therefore $2.

### CGT discount on shares or units acquired from exercise of rights or options

You can only use the discount method to calculate your capital gain from an asset if you own it for at least 12 months. In calculating any capital gain on shares or units you acquire from the exercise of a right or option the 12-month period applies from the date you acquire the shares or units (not the date you acquired the right or option).

## Convertible notes

A convertible note is another type of investment you can make in a company or unit trust. A convertible note earns interest on the amount you pay to acquire the note until the note's expiry date. On expiry of the note, you can either ask for the return of the money paid or convert that amount to acquire new shares or units.

Convertible notes you acquired after 10 May 1989 will generally not be subject to CGT if you sold or disposed of them before they converted into shares. Instead, any gain you make is included on your tax return as ordinary income or any loss you make is included as a deduction. For more information, get the publication *You and your shares* from the sources listed at the back of this guide.

If you have sold or disposed of a convertible note that you acquired before 11 May 1989, please contact the business enquiries line on **13 24 78**. When you phone make sure you know the date you acquired the convertible note as this may affect the tax treatment.

### Conversion of notes to shares

The tax treatment that applies when your convertible notes are converted to shares depends on when you acquired the convertible notes, the type of convertible note, when the conversion occurred and when the convertible note was issued.

Shares acquired by the conversion of a convertible note on or after 20 September 1985 will be subject to CGT when they are sold or disposed of and the shares are taken to be acquired when the conversion happens.

You may have acquired the convertible note on or after 20 September 1985 and, as a traditional security or qualifying security, the gain you made on the conversion of the note was already included on your tax return as income (or as a deduction if you made a loss).The way you calculate the cost base of the shares varies depending on whether the notes converted to shares before 1 July 2001 or on or after that date. The table on the next page provides a summary.

**Convertible notes**

The Government has introduced legislation in Parliament to change the tax treatment of convertible notes issued by a company after 14 May 2002 if the notes are traditional securities.

Under the proposal, there are no tax consequences at the time these convertible notes are converted or exchanged for ordinary shares in a company. Instead gains or losses will only be made when the shares are sold or disposed of.

For ordinary investors, any gains or losses on the sale or disposal of the shares will be subject to CGT. This means individuals will be able to get the benefit of the CGT discount if they hold the shares for more than 12 months and are not carrying on a business trading in this kind of investments. The table below sets out how you calculate the cost base.

**Treatment of convertible notes acquired after 10 May 1989**

| Convertible note | Converted before 1 July 2001 | Converted on or after 1 July 2001 |
|---|---|---|
| **The note is a traditional security* that was issued before 15 May 2002.** | Gain on conversion is included as income (or loss on conversion deducted).<br>Cost base of shares includes their ` market value at the date the convertible notes were converted. | Gain on conversion is included as income (or loss on conversion deducted).<br>Cost base of shares includes cost base of the convertible note, any amount paid on conversion and any amount taxed on conversion. |
| **The note is a traditional security* that was issued after 14 May 2002**.** | | Gain (or loss) on conversion disregarded<br>Cost base of shares includes cost base of the convertible note and any amount paid on conversion. |
| **The note is a qualifying security***.** | Accrued gains are included as income and any gain on conversion is included as income (or loss on conversion deducted).<br>Cost base of shares includes market value on conversion. | Accrued gains are included as income and any gain on conversion is included as income (or loss on conversion deducted).<br>Cost base of shares includes cost base of the convertible note, any amount paid on conversion and any amount taxed on conversion. |

* A traditional security is one that is not issued at a discount of more than 1.5%, does not bear deferred interest and is not capital indexed. It may be, for example, a bond, a debenture, a deposit with a financial institution or a secured or unsecured loan.

** The change to the treatment of certain traditional securities issued after 14 May 2002 had not been passed by parliament by mid-June 2003. You will need to contact the ATO business enquiries line **13 28 61** to find out if the law changed.

*** A qualifying security is one that has a deferred income element, that is, it is issued under terms such that the investor's return on investment (other than periodic interest) will be greater than 1.5% per annum.

### Conversion of notes to units

Special rules also apply to convertible notes issued by a unit trust after 28 January 1988 and before 11 May 1989. Any capital gain or capital loss made on their conversion to units in the unit trust is disregarded. Their cost base for future CGT purposes includes both the cost of the convertible note and any further amount payable on the conversion.

Where convertible notes were issued prior to 28 January 1988 and later converted into units, the cost base of the units received should include any amount payable on conversion plus the market value of the note at the time of conversion.

A capital gain or capital loss may arise on conversion of the note (except where notes were acquired before 20 September 1985) depending on the amount of capital proceeds received. The amount of capital proceeds is the value of the units received.

**Example**

#### Converting notes to shares

David bought 1,000 convertible notes in DCS Ltd on 1 July 1997. The notes cost $5 each. Each convertible note is convertible into one DCS Ltd share. On expiry of the notes on 1 July 2000, shares in the company were worth $7 each. David converted the notes to shares, which are subject to CGT. No further amount was payable on conversion of the notes. David sold the shares on 4 December 2002 for $10 each.

The $2 ($7 – $5) gain David made on the conversion of each the notes to shares was assessable to David as ordinary income at the time of conversion, that is, in the 1999–2000 income year. As such, David has no capital gain in that year.

The $3 ($10 – $7) gain David made on the sale of each of the shares is subject to CGT. The $7 cost base is the market value per share on the date the notes converted to shares. Because he sold the shares after 11.45am (by legal time in the ACT) on 21 September 1999 and owned them for at least 12 months, David can claim the CGT discount. David calculates his capital gain as follows:

| | |
|---|---|
| $3 per share × 1,000 shares = | $3,000 |
| Less: CGT discount of 50% | $1,500 |
| Net capital gain | $1,500 |

David includes the capital gain on his 2002–03 income tax return.

## Employee share schemes

Some companies encourage employees to participate in employee share schemes by offering them discounted shares or rights (including options) to acquire shares. Where the scheme complies with the employee share scheme income tax rules (ESS rules), an employee can choose when they include the discount given on the shares or rights in their assessable income.

The employee includes the discount in their assessable income:

- in the income year they acquire shares or rights, if the employee makes an election under the ESS rules. The discount is calculated at the date the shares or rights were acquired, or
- in the income year that cessation time of the shares or rights occurs. For shares, this is usually the earlier of employment ceasing or when the disposal restrictions cease and forfeiture conditions expire on the shares. For rights, this is usually the earlier of employment ceasing or the exercise of the rights to acquire the shares. The discount is calculated at the date of cessation time.

The first element of the cost base of the shares or rights (or any shares acquired as a result of exercise of the rights) is their market value (as determined under the ESS rules) at the date the discount was calculated. If a CGT event happens in relation to the shares or rights, the capital gain or capital loss is calculated under the rules that apply to that event.

If an arm's length CGT event A1 (sale or disposal of a CGT asset) happens, or a CGT event E1, E2 or E5 (implications of shares or rights acquired by a trustee) happens, in relation to the shares or rights (or any shares acquired as a result of exercise of the rights) within 30 days of cessation time, the capital gain or capital loss is disregarded.

For more information, refer to *Employee share schemes—answers to frequently asked questions*, available on the ATO's website

**Example**

**Employee share plans**

Manfred has been employed by MegaCorp Ltd for 13 years. Along with other employees who have been with the company for more than five years, he has been invited to participate in the company's employee share scheme. He is offered 100 shares for each year of service.

Manfred agrees to participate and is required to pay $1 per share, a total of $1,300. In addition, the company informs Manfred that he must include $325 in his taxable income as the amount of the discount on allotment of the shares. The cost base of the shares for CGT purposes is therefore a total of $1,625 ($1,300 + $325) or $1.25 per share.

## Non-assessable payments

The cost base of shares or units for CGT calculations may need to be adjusted if you receive a non-assessable payment without disposing of your shares or units. A payment or distribution can include money and property.

You need to keep accurate records of the amount and date of any non-assessable payments in relation to your shares and units.

### Non-assessable payments from a company (CGT event G1)

Non-assessable payments to shareholders are not very common and would generally be made only where a company has got shareholder approval to reduce its share capital—for example, to refund part of the paid-up value of shares to shareholders. Before 1 July 1998, a company needed court approval to reduce its share capital.

If you receive a non-assessable payment from a company (that is, a payment that is not a dividend), you need to adjust the cost base of the shares at the time of the payment. If the amount of the non-assessable payment is not more than the cost base of the shares at the time of payment, the cost base and reduced cost base are reduced by the amount of the payment.

You make a capital gain if the amount of the non-assessable payment is more than the cost base of the shares. The amount of the capital gain is equal to the excess. If you make a capital gain, the cost base and reduced cost base of the shares are reduced to nil. You cannot make a capital loss from the making of a non-assessable payment.

Interim liquidation distributions that are not dividends can be treated in the same way as other non-assessable payments under CGT event G1.

From the 1998–99 income year, interim distributions by a liquidator are not treated in this manner provided the company is deregistered within 18 months of the interim distribution. These payments will form part of the capital proceeds for the ending of the shares.

In preparing a tax return a shareholder may assume that the company will cease to exist within 18 months of an interim distribution, unless advised to the contrary by the liquidator in writing.

**Example**

**Non-assessable payments**

Rob bought 1,500 shares in RAP Ltd on 1 July 1994 for $2 each. On 30 November 2002, as part of a shareholder-approved scheme for the reduction of RAP's share capital, he received a non-assessable payment of 50 cents per share. At that date, the cost base of each share (without indexation) was $2.20.

As the amount of the payment is not more than the cost base (without indexation), the cost base of each share at 30 November 2002 is reduced by the amount of the payment to $1.70 ($2.20 – 50 cents). As Rob has chosen not to index the cost base, he can claim the CGT discount if he disposes of the shares in the future.

### Non-assessable payments from a unit trust (CGT event E4)

It is quite common for a unit trust to make non-assessable payments to unit holders. Your CGT obligations in this situation are explained in **chapter 4** on page 23.

When you sell the units, you must adjust their cost base or reduced cost base. The amount of the adjustment is based on the amount of non-assessable payments you received during the income year up to the date of sale. You use the adjusted cost base or reduced cost base to work out your capital gain or capital loss.

**NOTE** **Non-assessable payments under a demerger**

If non-assessable payments are made under a demerger, no adjustment is required to the cost base and the reduced cost base of your new interests for the payments unless they are more than the cost base or reduced cost base. Similarly, no capital gain arises in respect of these payments except in these circumstances. You may be able to choose CGT roll-over for a capital gain you make. For more information about demergers, see chapter 5 page 32.

## Using the **Capital gain or capital loss worksheet** for shares

In the examples on the following pages, Tony uses the indexation method, the discount method and the 'other' method to calculate his capital gain so he can decide which method gives him the best result. This example shows you how to complete the **Capital gain or capital loss worksheet** at the back of this guide to calculate your capital gain when you acquire or dispose of shares.

Refer to page 14 in **chapter 2** for a description of each method and when you can use each one.

Remember that if you bought and sold your shares within 12 months, you must use the 'other' method to calculate your capital gain. If you owned your shares for 12 months or more, you may be able to use either the discount method or the indexation method, whichever gives you the better result.

Because each share in a parcel of shares is a separate CGT asset, you can use different methods to work out the amount of any capital gain for shares within a parcel. This may be to your advantage if you have capital losses to apply.

For example, Belinda acquired a parcel of 1,000 shares on 1 December 1992. She sold them on 31 July 2002. Because she has capital losses, Belinda chooses to work out her capital gain from 460 of her shares using the indexation method. She uses the discount method to work out the capital gain from the other 540 shares.

### Example

#### Using all three methods to calculate a capital gain

On 1 July 1993, Tony bought 10,000 shares in Kimbin Ltd for $2 each. He paid stockbrokers fee of $250 and stamp duty of $50.

On 1 July 2002, Kimbin Ltd offered each of its shareholders one right for each four shares owned to acquire shares in the company for $1.80 each. The market value of the shares at the time was $2.50. On 1 August 2002, Tony exercised all rights and paid $1.80 per share.

On 1 December 2002, Tony sold all his shares in Kimbin Ltd for $3.00 each. He incurred stockbrokers fee of $500 and stamp duty of $50.

**NOTE** **Separate records**

Tony has two parcels of shares—those he acquired on 1 July 1993 and those he acquired at the time he exercised all rights, 1 August 2002. He needs to keep separate records for each parcel and apportion the stockbrokers fee of $500 and stamp duty of $50.

The completed **Capital gain or capital loss worksheets** on the following pages show how Tony can evaluate which method gives him the best result.

He uses the 'other' method for the shares he owned for less than 12 months, as he has no choice:

$7,500 – $4,610 = $2,890

For the shares he has owned for 12 months or more, his capital gain using the indexation method would be:

$30,000 – $23,257 = $6,743

This means his net capital gain would be:

| $2,890 'other' method | + | $6,743 indexation method | = | $9,633 net capital gain |
|---|---|---|---|---|

If Tony uses the discount method instead (assuming he has no losses), his capital gain would be:

$30,000 – $20,740 = $9,260

He applies the CGT discount of 50%:

$9,260 × 50% = $4,630

This means his net capital gain would be:

| $2,890 'other' method | + | $4,630 discount method | = | $7,520 net capital gain |
|---|---|---|---|---|

In this case he would choose the discount method rather than the indexation method, as it gives him the better result (less capital gains).

## Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

**CGT asset type or CGT event**

| | | | |
|---|---|---|---|
| Shares and units (in unit trusts) | X | Other CGT assts and any other CGT events[4] | |
| Real estate | | Collectables[5] | |

**Description of CGT asset or CGT event**: Tony's 2500 shares in Kimbin Ltd—Exercise of rights, given 1.7.2002, exercised 1.8.2002

**Date of acquisition**: 01/08/1993 **Date of CGT event**: 01/12/2002

### Elements of the cost base or reduced cost base

| | 1 Amount | 2 Amounts to be deducted for cost base[9] | 3 Cost base (1 – 2) | 4 Amounts to be deducted for reduced cost base[9] | 5 Reduced cost base[9] (1 – 4) | 6 Indexation factor[10] | 7 Cost base indexed (3 x 6) |
|---|---|---|---|---|---|---|---|
| Acquisition or purchase cost of the CGT asset[6] | 4500 | | 4500 | | | | |
| Incidental costs to acquire the CGT asset | 110 | | 110 | | | | |
| Incidental costs that relate to the CGT event[7] | | | | | | | |
| Non-capital costs of ownership of the CGT asset[8] | | | | | | | |
| Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event | | | | | | | |
| Capital costs to establish, preserve or defend title to, or a right over, the CGT asset | | | | | | | |
| | **Cost base unindexed** | | $ 4610 | | | | |
| | | **Reduced cost base** | | | $ | | |
| | | | | **Cost base indexed** | | | $ |

### Capital gain calculation

| **Indexation method** | | **Discount method** | | **'Other' method (CGT asset held less than 12 months)** | |
|---|---|---|---|---|---|
| Capital proceeds[11] | $ | Capital proceeds[11] | $ | Capital proceeds[11] | $ 7500 |
| *Less:* cost base indexed | $ | *Less:* cost base unindexed | $ | *Less:* cost base unindexed | $ 4610 |
| **Capital gain (a)** | **$** | **Capital gain (b)*** | **$** | **Capital gain** | **$** 2890 |

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

### Capital loss calculation

| **Capital loss** | |
|---|---|
| Reduced cost base | $ |
| *Less:* capital proceeds[11] | $ |
| **Capital loss**[12] | **$** |

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

## Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

**CGT asset type or CGT event**

Shares and units (in unit trusts) [X] Other CGT assts and any other CGT events[4] [ ]
Real estate [ ] Collectables[5] [ ]

**Description of CGT asset or CGT event** Tony's 10 000 shares in Kimbin Ltd

**Date of acquisition** 01/07/1993 **Date of CGT event** 01/12/2002

**Elements of the cost base or reduced cost base**

| | 1 Amount | 2 Amounts to be deducted for cost base[9] | 3 Cost base (1 – 2) | 4 Amounts to be deducted for reduced cost base[9] | 5 Reduced cost base[9] (1 – 4) | 6 Indexation factor[10] | 7 Cost base indexed (3 × 6) |
|---|---|---|---|---|---|---|---|
| Acquisition or purchase cost of the CGT asset[6] | 20 000 | | 20 000 | | | 1.124 | 22 480 |
| Incidental costs to acquire the CGT asset | 300 | | 300 | | | 1.124 | 337 |
| Incidental costs that relate to the CGT event[7] | 440 | | 440 | | | 1 | 440 |
| Non-capital costs of ownership of the CGT asset[8] | | | | | | | |
| Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event | | | | | | | |
| Capital costs to establish, preserve or defend title to, or a right over, the CGT asset | | | | | | | |
| | **Cost base unindexed** | | $ 20 740 | | | | |
| | | | **Reduced cost base** | | $ | | |
| | | | | | **Cost base indexed** | | $ 23 257 |

### Capital gain calculation

| **Indexation method** | | **Discount method** | | **'Other' method (CGT asset held less than 12 months)** | |
|---|---|---|---|---|---|
| Capital proceeds[11] | $ 30 000 | Capital proceeds[11] | $ 30 000 | Capital proceeds[11] | $ |
| *Less:* cost base indexed | $ 23 257 | *Less:* cost base unindexed | $ 20 740 | *Less:* cost base unindexed | $ |
| **Capital gain (a)** | **$** 6743 | **Capital gain (b)*** | **$** 9 260 | **Capital gain** | **$** |

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

### Capital loss calculation

| **Capital loss** | |
|---|---|
| Reduced cost base | $ |
| *Less:* capital proceeds[11] | $ |
| **Capital loss**[12] | **$** |

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

### Dividends paid by listed investment companies (LIC) that include LIC capital gain

If a LIC pays a dividend to you that includes a **LIC capital gain amount**, you may be entitled to an income tax deduction.

You can claim a deduction if:

- you are an individual
- you were an Australian resident when a LIC paid you a dividend
- the dividend was paid to you after 1 July 2001, and
- the dividend included a LIC capital gain amount.

The amount of the deduction is 50% of the LIC capital gain amount. The LIC capital gain amount will be shown separately on your dividend statement.

You do not show the LIC capital gain amount at item **17** on your tax return (or item **9** if you use the tax return for retirees).

**Example**

**LIC capital gain**

Ben, an Australian resident, was a shareholder in XYZ Ltd, a LIC. For the 2002–03 income year, Ben received a fully franked dividend from XYZ Ltd of $70,000 including a LIC capital gain amount of $50,000. Ben includes on his tax return the following amounts:

| | |
|---|---|
| Class C franked dividend (shown at T item **11** in *TaxPack 2003*) | $70,000 |
| Imputation credit (shown at U item **11** in *TaxPack 2003*) | $30,000 |
| *Less* deduction for LIC capital gain (shown as deduction at item **D7** in *TaxPack 2003*) | $25,000 |
| Net amount included in taxable income | $75,000 |

**NOTE**

If Ben uses the tax return for retirees, he shows the amounts as follows: Class C franked dividend at T item **8**; imputation credit at U item **8**; deduction for LIC capital gain at item **12**.

# CHAPTER 6 REAL ESTATE AND MAIN RESIDENCE

This chapter explains your capital gains tax (CGT) obligations in relation to real estate. Real estate includes vacant blocks of land, business premises, rental properties, holiday houses and hobby farms. The CGT exemption for a main residence is also explained in this chapter.

Apart from the main residence rules, capital gains and capital losses on real estate are worked out under the rules set out earlier in this publication.

Land is a CGT asset. In some cases improvements made to land are treated as separate CGT assets—see **Separate assets** on page 4. A depreciating asset that is part of a building (for example, carpet or a hot water system) is also taken to be a separate CGT asset from the building. When a CGT event happens to your property you are required to work out a capital gain or capital loss in respect of each CGT asset it comprises (or balancing adjustment in the case of depreciating assets sold with the property).

The most common CGT event that happens to real estate is its sale or disposal—CGT event A1. The time of the event is:

- when you enter into the contract for the disposal
- if there is no contract— when the change of ownership occurs, or
- if the asset is compulsorily acquired—the earliest of:
  - when you received compensation from the entity
  - when the entity became the asset's owner
  - when the entity entered it under a power of compulsory acquisition, or
  - when the entity took possession under that power.

Where land is disposed of under a contract the disposal is deemed to have taken place when the contract is made. However, you are not required to include any capital gain or capital loss on your income tax return for the relevant year until an actual change of ownership occurs. When settlement occurs, you are required to include any capital gain or capital loss in the year of income in which the contract was made. If an assessment has already been made for that year of income, you may need to have that assessment amended.

**NOTE** **New terms**

There may be terms in this chapter that are not familiar to you. Refer to **chapter 1** in **part A** for more information or to **Explanation of terms** at the back of this guide.

## Rules to keep in mind

There are a few rules that you may need to keep in mind when you calculate your capital gain or capital loss from real estate, in particular rules relating to:

- the non-capital costs of ownership, and
- cost base adjustments for capital works deductions.

### Non-capital costs of ownership

Rates, insurance, land tax, maintenance and interest on money you borrowed to buy the property or finance improvements to it are not included in the reduced cost base. They are only included in the cost base if:

- the property was acquired under a contract entered into after 20 August 1991 (or if you didn't acquire it under a contract, you became the owner after that date), and
- you could not claim a deduction for the costs because the property was not used to produce assessable income—for example, it was vacant land, your main residence or a holiday home during the period.

### Cost base adjustments for capital works deductions

In working out a capital gain in respect of property that you used to produce assessable income—such as a rental property or business premises—capital works deductions you claimed, or were entitled to claim, may need to be excluded from the cost base or reduced cost base.

*Cost base*

You must exclude from the cost base the amount of capital works deductions you claimed or were entitled to claim for a building, other structure or improvement if:

- for property (including vacant land) you acquired before 20 September 1985, the capital works deductions were for a building or other structure constructed on the property after 13 May 1997
- for property (including vacant land) you acquired before 20 September 1985, the capital works deductions were for improvements (such as renovations) made to the property after 13 May 1997 and the cost base of the improvements is more than:
  - the improvement threshold (see page 5) for the income year in which the property was disposed of, and

  – 5% of the proceeds received from the sale of the property
- for property (including vacant land) you acquired during the period 20 September 1985 to 13 May 1997, the capital works deductions were for a building, other structure or improvements constructed on the property after 30 June 1999
- for property (including vacant land) you acquired after 13 May 1997, the capital works deductions were for a building, other structure or improvements constructed on the property at any time.

*Reduced cost base*

The amount of the capital works deductions you claimed or were entitled to claim for a building, other structure or improvement is excluded from the reduced cost base.

### Roll-over

Roll-over may be available—in particular for destruction or compulsory acquisition of property, see chapter 7, and marriage breakdown, see chapter 8.

### Keeping records

You should keep appropriate records, see **Records relating to real estate** on page 20.

### Example

#### Sale of a rental property

Brett purchased a rental property on 1 July 1997. The price he paid was $150,000 of which $6,000 was attributable to depreciating assets. He also paid $20,000 in total for stamp duty and solicitors fees.

He rented out the property after spending $2,500 on initial repairs.

In the next few years, Brett incurred the following expenses on the property:

| | |
|---|---|
| Interest on money borrowed | $10,000 |
| Rates and land tax | $8,000 |
| Deductible (non-capital) repairs | $15,000 |
| **Total** | **$33,000** |

When Brett decided to sell the property, a real estate agent advised him that if he spent around $30,000 on major structural repairs, the property would be valued at around $500,000. He had the repairs done and put the property on the market.

On 1 April 2003, he sold the property for $500,000 (of which $4,000 was attributable to depreciating assets).

Brett's real estate agents fees and solicitors fees for the sale of the property totalled $12,500.

Brett could not claim any capital works (special building write-off) deductions as construction of the property began before 22 August 1979 and, as a result, the repairs he made did not qualify. (For information about capital works that qualify for a deduction, see *Rental properties* NAT 1729—6.2003 and for information about how capital works deductions affect the CGT cost base, see page 45 of this publication.)

This is Brett's only capital gain for the year—and he has no capital losses to offset from this year or previous years. Brett works out his cost base as follows:

| | |
|---|---|
| Purchase price of property (not including depreciating assets) | $144,000 |
| *Plus* | |
| Stamp duty and solicitors fees on purchase of the property | $20,000 |
| Capital expenditure (initial repairs) | $2,500 |
| Capital expenditure (major structural repairs) | $30,000 |
| Real estate agents fees and solicitors fees on sale of the property | $12,500 |
| **Cost base unindexed** | **$209,000** |

Brett deducts his cost base from his capital proceeds (sale price):

| | |
|---|---|
| Proceeds from selling the house (not including depreciating assets) | $496,000 |
| *Less* | |
| Cost base unindexed | $209,000 |
| | **$287,000** |

He decides the discount method will give him the best result, so he uses this method to calculate his capital gain:

$287,000 × 50% = $143,500

Brett shows $143,500 at **A** item **17** on his tax return (or item **9** if he uses the tax return for retirees).

Brett shows $287,000 at **H** **Total current year capital gains** at item **17** on his tax return (or at item **9** if he uses the tax return for retirees). Brett must also make balancing adjustment calculations in relation to his depreciating assets. Because he used the property 100% for taxable purposes he will not make a capital gain or capital loss from the depreciating assets.

## Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

**CGT asset type or CGT event**

Shares and units (in unit trusts) ☐
Real estate ☒
Other CGT assts and any other CGT events[4] ☐
Collectables[5] ☐

**Description of CGT asset or CGT event** Brett's property at 30 Jones St, Oldtown

**Date of acquisition** 01/07/1997 **Date of CGT event** 01/04/2003

**Elements of the cost base or reduced cost base**

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|---|---|---|---|---|---|---|
| | Amount | Amounts to be deducted for cost base[9] | Cost base (1 – 2) | Amounts to be deducted for reduced cost base[9] | Reduced cost base[9] (1 – 4) | Indexation factor[10] | Cost base indexed (3 x 6) |
| Acquisition or purchase cost of the CGT asset[6] | 144,000 | 0 | 144,000 | | | 123.4 ÷ 119.7 = 1.031 | 148,464 |
| Incidental costs to acquire the CGT asset | 20,000 | 0 | 20,000 | | | 1.031 | 20,620 |
| Incidental costs that relate to the CGT event[7] | 12,500 | 0 | 12,500 | | | 1 | 12,500 |
| Non-capital costs of ownership of the CGT asset[8] | 33,000 | 33,000 | 0 | | | | 0 |
| Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event | 2,500<br>30,000 | 0<br>0 | 2,500<br>30,000 | | | 1.031<br>1 | 2,577.50<br>30,000 |
| Capital costs to establish, preserve or defend title to, or a right over, the CGT asset | | | | | | | |
| | **Cost base unindexed** | | $ 209,000 | | | | |
| | | | **Reduced cost base** | | $ | | |
| | | | | | **Cost base indexed** | | $ 214,161.50 |

### Capital gain calculation

| **Indexation method** | | **Discount method** | | **'Other' method (CGT asset held less than 12 months)** | |
|---|---|---|---|---|---|
| Capital proceeds[11] | $ 496,000 | Capital proceeds[11] | $ 496,000 | Capital proceeds[11] | $ |
| *Less:* cost base indexed | $ 214,162 | *Less:* cost base unindexed | $ 209,000 | *Less:* cost base unindexed | $ |
| **Capital gain (a)** | **$** 281,838 | **Capital gain (b)*** | **$** 287,000 | **Capital gain** | **$** |

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

### Capital loss calculation

| **Capital loss** | |
|---|---|
| Reduced cost base | $ |
| *Less:* capital proceeds[11] | $ |
| **Capital loss**[12] | **$** |

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

### Other CGT events affecting real estate

**CGT event B1** happens to real estate if you enter into a terms contract. Generally speaking, a terms contract is one where the purchaser is entitled to possession of the land or the receipt of rents and profits before becoming entitled to a transfer or conveyance of the land (that is, before completing the purchase by paying the balance of the purchase price and receiving the instrument of transfer and title deeds).

CGT event B1 happens when use and enjoyment of the land is first obtained by the purchaser. Use and enjoyment of the land from a practical point of view takes place at the time the purchaser gets possession of the land or the date the purchaser becomes entitled to the receipt of rents and profits.

If the contract falls through before completion and title to the land does not pass to the purchaser, you may be entitled to amend your assessment for the year in which CGT event B1 happened.

**CGT event C1** happens if an asset is lost or destroyed. This event may happen if for example a building on your land is destroyed by fire. Your capital proceeds for CGT event C1 happening include any insurance proceeds you may receive in relation to the loss or destruction. The market value substitution rule that generally applies if you receive no capital proceeds does not apply if CGT event C1 happens. For more information, see chapter 7.

**CGT event D4** happens if you enter into a conservation covenant over land that you own. From 1 July 2002, CGT event D4 may apply if you receive no capital proceeds for the event. (Note that the market value substitution rule that generally applies if you receive no consideration for a CGT event does not apply if CGT event D4 happens.)

A 'conservation covenant' is a covenant that:

- restricts or prohibits certain activities on the land that could degrade the environmental value of the land
- is permanent and binding on current and future land owners (by way of registration on the title to the land where possible), and
- is approved by the Minister for the Environment and Heritage (including those entered into under a program approved by that Minister).

