About capital gains tax

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CHECK THIS SIGNPOST BEFORE YOU READ PART A OF THIS GUIDE

Do you understand the 3 methods of calculating a capital gain?

Read part A chapter 2, starting on page 13.

Have you received a distribution of a capital gain from a managed fund or other unit trusts in 2001–02?

Read part A chapter 4, starting on page 22.

Have you sold shares or units in a unit trust in 2001–02?

Read part A chapter 5, starting on page 26.

Did you sell your home (main residence) in 2001–02?

Read part A chapter 6, starting on page 41.

Do you need help completing the capital gains item on your individual tax return?

Read the relevant chapters in part A, then work through part B.

Do you need help completing the capital gains item on your entity's tax return?

Read the relevant chapters in part A, then work through part C.

CHAPTER 1 Does capital gains tax apply to you?

This chapter provides general background information about capital gains tax (CGT) and how it applies to you or your entity.

What is capital gains tax?

Capital gains tax is the tax you pay on any capital gain you make and include on your annual income tax return. There is no separate tax on capital gains, it is merely a component of your income tax. You are taxed on your net capital gain at your marginal tax rate.

Your **net capital gain** is:

your total capital gains for the year

minus

your total capital losses (including any net capital losses from previous years)

minus

any CGT discount and CGT small business concessions to which you are entitled.

You may make a **capital gain** from most **CGT events**, if your **capital proceeds** are greater than your **cost base**—for example, if you received more for an asset than you paid for it. You make a **capital loss** if your **reduced cost base** is greater than your capital proceeds. You can also make a capital gain if a managed fund or other trust distributes a capital gain to you.

NOTE ***New terms***

We may have used some terms that are not familiar to you. These words are explained in *Explanation of terms* at the back of this guide.

While we have sometimes used the word 'bought' rather than 'acquired', you may have acquired an asset without paying for it (for example, as a gift or through an inheritance). Similarly, we refer to 'selling' an asset when you may have 'disposed' of it in some other way (for example, by giving it away or transferring it to someone else). For the purposes of this guide, all of these 'acquisitions' and 'disposals' are CGT events.

Generally, you can disregard any capital gain or capital loss you make on an asset you acquired before 20 September 1985 (pre-CGT). For details of some other exemptions, see **Exemptions and roll-overs** on page 9.

There are special rules that apply when working out gains and losses from depreciating assets. To the extent that a depreciating asset is used for a taxable purpose (for example, in a business) any gain is treated as ordinary income and losses as deductions. A capital gain or capital loss may arise only to the extent that a depreciating asset has been used for a non-taxable purpose (for example, used privately). For details on the CGT treatment of depreciating assets, see **CGT and depreciating assets** on page 10.

If you are completing your entity's tax return, capital gains are shown at the following items:

- item **7** *Company tax return 2002*
- item **18** *Trust tax return 2002* or
- item **9** *Fund income tax and regulatory return 2002*.

If you are an individual, you show your total current year capital gains at **H** item **17** on your tax return.

You show your net capital gain at **A** item **17** on your tax return.

To work out whether you have to pay tax on your capital gains, you need to know:

- whether a CGT event has happened (this is the question asked at **G** item **17** on your tax return)
- the time of the CGT event
- how to calculate the capital gain or capital loss
- whether there is any exemption or roll-over that allows you to reduce or disregard the capital gain or capital loss
- how to apply any capital losses
- whether the CGT discount applies
- whether you are entitled to any of the CGT concessions for small business.

What is a CGT event?

CGT events are the different types of transactions or events that may result in a capital gain or capital loss. Many CGT events involve a CGT asset while other CGT events relate directly to capital receipts (capital proceeds).

To work out your capital gain or capital loss, you need to know which CGT event applies. The type of CGT event affects when you can include the capital gain in your assessable income and how you calculate the capital gain or capital loss.

There is a wide range of CGT events. Some happen often and affect many different people while others are rare and affect only a few people. There is a summary of CGT events A1 to K7 at appendix 1.

