


TD 93/D266 - Income tax: capital gains: how does CGT apply to the disposal of an income-producing property acquired after 19 September 1985?

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This document has been finalised by TD 94/64.

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Draft Taxation Determination

Income tax: capital gains: how does CGT apply to the disposal of an income-producing property acquired after 19 September 1985?

1. For CGT purposes, each of the following is treated as an asset separate from land:
 - a building (or part of a building) with qualifying expenditure eligible for write-off under Division 10D of Part III of the *Income Tax Assessment Act 1936*;
 - any other capital improvement to land which is treated by non-CGT provisions as an asset separate from the land (e.g. an improvement which qualifies as depreciable plant or a dam for which capital expenditure is eligible for write-off under section 75B).

Depreciable chattles (e.g. items of furniture used by tenants in a rental property) which are sold with the property, are also separate assets for CGT purposes. This is the case whether the depreciable items were acquired with the property or subsequently.

2. On disposal of the property, a separate capital gain or loss calculation is necessary for each CGT asset.
3. It is preferable that a person acquiring or disposing of an income-producing property apportion the purchase or sale consideration among the CGT assets in the relevant contract. Where parties are dealing with each other at arm's length, the apportioned amounts would be expected to reflect the market values of the CGT assets.
4. If the property is acquired or disposed of for an undissected sum, the total acquisition cost or disposal consideration has to be apportioned among the CGT assets. Again, it is expected that the apportionment would be consistent with the market values of the assets.
5. It should be noted that the amount of 'residual capital expenditure' of a building which is eligible for write-off under Division 10D, is not necessarily its market value. Similarly, the written down values of depreciable assets are not indications of their market values.

Example 1:

A person acquires a rental property in March 1986 for a total consideration of \$100,000. At that time, the market value of the land is \$70,000 and the building \$30,000. In respect of the building, there is \$25,000 qualifying capital expenditure under Division 10D. The person is therefore entitled to an annual Division 10D deduction of \$1,000.

The property is sold in March 1990 for a total consideration of \$200,000. At that time, the market value of the land is \$190,000 and the building \$10,000.

If the land and building were incorrectly treated as a single asset, the capital gain arising would be \$64,400 (Sale Price \$200,000 - Indexed Cost (\$100,000 x 1.356)).

Correctly treating the land and building as separate assets results in a net capital gain of \$79,080.

<i>Land</i>	<i>Sale Price \$190,000 - Indexed Cost (\$70,000 x 1.356)</i>	<i>\$95,080</i>
<i>Building</i>	<i>Reduced Cost Base (\$30,000 - \$4,000) - Sale Price \$10,000</i>	<i><u>(16,000)</u></i>
		<i><u>\$79,080</u></i>

Example 2:

A person acquires a residential property for rental purposes. The building was constructed in the 1970's and there is no entitlement to building write-off. The previous owner had recently replaced the hot water system and curtains throughout the house and this is depreciable property in the hands of the new owner. Other depreciable items are purchased by the new owner over the period the rental property is owned.

For CGT purposes, the person is required to account separately for all depreciable items sold with the property. This may involve apportioning part of the sale proceeds to such items, and where items have been acquired with the property, apportionment of the original purchase cost. It is preferable that this apportionment form part of the relevant contract.

For simplicity, incidental costs on acquisition and disposal have been ignored in these examples. In practice, they would need to be apportioned.

Commissioner of Taxation

14/10/93

FOI INDEX DETAIL: Reference No.

Related Determinations: TD 93/D267

Subject Ref: building write-off; depreciation; separate assets

Legislative Ref: ITAA Pt III Div 10D ; ITAA 160P(4); ITAA160P(7); ITAA160ZH; ITAA160ZD(4)

ATO Ref: CHM ADV (CGTDET82)

ISSN 1038 - 8982