If CGT event D4 happens, you calculate your capital gain by comparing your capital proceeds from entering into the covenant with a portion of the cost base of the entire land over which the covenant is granted.

Similarly, you calculate your capital loss by comparing your capital proceeds from entering into the covenant with a portion of the reduced cost base of the entire land over which the covenant is granted.

The relevant portion of the cost base or reduced cost base is calculated using this formula:

$$\text{Cost base (reduced cost base)} \times \frac{\text{capital proceeds from entering into the covenant of land}}{\text{those capital proceeds plus the market value of the land just after you enter into the covenant}}$$

As the conservation covenant will affect the value of the entire land you must use the cost base of the entire land in calculating the cost base apportioned to the covenant. This is the case even if the covenant specifically states within its terms that the restrictions as to use only apply to part of the land.

**CGT event D2** happens if you grant an option to a person or an entity or renew or extend an option that you had granted.

The amount of your capital gain or capital loss from CGT event D2 is the difference between what you receive for granting the right and any expenditure you incurred in relation to it. The CGT discount does not apply to CGT event D2.

**Example**

**Granting of an option**

You are approached by Colleen who is interested in buying your land. On 30 June 2002, you granted her an option to purchase your land within 12 months for $200,000. Colleen pays you $10,000 in respect of the grant of the option. You incur legal fees of $500. You made a capital gain in the 2001–02 income year of $9,500.

*Exercise of an option*

If the option you granted is later exercised any capital gain or capital loss you made from the grant, renewal or extension is ignored. You may have to amend your income tax assessment for an earlier income year.

Similarly, any capital gain or capital loss that the grantee would otherwise make from the exercise of the option is disregarded.

The effect of the exercise of an option depends on whether the option was a call option or a put option. A call option is one that binds the grantor to dispose of an asset. A put option binds the grantor to acquire an asset.

**Example**

**Granting of an option (cont)**

(Continuing the example from the previous page):

On 1 February 2003, Colleen exercises the option. The capital gain that you made in 2002 is disregarded and you request an amendment of your income tax assessment to exclude that amount. The $10,000 you received for the grant of the option is considered to be part of the capital proceeds for the sale of your property in the 2002–03 income year. You capital gain/loss from the property is the difference between its cost base/reduced cost base and $210,000.

### CGT events involving leases

There are a number of CGT events that might apply in relation to the lease of land.

**CGT event F1** happens if you grant a lease to a person or entity or if you extend or renew a lease that you had previously granted. In the case of a long-term lease (one that may be expected to continue for at least 50 years) you can choose to treat the grant (renewal or extension) of the lease as a part disposal of the underlying leased property.

**Example**

**Receiving an amount for granting a lease**

Elisabeth operates a profitable footwear retailing business, and wishes to lease some shop space in a prestigious location in the Sydney CBD. However, the demand for shop space in the locality is great, and competition between prospective tenants is fierce. In order to ensure that she secures the lease of the particular shop space that she wants, Elisabeth pays John Rich (the owner of the shop space) a premium of $6,000 in consideration for the grant of that particular lease.

The lease is entered into on 6 September 2002, and John Rich incurs stamp duty of $300 and solicitors fees of $500 on the grant of the lease.

John makes a capital gain of $5,200 from CGT event F1

| | | |
|---|---|---|
| Capital proceeds: | $6,000 | |
| Incidental costs: | $800 | (that is, stamp duty of $300 and solicitors fees of $500) |

Note: For Elisabeth, this transaction results in CGT event C2 when the lease expires.

The amount of your capital gain or capital loss from CGT event F1 is the difference between any premium you got for granting the lease and the expenditure you incurred in granting it. The CGT discount does not apply to CGT event F1. The market value substitution rule that generally applies if you receive no consideration for a CGT event does not apply if CGT event F1 happens.

You can choose for CGT event F2 to apply (rather than CGT event F1) when you grant, renew or extend a long-term lease. It can apply if you are the owner of the underlying land or if you grant a sub-lease.

Your capital proceeds if CGT event F2 happens are the greatest of:

- the market value of the freehold or head lease (at the time you grant, renew or extend the lease)
- the market value if you had not granted, renewed or extended the lease, and
- any premium from the grant, renewal or extension.

There are special cost base rules that apply if you choose for CGT event F2 to apply.

For any later CGT event that happens to the land or the lessor's lease of it, its cost base and reduced cost base (including the cost base and reduced cost base of any building, part of a building, structure or improvement that is treated as a separate CGT asset) excludes:

- any expenditure incurred before CGT event F2 happens, and
- the cost of any depreciating asset for which the lessor has deducted or can deduct an amount for its decline in value.

The fourth element of the property's cost base and reduced cost base includes any payment by the lessor to the lessee to vary or waive a term of the lease or for the forfeiture or surrender of the lease, reduced by the amount of any input tax credit to which the lessor is entitled for the variation or waiver.

**CGT event F3** happens if you make a payment to a lessee to vary a lease. You can only make a capital loss from this CGT event. Your capital loss is equal to the expenditure you incurred to change the lease.

**CGT event F4** happens if you (as lessee) receive a payment from the lessor for agreeing to vary or waive a term of the lease.

You cannot make a capital loss from this CGT event. You will only make a capital gain from CGT event F4 if the amount of the payment you received exceeds the cost base of your lease at the time when the term is varied. In other cases, you will be required to adjust the cost base of your lease.

The market value substitution rule that applies if you do not receive market value capital proceeds for a CGT event does not apply if CGT event F4 happens.

**Example**

### Payment to lessee for change in lease

Sam is the lessor of a commercial property. His tenant, Peter, currently holds a three-year lease over the property, which has another 26 months to run. A business associate of Sam's wishes to lease the property from Sam for a 10-year period, beginning in six months' time, for twice the rent that Peter is currently paying. Sam approaches Peter with an offer of $5,000 cash for Peter to agree to vary the terms of the lease so that the lease will expire in six months' time. Peter agrees to vary the terms on 10 August 2002.

Sam will make a capital loss of $5,000 from CGT event F3 happening:

| | |
|---|---|
| Capital proceeds: | $0 |
| Incidental costs/expenditure incurred: | $5,000 |

For Peter this transaction results in CGT event F4 happening. The cost base of Peter's lease at the time of the variation was $500. He makes a capital gain of $4,500 ($5,000 – $500).

**CGT event F5** happens if you as lessor receive a payment for changing a lease.

The amount of your capital gain or capital loss from CGT event F5 is the difference between what you receive for changing the lease and any expenditure you incurred in relation to it. The CGT discount does not apply to CGT event F5.

## Subdivision of land

If you subdivide a block of land, each block that results is registered with a separate title. For CGT purposes, the original land parcel is divided into two or more separate assets. Subdividing land does not result in a CGT event if you retain ownership of the subdivided blocks. Therefore, you do not make a capital gain or a capital loss at the time of the subdivision.

However, you may make a capital gain or capital loss when you sell the subdivided blocks. The date you acquired the subdivided blocks is the date you acquired the original parcel of land and the cost base of the original land is divided between the subdivided blocks on a reasonable basis.

**NOTE** **When the profit is ordinary income**

You may have made a profit from the subdivision and sale of land which occurred in the ordinary course of your business or which involved a commercial transaction or business operation entered into with the purpose of making a profit. In this case, the profit is ordinary income (see *Taxation Ruling TR 92/3—Income tax: whether profits on isolated transactions are income*). Any capital gain from the land is reduced by the amount otherwise included in your assessable income.

**Example**

### Dwelling purchased before 20 September 1985, land subdivided after that date and house built on subdivided land

In 1983, Mike bought a block of land that was less than 2 hectares. He subdivided the land into two blocks in May 2002 and began building a house on the rear block, which he finished in August 2002. He sold the rear block (including the house) in October 2002 for $150,000. Mike got a valuation from a qualified valuer who valued the rear block at $70,000 and the house at $80,000. The construction cost of the house was $65,000.

Mike acquired the rear block before 20 September 1985, so it is not subject to CGT. As the new house was constructed after 20 September 1985 on land purchased before that date, the house is taken to be a separate asset from the land. Mike is taken to have acquired the house in May 2002 when he began building it. Mike made a capital gain of $15,000 ($80,000 – $65,000) when he sold the house because he did not use it as his main residence.

As Mike had owned the house for less than 12 months, he used the 'other' method to calculate his capital gain.

**Example**

**Dwelling purchased on or after 20 September 1985 and land subdivided after that date**

Kym bought a house on a 0.1 hectare block of land in June 2002 for $250,000. The house was valued at $80,000 and the land at $170,000. Kym lived in the house as her main residence. In January 2003, she subdivided the land into two blocks of equal size. She incurred $10,000 in survey, legal and subdivision application fees and $1,000 to connect water and drainage to the rear block. In March 2003, she sold the rear block for $100,000.

As Kym sold the rear block of land separately, the **main residence exemption** does not apply to that land. She contacted several local real estate agents who advised her that the value of the front block was $15,000 higher than the rear block. Kym apportioned the $170,000 original cost base into $77,500 for the rear block (45.6%) and $92,500 for the front block (54.4%).

The cost base of the rear block is calculated as follows:

| | |
|---|---|
| Cost of the land | $77,500 |
| 45.6% of the cost of survey, legal and application fees | $4,560 |
| Cost of connecting water and drainage | $1,000 |
| **Total** | **$83,060** |

The capital gain on the sale of the rear block is $16,940. As Kym had owned the land for less than 12 months, she used the 'other' method to calculate her capital gain.

Kym will get the full exemption for her house and the front block if they are used as her main residence for the full period she owns them.

## Amalgamation of title

The amalgamation of the title to various blocks of land that you own does not result in a CGT event happening.

Land you acquire before 20 September 1985, that is amalgamated with land acquired on or after that date retains its pre-CGT status.

**Example**

**Amalgamation of title**

On 1 April 1984, Robert bought a block of land. On 1 June 1999, he bought another block adjacent to the first one. Robert amalgamated the titles to the two blocks into one title.

Robert is taken to have two separate assets. The first block continues to be treated as a pre-CGT asset.

### Examples of CGT calculations affecting real estate

There are a number of other examples in this publication that explain how to calculate your capital gain or capital loss on the sale of real estate:

- calculation of capital gain (including worksheet) where a person can choose the indexation or discount method to calculate their capital gain—see example of Val on page 17.
- calculation of capital gain on property owned for 12 months or less—see example of Marie-Anne on page 15
- recoupment of expenditure affecting CGT cost base calculation—see example of John on page 8
- deductions affecting CGT cost base calculations—see example of Zoran on page 7.

## Main residence

Generally, you can ignore a capital gain or capital loss from a CGT event that happens to your **ownership interest** in a dwelling that is your main residence (also referred to as 'your home').

To get full exemption from CGT:

- the dwelling must have been your home for the whole period you owned it
- the dwelling must not have been used to produce assessable income, or
- any land on which the dwelling is situated must be 2 hectares or less.

If you are not fully exempt, you may be partially exempt if:

- the dwelling was your main residence during only part of the period you owned it
- you used the dwelling to produce assessable income, or
- the land on which the dwelling is situated is more than 2 hectares.

Short absences from your home—for example, annual holidays, do not affect your exemption.

### Special rules

There are some special CGT rules that are not covered in this chapter that may affect you if your home was:

- destroyed and you receive money or another asset as compensation or under an insurance policy (see chapter 7)
- transferred by you as a result of the breakdown of your marriage (see chapter 8)
- transferred to you as a result of its conversion to strata title, or
- compulsorily acquired by an Australian government agency (see chapter 7).

If you own more than one dwelling during a particular period, only one of them can be your main residence at any one time.

The exception to this rule is if you move from one main residence to another. In this case you can treat two dwellings as your main residence for a limited time (see page 57 for more information). Special rules apply if you have a different main residence from your spouse or dependent children (see page 62).

## What is a dwelling?

A dwelling is anything that is used wholly or mainly for residential accommodation. Certain mobile homes can also be a dwelling. Examples include:

- a home or cottage
- an apartment or flat
- a strata title unit
- a unit in a retirement village, and
- a caravan, houseboat or other mobile home.

Any land the dwelling is on is included as part of the dwelling but it only qualifies for the main residence exemption if the land and the dwelling are sold together. Land adjacent to the dwelling may also qualify for exemption (see page 54 for more information).

## What is an ownership interest?

In the case of a flat or home unit, you have an ownership interest if you have:

- a legal or equitable interest in a strata title in the flat or home unit
- a licence or right to occupy the flat or home unit, or
- a share in a company that owns a legal or equitable interest in the land on which the flat or home unit is constructed and that share gives you a right to occupy the flat or home unit.

In the case of a dwelling that is not a flat or home unit, you have an ownership interest if you have:

- a legal or equitable interest in the land on which it is constructed, or
- a licence or right to occupy it.

In the case of land, you have an ownership interest if you have:

- a legal or equitable interest in it, or
- a right to occupy it.

An equitable interest may include life tenancy of a dwelling that you acquire—for example, under a deceased's will.

### When do you acquire an ownership interest?

For the purposes of the main residence exemption, you have an ownership interest in a dwelling or land you acquire under a contract from the time you get legal ownership (unless you have a right to occupy it at an earlier time).

You have legal ownership of a dwelling or land from the date of settlement of the contract of purchase (or if you have a right to occupy it at an earlier time, that time) until the date of settlement of the contract of sale. This period is called your ownership period. If the home is your main residence for the whole of the ownership period and you do not use it to produce assessable income, the home is fully exempt.

**Example**

**Full exemption**

Frank signed a contract on 14 August 1999 to purchase land from a developer and to have a house constructed on the land. Under the contract, settlement did not occur until construction was completed on 26 October 2000.

Frank moved into the house immediately upon settlement of the contract he had with the developer, that is, on 26 October 2000. He did not have a right to occupy the house at an earlier time under the purchase contract. He signed the contract to sell it on 25 May 2003 and settlement occurred on 20 July 2003. The house was Frank's main residence for the full period he owned it and he did not use any part of it to produce income.

For CGT purposes, Frank is taken to have acquired the land on which the house was constructed on the date he entered into the contract—14 August 1999. However, because the house was Frank's main residence for the whole period between settlement of the purchase contract and settlement of the sale contract, it is fully exempt.

The period between when Frank entered into the purchase contract and actually lived in the house—14 August 1999 to 25 October 2000—is ignored. This is because the relevant dates for the main residence exemption are the settlement dates or if you had a right under the purchase contract to occupy the dwelling at an earlier time, that time until settlement of the sale contract.

Even though the settlement dates are used to calculate the period for which the main residence exemption applies the dates you enter into the purchase and sale contracts are important if your main residence is not fully exempt.

A CGT event occurs when you enter into the sale contract and any capital gain is included on your tax return for the year of income in which the CGT event occurs. The contract date is also relevant for determining what method you can use to work out your capital gain from your main residence.