The most common CGT event happens if you dispose of an asset to someone else—for example, if you sell or give away an asset. Some other CGT events from which you may make a capital gain or capital loss include when:

- an asset you own is lost or destroyed (the destruction may be voluntary or involuntary)
- shares you own are cancelled, surrendered or redeemed
- you enter into an agreement not to work in a particular industry for a set period of time
- a trustee makes a non-assessable payment to you from a managed fund or other unit trusts
- a company makes a payment (not a dividend) to you as a shareholder
- a liquidator declares that shares you own are worthless
- you receive an amount from a local council for disruption to your business assets by roadworks
- you stop being an Australian resident
- you enter into a conservation covenant or
- you dispose of a depreciating asset that you used for private purposes.

Australian residents make a capital gain or capital loss if a CGT event happens to any of their assets anywhere in the world. As a general rule, non-residents make a capital gain or capital loss only if a CGT event happens to a CGT asset that has a necessary connection with Australia.

Non-Australian residents may also make a capital gain or capital loss where CGT events create:

- contractual or other rights (CGT event D1) or
- a trust over future property (CGT event E9).

Order in which CGT events apply

If more than one CGT event could apply to your transaction or circumstances, the most relevant CGT event applies.

Time of the CGT event

The timing of a CGT event is important because it tells you in which income year a capital gain or capital loss from the event affects your income tax.

If you dispose of a CGT asset to someone else, the CGT event happens when you enter into the contract for disposal. If there is no contract, the CGT event generally happens when you stop being the asset's owner.

EXAMPLE

Contract

In June 2002, Sue enters into a contract to sell land. The contract is settled in October 2002.

Sue makes the capital gain in the 2001–02 income year when she enters into the contract and not the 2002–03 income year when settlement takes place.

If a CGT asset you own is lost or destroyed, the CGT event happens when you first receive compensation for the loss or destruction. If you do not receive any compensation, the CGT event happens when the loss is discovered or the destruction occurred.

EXAMPLE

Insurance policy

Laurie owned a rental property that was destroyed by fire in June 2001. He received a payment under an insurance policy in October 2001. The CGT event happened in October 2001.

The CGT events relating to shares and units, and the times of the events, are dealt with in chapter 5.

What is a CGT asset?

Many CGT assets are easily recognisable—for example, land, shares in a company and units in a unit trust. Other CGT assets are not so well understood—for example, contractual rights, options, foreign currency and goodwill. All assets are subject to the CGT rules unless they are specifically excluded.

CGT assets fall into 3 categories:

- collectables
- personal use assets
- other assets.

Collectables

Collectables include the following items that are used or kept mainly for the personal use or enjoyment of you or your associate(s):

- paintings, sculptures, drawings, engravings or photographs; reproductions of these items or property of a similar description or use

- jewellery
- antiques
- coins or medallions
- rare folios, manuscripts or books
- postage stamps or first day covers.

A collectable is also:

- an interest in any of those items
- a debt that arises from any of those items or
- an option or right to acquire any of those items.

Any capital gain or capital loss you make from a collectable acquired for $500 or less is disregarded. A capital gain or capital loss you make from an interest in a collectable is disregarded if the market value of the collectable when you acquired the interest was $500 or less. However, if you acquired the interest for $500 or less before 16 December 1995, a capital gain or capital loss is disregarded.

If you dispose of collectables individually that you would usually dispose of as a set, you are exempt from paying CGT only if you acquired the set for $500 or less. This does not apply to collectables you acquired before 16 December 1995.

Personal use assets

A personal use asset is:

- a CGT asset, other than a collectable, that is used or kept mainly for the personal use or enjoyment of you or your associate(s)
- an option or a right to acquire a personal use asset
- a debt resulting from a CGT event involving a CGT asset kept mainly for your personal use and enjoyment or
- a debt resulting from your doing something other than gaining or producing your assessable income or carrying on a business.

Personal use assets include such items as boats, furniture, electrical goods and household items. Land and buildings are not personal use assets. Any capital loss you make from a personal use asset is disregarded.

