

TD 95/D26 - Income tax: capital gains: if a person (A): improves a pre-CGT asset to which subsection 160P(6) applies; and disposes of the improved asset to A's spouse (B) under an order of the court under the Family Law Act 1975 following marriage breakdown; how does section 160ZZM apply:(i) to the disposal of the improved asset by A; and (ii) to any later disposal of the improved asset by B?

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This document has been finalised by TD 96/19.

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Draft Taxation Determination

Income tax: capital gains: if a person (A):

- **improves a pre-CGT asset to which subsection 160P(6) applies; and**
- **disposes of the improved asset to A's spouse (B) under an order of the court under the *Family Law Act 1975* following marriage breakdown;**

how does section 160ZZM apply:

- (i) to the disposal of the improved asset by A; and**
- (ii) to any later disposal of the improved asset by B?**

1. Subsection 160P(6) of the *Income Tax Assessment Act 1936* deems the improved asset to be two separate assets. Therefore, subsection 160ZZM(1) applies to each asset. We accept that each asset is disposed of, in terms of subsection 160ZZM(1), 'pursuant to an order' of the Family Court.

Disposal by the person:

2. On the disposal of the separate assets by A to B, subsection 160ZZM(1) states that the other provisions of Part IIIA do not apply to either disposal. Therefore, there are no CGT consequences for A in respect of the disposal of the improved asset (or the separate assets) to B.

Later disposal by the person's spouse:

3. Subsection 160ZZM(1) applies to the receipt by B of the separate assets. In B's hands, the asset which has been improved retains its pre-CGT status under paragraph 160ZZM(1)(c) and the improvement retains its post-CGT status under paragraph 160ZZM(1)(d).

4. There are no CGT consequences on the disposal of the pre-CGT asset, assuming that B does not further improve it.

5. There may be CGT consequences on the disposal of the improvement. Paragraph 160ZZM(1)(d) provides that the cost base of the improvement includes the indexed cost base, cost

base, or reduced cost base ('relevant cost base') as applicable to A at the time of A's disposal to B. Whether a capital gain or capital loss arises on a disposal by B depends on whether or not the disposal consideration exceeds the relevant cost base.

Alternative view:

6. An alternative view is either that section 160ZZM applies before subsection 160P(6), or has the effect that the disposal does not trigger the operation of subsection 160P(6). As a result, section 160ZZM applies just to the composite asset. We do not accept this view because it may extinguish a potential capital gains tax liability (if the improvement is later disposed of by B) rather than permit the deferral of a liability as is intended by section 160ZZM. This alternative view would not therefore promote the purpose or object of a roll-over provision such as section 160ZZM.

Example 1

Al acquires an asset in 1983. In 1990 he makes significant capital improvements, in terms of subsection 160P(6), to the asset. Following the breakdown of his marriage, he transfers the asset to his former spouse, Peggy, to comply with an order of the court under the Family Law Act 1975.

What are the tax consequences? There are no CGT consequences for Al. Peggy acquires a pre-CGT asset and a post-CGT improvement. Peggy is deemed to have paid an amount equal to Al's relevant cost base as consideration for the improvement. In effect, Peggy is in the same position as Al had he retained the assets.

Example 2

Peggy sells the asset and the improvement to Bud in 1995. What are the tax consequences? There are no CGT consequences in respect of the sale of the pre-CGT asset because the asset is deemed to have been acquired before 20 September 1985 under paragraph 160ZZM(1)(c). A capital gain or capital loss may arise in respect of the sale of the post-CGT improvement. This is calculated by reference to the relevant cost base of the improvement.

Technical note: In determining whether the threshold test in paragraph 160P(6)(d) is met if an asset is disposed of under an order of the Family Court following marriage breakdown, it is acceptable to regard the market value of the asset as being the consideration in respect of its disposal: see Taxation Determination TD 10. Note that this draft Taxation Determination does not consider whether the time of disposal is the date of the court order, the date of transfer or some other time.

Commissioner of Taxation

29/11/95

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