**Example**

### Part exemption

The facts are the same as in the example on the previous page except that Frank rented out the house from 26 October 2000—the date of settlement of the purchase contract—until 2 March 2002.

Frank makes a capital gain of $30,000 on the house. To work out the part of the capital gain that is exempt, Frank must determine how many days in his ownership period the dwelling was not his main residence.

Frank had an ownership interest in the property from settlement of the purchase contract (26 October 2000) until settlement of the sale contract (20 July 2003) —a total of 998 days.

The period between the dates the purchase contract was signed (14 August 1999) and settled (25 October 2000) is ignored. Because the house was not Frank's main residence from 26 October 2000 to 2 March 2002 (493 days), he does not get the exemption for this period.

Frank calculates his net capital gain as follows:

$$\underset{\text{Capital gain}}{\$30{,}000} \times \frac{493 \text{ days}}{998 \text{ days}} = \underset{\text{taxable portion}}{\$14{,}819}$$

Because Frank entered into the purchase contract before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the sale contract after this time (and he owned the house for at least 12 months), he can choose either the indexation or the discount method to calculate his capital gain. Frank decides to reduce his capital gain by the CGT discount of 50% after applying any capital losses.

Because Frank signed the sale contract on 25 May 2003, the CGT event occurred in the 2002–03 income year, even though settlement occurred in the next income year. Frank shows the capital gain on his 2002–03 income tax return.

## Is the dwelling your main residence?

The following factors may be relevant in working out whether a dwelling is your main residence:

- the length of time you live there—there is no minimum time a person has to live in a home before it is considered to be their main residence
- whether your family lives there
- whether you have moved your personal belongings into the home
- the address to which your mail is delivered
- your address on the electoral roll
- the connection of services (for example, phone, gas or electricity)
- your intention in occupying the dwelling.

A mere intention to construct or occupy a dwelling as your main residence—without actually doing so—is not sufficient to get the exemption.

In certain circumstances, you may choose to treat a dwelling as your main residence even though:

- you no longer live in it (for more information, see **Continuing main residence status after dwelling ceases to be your main residence** on page 58), or
- you are yet to live in it but will do so as soon as practicable after it is constructed, repaired or renovated and you will continue to live in it for at least three months (for more information, see **Constructing, renovating or repairing a dwelling on land you already own** on page 61).

## Moving into a dwelling

A dwelling is considered to be your main residence from the time you acquired your ownership interest in it if you moved into it as soon as practicable after that time. This would generally be the date of settlement of the purchase contract. This means if there is a delay in moving in because of illness or other reasonable cause, the exemption is still available from when you acquired your ownership interest in the dwelling.

If you could not move in because the dwelling was being rented to someone, you are not considered to have moved in as soon as practicable after you acquired your ownership interest.

As mentioned earlier, there is a special rule that allows you to treat more than one dwelling as your main residence for a limited time if you are changing main residences (see **Moving from one main residence to another** on page 57).

## Land adjacent to the dwelling

The land adjacent to a dwelling is also exempt if:

- during the period you owned it, the land is used mainly for private and domestic purposes in association with the dwelling, and
- the total area of the land around the dwelling, including the land on which it stands, is not greater than 2 hectares (4. 94 acres). If the land used for private purposes is greater than 2 hectares, you can choose which 2 hectares are exempt.

Land is adjacent to your dwelling if it is close to, near, adjoining or neighbouring the dwelling.

If you sell any of the land adjacent to your dwelling separately from the dwelling, the land is not exempt. It is only exempt when sold with the dwelling. There is an exception if the dwelling is accidentally destroyed and you sell the vacant land (see **Destruction of dwelling and sale of land** on page 62).

Any part of the land around a dwelling used to produce income is not exempt, even if the total land is less than 2 hectares. However, the dwelling and any buildings and other land used in association with it remain exempt if you do not use them to produce income.

**Example**

**Land used for private purposes**

Tim bought a home with 15 hectares of land in November 2000. He uses 10 hectares of the land to produce income and 5 hectares for private purposes. Tim can get the main residence exemption for the home and 2 hectares of land he selects out of the 5 hectares that are used for private purposes.

Tim gets a valuation which states that the home and 2 hectares of land that he has selected are worth two-thirds of the total value of the property. The relative values of the different parts of the property remained the same between the time of purchase and the time of sale.

Tim entered into a contract to sell the property on 8 May 2003. The capital gain from the property is $15,000. Tim may claim the main residence exemption on the two-thirds of the capital gain attributable to the house and 2 hectares of land, that is, $10,000.

Because he entered into the contract to acquire the property after 11.45am (by legal time in the ACT) on 21 September 1999 and owned it for at least 12 months, Tim reduces his remaining $5,000 gain (attributable to the land) by the CGT discount of 50% after applying any capital losses.

## Other structure associated with the dwelling

A flat or home unit often includes areas (for example, a laundry, storeroom or garage) that are physically separate from the flat or home unit. As long as these areas are used primarily for private or domestic purposes in association with the flat or home unit for the whole period you own it, they are exempt on the same basis as the flat or home unit is exempt.

However, if you dispose of one of these structures separately from the flat or home unit, they are not exempt.

## Part exemption

*Main residence for only part of the period you owned it*

If a CGT event happens in relation to a dwelling you acquired on or after 20 September 1985 and that dwelling was not your main residence for the whole time you owned it, you get only a part exemption.

The part of the capital gain that is taxable is calculated as follows:

$$\text{Total capital gain made from the CGT event} \times \frac{\text{number of days in your ownership period when the dwelling was not your main residence}}{\text{total number of days in your ownership period}}$$

**Example**

### Main residence for part of the ownership period

Andrew bought a house under a contract that was settled on 1 July 1990 and moved in immediately. On 1 July 1993, he moved out and began to rent out the house. He did not choose to treat the house as his main residence for the period after he moved out, although he could have done this under the continuing main residence status after dwelling ceases to be your main residence rule (see page 58). The 'home first used to produce income' rule (explained on page 56) does not apply because Andrew used the home to produce income before 21 August 1996.

The contract for the sale of the house was settled on 1 July 2002 and Andrew made a capital gain of $10,000. As he is entitled to a part exemption, Andrew's capital gain is reduced as follows:

$$\$10{,}000 \times \frac{3{,}288 \text{ days}}{4{,}384 \text{ days}} = \$7{,}500$$

As Andrew entered into the contract to acquire the house before 11.45am (by legal time in the ACT) on 21 September 1999 but the CGT event occurred after this date, Andrew can choose to use the discount method or the indexation method to calculate his capital gain.

If a dwelling was not your main residence for the whole time you owned it, some special rules may entitle you to a full exemption or extend the part exemption you would otherwise get. These rules apply to land or a dwelling if:

- you choose to treat the dwelling as your main residence, even though you no longer live in it (see **Continuing main residence status after dwelling ceases to be your main residence** on page 58)
- you moved into the dwelling as soon as practicable after its purchase (see **Moving into a dwelling** on page 53)
- you are changing main residences (see **Moving from one main residence to another** on page 57)
- you are yet to live in the dwelling but will do so as soon as practicable after it is constructed, repaired or renovated and you will continue to live in it for at least three months (see **Constructing, renovating or repairing a dwelling on land you already own** on page 61), or
- you sell vacant land after your main residence is accidentally destroyed (see **Destruction of dwelling and sale of land** on page 62).

### Dwelling used to produce income

Usually you cannot get the full main residence exemption if you:

- acquired your dwelling on or after 20 September 1985 and used it as your main residence
- used any part of it to produce income during all or part of the period you owned it, and
- would be allowed a deduction for interest had you incurred it on money borrowed to acquire the dwelling (interest deductibility test).

The interest deductibility test applies regardless of whether you actually borrowed money to acquire your dwelling. You must apply it on the assumption that you did borrow money to acquire the dwelling.

If you rent out part of your home, you would be entitled to deduct part of the interest if you had borrowed money to acquire the dwelling.

If you run a business or professional practice in part of your home, you would be entitled to deduct part of the interest on money you borrowed to acquire the dwelling if:

- part of the dwelling is set aside exclusively as a place of business and is clearly identifiable as such, and
- that part of the home is not readily adaptable for private use—for example, a doctor's surgery located within the doctor's home.

You would not be entitled to deduct any interest expenses if, for convenience, you use a home study to undertake work usually done at your place of work. Similarly, you would not be entitled to deduct interest expenses if you do paid child-minding at home (unless a special part of the home was set aside exclusively for that purpose). In these situations, you would still get a full main residence exemption.

You can still get a full main residence exemption if someone else uses part of your home to produce income and you receive no income from that person.

When a CGT event happens in relation to the home, the proportion of the capital gain or capital loss that is taxable is an amount that is reasonable having regard to the extent to which you would have been able to deduct the interest on money borrowed to acquire the home.

In most cases this is the proportion of the floor area of the home that is set aside to produce income and the period the home is used to produce income. This includes if the dwelling is available (for example, advertised) for rent.

**Example**

### Renting out part of a home

Thomas purchased a home under a contract that was settled on 1 July 1997 and sold it under a contract that was settled on 30 June 2003. The home was his main residence for the entire six years.

Throughout the period Thomas owned the home, a tenant rented one bedroom, which represented 20% of the home. Both Thomas and the tenant used the living room and kitchen which represented 30% of the home. Only Thomas used the remainder of the home. Therefore Thomas would be entitled to a 35% deduction for interest if he had incurred it on money borrowed to acquire his home. The 'home first used to produce income' rule (explained below) does not apply because Thomas used the home to produce income from the date he purchased it.

Thomas made a capital gain of $20,000 when he sold the home. Of this total gain, the following proportion is not exempt:

| Capital gain | × | percentage of floor area | = | taxable portion |
|---|---|---|---|---|
| $20,000 | × | 35% | = | $7,000 |

As Thomas entered into the contract to acquire the home before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

**Example**

### Running a business in part of a home for part of the period of ownership

Ruth bought her home under a contract that was settled on 1 January 1999. She sold it under a contract that was entered into on 1 November 2002 and was settled on 31 December 2002. It was her main residence for the entire four years.

From the time she bought it until 31 December 2001, Ruth used part of the home to operate her photographic business. The rooms were modified for that purpose and were no longer suitable for private and domestic use. They represented 25% of the total floor area of the home.

When she sold the home, Ruth made a capital gain of $8,000. The following proportion of the gain is taxable:

| Capital gain | × | percentage of floor area not used as main residence | × | percentage of period of ownership that that part of the home was not used as main residence | = | taxable portion |
|---|---|---|---|---|---|---|
| $8,000 | × | 25% | × | 75% | = | $1,500 |

As Ruth entered into the contract to acquire the home before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, she can use either the indexation or discount method to calculate her capital gain.

The 'home first used to produce income' rule (explained below) does not apply because Ruth used the home to produce income from the date she purchased it.

For more information on rental properties (for example, negative gearing and deductions), get the publication *Rental properties* from the sources listed at the back of this guide.

#### *Home first used to produce income*

If you start using your main residence to produce income for the first time after 20 August 1996, a special rule affects the way you calculate your capital gain or capital loss.

In this case, you are taken to have acquired the dwelling at its market value at the time it is first used to produce income if all of the following apply:

- you acquired the dwelling on or after 20 September 1985
- you first used the dwelling to produce income after 20 August 1996

- when a CGT event happens in relation to the dwelling, you would get only a part exemption because the dwelling was used to produce assessable income during the period you owned it, and
- you would have been entitled to a full exemption if the CGT event happened to the dwelling immediately before you first used it to produce income.

If a deceased's main residence passed to you as a beneficiary or as trustee of their estate on or after 20 September 1985, you are taken to have acquired the dwelling at its market value at the time it was first used to produce your income only if:

- you first used the dwelling to produce income after 20 August 1996
- when a CGT event happens in relation to the dwelling, you would get only a part exemption because the dwelling was used to produce assessable income during the period you owned it
- you would have been entitled to a full exemption if the CGT event happened to the dwelling immediately before you first used it to produce income, and
- the CGT event did not happen in relation to the dwelling within two years of the person's date of death.

**NOTE** **Full exemption**

You may have made the choice to treat a dwelling as your main residence after the dwelling ceases to be your main residence (see **Continuing main residence status after the dwelling ceases to be your main residence** on page 58). In this case, if the dwelling is fully exempt, the 'home first used to produce income' rule does not apply.

In working out the amount of capital gain or capital loss, the period before the dwelling is first used by you to produce income is not taken into account. The extent of the exemption depends on the period after that time and the proportion of the home used to produce income. This example explains this.

**Example**

### Home first used to produce income after 20 August 1996

Louise purchased a home in December 1991 for $200,000. The home was her main residence. On 1 November 2001, she started to use 50% of the home for a consultancy business. At that time the market value of the house was $220,000.

She decided to sell the property in August 2002 for $250,000. As Louise had not ceased living in the home, she could not get a full exemption under the continuing main residence status after dwelling ceases to be your main residence rule (see page 58). The capital gain is 50% of the proceeds less the cost base.

| Percentage of use | × | (proceeds – cost base) | = | capital gain |
|---|---|---|---|---|
| 50% | × | ($250,000 – $220,000) | = | $15,000 |

Louise is taken to have acquired the property on 1 November 2001 at a cost of $220,000. Because she is taken to have acquired it at this time, Louise is taken to have owned it for less than 12 months and must use the 'other' method to calculate her capital gain.

## Moving from one main residence to another

If you acquire a new home before you dispose of your old one, both dwellings are treated as your main residence for up to six months if:

- the old dwelling was your main residence for a continuous period of at least three months in the 12 months before you disposed of it
- you did not use it to produce assessable income in any part of that 12 months when it was not your main residence, and
- the new dwelling becomes your main residence.

If you dispose of the old dwelling within six months of acquiring the new one, both dwellings are exempt for the whole period between when you acquire the new one and dispose of the old one.

If you disposed of your old home before 1 July 1998, both homes are exempt for a maximum of three months.

**Example**

**Exemption for both homes**

Jill and Norman bought their new home under a contract that was settled on 1 January 2003 and moved in immediately. They sold their old home under a contract that was settled on 15 April 2003. Both the old and new homes are treated as their main residence for the period 1 January to 15 April even though they did not live in the old home during that period.

If it takes longer than six months to dispose of your old home, both homes are exempt only for the last six months before you dispose of the old one. You get only a part exemption when a CGT event happens in relation to your old home.

**Example**

**Part exemption for a first home**

Jeneen and John bought their first home under a contract that was settled on 1 January 1997 and moved in immediately. It was their main residence until they bought their second home under a contract that was entered into on 2 November 2001 and settled on 1 January 2002.

They retained the first home after moving into the new one but did not use it to produce income. They sold the first home under a contract that was settled on 1 October 2002. They owned this home for a total period of 2100 days.