If a CGT event happened to a personal use asset during or after the 1998–99 income year, any capital gain you make from the asset or part of the asset is disregarded if you acquired the asset for $10 000 or less.

If you dispose of personal use assets individually that would usually be sold as a set, you obtain the exemption only if you acquired the set for $10 000 or less.

Other assets

Assets that are not collectables or personal use assets include:

- land
- shares in a company
- rights and options
- leases
- units in a unit trust
- instalment receipts
- goodwill
- licences
- convertible notes
- your home (see **Exemptions** on page 9)
- contractual rights
- foreign currency
- any major capital improvement (above the improvement threshold) made to certain land or pre-CGT assets. Improvement thresholds are listed in the table on the next page.

Partnerships

It is the individual partners who make a capital gain or capital loss from a CGT event, not the partnership itself. For CGT purposes, each partner owns a proportionate share of each CGT asset.

Joint tenants

For CGT purposes, individuals who own an asset as joint tenants are each treated as if they own an equal interest in the asset as a tenant in common (see page 68 for more information).

Separate assets

For CGT purposes, there are exceptions to the rule that what is attached to the land is part of the land. In some circumstances, a building or structure is considered to be a separate CGT asset from the land.

Other improvements to an asset (including land) acquired before 20 September 1985 may also be treated as a separate CGT asset.

Buildings, structures and other improvements to land you acquired on or after 20 September 1985

A building, structure or other capital improvement on land that you acquired on or after 20 September 1985 will be a separate CGT asset from the land if a balancing adjustment provision applies to it. For example, a timber mill building is subject to a balancing adjustment if it is sold or destroyed, so it is treated as a separate asset from the land.

Buildings and structures on land acquired before 20 September 1985

A building or structure on land that you acquired before 20 September 1985 will be a separate asset if:

- you entered into a contract for the construction of the building or structure, or
- construction began on or after that date.

Other capital improvements to pre-CGT assets

If you make a capital improvement to a CGT asset you acquired before 20 September 1985, this improvement will be treated as a separate asset and be subject to CGT if certain conditions are met. These conditions relate to the improvement thresholds in the table below.

If these conditions are met, when a CGT event happens to the original asset, the cost base of the capital improvement must be:

- more than the improvement threshold for the year in which the event happens
- more than 5 per cent of the amount of money and property you receive from the event.

If there is more than one capital improvement and they are related to each other, they are treated as one separate CGT asset if the total of their cost bases is more than the threshold.

The improvement threshold is changed to take account of inflation. The thresholds for 1985–86 to 2001–02 are shown in the following table.

Improvement thresholds for 1985–86 to 2001–02

Income year	*Threshold ($)*	*Income year*	*Threshold ($)*
1985–86	50 000	1994–95	82 290
1986–87	53 950	1995–96	84 347
1987–88	58 859	1996–97	88 227
1988–89	63 450	1997–98	89 992
1989–90	68 018	1998–99	89 992
1990–91	73 459	1999–2000	91 072
1991–92	78 160	2000–01	92 802
1992–93	80 036	2001–02	97 721
1993–94	80 756		

EXAMPLE

Adjacent land

On 1 April 1984, Dani bought a block of land. On 1 June 2001, she bought another block adjacent to the first one. Dani amalgamated the titles to the 2 blocks into one title.

The 2nd block is treated as a separate CGT asset acquired on or after 20 September 1985 and is therefore subject to CGT.

What are capital proceeds?

Capital proceeds is the term used to describe what you receive from a CGT event. This is usually an amount of money or the value of any property you receive (or are entitled to receive) as a result of a CGT event.

In some cases, if you receive nothing in exchange for a CGT asset (for example, if you give the CGT asset as a gift) you are taken to have received the market value of the asset at the time of the CGT event. You may also be taken to have received the market value if:

- your capital proceeds are more or less than the market value of the CGT asset
- you and the purchaser were not dealing with each other at arm's length in connection with the event.

You are said to be dealing at arm's length with someone if each party acts independently and neither party exercises influence or control over the other in connection with the transaction. The law looks at not only the relationship between the parties but also the quality of the bargaining between them.

