# *IT 2673 - Income tax: capital gains tax - use of sole or principal residence for income producing purposes*

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Part of this document has been Withdrawn.
There is a Partial Withdrawal notice for this document.

This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

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# TAXATION RULING IT 2673



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| Reference no.: | Subject refs: | Legislative refs: |
|---|---|---|
| **I 1013115** | **CAPITAL GAINS TAX**<br>**- SOLE OR PRINCIPAL RESIDENCE**<br>**- INCOME PRODUCING PURPOSES**<br>**USE OF HOME TO GAIN INCOME** | **69(9)**<br>**160ZZQ** |

OTHER RULINGS ON THIS TOPIC:

**TITLE: INCOME TAX: CAPITAL GAINS TAX - USE OF SOLE OR PRINCIPAL RESIDENCE FOR INCOME PRODUCING PURPOSES**

TE: NOTE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

The purpose of the Ruling is to consider the scope of operation of subsection 160ZZQ(21) of the Income Tax Assessment Act 1936 and its application to common situations in which activities are undertaken in a sole or principal residence to derive income.

2. A profit or loss on disposal of a dwelling which is a taxpayer's sole or principal residence is, broadly speaking, excluded from the operation of the capital gains and capital losses provisions in the income tax law (Part IIIA). Section 160ZZQ in Division 18 of Part IIIA provides for this exclusion or exemption (see especially subsection 160ZZQ(12)).

3. In accordance with subsection 160ZZQ(21), the exemption available for a sole or a principal residence does not apply if the property is used for the purpose of gaining or producing assessable income. The capital gain, or loss, is limited to the extent to which the dwelling is used for this purpose.

RULING

Scope of subsection 160ZZQ(21) broadly stated

4. Broadly speaking, subsection 160ZZQ(21) applies most commonly to deem a capital gain to have accrued to a taxpayer (or

a capital loss to have been incurred by the taxpayer) in a situation where:

(a) a dwelling owned by the taxpayer is disposed of;

(b) the dwelling was, during a particular period, the sole or principal residence of the taxpayer; and

(c) the dwelling was, during the whole or part of that period, also used for the purpose of gaining or producing assessable income.

5. The amount of the capital gain or capital loss will depend on the extent to which, and the period for which, the dwelling was used for the purpose of gaining or producing assessable income.

6. The subsection also applies in certain situations to deem a capital gain to have accrued to a taxpayer (or a capital loss to have been incurred by the taxpayer) even though in some of these situations the dwelling may have been the sole or principal residence of some other person. For example, a taxpayer may have acquired a dwelling as a beneficiary in the estate of a deceased parent where the dwelling was the sole or principal residence of the parent before the parent's death and the sole or principal residence of the taxpayer since the parent's death.

Use of a dwelling by a taxpayer or some other person to derive income

7. Paragraphs 160ZZQ(21)(c) and 160ZZQ(21)(e) refer to a dwelling being used for the purpose of gaining or producing assessable income without specifying the person or persons by whom it is so used. The paragraphs do not expressly limit the use of the dwelling for the relevant purpose to use by the taxpayer. In the absence of any limitation on the persons who use the dwelling for the purpose of gaining or producing assessable income, subsection 160ZZQ(21) applies if the dwelling is used for the required person by:

(a) the taxpayer; or

(b) any other person.

Use of a dwelling to derive income

8. Whether a dwelling, or part of it, is used for the purpose of gaining or producing assessable income in terms of subsection 160ZZQ(21) will depend on the nature of any income producing activities conducted in it and the role played by the dwelling in those activities.

9. An appropriate part of any capital gain or capital loss on the disposal of a dwelling would come within the capital gains provisions in the income tax law where part of the dwelling is used for income producing purposes. Examples include where part of a dwelling is dedicated for use in deriving rental income from

tenants and where a doctor's dwelling contains a surgery that is used solely as a place of business and is clearly identifiable as a place of business.

10. Many other income producing activities may be conducted, in whole or in part, from a dwelling. To take some examples, each of the following activities may be undertaken for reward, namely, children may be cared for by a daycare giver, music or swimming lessons may be given, tutoring or other tuition may be given, and car or television repair services may be provided. In other cases, professional people and self-employed persons might undertake income producing activities from a study or other room of a principal residence merely because it is inconvenient for the work to be done at their normal place of work. The dwelling in each of these instances would only be regarded as being used for the purpose of gaining or producing assessable income where that part of the dwelling used for these activities has the character of a place of business.

11. Whether a dwelling, or part of it, has the character of a place of business is a question of fact that turns on the particular circumstances of each case but the broad test to be applied is whether a particular part of the dwelling:

(a) is set aside exclusively as a place of business;

(b) is clearly identifiable as a place of business; and

(c) is not readily suitable or adaptable for use for private or domestic purposes in association with the dwelling generally.

These factors will generally also entitle the taxpayer to claim income tax deductions for interest, rent, rates and insurance premiums paid in respect of the dwelling and the land on which it stands (see Taxation Rulings IT 140 (paragraphs 9 and 10), IT 191 (paragraph 5) and IT 194 (paragraph 7)). As a rule of thumb, it can be expected that where a person is entitled to claim a deduction for these expenses, subsection 160ZZQ(21) will apply. This will not be the case, however, where a person merely incurs additional expenses by performing work at home occasioned by the nature of the person's occupation, profession or calling and the only deductions allowable to the person are for lighting and heating expenses and depreciation (see Taxation Rulings IT 126 (paragraph 9) and IT 140 (paragraphs 11 to 16)).

12. The test would not be satisfied, for example, where music lessons are provided or tuition is given from a study in a home, nor if an insurance agent uses a study in his or her residence for personal and family purposes but also uses it to interview prospective clients and to store business papers. Nor would the test be satisfied in the common family daycare giver situation where, within limits, children who are being cared for are treated more or less as members of the care giver's family.