Both homes are treated as their main residence for the period 1 April 2002 to 1 October 2002, the last six months that Jeneen and John owned their first home. Therefore, their first home is treated as their main residence only for the period before they moved into their new home and during the last six months before its sale.

The 89 days from 1 January 2002 to 30 March 2002, when it was not their main residence, are taken into account in calculating the proportion of their capital gain that is taxable (89/2100).

Because they entered into the contract to acquire their old home before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, Jeneen and John can use either the indexation or the discount method to calculate their capital gain.

## Continuing main residence status after dwelling ceases to be your main residence

In some cases you can choose to have a dwelling treated as your main residence even though you no longer live in it. You cannot make this choice for a period before a dwelling first becomes your main residence.

**Example**

**Not main residence until you move in**

Therese bought a house and rented it out immediately. Later she stopped renting it out and moved in.

Therese cannot choose to treat the house as her main residence during the period she was absent under the continuing main residence rule because the house was not her main residence before she rented it out. She will only be entitled to a part exemption if she sells the dwelling.

This choice needs to be made only for the income year that the CGT event happens to the dwelling, that is, the year that you enter into a contract to sell it. If you make this choice, you cannot treat any other dwelling as your main residence for that period (except for a limited time if you are changing main residences, see **Moving from one main residence to another** on page 57).

If you do not use it to produce income, you can treat the dwelling as your main residence for an unlimited period after you cease living in it.

If you do use it to produce income, you can choose to treat it as your main residence for up to six years after you cease living in it. If, as a result of you making this choice, the dwelling is fully exempt, the 'home first used to produce income' rule (explained on page 56) does not apply.

If you are absent more than once during the period you own the home, the six-year maximum period that you can treat it as your main residence while you use it to produce income applies separately to each period of absence.

**Example**

### One period of absence of 10 years

*Home ceases to be the main residence and is used to produce income for one period of six years*

Lisa buys a house after 20 September 1985 but ceases to use it as her main residence for the 10 years immediately before she sells it. During this period, she rents it out for six years and leaves it vacant for four years.

Lisa chooses to treat the dwelling as her main residence for the period after she ceased living in it, so any capital gain or capital loss she makes on the sale of the dwelling is disregarded. The maximum period the dwelling can continue to be her main residence while it is used to produce income is six years. However, while the house is vacant, the period is unlimited, which means the exemption applies for the whole 10 years.

In addition to this, because the dwelling is fully exempt as a result of Lisa making this choice, the 'home first used to produce income' rule (explained on page 56) does not apply.

*Home used to produce income for more than one period totalling six years*

In the 10-year period after Lisa stopped living in the dwelling she rents it out for three years, leaves it vacant for two years, rents it out for the next three years, then once more leaves it vacant for two years.

If she chooses to treat the dwelling as her main residence for the period after she ceased living in it, any capital gain or capital loss she makes on selling it is again disregarded. This is because the period the home was used to produce income during each absence is not more than six years.

**Example**

## Home ceases to be the main residence and is used to produce income for more than six years during a single period of absence

**1 July 1990**

Ian bought a home in Sydney and used it as his main residence.

**1 January 1992**

Ian was posted to Brisbane and bought another home there.

**1 January 1992 to 31 December 1996**

Ian rented out his Sydney home during the period he was posted to Brisbane.

**31 December 1996**

Ian sold his Brisbane home and the tenant in his Sydney home left.

The period of five years from 1992 to 1996 is the first period the Sydney home was used to produce income for the purpose of the six-year test.

**1 January 1997**

Ian was posted from Brisbane to Melbourne for three years and bought a home in Melbourne. He did not return to his Sydney home.

**1 March 1997**

Ian again rented out his Sydney home—this time for two years.

**28 February 1999**

The tenant of his Sydney home left.

The period of two years from 1997 to 1999 is the second period the Sydney home was used to produce income under the six-year test.

**31 December 1999**

Ian sold his home in Melbourne.

**31 December 2000**

Ian returned to his home in Sydney and it again became his main residence.

**28 February 2003**

Ian sold his Sydney home.

Ian chooses to treat the Sydney home as his main residence for the period after he ceased living in it. The effect of making this choice is that any capital gains Ian made on the sale of both his Brisbane home in 1996–97 and his Melbourne home in 1999–2000 are not exempt.

Ian cannot get the main residence exemption for the whole period of ownership of the Sydney home because the combined periods it was used to produce income (1 January 1992 to 31 December 1996 and 1 March 1997 to 28 February 1999) during his one absence was more than six years.

As a result, the Sydney house is not exempt for the period it was used to produce income that exceeds the six-year period, that is, one year.

If the capital gain on the disposal of the Sydney home is $50,000, the amount of the gain that is taxable is calculated as follows:

***Period of ownership of the Sydney home:***

| | |
|---|---|
| 1 July 1990 to 28 February 2003 | 4,626 days |

***Periods the Sydney home was used to produce income after Ian ceased living in it:***

| | |
|---|---|
| 1 January 1992 to 31 December 1996 | 1,827 days |
| 1 March 1997 to 28 February 1999 | 730 days |
| | 2,557 days |

***First six years the Sydney home was used to produce income:***

| | |
|---|---|
| 1 January 1992 to 31 December 1996 | 1,827 days |
| 1 March 1997 to 28 February 1998 | 365 days |
| | 2,192 days |

***Income producing for more than six years after Ian ceased living in it:***

365 days

Proportion of capital gain taxable in 2002–03

$$365 \times \frac{\$50,000}{4,626} = \$3,945$$

Because Ian entered into the contract to acquire the house before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and owned it for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

**NOTE** **21 August 1996 important**

The 'home first used to produce income' rule explained on page 56 does not apply because the home was used by Ian to produce income before 21 August 1996.

## Home used to produce income and then you cease living in it

If you use any part of your home to produce income before you cease living in it, you cannot apply the 'continuing main residence status after dwelling ceases to be your main residence' rule (see page 58) to that part. This means you cannot get the main residence exemption for that part of the dwelling either before or after you cease living in it.

**Example**

**Ceasing to live in a home after part of it is used to produce income**

Helen purchased a home under a contract that was settled on 1 July 1992 and she moved in immediately. She used 75% of the home as her main residence and the remaining 25% as a doctor's surgery, which she used until 30 June 1997.

On 1 July 1997, she moved out and rented out the home until it was sold under a contract that was settled on 30 June 2003. Helen chose to treat the dwelling as her main residence for the six years it was rented out. She made a capital gain of $10,000 when the home was sold.

As 25% of the home was not used as her main residence during the period before Helen ceased living in it, part of the capital gain is taxable, calculated as follows:

$10,000 × 25% = $2,500

Because Helen entered into the contract to acquire the house before 11.45am (by legal time in the ACT) on 21 September 1999 and sold it after that time, and owned it for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

The 'home first used to produce income rule' does not apply because she used it to produce income from the time she purchased it.

## Constructing, renovating or repairing a dwelling on land you already own

Generally, if you build a dwelling on land you already own, the land does not qualify for exemption until the dwelling becomes your main residence. However, you can choose to treat land as your main residence for up to four years before the dwelling becomes your main residence in certain circumstances. If you make this choice, the land is exempt for the period both before construction and after it becomes your main residence.

You can choose to have this exemption apply if you acquire an ownership interest (other than a life interest) in land and you:

- build a dwelling on the land
- repair or renovate an existing dwelling on the land, or
- finish a partly constructed dwelling on the land.

There are a number of conditions that must be satisfied before you can claim the exemption. You must first finish building, repairing or renovating the dwelling and then:

- move into the dwelling as soon as practicable after it is finished, and
- continue to use the dwelling as your main residence for at least three months after it becomes your main residence.

The land, including the dwelling that is being built, renovated, repaired or finished on it, is exempt for the shorter of the following periods:

- the four-year period immediately before the date the dwelling becomes your main residence, or
- the period between the date you acquired the land and the date the dwelling becomes your main residence.

The period of exemption usually starts from the date you acquired the land. However, if after you acquired the land you or someone else occupied a dwelling that was already on the land, the period of exemption starts from the date that dwelling was vacated.

If a newly constructed dwelling is built to replace a previous dwelling that was demolished or destroyed, a full exemption is available when you dispose of the property if:

- the original dwelling was your main residence for the full period you owned it, it was not used by you to produce assessable income and it was on land covering an area of 2 hectares or less,
- the new dwelling becomes your main residence as soon as practicable after it is completed, it continues to be your main residence until you dispose of it and that period is at least three months,
- you make a choice to treat the vacant land and new dwelling as your main residence in the period starting when you ceased occupying the previous dwelling and ending when the new dwelling becomes your main residence, and this period is four years or less, and
- you dispose of the land and new dwelling together.

If you make this choice, you cannot treat any other dwelling as your main residence for the period, except

for a limited time under the 'moving from one main residence to another' rule (explained on page 57).

Therefore, if you have a dwelling you acquired on or after 20 September 1985 and you live in it while you build your new home, you must decide whether to:

- maintain the exemption for your old home, or
- have the exemption apply to the land (including the dwelling that is being built, renovated, repaired or finished on it) for the shorter of:
  - the time from when you acquire the land until the new home becomes your main residence, or
  - the four-year period immediately before the date on which the new home becomes your main residence.

If you acquired your old main residence before 20 September 1985, it is exempt. This means you will benefit from choosing to treat the land on which your new dwelling is to be built, renovated, repaired or finished as your main residence for the relevant dates above.

You cannot choose to have a shorter period of exemption for the new home in order to exempt the old home for part of the construction period.

**Example**

**Choosing to claim exemption for the land from the date of construction**

Grant bought vacant land on which he intended to build a new home under a contract that was settled on 3 September 1999. He bought his previous home under a contract that was settled on 3 November 1991.

Grant finished building his new home on 8 September 2002. He moved into it on 7 October 2002, which was as soon as practicable after completion. He sold his previous home under a contract that was settled on 1 October 2002.

If Grant wants to, he can:

- treat the new home as his main residence from 3 September 1999, and
- claim the exemption for his previous home from 3 November 1991 to 2 September 1999.

Both homes are also exempt from 1 April 2002 to 1 October 2002, the date Grant disposed of the old home. This is because the maximum six-month exemption outlined in the section **Moving from one main residence to another** on page 57 also applies.

If you were to die at any time between entering into contracts for the construction work and the end of the first three months of residence in the new home, this exemption can still apply.

If you owned the land as a joint tenant and you die, the surviving joint tenant (or if none, the trustee of your estate) can choose to treat the land and the dwelling as your main residence for the shorter of:

- four years before your death, or
- the period starting when you acquired the land and ending when you die.

## Destruction of dwelling and sale of land

If your home is accidentally destroyed and you then dispose of the vacant land on which it was built, you can choose to treat the land as your main residence.

If you make this choice, the land is exempt from the time your home was destroyed until you dispose of the land, as well as for the period it was used as part of your main residence. The maximum area of land that can be exempt is 2 hectares. You cannot claim the main residence exemption for this period for any other dwelling, except for a limited time if you are changing main residences (see **Moving from one main residence to another** on page 57).

## Having a different home from your spouse or dependent child

If you and a dependent child under 18 years old have different homes for a period, you must choose one of the homes as the main residence for both of you for the period.

If you and your spouse have different homes for a period, you and your spouse must either:

- choose one of the homes as the main residence for both of you for the period, or
- nominate the different homes as your main residences for the period.

If you nominate different homes for the period and you own 50% or less of the home you have nominated, you qualify for an exemption for your share. If you own more than 50%, your share is exempt for half the period you and your spouse had different homes.

The same applies to your spouse. If your spouse owns 50% or less of the home they have nominated, they qualify for an exemption for their share. However, if your spouse owns more than 50% of the home, their share is exempt for only half the period you had different homes.

This rule applies to each home the spouses own whether they have sole ownership or own the home jointly (either as joint tenants or tenants in common).

This rule applies also if you choose to treat a dwelling as your main residence when you no longer live in it (see **Continuing main residence status after dwelling ceases to be your main residence** on page 58), and this choice results in you having a different main residence from your spouse or a dependent child for a period.

**Example**

### Spouses with different main residences

Under a contract that was settled on 1 July 1996, Kathy and her spouse Grahame purchased a townhouse where they lived together. Grahame owns 70% of the townhouse while Kathy owns the other 30%.

Under a contract that was settled on 1 August 1998, they purchased a beach house which they own in equal shares. From 1 May 1999, Kathy lives in their beach house while Grahame keeps living in the townhouse. Grahame nominated the townhouse as his main residence and Kathy nominated the beach house as her main residence.

Kathy and Grahame sold the beach house under a contract that was settled on 15 April 2003. As it is Kathy's home and she owns 50% of it, her share of any capital gain or capital loss is disregarded for the period she and Grahame had different homes (1 May 1999–15 April 2003).

As Grahame did not live in the beach house or nominate it as his main residence when he and Kathy had different homes, his share of any capital gain or capital loss is not ignored for any of the period he owned it.

Grahame and Kathy also sold the townhouse under a contract that was settled on 15 April 2003.

Because Grahame owns more than 50% of the townhouse, it is taken to have been his main residence for half of the period when he and Kathy had different homes.

If the total capital gain on the sale of the townhouse is $10,000, Grahame's share of the capital gain is $7,000 (reflecting his 70% ownership interest). The portion of the gain that Grahame disregards under the main residence exemption is:

$$\$7{,}000 \times \frac{1{,}034 \text{ days}^{*}}{2{,}479 \text{ days}^{**}} = \$2{,}920$$

plus

$$\$7{,}000 \times 50\% \times \frac{1{,}446 \text{ days}^{***}}{2{,}479 \text{ days}^{**}} = \$2{,}041$$

* townhouse was Grahame's home and he and Kathy did not have different homes

** total ownership period

*** when Grahame and Kathy had the different homes

The total amount disregarded by Grahame is: $2,920 + $2,041 = $4,961

As Grahame bought the townhouse before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and owned his share for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

Kathy's share of the $10,000 capital gain on the townhouse is $3,000, reflecting her 30% ownership interest. The portion she disregards is:

$$\$3{,}000 \times \frac{1{,}034 \text{ days}^{*}}{2{,}479 \text{ days}^{**}} = \$1{,}251$$

* period before 1 May 1999 when the townhouse was Kathy's home

** total ownership period

As Kathy entered into the contract to buy the townhouse before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and owned her share for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

**Example**

**Different main residences**

Anna and her spouse Mark jointly purchased a townhouse under a contract that was settled on 5 February 1999 and both lived in it from that date until 29 April 2003, when the contract of sale was settled. Anna owned more than 50% of the townhouse.

Before 5 February 1999, Anna had lived alone in her own flat which she rented out after moving to the townhouse. She then sold her flat and settled the sale on 11 March 2000. Anna chose to treat the flat as her main residence from 5 February 1999 until she sold it under the continuing main residence status after dwelling ceases to be your main residence rule (see page 58).