Capital proceeds from a CGT event are reduced if:

- you are not likely to receive some or all of those proceeds
- the non-receipt is not due to anything you have done or failed to do
- you took all reasonable steps to obtain payment.

Provided you are not entitled to a tax deduction for the amount you repaid, capital proceeds are reduced by:

- any part of the proceeds that you repay or
- any compensation you pay that can reasonably be regarded as a repayment of the proceeds.

If you are registered for GST and you receive payment when you dispose of a CGT asset, any GST payable is not part of the capital proceeds.

There are special rules for calculating the proceeds from a depreciating asset. A depreciating asset is a tangible asset (other than land or trading stock) that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Certain intangible assets are also depreciating assets.

For more information, refer to the *Guide to depreciating assets*.

What is the cost base?

For most CGT events, the cost base of a CGT asset is important in working out if you have made a capital gain. For working out the amount of a capital loss for these events, the reduced cost base of a CGT asset is relevant.

For some CGT events, the cost base is not relevant. In these cases, the CGT event explains the amounts to use to work out your capital gain. For example, if you enter into an agreement not to work in a particular industry for a set period of time, CGT event D1 specifies that you make a capital gain or capital loss by comparing the capital proceeds with the incidental costs. Also the cost base of an asset that is a depreciating asset is not relevant in working out a capital gain from that asset.

For details of the CGT treatment of depreciating assets, see **CGT and depreciating assets** on page 10.

Elements of the cost base

The cost base of a CGT asset is made up of 5 elements. You need to add together all these elements to work out your cost base for each CGT asset.

Where relevant, the elements of the cost base are reduced by any GST included in the price.

First element: money paid for the asset

This element includes money paid (or required to be paid) for the asset and the market value of property given (or required to be given) to acquire the asset.

2nd element: incidental costs of the CGT event or of acquiring the CGT asset

Examples of these incidental costs include agents commission, the cost of advertising to find a seller or buyer, stamp duty and fees paid for professional services (for example, to an accountant, professional tax adviser, valuer or lawyer).

You can include expenditure for advice concerning the operation of the tax law as an incidental cost only if it was provided by a recognised professional tax adviser and you incurred the expenditure after 30 June 1989.

Do not include expenditure for which you have or may have a deduction for income tax purposes in any year.

3rd element: non-capital costs associated with owning the asset

Examples of these non-capital costs include interest, rates, land taxes, repairs and insurance premiums. They also include non-deductible interest on borrowings to re-finance a loan used to acquire a CGT asset and on loans used to finance capital expenditure you incur to increase an asset's value.

You can include non-capital costs of ownership only in the cost base of assets acquired on or after 21 August 1991. You cannot include these non-capital costs in the cost base of any collectables or personal use assets.

These costs cannot be indexed or used to work out a capital loss. Do not include expenditure for which you have or may have a deduction for income tax purposes in any year.

4th element: capital costs associated with increasing the value of your asset

This element is relevant only if the expenditure is reflected in the state or nature of the asset at the time of the CGT event—for example, if you paid for a car port to be built on your rental investment property.

5th element: capital costs to preserve or defend your title or rights to your asset

This element includes capital expenditure you incur to preserve or defend your title or rights to the asset—for example, if you paid a call on shares.

In some cases, a deduction you have claimed on a CGT asset can be partly or wholly 'reversed'; that is, the value of part or all of the deduction may be declared as income in the year the CGT event happens. In this case, the capital gains cost base of the CGT asset is increased by the amount you have to include in your assessable income.

Any expenditure you recoup does not form part of the cost base of a CGT asset except if the recouped amount is included in your assessable income.

EXAMPLE

Recouped expenditure

John bought a building in 2000 for $200 000 and incurred $10 000 in legal costs associated with the purchase. As part of a settlement, the vendor agreed to pay $4000 of the legal costs. John did not claim as a tax deduction any part of the $6000 he paid in legal costs.

He later sells the building. As he received reimbursement of $4000 of the legal costs, in working out his capital gain he includes only $6000 in the cost base.