13. A dwelling would be considered not to be used for the purpose of gaining or producing assessable income in a situation where:

(a) the owner of the dwelling allows people to share it on the basis that all occupants, including the owner, bear an appropriate proportion of the household costs such as food, electricity and cleaning; or

(b) family members or others pay an amount for board.

14. In each of the situations in paragraphs 12 and 13, the dwelling would not be regarded as being used for the purpose of gaining or producing assessable income and would retain its exempt status as a sole or principal residence for capital gains purposes.

Tax-related matter

15. Where a taxpayer's sole or principal residence is used for a "tax-related matter" in terms of subsection 69(9) (e.g. to administer his or her personal tax affairs), an issue arises whether:

(a) subsection 69(9), in taking this activity to be use of the residence for the purpose of producing assessable income; and

(b) subsection 160ZZQ(21), in deeming a capital gain to have accrued on the disposal of a residence if it is used for the purpose of gaining or producing assessable income;

mean that an appropriate part of a capital gain may accrue, or a capital loss may be incurred, on the disposal of the sole or principal residence in this situation.

16. This Office takes the view that these subsections, when read together, do apply to deem a capital gain to accrue, or a capital loss to be incurred, on the disposal of a sole or principal residence which was used for a tax-related matter.

17. However, the Commissioner is given a discretion by subsection 160ZZQ(21) to determine the amount of the capital gain or capital loss, as the case may be, in respect of the disposal of the residence. The Commissioner must have regard to the amount of the capital gain or capital loss made on the sale of the residence and also the extent to which, and the period for which, it was used for income producing purposes. The extent of use of a residence for a tax-related matter is likely to be exceedingly small. The exercise of the Commissioner's discretion in these circumstances, where the use of the residence for income producing purposes is minimal and incidental to its main use, could result in there being no capital gain or capital loss.

Part of a dwelling

18. The expression "the dwelling" in its context in paragraph 160ZZQ(21)(c) is considered to extend to a part of the dwelling. The subsection would therefore apply, on this view, where part only of a dwelling (e.g. a room, garage etc.) is used for an income producing purpose. Paragraph 160ZZQ(21)(e), in referring to "the extent to which .....the dwelling was used ..... for the purpose of gaining or producing assessable income", lends support to the view that the subsection may apply to a part of a dwelling.

Adjacent land, associated buildings and fixtures

19. "Dwelling" is defined in subsection 160ZZQ(1) to include a unit of residential accommodation constituted by a building. That is, the building (for example, a house) itself is the dwelling for the purposes of the section. However, subsection 160ZZQ(3) deems a dwelling owned by a person to also include land owned by that person which is adjacent to the dwelling, to the extent that the land is used for private or domestic purposes in association with the dwelling and the sum of the area of that adjacent land and the area of the land on which the dwelling is situated does not exceed 2 hectares. Land, for legal purposes, means an area of ground together with, among other things, permanently attached buildings and fixtures. A garage, swimming pool, garden shed, etc., in close proximity (without being attached) to a dwelling and situated on the adjacent land is part of that adjacent land and, therefore, part of the dwelling by virtue of subsection 160ZZQ(3).

Disposals of adjacent land or parts of dwellings

20. Where land which is deemed by paragraph 160ZZQ(3)(a) to form part of a dwelling is sold separately from the rest of the dwelling, the exempting provisions of section 160ZZQ for a sole or principal residence do not apply (paragraph 160ZZQ(4)(a)). A capital gain or capital loss will arise on the disposal of the land and any structures attached to that land. Similarly, the exempting provisions of section 160ZZQ do not apply where a garage, storeroom or other structure that forms part of a dwelling being a flat or home unit is sold separately from the rest of the dwelling (paragraph 160ZZQ(4)(b)).

Calculation of capital gain or loss

21. In determining the amount of capital gain or capital loss for the purposes of subsection 160ZZQ(21), the Commissioner will have regard to the amount of the capital gain or capital loss, as the case may be, made on the sale of the dwelling and also the extent to which, and the period for which, it was used for income producing purposes.

22. Generally speaking, unless the part of the dwelling used to gain assessable income is distinctly of a greater or lesser proportionate value than the rest of the dwelling, the extent to which it was used to gain assessable income will be determined on an area basis. The amount of the capital gain or capital loss

will also be determined having regard to the period for which that part of the dwelling was used:

(a) by the taxpayer; or

(b) by any other person,

to gain assessable income.

Income and allowable deductions

23. Accepting that a dwelling is not used for the purpose of gaining or producing assessable income does not mean that tuition fees (e.g. for music, swimming lessons, etc.) derived from tuition given in that dwelling are not income. The fees are a reward for services and are income according to the ordinary concepts and usages of mankind. Nor does this acceptance mean that outgoings incurred in gaining or producing those tuition fees are not allowable as income tax deductions. As paragraphs 11 to 15 of Taxation Ruling IT 140 indicate, heating and lighting expenses and depreciation would be allowable deductions in such cases.

Effect of foregoing allowable deductions

24. The question has been raised with this Office whether, in a situation in which the sole or principal residence exemption would otherwise be denied to a taxpayer because a dwelling is used for the purposes of gaining or producing assessable income , the exempt status of the dwelling would be preserved if the taxpayer made no claims under subsection 51(1) for allowable deductions in relation to the income earning activities. Whether or not deductions are claimed or allowed in relation to the income producing activities does not affect the capital gains tax status of the dwelling. Subsection 160ZZQ(21) applies where a sole or principal residence is used for the purpose of gaining or producing assessable income and does not depend for its operation on whether income tax deductions are claimed or allowed.

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