Because of Anna's choice, Mark had a different main residence from Anna for the period 5 February 1999 to 11 March 2000. Therefore, Mark must either:

- treat Anna's flat as his main residence for that period, or
- nominate the townhouse as his main residence for that period.

If he chooses to treat Anna's flat as his main residence, a part of any gain Mark makes when he sells the townhouse will be taxable. He will not get an exemption for the townhouse for the period that he nominated Anna's flat as his main residence (that is, 5 February 1999–11 March 2000).

If Mark nominates the townhouse as his main residence, he qualifies for a full exemption on any capital gain he makes when it is sold because he owned 50% or less of it. However, because Mark and Anna have different main residences as a result of Mark's choice, and Anna owns more than 50% of the flat, her gain on the flat will only qualify for a 50% exemption for the period from 5 February 1999 to 11 March 2000.

Any capital gain Anna makes on the townhouse is taxable except for the period from 12 March 2000 to 29 April 2003 and the part that is ignored under the 'moving from one main residence to another' rule (see page 57).

## Major capital improvements to a dwelling acquired before 20 September 1985

If you acquired a dwelling before 20 September 1985 and you make major capital improvements after that date, part of any capital gain you make when a CGT event happens in relation to the dwelling could be taxable. Even though you acquired the dwelling before CGT started, major capital improvements are considered to be separate CGT assets from the original asset and may therefore be subject to CGT in their own right if they are made on or after 20 September 1985.

If the dwelling is your main residence and the improvements are used as part of your home, they are still exempt. This includes improvements on land adjacent to the dwelling (for example, installing a swimming pool) if the total land, including the land on which the home stands, is 2 hectares or less.

However, if the dwelling is not your main residence or you used the improvements to produce income for any period, the part of any gain that is attributable to the improvements for that period is taxable.

A capital improvement is taken to be major if its original cost (indexed for inflation) is more than 5% of the amount you receive when you dispose of the dwelling and the improvement is also over a certain threshold. The threshold increases every year to take account of inflation.

Improvement thresholds for 1985–86 to 2002–03 are shown in the table on page 5.

When you dispose of the dwelling, the capital gain or capital loss on the major improvements is calculated by taking away the cost base of the improvements from the proceeds of the sale that are reasonably attributable to the improvements:

| Capital gain on major improvements | = | proceeds of sale attributable to improvements | – | cost base of improvements |
|---|---|---|---|---|

You can choose to calculate the capital gain made on the improvements using either the indexation or the discount method if:

- the improvements were made under a contract entered into before 11.45am (by legal time in the ACT) on 21 September 1999
- the dwelling was sold after that time, and
- you owned the improvements for at least 12 months.

If you entered into the contract to make the improvements after 11.45am (by legal time in the ACT) on 21 September 1999 and you owned them for more than 12 months, you can calculate your capital gain using the CGT discount of 50%.

In calculating the amount of capital proceeds to be attributed to the improvements, you must take whatever steps are appropriate to work out their value. If you make an estimate of this amount, it must be reasonable and you must be able to show how you arrived at the estimated amount.

**Example**

**Improvement on land acquired before 20 September 1985**

Martin bought a home in 1984. On 1 December 1993, he undertook major capital improvements worth $95,000. He sold the home for $500,000 under a contract that was settled on 1 December 2002. At the date of sale, the indexed cost base of the improvements was $106,573.

Of the $500,000 he received for the home, $120,000 could be attributed to the improvements. The improvements were used by Martin to produce income from the time they were finished until the time they were sold with the home.

The 'home first used to produce income' rule (explained on page 56) does not apply to the improvements because they were first used to produce income before 21 August 1996.

**Test 1** Is the cost base of the improvements more than 5% of $500,000, that is, $25,000? **Yes** (note indexation is taken into account for the purpose of this test)

**Test 2** Is the cost base of the improvements more than the 2002–03 threshold of $101,239? **Yes**

As the answer to both questions is **Yes** and the improvements were used to produce income, the capital gain on the improvements is taxable. The capital gain is calculated as follows:

| | |
|---|---|
| Amount of proceeds attributable to the improvements | $120,000 |
| less cost base of improvements indexed for inflation | $106,573 |
| **Taxable capital gain** | **$13,427** |

If the improvements had been used as part of Martin's main residence, this gain would be exempt. However, if the home (including the improvements) had been rented out for one-third of the period, one-third of the capital gain made on the improvements would have been taxable.

As Martin acquired the improvements before 11.45am (by legal time in the ACT) on 21 September 1999 and sold the home after that time, and had held the improvements for at least 12 months, he could use either the indexation method (as in the calculation above) or the discount method to calculate his capital gain on the improvements.

Martin's capital gain using the discount method (assuming he has no capital losses or capital gains in the 2002–03 income year and does not have any prior year net capital losses) is:

| | |
|---|---|
| Amount of proceeds attributable to the improvements | $120,000 |
| less cost base of improvements (without indexation) | $95,000 |
| Capital gain | $25,000 |
| Less: 50% discount | $12,500 |
| **Net capital gain** | **$12,500** |

Martin chooses the discount method because this gives him a lower capital gain.

### Buildings or structures constructed on land acquired before 20 September 1985

Buildings or structures constructed on or after 20 September 1985 on land acquired before that date are also considered to be separate CGT assets from the original land. The major capital improvement threshold and 5% of capital proceeds rule (see page 64) do not apply to them. Therefore, they may be subject to CGT if they are used other than as your main residence.

## Inherited main residence

If you inherit a deceased person's dwelling, you may be exempt or partially exempt when a CGT event happens in relation to it. The same exemptions apply if a CGT event happens in relation to a deceased's estate of which you are the trustee.

### Full exemption

*Deceased died before 20 September 1985*

As you acquired the dwelling before 20 September 1985, any capital gain you make is exempt. However, major capital improvements you make to the dwelling on or after 20 September 1985 may be taxable (see Major capital improvements to a dwelling acquired before 20 September 1985 on page 64).

*Deceased died on or after 20 September 1985*

**(a) The deceased acquired the dwelling before 20 September 1985 (it does not matter whether the dwelling was the main residence of the deceased person).**

You may have an ownership interest in a dwelling that passed to you as a beneficiary in a deceased estate or you may have owned it as trustee of a deceased estate. In either case, any capital gain or capital loss

you make from a CGT event that happens in relation to the dwelling is disregarded if either of the following applies:

1 you disposed of your ownership interest within two years of the person's death. This applies whether or not you used the dwelling as your main residence or to produce income during the two-year period, or
2 from the deceased's death until you disposed of your ownership interest, the dwelling was not used to produce income. For this period, the dwelling must also have been the main residence of one or more of:
   - a person who was the spouse of the deceased immediately before the deceased's death (but not a spouse who was permanently separated from the deceased)
   - an individual who had a right to occupy the home under the deceased's will, or
   - you, as a beneficiary, if you disposed of the dwelling as a beneficiary.

The dwelling can be the main residence of one of the above people (even though they may have ceased living in it) if they choose to treat it as their main residence under the 'continuing main residence status after dwelling ceases to be your main residence' rule (explained on page 58).

The Australian Taxation Office has no discretion to extend the two-year period.

**(b) The deceased acquired the dwelling on or after 20 September 1985.**

Any capital gain or capital loss you make when a CGT event happens in relation to a dwelling or ownership interest in a dwelling you inherit will be disregarded if:

- condition 2 in (a) above is met and the dwelling passed to you as beneficiary or trustee on or before 20 August 1996. For this to apply, the deceased must have used the dwelling as their main residence from the date they acquired it until their death and they must not have used it to produce income, or
- one of the conditions 1 or 2 in (a) above is met and the dwelling passed to you as beneficiary or trustee after 20 August 1996, and just before the date the deceased died it was their main residence and was not being used to produce income.

A dwelling can still be regarded as the deceased's main residence even though they ceased living in it if they or their trustee chose to treat the dwelling as the deceased's main residence. This may happen if—for example, the person moved to a nursing home. You may need to contact the trustee or the deceased's tax adviser to find out whether this choice was made.

If it was, the dwelling can still be regarded as the deceased's main residence:

- for an indefinite period if the dwelling was not used to produce income after the deceased stopped living in it, or
- for a maximum of six years after they ceased living in it if it was used to produce income after they ceased living in it.

**Example**

**Full exemption**

Rodrigo was the sole occupant of a home he bought in April 1990. He did not live in or own another home.

He died in January 2002 and left the house to his son, Petro. Petro rented out the house and then disposed of it 15 months after his father died.

Petro is entitled to a full exemption from CGT as he acquired the house after 20 August 1996 and disposed of it within two years of his father's death.

**Part exemption**

If you do not qualify for a full exemption from CGT for the home you may be entitled to a part exemption.

You calculate your capital gain or capital loss as follows:

$$\text{Capital gain or capital loss amount} \times \frac{\text{non-main residence days}}{\text{total days}}$$

*Non-main residence days*

'Non-main residence days' is the number of days that the dwelling was not the main residence.

(a) If the deceased acquired the dwelling before 20 September 1985, non-main residence days is the number of days in the period from their death until settlement of your contract for sale of the dwelling when it was not used to produce income and was not the main residence of one of the following:
   - a person who was the spouse of the deceased (except a spouse who was permanently separated from the deceased)
   - an individual who had a right to occupy the dwelling under the deceased's will, or
   - you, as a beneficiary, if you disposed of the dwelling as a beneficiary.

(b) If the deceased acquired the dwelling on or after 20 September 1985, non-main residence days is the number of days calculated under (a) plus the number of days in the deceased's period of ownership when the dwelling was not their main residence.

*Total days*

(a) If the deceased acquired their ownership interest before 20 September 1985, 'total days' is the number of days from their death until you disposed of your ownership interest.

(b) If the deceased acquired the ownership interest on or after 20 September 1985, total days is the number of days in the period from when the deceased acquired the dwelling until you disposed of your ownership interest.

**Example**

**Part exemption**

Vicki bought a house under a contract that was settled on 12 February 1995 and she used it solely as a rental property. When she died on 17 November 1998, the house became the main residence of her beneficiary, Lesley. Lesley sold the property under a contract that was settled on 27 November 2002.

As Vicki had never used the property as her main residence, Lesley cannot claim a full exemption from CGT. However, as Lesley used the house as her main residence, she is entitled to a part exemption from CGT.

Vicki owned the house for 1,375 days and Lesley then lived in the house for 1,471 days, a total of 2,846 days. Assuming Lesley made a capital gain of $10,000, the taxable portion is:

$$\$10{,}000 \times \frac{1{,}375}{2{,}846} = \$4{,}831$$

As Lesley is taken to have acquired the property before 11.45am (by legal time in the ACT) on 21 September 1999 and entered into the contract to sell it after that time, and held the property for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

If you dispose of your ownership interest in a dwelling within two years of the person's death, you can ignore the main residence days and total days in the period from the person's death until you dispose of the dwelling if this lessens your tax liability.

Also any non-main residence days before the deceased's death are ignored in calculating the capital gain or capital loss if:

- you acquired the dwelling after 20 August 1996
- the dwelling was the deceased's main residence just before their death, and
- the dwelling was not being used to produce income at the time of their death.

### Cost to you of acquiring the dwelling

If you acquire a dwelling the deceased had owned, there are special rules for calculating your cost base.

These rules apply in calculating any capital gain or capital loss when a CGT event happens in relation to the dwelling.

The first element of the cost base or reduced cost base of a dwelling—its acquisition cost—is its market value at the date of death if either:

- the dwelling was acquired by the deceased before 20 September 1985, or
- the dwelling passes to you after 20 August 1996 and it was the main residence of the deceased immediately before their death and was not being used to produce income at that date.

In any other case, your acquisition cost is the deceased's cost base or reduced cost base on the day they died. If that cost base includes indexation you must recalculate it to exclude the indexation component if you prefer to use the discount method to work out you capital gain from the property.

**Example**

**Continuing main residence status**

Aldo bought a house in March 1995 and lived in it.

He moved into a nursing home in December 1996 and left the house vacant. He chose to treat the house as his main residence after he ceased living in it under the continuing main residence status after dwelling ceases to be your main residence rule (explained on page 58).

Aldo died in February 2003 and the house passed to his beneficiary, Con who uses the house as a rental property.

As the house was Aldo's main residence immediately before his death and was not being used to produce income at that time, Con can get a full exemption for the period Aldo owned it.

If Con rented out the house and sold it more than two years after Aldo's death, the capital gain for the period from the date of Aldo's death until Con sold it is taxable.

If Con had sold the house within two years of Aldo's death, he could have ignored the main residence days and total days between Aldo's death and him selling it—which would have given him exemption for this period.

If Aldo had rented out the house after he ceased living in it and had chosen to treat it as his main residence under the continuing main residence status after dwelling ceases to be your main residence rule (explained on page 58), the house would be considered to be his main residence until his death because he rented it out for less than six years.

However, even if this choice had been made, Con would only get a part exemption for the period Aldo owned the house because it was being used to produce income just before Aldo died. Con would get the exemption for the period Aldo did not use the house to produce income.

Note that even though the deceased was not living in the home at the date of their death, they or their trustee may have chosen to treat it as their main residence. You may need to contact the trustee or the deceased's tax adviser to find out whether this choice was made. If it was, the dwelling can still be regarded as the deceased's main residence:

- for an indefinite period—if the dwelling was not used to produce income after the deceased stopped living in it, or
- for a maximum of six years after they ceased living in it—if it was used to produce income after they ceased living in it.

If you are a beneficiary, the cost base or reduced cost base also includes amounts that the trustee of the deceased's estate would have been able to include in the cost base or reduced cost base.

For more information about deceased estates, see chapter 9.

## Death during construction

If an individual entered into a contract to construct, repair or renovate a home on land they already owned, and they die before certain conditions are met, the trustee may choose that the home and land be treated as the deceased's main residence for up to four years before the home became (or was to become) their main residence.

This choice can be made if the deceased dies:

- before the home is finished
- before it was practicable for the home to be their main residence, or
- before they had lived in the home for three months.

If the trustee makes this choice, no other dwelling can be treated as the deceased's main residence during that time.

## Acquisition of a dwelling from a company or trust upon marriage breakdown

If a dwelling is transferred to you from a company or trustee of a trust as a result of your marriage breakdown and marriage breakdown roll-over applied to the transfer, you are treated as having owned the dwelling while it was owned by the company or trustee. However, you cannot get the main residence exemption during any part of the period that the company or trustee owned it (even if you lived in the dwelling during that time).

Therefore, if a company or trustee as a result of your marriage breakdown transfers a dwelling to you, you will be entitled to the exemption only for the period after it was transferred when it was your main residence. This is calculated by dividing the period after the transfer that it was your main residence by the combined period you and the company or trustee owned it.

For more information about CGT assets and marriage breakdown, see chapter 8.

