
Taxation Determination

Income tax: capital gains: what are the CGT consequences of a lessee incurring capital expenditure on improvements to leased property?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 5 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the *Taxation Administration Act 1953* and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Determination is a public ruling and how it is binding on the Commissioner.

Date of effect

This Determination applies to capital expenditure on improvements to leased property incurred by a lessee both before and after its date of issue, that is, both before and after the beginning of the 1998-99 income year. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

1. If a lessee incurs expenditure of a capital nature on making improvements to leased property, the CGT consequences depend on whether the lessee or the lessor is the owner of the improvements.

Improvements owned by lessee

2. If the lessee owns the improvements (see Taxation Determination TD 46), the cost base of the improvements includes the amount of capital expenditure incurred in making the improvements. On a CGT event happening to the improvements, the amount of any capital proceeds received will determine whether a capital gain or loss is made. If the improvements remain affixed to the land on the expiry or termination of the lease, CGT event A1 (disposal of a CGT asset - section 104-10 of the *Income Tax Assessment Act 1997*) happens to the improvements. The improvements are disposed of by the lessee to the lessor.

3. If the parties are not dealing with each other at arm's length or no capital proceeds are received, sections 116-30 and 112-20 apply and the lessee is taken to have received, and the lessor to have paid, the market value of the improvements.

Improvements owned by lessor

4. If the lessee does not own (and has never owned) the improvements, but the capital expenditure is incurred by the lessee to increase the value of the lease and is reflected in the state or nature of the lease at the time of a CGT event happening to it, subsection 110-25(5) allows for the expenditure incurred to be included in the cost base of the lease to the lessee. If any part of the lessee's expenditure is recouped, and the amount of the recoupment received is not included in the

lessee's assessable income, subsection 110-25(8) precludes the amount from forming part of the cost base of the lease.

5. On expiry or termination of the lease, CGT event C2 in section 104-25 - about cancellations, surrenders and similar endings of intangible assets - happens to the lease and the amount of capital proceeds, if any, will determine whether a capital gain or loss is made by the lessee (see, in particular, section 116-75).

Note

6. This Taxation Determination rewrites and replaces Taxation Determination TD 56, which is now withdrawn. TD 56 is being rewritten under a project to review and rewrite Taxation Rulings and Taxation Determinations as necessary to reflect changes made to the income tax law by the Taxation Law Improvement Project. There is no material change in the views expressed in TD 56. However, we have included a reference, in paragraph 4, to the cost base recoupment provision (subsection 110-25(8)) which now includes a change made to clarify that a recoupment of expenditure cannot both reduce the cost base and be included in assessable income. The change adopts the Commissioner's interpretation of the old law.

Commissioner of Taxation

28 October 1998

FOI INDEX DETAIL: [Reference No.](#) I 1017764

Previously issued as Draft TD 98/D8

[Related Determinations:](#) TD 46; TD 47; TD 48

[Related Rulings:](#)

[Subject Ref:](#) capital expenditure by lessee; CGT cost base; cost base; improvements; leased property; recoupment

[Legislative Ref:](#) ITAA97 104-10; ITAA97 104-25; ITAA97 [110-25\(5\)](#); ITAA97 [110-25\(8\)](#); ITAA97 [112-20](#); ITAA97 [116-30](#); ITAA97 [116-75](#)

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