Assets acquired after 13 May 1997

If you acquired a CGT asset after 13 May 1997, the cost base of the asset does not include:

- any expenditure on the asset that has been (or can be) allowed as an income tax deduction; this applies to all elements of the cost base, or
- heritage conservation expenditure and landcare and water facilities expenditure incurred after 12 November 1998 that give rise to a tax offset.

NOTE ***Special rules for land***

Special rules apply if you acquired land on or before 13 May 1997 but you incurred expenditure between this date and 1 July 1999 on constructing a building that is treated as a separate asset from the land for CGT purposes. If you think this may be relevant to you, contact the Australian Taxation office (ATO) for more information.

EXAMPLE

Special building write-off deduction

Zoran acquired a rental property on 1 July 1997 for $200 000. Before disposing of the property on 30 June 2002, he had claimed $10 000 in special building write-off deductions.

At the time of disposal, the cost base of the property was $210 250. Zoran must reduce the cost base of the property by $10 000 to $200 250.

Indexation of the cost base

If a CGT event happened in the 2001–02 income year in relation to a CGT asset you acquired before 21 September 1999, you may be able to use either the indexation method or the discount method to calculate your capital gain.

If you use the indexation method, some of the cost base expenditure you incurred up to 21 September 1999 may be indexed to account for inflation up to the September 1999 quarter. Only expenditure incurred before 21 September 1999 may be indexed because changes to the law mean indexation was frozen at that date. Refer to chapter 2 page 14 for more information.

Reduced cost base

The reduced cost base is the amount you take into account when you are working out whether you have made a capital loss when a CGT event happens to a CGT asset. Remember that a capital loss can only be used to reduce a capital gain—it cannot be used to reduce other income.

The reduced cost base of a CGT asset has the same 5 elements as the cost base (see previous page), except for the 3rd element. The 3rd element of the reduced cost base of an asset is any amount that is assessable because of a balancing adjustment for the asset or that would be assessable if certain balancing adjustment relief was not available. These elements are not indexed and do not include any relevant GST input tax credits. You need to add together all these elements for a CGT asset to find out your reduced cost base for the relevant CGT event.

The reduced cost base does not include any of those costs that have been (or can be) allowed as deductions—for example, write-off deductions for capital expenditure. It also does not include any expenditure that you have recouped—for example, a claim on an insurance policy (except for any recouped amount included in your assessable income).

EXAMPLE

Write-off deduction

Danuta acquired a new income-producing asset on 28 September 1994 for $100 000. She sold it for $90 000 in November 2001. During the period she owned it she was allowed write-off deductions of $7500. Her capital loss is worked out as follows:

Cost base	$100 000
less write-off deduction	$7 500
Reduced cost base	**$92 500**
less capital proceeds	$90 000
Capital loss	**$2 500**

Modifications to the cost base and reduced cost base

In some cases, the general rules for calculating the cost base and reduced cost base have to be modified. For example, the market value may be substituted for the first element of the cost base or reduced cost base if:

- you did not incur expenditure to acquire the asset
- some or all of the expenditure you incurred cannot be valued, or
- you did not deal at arm's length with the vendor in acquiring the asset.

If you acquire a CGT asset or incur expenditure and only part of the expenditure you incur relates to the CGT asset, only that part of the expenditure that is reasonably attributable to the asset can be included in its cost base or reduced cost base.

Similarly, if a CGT event happens only to part of a CGT asset, the cost base or reduced cost base of the asset is generally apportioned to work out the capital gain or capital loss from the CGT event.

Special rules for the cost base and reduced cost base

There are other rules that may affect the cost base or reduced cost base of an asset. For example, they are calculated differently:

- when you first use your main residence to produce income (see chapter 6)
- for an asset that you receive as a beneficiary or as the legal personal representative of a deceased estate (see chapter 9)
- for bonus shares or units, rights and options and convertible notes (see chapter 5).

Debt forgiveness

A debt is forgiven if you are freed from the obligation to pay it. Commercial debt forgiveness rules apply to debts forgiven after 27 June 1996. A debt is a commercial debt if part or all of the interest payable on the debt is, or would be, an allowable deduction.