# CHAPTER 7 LOSS, DESTRUCTION OR COMPULSORY ACQUISITION OF AN ASSET

This chapter explains your capital gains tax (CGT) obligation if your CGT asset is lost, destroyed or compulsorily acquired.

Generally, there is no CGT obligation for assets acquired before 20 September 1985 (pre-CGT).

**NOTE** **New terms**

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in **part A** for more information or to **Explanation of terms** at the back of this guide.

There may be a situation where you receive money or another CGT asset (or both) as compensation when you dispose of an asset involuntarily (or under an insurance policy against the risk of such an event happening). In this case, you may be able to choose to:

- defer your liability to pay tax on any capital gain arising on the disposal, or
- get a CGT exemption for any replacement asset if you acquired the original asset before 20 September 1985.

This concession is known as roll-over. It may be available if one of the following events happens:

- all or part of your CGT asset is lost or destroyed
- your CGT asset is compulsorily acquired by an Australian government agency (that is, the Commonwealth, a State, a Territory or one of their authorities)
- you dispose of your CGT asset to an Australian government agency after they serve a notice on you inviting you to negotiate a sale agreement. They must have informed you that, if the negotiations are unsuccessful, the asset will be compulsorily acquired, or
- a lease that had been granted to you by an Australian government agency under a Commonwealth, State or Territory law expires and is not renewed.

This roll-over is not available for plant disposed of after 11.45am (by legal time in the ACT) on 21 September 1999 and other depreciating assets from 1 July 2001. Instead, where a depreciating asset is lost or destroyed or an Australian government agency acquires it compulsorily or by forced negotiation, the capital allowances provisions may allow for a balancing charge offset.

This means that rather than including an amount in your assessable income by way of a balancing adjustment, you can offset that amount against the cost of a replacement asset (or assets).

If you choose to take roll-over, you do not need to lodge a written election stating your choice—it will be clear from the way you prepare your tax return.

You cannot choose to defer a capital loss but you can use it to reduce any capital gain made in the current income year or a later year.

From 1 July 2001, for roll-over relief to apply, the replacement asset you acquire cannot become an item of your trading stock nor can it be a depreciating asset.

## Time of the CGT event

You need to know the time of a CGT event to work out in which income year a capital gain or capital loss affects your income tax.

If an asset is lost or destroyed and you receive compensation, the time of the CGT event is when you first receive the compensation.

If you do not receive any compensation, the time of the CGT event is when the loss is discovered or the destruction occurred.

If an Australian government agency compulsorily acquires your asset, the time of the CGT event is when:

- you first received compensation from the agency, or
- the agency enters the asset (for example, land) or takes possession of it.

If an Australian government agency acquires your asset following negotiation (rather than compulsorily acquiring it), the time of the CGT event is:

- the date the contract to acquire it is made, or
- the date of the change of ownership if there is no contract.

If a lease that had been granted to you by an Australian government agency expires and is not renewed, the time of the CGT event is when the lease expires.

## If you receive money

If you receive money because a CGT event happens, you can choose roll-over only if:

- you incur expenditure in acquiring another CGT asset that is used:
  - in your business for a reasonable period if the original asset was a business asset, or
  - otherwise for the same or a similar purpose as the original asset, or
- part of the original asset is lost or destroyed and you incur expenditure of a capital nature in repairing or restoring it.

You must incur at least some of the expenditure:

- no earlier than one year before the event happens, or
- within one year after the end of the income year in which the event happens.

This period may be extended in special circumstances.

**Example**

**Roll-over applies**

Trish paid for the repair of an asset for which she was compensated after part of it was destroyed on 1 September 2001. Trish's expenditure qualifies for the roll-over concession if it was incurred any time during the period 1 September 2000 to 30 June 2003.

The replacement asset need not be identical to the one it is replacing. However, for roll-over to apply, you must use it in the same business or for the same (or a similar) purpose as the one for which you used the original asset. Also, your replacement asset cannot become an item of trading stock nor can it be a depreciating asset.

**Example**

**Roll-over does not apply**

Denise receives money when her manufacturing business premises are destroyed. She buys a rental property with this money.

Denise cannot access the roll-over concession because she does not use the rental property for the same or similar purpose as her old business premises.

### Consequences of receiving money

If you receive money and choose to take a roll-over, the following are the consequences.

*Original asset acquired before 20 September 1985*

If you acquired the original asset before 20 September 1985, you are taken to have acquired the repaired or replacement asset before that day if:

- you repair or restore it, or
- you replace it:
  - at a cost of no more than 120% of its market value at the time of the event, or
  - at any cost, provided it (or part of it) was lost or destroyed by a natural disaster and the replacement asset is substantially the same.

This means you disregard any capital gain or capital loss you make when a later CGT event happens to the repaired or replacement asset.

*Original asset acquired on or after 20 September 1985*

If you acquired the original asset on or after 20 September 1985, the way roll-over applies will depend on whether the money you received is more or less than the cost of repairing or replacing the asset. If it is more, it also depends on whether the capital gain you make when the event happens is:

- more than that excess, or
- less than or equal to that excess.

*Money received is more than the cost of repair or replacement*

If you do not use all of the money you received to repair or replace the original asset, this affects your CGT obligation. The amount of capital gain you include on your tax return depends on whether the capital gain is more or less than the difference between the amount you received and the cost of the repair or replacement.

If the capital gain is more than that difference, your capital gain is reduced to the amount of the excess. Include this amount on your tax return in the year the event happens. This gain may be eligible for the CGT discount (see chapter 2 for more information).

When a later CGT event happens, the expenditure to include in the cost base of the asset is reduced by the difference between the gain before it is reduced and the excess. This enables you to defer part of your CGT liability until a later CGT event happens.

If the capital gain is less than or equal to the excess (the compensation amount less the cost of the repair or replacement), the capital gain and the expenditure on the repair or replacement are not reduced.

*Money received does not exceed the cost of repair or replacement*

If the amount of money you received is less than or equal to the expenditure you incurred to repair or replace the original asset, any capital gain is disregarded. The expenditure you include in the cost base of the asset when a later CGT event happens is reduced by the amount of the gain.

**Example**

**Money received is less than expenditure incurred**

Gerard's business premises were destroyed by fire on 15 March 2003. He received $46,000 in compensation from his insurance company.

It cost him $57,000 to reconstruct the premises, $11,000 more than the amount of compensation he received.

Gerard made a capital gain of $2,000 because his cost base apportioned to the building was $44,000 at the time of the fire.

| | |
|---|---|
| Money received | $46,000 |
| Cost base | $44,000 |
| Capital gain | $2,000 |
| Money received | $46,000 |
| Replacement expenditure | $57,000 |
| Shortfall | $11,000 |

As the compensation money does not exceed the repair expenditure, the capital gain is disregarded.

However, the amount of expenditure that Gerard can include in the cost base of the repaired building is reduced by the amount of the capital gain ($2,000) to $55,000.

**Example**

**Money received is more than the expenditure incurred**

Assume that in the above example, Gerard incurred only $40,000 for repairs and the cost attributed to the building was $30,000.

| | |
|---|---|
| Money received | 46,000 |
| Cost base | 30,000 |
| Capital gain | 16,000 |
| Money received | 46,000 |
| Replacement expenditure | 40,000 |
| Excess | 6,000 |

The compensation money ($46,000) is $6,000 more than the replacement expenditure ($40,000). The capital gain ($16,000) is $10,000 more than the excess of $6,000. The capital gain is reduced to the excess amount of $6,000.

Gerard's capital gain (before applying the CGT discount of 50%) is $6,000. Therefore, assuming he has not made any other capital losses or capital gains in the 2002–03 income year and does not have any prior year net capital losses) Gerard must include $3,000 ($6,000 x 50%) as his net capital gain for the 2002–03 income year.

Also, the expenditure he incurred on the replacement asset is reduced by the balance of the capital gain ($10,000) to $30,000. This means $10,000 of the capital gain is deferred.

## If you receive an asset

If you receive a replacement asset when the event happens, you can choose a roll-over only if:

- the replacement asset is not a depreciating asset or held as trading stock when you acquire it, and
- the market value of the replacement asset is more than the cost base of the original asset just before the event happened.

### Consequences of receiving an asset

If you choose to take a roll-over when you receive a replacement asset, any capital gain you make from the original asset is disregarded. The other consequences are outlined below.

*Original asset acquired before 20 September 1985*

If you acquired the original asset before 20 September 1985, you are taken to have acquired the new asset before that day.

*Original asset acquired on or after 20 September 1985*

If you acquired the original asset on or after 20 September 1985, the first element of the cost base or reduced cost base of the replacement asset is taken to be the cost base or reduced cost base of the original asset at the time of the event.

However you may have to recalculate the first element of the cost base of your replacement asset if the cost base of the original asset included an amount of indexation and you are seeking to apply the CGT discount to a capital gain from the replacement asset.

**Example**

**Asset received**

Jon acquired land after 19 September 1985 that the State Government compulsorily acquired on 14 July 2002. The cost base of the land at the time it was compulsorily acquired was $180,000. As compensation, Jon received another piece of land with a market value of $200,000.

Because the market value of the replacement land was greater than the cost base of the original land just before it was compulsorily acquired, the capital gain Jon made on the disposal of the original land is disregarded. Jon is taken to have paid $180,000 to acquire the replacement land (that is, the cost base of the original land at the time it was compulsorily acquired).

## If you receive both money and an asset

If you receive both money and an asset and choose to take a roll-over, the requirements and consequences are different for each part of the compensation.

**Example**

**Money and an asset received as compensation**

The State Government compulsorily acquires land Kris bought in 2002. Its cost base at the time was $150,000 but Kris received compensation worth $160,000.

Half of the total compensation is money ($80,000) and half is replacement land (market value $80,000).

Therefore, the cost base of the original land attributable to each part of the compensation is $75,000 (50% × $150,000). Kris bought additional replacement land for $82,000.

The total capital gain is $10,000 which is capital proceeds of cash and property totalling $160,000 less the cost base of $150,000. Half of this capital gain can be attributed to the money and half to the asset (the replacement land).

The money Kris received as compensation is less than the amount he paid to buy the additional land. He can therefore disregard the $5,000 of the capital gain that is attributable to the money compensation. The expenditure on the additional land is reduced by $5,000, so the first element of its cost base is only $77,000.

As the market value of the replacement land is more than that part of the cost base of the original land, Kris can choose to take roll-over relief and disregard the capital gain of $5,000 relating to the land.

As a result, the value of the replacement land ($75,000) forms the first element of its cost base, not its market value ($80,000) when it was acquired.

### Consequences of receiving both money and an asset

You need to separately determine what happens in relation to the replacement asset and the money, having regard to the proportion of the original asset attributable to each type of compensation.

The rules are then applied separately to the money and to the asset.

## Indexation or CGT discount

If a CGT event happens to the replacement asset (for example, a later disposal), you may be able to use the indexation method or the discount method to calculate your capital gain. This applies only if the periods of ownership of the original asset and the replacement asset add up to at least 12 months. For indexation to apply, you must have acquired the asset before 11.45am (by legal time in the ACT) on 21 September 1999.

# CHAPTER 8 MARRIAGE BREAKDOWN

Read this chapter if your legal or de facto marriage ended on or after 20 September 1985 and:

- you transfer an asset to or receive an asset from your spouse, or
- a company or trustee of a trust transfers an asset to you or your spouse.

**NOTE New terms**

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in **part A** for more information or to **Explanation of terms** at the back of this guide.

When we talk about 'your spouse', this includes your de facto spouse, while 'transfer of an asset' includes disposing of an asset to the transferee spouse or 'creating' an asset in their favour.

The term 'transferee spouse' refers to the spouse to whom an asset is transferred, while the 'transferor' is the person (or a company or the trustee of a trust) who transfers an asset to the transferee spouse.

As a general rule, capital gains tax (CGT) applies to all changes of ownership of assets on or after 20 September 1985. However, if you transfer an asset to your spouse as a result of a marriage breakdown, there is automatic roll-over in certain cases (you cannot choose whether or not it applies).

This roll-over allows the transferor spouse to disregard a capital gain or capital loss that would otherwise arise. In effect, the one who receives the asset (the transferee spouse) will make the capital gain or capital loss when they dispose of the asset. If you are the transferee spouse, the cost base and other attributes of the asset are transferred to you.

You must keep all relevant records, as explained in chapter 3.

## Conditions for marriage breakdown roll-over

For the roll-over conditions to be met, a CGT event must happen because of:

- an order of a court or court order made by consent under the *Family Law Act 1975* or a similar law of a foreign country
- a maintenance agreement approved by a court under section 87 of that Act or a similar agreement under a foreign law, or
- a court order under a State, Territory or foreign law relating to de facto marriage breakdowns.

Please note that maintenance agreements registered under section 86 of the *Family Law Act 1975* are excluded.

### Relevant CGT events

For roll-over to apply, one of the following events must happen. The transferor:

- disposes of an asset to the transferee spouse (CGT event A1)
- enters into an agreement with the transferee spouse under which:
  - the right to use and enjoy a CGT asset passes to them
  - title in the asset will or may pass to them at the end of the agreement (CGT event B1). There is no roll-over if title in the CGT asset does not pass to them when the agreement ends
- creates a contractual or other right in favour of the transferee spouse (CGT event D1)
- grants an option to the transferee spouse or renews or extends an option granted to them (CGT event D2)
- owns a prospecting or mining entitlement, or an interest in one, and grants the transferee spouse a right to receive income from operations carried on by the entitlement (CGT event D3), or
- is a lessor and grants, renews or extends a lease to the transferee spouse (CGT event F1).

There is no roll-over for the transfer of trading stock.

## Consequences of roll-over

### Where you transfer the asset

Where you transfer the asset, the consequences of roll-over are:

- for assets acquired before 20 September 1985: any capital gain or capital loss is disregarded, and
- for assets acquired on or after 20 September 1985: marriage breakdown roll-over enables you to disregard any capital gain or capital loss you make from the CGT event that involves you and the transferee spouse.

### Where the asset is transferred to you

*Assets acquired before 20 September 1985*

If a CGT asset, including a share of a jointly owned asset, was transferred to you because of the breakdown of your marriage and it was acquired by the transferor before 20 September 1985, you are

also taken to have acquired the asset before that date. Any capital gain or capital loss you make when you later dispose of the asset will be disregarded.

However, if you make a major capital improvement to that asset after 20 September 1985, you may be subject to CGT when a CGT event happens to that asset (see **Other capital improvements to pre-CGT assets** on page 4).

*Assets acquired on or after 20 September 1985*

The rules are different if the asset was acquired by the transferor on or after 20 September 1985. In this case, if you receive the CGT asset (or a share of a jointly owned asset) and there is a marriage breakdown roll-over, you are taken to have acquired the asset (or share of the asset) at the time it was transferred from your spouse (or the company or trustee).

