

TD 1999/66A - Addendum - Income tax: capital gains: what factors should be taken into account in determining the 'amount that is reasonable' in applying subsection 118-190(2) of the Income Tax Assessment Act 1997 ?

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Addendum

Taxation Determination

Income tax: capital gains: what factors should be taken into account in determining the 'amount that is reasonable' in applying subsection 118-190(2) of the *Income Tax Assessment Act 1997*?

This Addendum amends Taxation Determination TD 1999/66 to correct the explanation in Example 2 which does not take into account the special rule in section 118-192 of the *Income Tax Assessment Act 1997* which is relevant in the circumstances of the example. The rule in section 118-192 applies when a dwelling is first used for the purpose of producing assessable income after 20 August 1996.

This Addendum also inserts Example 3 which explains the capital gains tax consequences of the sale of a dwelling that was first used for the purpose of producing assessable income before 20 August 1996.

Omit paragraphs 9 and 10 and replace with:

9. *Peter owns a home that he lived in since October 1994. In October 1995, after taking a redundancy package, he extended the rear of the home and built a studio for his photography business. He has conducted business from these premises since October 1996. Peter borrowed \$50,000 to build the studio. On the basis that the interest on the \$50,000 relates solely to the studio, Peter has claimed 100% deduction. In October 1999, Peter sells the property.*

10. *Because Peter first used his dwelling to produce income after 20 August 1996 he is taken by subsection 118-192(2) to have acquired it in October 1996 for its market value. Having regard to the market value acquisition cost Peter made a capital gain of \$10,000 on the disposal of the property in October 1999.*

11. *As the dwelling was Peter's main residence for the whole period from October 1996 (when he is taken to have acquired the dwelling) to October 1999, apart from subsection 118-190(2) he would have been able to disregard the \$10,000 capital gain, so that he would have made a capital gain of nil.*

12. *Subsection 118-190(2) requires Peter to increase the capital gain that he would have made by an amount that is reasonable having regard to the amount of interest he would have been able to deduct had he borrowed to acquire the whole house, including the studio, and incurred interest. The interest Peter actually incurred on the money he borrowed to build the studio is irrelevant. Under the hypothetical test, assuming that the studio is 10% of the floor space of the house, the proportion of the hypothetical interest deduction is 10%. Peter would increase the capital gain from nil to 10% of the capital gain made on the disposal of the house (10% of \$10,000, being \$1,000). No adjustment is made to take account of the use of the property prior to October 1996 because Peter is not regarded as having owned it before that time.*

Insert after new paragraph 12:

Example 3

13. *Assume the same facts as in example 2 except that Peter commenced to use the premises for business in April 1996 and made a capital gain of \$15,000 on the sale of the property (based on the actual acquisition cost).*

14. *In determining his capital gain Peter would take into account the fact that only 10% of the dwelling was used for income producing purposes and the fact that the income producing activity was carried out for only 42 of the 60 months in the period of ownership of the house. His capital gain would be \$1,050 ($42/60 \times \$1,500$).*

Commissioner of Taxation

27 November 2002

ATO references

NO: 2002/011971

ISSN: 1038-8982