EXAMPLE

Debt forgiveness

On 1 July 2001, Josef had available net capital losses of $9000. On 1 January 2002, he sold some shares for $20 000. They had a cost base (no indexation) of $7500. On 1 April 2002, a commercial debt of $15 000 that Josef owed to AZC Pty Ltd was forgiven. Josef had no prior year revenue losses and no deductible capital expenditure.

Josef would work out what net capital gain to include in his assessable income as follows:

Available net capital losses	$9 000
less debt forgiveness adjustment	$9 000
Adjusted net capital loss	**Nil**
Cost base of shares (no indexation)	$7 500
less debt forgiveness adjustment	$6 000
Adjusted cost base	**$1 500**
Calculation of net capital gain	
Sale of shares	$20 000
Adjusted cost base (no indexation)	$1 500
less carried forward loss	Nil
Capital gain (eligible for discount)	$18 500
less discount percentage (50%)	$9 250
Net capital gain	**$9 250**

Under the commercial debt forgiveness rules, a forgiven amount may reduce (in the following order) your:

- prior year revenue losses
- prior year net capital losses
- deductible expenditure
- cost base and reduced cost base of assets.

These rules do not apply if the debt is forgiven as a result of:

- an action under bankruptcy law
- a deceased person's will or
- reasons of natural love and affection.

Acquiring CGT assets

Generally, you acquire a CGT asset when you become its owner. You may acquire a CGT asset as a result of:

- a CGT event happening (for example, the transfer of land under a contract of sale)

- other events or transactions happening (for example, a company issuing shares, where their issue is not a CGT event), or
- applying specific rules (for example, if a CGT asset passes to you as a beneficiary when someone dies).

Time of acquisition

The time a CGT asset is acquired is important for 4 reasons:

- CGT generally does not apply to pre-CGT assets; that is, assets acquired before 20 September 1985
- different cost base rules apply to assets acquired at different times—for example, non-capital costs are not included in the cost base of an asset acquired before 21 August 1991
- the time of acquisition determines whether the cost base of a CGT asset is indexed to take account of inflation and the extent of that indexation (see chapter 2 page 14)
- the time of acquisition also determines whether you are eligible for the CGT discount—for example, one requirement is that you need to have owned a CGT asset for at least 12 months (see chapter 2 page 15).

If you acquire a CGT asset as a result of a CGT event, certain rules determine when you are taken to have acquired the asset. These rules depend on which CGT event is involved. For example, if you enter into a contract to purchase a CGT asset, the time of acquisition is when you enter into the contract. If someone disposes of an asset to you without entering into a contract, you acquire the asset when you start being the asset's owner. If a CGT asset passes to you as a beneficiary of someone who has died, you acquire the asset on the date of their death.

If you acquire a CGT asset without a CGT event happening, different rules apply to determine when you acquire the asset. If—for example, a company issues or allots shares to you, you acquire the shares when you enter into a contract to acquire them, or if there is no contract, at the time of their issue or allotment.

Becoming a resident

Special CGT rules apply to assets you own when you become a resident of Australia. You are taken to have acquired these assets at the time you became a resident.

This rule only applies to assets that you acquired on or after 20 September 1985 that did not have a necessary connection with Australia—for example, land in a foreign country. The general cost base rules apply to an asset that had a necessary connection with Australia (for example, land in Australia) when you became a resident.

Choices

In some cases you are given a choice as to how the CGT rules apply to you. As a general rule, if you wish to make a choice you must make it by the day you lodge your tax return. Generally, the way you prepare your tax return is sufficient evidence of your choice.

However, there are some exceptions:

- some replacement asset roll-overs for companies must be made earlier
- choices relating to the small business retirement exemption must be made in writing
- a longer period is allowed to choose the small business roll-over.

Exemptions and roll-overs

There may be exemptions or roll-overs that allow you to reduce, defer or disregard your capital gain or capital loss. The most common exemption is if you dispose of an asset you acquired before 20 September 1985.