To calculate your capital gain or capital loss when a later CGT event happens, the first element of your cost base or reduced cost base will be the same as that of your spouse (or the company or trustee) at the time of the transfer.

If the transferor' s cost base includes an amount of indexation you may later have to recalculate the first element of your cost base to exclude that amount if you want to apply the CGT discount to your capital gain.

Transfer costs incurred by your spouse (or the company or trustee)—for example, conveyancing fees and stamp duty are included in the cost base.

If you acquired the asset from your spouse (or the company or trustee) before 11.45am (by legal time in the ACT) on 21 September 1999, you may be able to use the indexation method when calculating your capital gain. This can only apply if the total ownership period of you and your spouse (or the company or trustee) is 12 months or more.

If you acquired the asset after 11.45am (by legal time in the ACT) on 21 September 1999, you cannot use the indexation method when calculating your capital gain but you may be able to use the discount method. You can use the discount method to calculate your capital gain if the combined period of ownership of the asset for you and your spouse is 12 months or more. If the period is less than 12 months, you use the 'other' method.

Collectables or personal use assets remain collectables or personal use assets when they are transferred from your spouse (or the company or trustee) in the case of a marriage breakdown roll-over.

For information about collectables and personal use assets, see **What is a CGT asset?** on page 3.

As explained earlier, there are several instances where your spouse (or a company or trustee) may create an asset in your favour. The table below explains how to calculate the first element of your cost base or reduced cost base of that asset in each case.

| CGT event | Cost base or reduced cost base |
|---|---|
| Creating contractual other rights (D1) | Incidental costs incurred or by the transferor that relate to the event |
| Granting an option (D2) | Expenditure incurred by the transferor to grant the option |
| Granting a right to income from mining (D3) | Expenditure incurred by the transferor to grant the right |
| Granting a lease (F1) | Expenditure incurred by the transferor on the grant renewal or extension of the lease |

You are taken to have acquired the asset at the time specified by the CGT event. For example, for CGT event D1, you acquire the asset at the time you enter into the contract or if there is no contract, the time the right is created. For more information, see appendix 1: Summary of CGT events on page 98.

## CGT assets transferred by a company or trust

If a company or a trustee of a trust transfers a CGT asset to a spouse, adjustments are required to the relevant cost base or reduced cost base of interests in the company or trust. These may be shares (or indirect interests in shares) in the company, units in a unit trust and other interests in the trust. They are reduced in value by an amount that reasonably reflects the fall in their market value as a result of the transfer of the CGT asset.

**Example**

### Transfer of assets from a legal or a de facto marriage

Danny and Claudia jointly owned the following assets immediately before their marriage breakdown:

| *Asset* | *When purchased* | *Cost* |
|---|---|---|
| The family home | January 1985 | $75,000 |
| Holiday house | December 1988 | $65,000 |
| Shares in a company | March 1999 | $35,000 |

On their divorce in October 2002, the Family Court approved the couple's voluntary asset agreement and made an appropriate court order by consent.

Claudia received the family home. Because it was acquired by the couple before 20 September 1985, she is taken to have acquired both her original interest in the home and Danny's share before that date. Claudia will not have to pay tax on capital gains when she sells the home.

Danny has no CGT obligation in relation to the transfer to Claudia of his share in the family home.

Danny received the shares and the holiday house which did not become his home.

Although the couple acquired these assets after 20 September 1985, Claudia's capital gain from the transfer of her share of these assets to Danny is disregarded under the marriage breakdown roll-over.

Danny is taken to have acquired Claudia's share of these assets at the time of transfer for her relevant cost base. If he were to sell the holiday home or the shares, he would calculate his capital gain or capital loss in respect of his original interest and the interest he acquired from Claudia.

When he sells the assets, Danny can choose to apply the indexation method or the discount method to work out the amount of any capital gain from his original interests because they were acquired before 21 September 1999.

Because he acquired Claudia's interests after that date he can only choose the discount method to work out any capital gain in relation to them. However, in applying the 12-month ownership test for the purposes of the CGT discount, he can take into account the period that Claudia owned the interest.

Danny will have to ensure that the cost base of the interest that he acquired from Claudia does not include any amount of indexation.

Special rules apply to marriage breakdown roll-overs involving a controlled foreign corporation or certain non-resident trusts.

For more information, refer to the sources listed at the back of this guide.

## Main residence

If the CGT asset transferred in a marriage breakdown roll-over is your home, you may be entitled to an exemption from CGT for the period the home was your main residence. Special rules apply if the dwelling is transferred to you from a company or trust (see chapter 6 for more information).

## Where there is no court approval

If you and your spouse divide your property by some means other than by a court order or an agreement approved by the court, normal CGT rules apply—not the rules explained in this chapter. You must include on your tax return for that year any capital gain or capital loss you make on the transfer of a CGT asset.

The spouse to whom the asset is transferred is taken to have acquired the asset at the time of transfer.

Special rules may apply if the amount paid by one spouse for property owned by the other is greater or less than the market value of the property and they are not dealing at arm's length. In these cases, for CGT purposes, they are taken to have paid or received the market value of the property.

# CHAPTER 9 DECEASED ESTATES

If you are a deceased person's legal personal representative or a beneficiary of a deceased estate, you should read this chapter to find out about the special capital gains tax (CGT) rules that apply.

**NOTE** **New terms**

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in **part A** for more information or to **Explanation of terms** at the back of this guide.

When a person dies, the assets that make up their estate can:
- pass directly to a beneficiary (or beneficiaries), or
- pass directly to their legal personal representative (for example, their executor) who may dispose of the assets or pass them to the beneficiary (or beneficiaries).

A beneficiary is a person entitled to assets of a deceased estate. They can be named as a beneficiary in a will or they can be entitled to the assets as a result of the laws of intestacy (when the person does not make a will).

A legal personal representative can be either:
- the executor of a deceased estate (that is, a person appointed to wind up the estate in accordance with the will), or
- an administrator appointed to wind up the estate if the person does not leave a will.

## Capital gain or capital loss on death is disregarded

There is a general rule that CGT applies to any change of ownership of a CGT asset, unless the asset was acquired before 20 September 1985 (pre-CGT).

There is a special rule that allows any capital gain or capital loss made on a post-CGT asset to be disregarded if, when a person dies, an asset they owned passes:
- to their legal personal representative or to a beneficiary, or
- from their legal personal representative to a beneficiary.

### *Exceptions to this rule*

A capital gain or capital loss is not disregarded if a post-CGT asset owned at the time of death passes from the deceased to a **tax-advantaged entity** or to a non-resident. In these cases, a CGT event is taken to have happened in relation to the asset just before the person died. The CGT event will result in:
- a capital gain if the market value of the asset on the day the person died was more than the cost base of the asset, or
- a capital loss if the market value was less than the asset's reduced cost base.

However, any capital gain or capital loss from a testamentary gift of property can be disregarded if:
- the gift is made under the Cultural Bequests Program (which applies to certain gifts of property (not land or buildings) to a library, museum or art gallery), or
- the gift is made to a deductible gift recipient or a registered political party and the gift would have been income tax deductible if it had not been a testamentary gift.

These capital gains and losses should be taken into account in the deceased person's 'date of death return' (the tax return for the period from the start of the income year to the date of the person's death).

### Tax-advantaged entity

A tax-advantaged entity is:
- a tax-exempt entity (for example, a church or charity), or
- the trustee of:
  - a complying superannuation fund
  - a complying approved deposit fund, or
  - a pooled superannuation trust.

### Non-resident beneficiary

If a non-resident is a beneficiary of a deceased's post-CGT asset, any capital gain or capital loss is not disregarded if:
- the deceased was an Australian resident when they died, and
- the asset does not have the necessary connection with Australia.

Examples of assets that do not have the necessary connection with Australia include:
- real estate located overseas
- shares in a non-resident company, and
- shares in an Australian public company if the total number of shares owned is less than 10% of the value of shares in the company.

## Assets which pass to the beneficiary or legal personal representative

### Main residence

Special rules apply if the asset was the deceased person or beneficiary's main residence (see **Inherited main residence** on page 65).

### Other assets

In administering and winding up a deceased estate, a legal personal representative may need to dispose of some or all of the assets of the estate. Assets disposed of in this way are subject to the normal rules and any capital gain the legal personal representative makes on the disposal is subject to CGT.

Similarly, it may be necessary for the legal personal representative to acquire an asset (for example, to satisfy a specific legacy made). Any capital gain or capital loss they make on disposal of that asset to the beneficiary is subject to the normal CGT rules.

If a beneficiary sells an asset they have inherited, the normal CGT rules also apply.

*Acquisition of asset*

If you acquire an asset owned by a deceased person as their legal personal representative or beneficiary you are taken to have acquired the asset on the day the person died. If that was before 20 September 1985, any capital gain or capital loss you make from the asset will be disregarded.

*Cost base of asset*

If the deceased person acquired their asset before 20 September 1985, the first element of your cost base or reduced cost base (that is, the amount taken to have been paid for the asset) is the market value of the asset on the day the person died.

If, before they died, a person made a major improvement to a pre-CGT asset on or after 20 September 1985, the improvement is not treated as a separate asset.

The beneficiary or legal personal representative is taken to have acquired the improved asset when the person died. Although the deceased used to treat the asset and the improvement as separate assets, the beneficiary or legal personal representative now treats them as one asset.

If a deceased person acquired their asset on or after 20 September 1985, the first element of your cost base or reduced cost base is taken to be the cost base (indexed where relevant) or reduced cost base of the asset on the day the person died.

If the deceased's cost base includes an amount of indexation, you may later have to recalculate the first element of your cost base to exclude that amount if you want to apply the CGT discount to your capital gain.

*Expenditure incurred by a legal personal representative*

As a beneficiary, you can include in your cost base (or reduced cost base) any expenditure the legal personal representative (for example, the executor) would have been able to include in their cost base if they had sold the asset instead of distributing it to you. You can include the expenditure on the date they incurred it.

For example, if an executor incurs costs in confirming the validity of the deceased's will, these costs form part of the cost base of the estate's assets.

## Choosing the indexation method or the discount method

If you become the beneficiary (or legal personal representative) of a deceased estate on or before 11.45am (by legal time in the ACT) on 21 September 1999 and dispose of the asset that you inherited after that date, there are two ways of calculating your capital gain. You can use either the indexation method or the discount method, whichever gives you the better result. However, the CGT discount is only available if you are an individual, a trust or a complying superannuation entity.

As a general rule, elements of the estate's cost base of an asset can be indexed if you own the asset for at least 12 months before disposing of it. If you receive an asset from an estate, the 12-month period is calculated from the time the deceased acquired the asset, not from the date of their death.

For the CGT discount to apply, you must have acquired the asset at least 12 months before disposing of it. For the purposes of this 12-month ownership test, you are taken to have acquired the asset at one of the following times:

- for pre-CGT assets, the date the deceased died, and
- for post-CGT assets, the date the deceased acquired it.

**Example**

### Transfer of an asset from the executor to a beneficiary

Maria died on 13 October 2000 leaving two assets: a parcel of 2,000 shares in ABC Ltd and a vacant block of land. Giovanni was appointed executor of the estate (the legal personal representative).

When the assets are transferred to Giovanni, any capital gain or capital loss is disregarded. Giovanni disposes of (sells) the shares to pay Maria's outstanding debts. As the shares are not transferred to a beneficiary, any capital gain or capital loss on this disposal must be included on the tax return for Maria's deceased estate.

When all debts and tax have been paid, Giovanni transfers the land to Maria's beneficiary, Antonio, and pays the conveyancing fee of $5,000. As the land is transferred to a beneficiary, any capital gain or capital loss is disregarded. The first element of Antonio's cost base is taken as Maria's cost base on the date of her death. Antonio is also entitled to include in his cost base the $5,000 Giovanni spent on the conveyancing.

**Example**

### Indexation and CGT discount

Leonard acquired a property on 14 November 1999 for $26,000. He died on 6 August 2000 and left the property to Gladys. She sold the property on 6 July 2002 for $40,000. The property was not the main residence of either Leonard or Gladys.

Although Gladys acquired the property on 6 August 2000, for the purpose of determining whether she had owned the property for at least 12 months, she was taken to have acquired it on 14 November 1999 (the day Leonard acquired it).

At the time of disposal, Gladys is taken to have owned the property for more than 12 months. As she acquired it before 11.45am (by legal time in the ACT) on 21 September 1999 and disposed of it after that date, Gladys could choose to index the cost base. However, if the discount method gave her a better result, she could choose to claim the CGT discount.

If Gladys chose the discount method she would have to exclude from the first element of her cost base the amount that represented indexation that had accrued to Leonard up until the time he died.

**Collectables and personal use assets**

A post-CGT collectable or personal use asset is still treated as such when you receive it as a beneficiary or the legal personal representative of the estate.

## Joint tenants

If two or more people acquire a property asset together, it can be either as joint tenants or as tenants in common.

If one of the joint tenants dies, their interest in the property passes to the surviving joint tenant(s). It is not an asset of the deceased estate.

If a tenant in common dies, their interest in the property is an asset of their deceased estate. This means it can be transferred only to a beneficiary of the estate or be sold (or otherwise dealt with) by the legal personal representative of the estate.

For CGT purposes, if you are a joint tenant, you are treated as if you are a tenant in common owning equal shares in the asset. However, if one of the other joint tenants dies, on that date their interest in the asset is taken to pass in equal shares to you and any other surviving joint tenants, as if their interest is an asset of their deceased estate and you are beneficiaries.

The cost base rules relating to other assets of the deceased estate apply to their interest in the asset or the equal share of it which passes to you and any other surviving joint tenants.

For the indexation and discount methods to apply, you must have owned the asset (or your share of it) for at least 12 months. As a surviving joint tenant, for the purposes of this 12-month test, you are taken to have acquired the deceased's interest in the asset (or your share of it) at the time the deceased person acquired it.

**Example**

### CGT and joint tenants

Trevor and Kylie acquired land as joint tenants before 20 September 1985. Trevor died in October 2002. For CGT purposes, Kylie is taken to have acquired Trevor's interest in the land at its market value at the date of his death.

Kylie holds her original 50% interest as a pre-CGT asset, and the inherited 50% interest as a post-CGT asset which she is taken to have acquired at its market value at the date of Trevor's death.

If Kylie sold the land within 12 months of Trevor's death, she would qualify for the CGT discount on any capital gains she makes on her post-CGT interest. She qualifies for the CGT discount because, for the purposes of the 12-month ownership test, she is taken to have acquired Trevor's interest at the time when he acquired it, which was before 20 September 1985.

## Prior year net capital losses

If the deceased had any unapplied net capital losses when they died, these cannot be passed on to you as the beneficiary or legal personal representative for you to offset against any net capital gains.