PS LA 2006/1 (GA) - Calculating the cost base and reduced cost base of a CGT asset if a taxpayer does not have sufficient information to determine the amount of construction expenditure on the asset for the purpose of working out their entitlement to a deduction under Division 43 of the Income Tax Assessment Act 1997 .

This cover sheet is provided for information only. It does not form part of *PS LA 2006/1 (GA) - Calculating the cost base and reduced cost base of a CGT asset if a taxpayer does not have sufficient information to determine the amount of construction expenditure on the asset for the purpose of working out their entitlement to a deduction under Division 43 of the Income Tax Assessment Act 1997 .*

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Australian Government
Australian Taxation Office

Practice Statement Law Administration (General Administration)

PS LA 2006/1 (GA)

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This law administration practice statement is issued under the authority of the Commissioner and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. ATO personnel, including non ongoing staff and relevant contractors, must comply with this law administration practice statement, unless doing so creates unintended consequences or is considered incorrect. Where this occurs, ATO personnel must follow their business line's escalation process.

Taxpayers can rely on this law administration practice statement to provide them with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and taxpayers underpay their tax as a result, they will not have to pay a penalty. Nor will they have to pay interest on the underpayment provided they reasonably relied on this law administration practice statement in good faith. However, even if they don't have to pay a penalty or interest, taxpayers will have to pay the correct amount of tax provided the time limits under the law allow it.

SUBJECT:	**Calculating the cost base and reduced cost base of a CGT asset if a taxpayer does not have sufficient information to determine the amount of construction expenditure on the asset for the purpose of working out their entitlement to a deduction under Division 43 of the *Income Tax Assessment Act 1997***
PURPOSE:	**To outline the circumstances in which the Commissioner will accept that a taxpayer cannot deduct an amount under Division 43 for a CGT asset and is therefore not required to reduce the asset's cost base and reduced cost base**

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STATEMENT

1. For the purpose of working out the cost base and reduced cost base of a CGT asset under Division 110 of the *Income Tax Assessment Act 1997* (ITAA 1997),[1] the Commissioner will accept that a taxpayer cannot deduct an amount under Division 43 for construction expenditure in respect of an asset if the taxpayer:

   - does not (as a question of fact) have sufficient information to determine the amount and nature of the expenditure, and
   - does not seek to deduct an amount in relation to the expenditure under Division 43 (or any other provision).

2. This means that in working out a capital gain or capital loss arising from a CGT event happening in relation to the asset, the taxpayer is not required to reduce the asset's cost base and reduced cost base by the amount not deducted under Division 43 in relation to the asset.

3. This practice recognises that the impediment which has prevented the taxpayer from claiming a Division 43 deduction also prevents them from complying strictly with the CGT cost base reduction rules. An asset's cost base and reduced cost base must generally be reduced – not just by amounts that a taxpayer has actually deducted – but also by amounts that a taxpayer can deduct. The broad policy underpinning those rules is that an amount should either be allowed as a deduction or included in the asset's cost base and reduced cost base, but not both. The practice outlined above is consistent with that policy in that it results in the amount being recognised only once for tax purposes.

4. In the absence of this practice, taxpayers who were unable to deduct an amount under Division 43 because of insufficient information and could still deduct the amount because the relevant amendment period had not expired would nonetheless be obliged to incur the expense of a building cost estimate in order to ascertain the extent of their entitlement to the deduction for the purpose of reducing their cost base and reduced cost base.

EXPLANATION

5. Division 43 allows a deduction for construction expenditure in respect of certain income producing buildings and structural improvements (capital works). A deduction is available for construction expenditure incurred by the taxpayer and also for construction expenditure incurred by a previous owner of the building or improvement. The expenditure is written-off over 25 or 40 years, depending on when it was incurred and the use of the capital works.

Cost base

6. Expenditure does not form part of the cost base of a CGT asset to the extent the taxpayer has deducted or can deduct it for an income year: subsections 110-45(2) and 110-50(2). As a result, where a taxpayer has incurred Division 43 construction expenditure in relation to a CGT asset, the cost base does not include the expenditure to the extent the taxpayer has deducted or can deduct it.

[1] All legislative references in this practice statement refer to the ITAA 1997 unless otherwise indicated.

7. A CGT asset's cost base is also reduced to the extent that the taxpayer has deducted or can deduct for an income year capital expenditure incurred by another entity in respect of the asset: subsections 110-45(4) and 110-50(4). Where a previous owner has incurred Division 43 construction expenditure in relation to a CGT asset, this means that the cost base is reduced by so much of that expenditure as the taxpayer has deducted or can deduct.

8. These cost base adjustments generally only apply to CGT assets acquired after 7.30pm (by legal time in the Australian Capital Territory) on 13 May 1997. However, they may also apply to expenditure on land or a building acquired before that time provided the expenditure is incurred after 30 June 1999 and forms part of the fourth element of the cost base of the asset: subsections 110-45(1A) and 110-50(1A).

Reduced cost base

9. The reduced cost base of a CGT asset does not include an amount to the extent the owner has deducted or can deduct it: subsections 110-55(4) and 110-60(2). This reduced cost base adjustment applies regardless of when the asset was acquired. But there is no provision that requires the reduced cost base to be reduced in respect of a deduction for expenditure incurred by another entity.

Difficulty in obtaining amount of construction expenditure

10. Subsection 262A(4AJA) of the *Income Tax Assessment Act 1936* (ITAA 1936) is designed to assist taxpayers to obtain the information they need to work out their deductions under Division 43. This provision requires the previous owner of capital works to provide the new owner, within six months after the end of the income year in which the disposal occurs, or within such further time as the Commissioner allows, a notice containing the information necessary for the new owner to work out how Division 43 applies to them.

