TD 93/D177 - Income tax: capital gains: in the case of an involuntary disposal of a post-CGT asset that satisfies section 160ZZK, what is the CGT treatment of the 'notional capital gain' that arises where the compensation or insurance proceeds exceed the indexed cost base?

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Draft Taxation Determination

Income tax: capital gains: in the case of an involuntary disposal of a post-CGT asset that satisfies section 160ZZK, what is the CGT treatment of the 'notional capital gain' that arises where the compensation or insurance proceeds exceed the indexed cost base?

1. Section 160ZZK is a roll-over provision which potentially provides a deferral of the tax liability that might otherwise arise on the involuntary disposal of a post-CGT asset until the replacement asset is disposed of. The extent to which the tax liability is deferred depends on the difference between the amount of the compensation or insurance proceeds and the cost of the replacement asset (subsection 160ZZK(6)).

2. (a) If the compensation or insurance proceeds is less than the cost of the replacement asset, the cost of the replacement asset is reduced by the notional capital gain (example 1).

(b) If the compensation or insurance proceeds is more than the cost of the replacement asset, and

(i) the notional capital gain is more than that excess, the excess is treated as a capital gain and the cost of the replacement asset is reduced by the balance of the notional capital gain (example 2); or

(ii) the notional capital gain is less than that excess, the notional capital gain is treated as a capital gain (example 3).

Description	*Example 1*	*Example 2*	*Example 3*
(a) Indexed cost base of original asset	*$100,000*	*$100,000*	*$100,000*
(b) Compensation or insurance proceeds	*$120,000*	*$120,000*	*$120,000*
(c) Cost of replacement asset	*$130,000*	*$110,000*	*$90,000*
(d) Notional Capital gain	*$20,000 {(b)-(a)}*	*$20,000 {(b)-(a)}*	*$20,000 {(b)-(a)}*
(e) Capital gain	*Nil*	*$10,000 {(b)-(c)}*	*$20,000 (d)*
(f) Reduction to cost of replacement asset	*$20,000 (d)*	*$10,000 {(d)-((b)-(c))}*	*Nil*

[Note: In practical terms, the notional capital gain is used to reduce the cost of the replacement asset to the level of the indexed cost base of the original asset. Any balance is treated as a capital gain.]

Note: For the purposes of subsection 160ZZK(6), the 'notional capital gain' refers to the amount that, but for section 160ZZK, would have been for Part IIIA, a capital gain on the disposal of the post-CGT asset.

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