

# ***TD 98/D8 - Income tax: capital gains: what are the CGT consequences of a lessee incurring capital expenditure on improvements to leased property?***



This cover sheet is provided for information only. It does not form part of *TD 98/D8 - Income tax: capital gains: what are the CGT consequences of a lessee incurring capital expenditure on improvements to leased property?*

This document has been finalised by TD 98/23.

Draft Taxation Determinations (TDs) represent the preliminary, though considered, views of the ATO. Draft TDs may not be relied on; only final TDs are authoritative statements of the ATO.

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## Draft Taxation Determination

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

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. A CGT event happens to the improvements on the expiry or termination of the lease (CGT event C2 in section 104-25 - about cancellations, surrenders and similar endings of intangible assets - of the *Income Tax Assessment Act 1997*).

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 to deem the lessee to have received, and the lessor to have paid, market value for 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 its disposal, 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 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:** This Taxation Determination rewrites and replaces Taxation Determination TD 56. There is no material change in the views expressed in Taxation Determination 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.*

***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.*

### **Your comments**

If you want to comment on this draft Determination, please send your comments by Friday 17 July 1998 to:

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Note that, due to the short comment period, comments by mail are not being accepted.

### **Commissioner of Taxation**

1 July 1998

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

[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 104-25; ITAA97 110-25(5); ITAA97 110-25(8); ITAA97 112-20; ITAA97 116-30; ITAA97 116-75

[Case Ref:](#)

[ATO Ref:](#) BRI CG ITD 98; NAT 98/6645-1

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