11. Despite this requirement, there are circumstances when this information may not be available. Even if the construction expenditure was incurred by the taxpayer themselves, they may have difficulty in ascertaining the precise amount of that expenditure that qualifies for the Division 43 write-off.

12. Also, the requirement only applies if the previous owner has deducted an amount under Division 43. But there are some circumstances in which an owner of capital works will be entitled to obtain a Division 43 deduction even though the previous owner was not (for example, if the capital works were acquired from a speculative builder or a previous owner who used the capital works as a private residence).

13. Taxation Ruling TR 97/25 *Income tax: property development: deduction for capital expenditure on construction of income producing capital works, including buildings and structural improvements* recognises the difficulties faced by owners of capital works in establishing the precise amount of the construction expenditure attached to those works, particularly in circumstances where the builder or previous owner becomes bankrupt or is unable, for other reasons, to provide the information. In these circumstances, the Australian Taxation Office (ATO) accepts that a building cost estimate provided by an appropriately qualified person can be used.

14. Even though the cost of these estimates is deductible under section 25-5 (about expenditure incurred in managing tax affairs) it is acknowledged that they can be expensive and obtaining one can impose a significant burden on taxpayers in order to satisfy their taxation obligations. Because of this, some taxpayers simply do not deduct the amounts to which they are entitled under Division 43.

15. However, on a strict application of the law, cost base and reduced cost base reductions under Division 110 may be required even if a taxpayer does not deduct an amount as reductions are also required in respect of amounts the taxpayer can deduct. A taxpayer 'can deduct' an amount if the terms of the relevant deduction provision have been satisfied in respect of the amount and the time periods prescribed by section 170 still allow for the amount to be deducted.

Commissioner's practice

16. Therefore, to facilitate practical compliance, the Commissioner will accept that a taxpayer cannot deduct an amount under Division 43, and is therefore *not* required to reduce their cost base and reduced cost base under Division 110, in respect of construction expenditure for which the taxpayer:

    - does not (as a question of fact) have sufficient information to determine the amount and nature of the expenditure, and
    - does not seek to deduct any amount in relation to the expenditure under Division 43 (or any other provision).

17. Obviously, if a taxpayer has, as a question of fact, sufficient information to determine the nature and amount of the expenditure, then the Commissioner's practice is not available. This may occur, for example, if a taxpayer has been provided with all the relevant information by a previous owner, and the taxpayer has retained that information.

18. It will normally be in a taxpayer's best financial interests to try and obtain the relevant information and claim the deductions provided compliance costs are not prohibitive. In the vast majority of cases, the tax benefit of deductions now will exceed the tax benefit of a larger cost base and reduced capital gain in the future.

19. It would be very difficult for the ATO to provide general guidance on whether a taxpayer has acted reasonably in attempting to obtain the relevant information, or, indeed to make judgments in particular cases which may involve subjective considerations. For example, it has been suggested that the practice should not be available if the costs to the taxpayer of obtaining the information are not undue. But, what is a significant cost for one taxpayer may not be significant for another, and it is difficult to weigh the relative difficulty of obtaining the information in particular cases.

20. For that reason, the Commissioner's practice is available whenever, as a question of fact, the taxpayer does not have the relevant information in order to make the claims.

Example 1

21. Angie purchased a rental property on 1 August 2001. Marty, the previous owner of the property, incurred construction expenditure on the property in the 1998 income year. Marty deducted amounts under Division 43 in relation to this expenditure. When Angie purchased the property she became entitled to claim deductions under Division 43 for the capital works undertaken by Marty.

22. At the time Angie purchased the property, Marty failed to provide her with the information she would need to calculate her deductions under Division 43. Marty said he could not find the information Angie needed and a few months after selling the property to Angie, Marty moved overseas. Angie tried to contact Marty overseas but was unable to do so.

23. As Angie did not have the information she needed to deduct an amount under Division 43, she did not claim these deductions. On 1 May 2004, Angie sold the property to Daniel and made a capital gain.

24. The Commissioner will accept that Angie cannot deduct an amount under Division 43. She will not have to adjust the cost base of her rental property.

Example 2

25. Courtney purchased a property from Anthony in August 2002 and occupied it as his main residence.

26. Anthony had undertaken capital works on the property and deducted amounts for the construction expenditure incurred in respect of those capital works under Division 43. However he did not provide Courtney with information that would enable Courtney to work out how Division 43 might apply to him.

27. In February 2005 Courtney moved interstate and decided to rent out the dwelling. When he came to prepare his income tax return for the 2005 income year, Courtney's tax agent told him that he was entitled to deduct amounts under Division 43 for the construction expenditure Anthony incurred.

28. Courtney did not contact Anthony to obtain information on the construction expenditure and did not engage a quantity surveyor to provide him with an estimate of the building costs. He did not deduct the amounts under Division 43 to which he was entitled.

29. The Commissioner will accept that Courtney cannot deduct an amount under Division 43 and so will not require him to adjust the cost base of the property.

Amendment history

Date of amendment	Part	Comment
17 April 2014	Contact details	Updated.
9 October 2012	Contact details	Updated.
24 February 2012	Generally	Updated to current publication style.
	Paragraph 1	Inserted footnote 1.
	Paragraph 13	Added title for TR 97/25.
	References	Contact officer updated.
6 August 2008	Paragraphs 10 and 12	Minor change in wording.
	Contact details	Business line to Law & Practice.

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Other Business Lines consulted	All business lines consulted