Exemptions

The exemptions listed below allow you to reduce or disregard a capital gain or capital loss you make from certain CGT events.

General exemptions

A capital gain or capital loss you make from any of the following is disregarded:

- a car (that is, a motor vehicle designed to carry a load of less than one tonne and fewer than 9 passengers) or motor cycle or similar vehicle
- a decoration awarded for valour or brave conduct unless you paid money or gave any other property for it
- collectables acquired for $500 or less and personal use assets acquired for $10 000 or less
- CGT assets used solely to produce exempt income
- shares in a pooled development fund
- use of a GST direct assistance certificate of up to $200 value
- compensation or damages you receive for any wrong or injury you suffer in your occupation
- compensation or damages you receive for any wrong, injury or illness you or your relatives suffer
- compensation you receive under the firearms surrender arrangements
- winnings or losses from gambling, a game or a competition with prizes

- an amount you receive as reimbursement or payment of your expenses under the General Practice Rural Incentives Program or the Sydney Aircraft Noise Insulation Project
- a CGT asset that is your trading stock at the time of a CGT event
- a re-establishment grant made under section 52A of the *Farm Household Support Act 1992*
- a dairy exit payment under the *Farm Household Support Act 1992*
- a reimbursement or payment made under the M4/M5 Cashback Scheme
- some types of testamentary gifts or
- in certain circumstances, a general insurance policy, a life insurance policy or an annuity instrument.

Other exemptions

Any capital gain you make may be reduced if, because of a CGT event, an amount has been included in your assessable income other than as a capital gain. Any capital loss you make from the following is disregarded:

- the expiry, forfeiture, surrender or assignment of a lease if the lease is not used solely or mainly for the purpose of producing assessable income
- a payment to an entity of alienated personal services income that is included in an individual's assessable income (or any other amount attributable to that income).

A capital loss made by an exempt entity is also disregarded.

Specific exemption—main residence

You can ignore a capital gain or capital loss you make from a CGT event relating to a dwelling that was your main residence. This can change, however, depending on how you came to own the dwelling and what you have done with it—for example, if you rented it out (see chapter 6 for more information).

Roll-overs

Roll-over allows a capital gain or capital loss to be deferred or disregarded until a later CGT event happens. The types of roll-over available are listed in the next column; however, only the following 3 types are covered in this guide. If you would like information on the other roll-overs, please contact the ATO.

Marriage breakdown

When an asset is transferred from one spouse to another after their marriage breakdown, any CGT is deferred until a later CGT event happens (for example, when the former spouse sells the asset to someone else). For more examples of how CGT obligations are affected by marriage breakdown, see chapter 8.

Loss, destruction or compulsory acquisition of an asset

You may defer a capital gain in some cases where a CGT asset has been lost or destroyed or is compulsorily acquired (see chapter 7).

Scrip-for-scrip

You may also be able to defer a capital gain if you dispose of your shares in a company or interest in a trust as a result of a takeover (see chapter 5 page 28).

Other replacement asset roll-overs

- Disposal or creation of assets by individual or trustee to a wholly-owned company
- Disposal or creation of assets by partners to a wholly-owned company
- CGT event happens to small business assets and you acquire replacement assets
- Renewal or extension of a statutory licence
- Strata title conversion
- Exchange of shares in the same company or units in the same unit trust
- Exchange of rights or options to acquire shares in a company or units in a unit trust
- Exchange of shares in one company for shares in an interposed company
- Exchange of units in a unit trust for shares in a company
- Body is converted to an incorporated company
- Crown leases
- Depreciating assets
- Prospecting and mining entitlements
- Disposal of a security under a securities lending arrangement

Other same asset roll-overs

- Transfer of a CGT asset to a wholly-owned company
- Transfer of a CGT asset of a partnership to a wholly-owned company
- Transfer of a CGT asset between related companies

CGT and depreciating assets

The uniform capital allowance system (UCA) applies from 1 July 2001. Unlike the previous capital allowance regime for plant which operated prior to 1 July 2001, a capital gain or capital loss from the disposal of a depreciating asset will only arise to the

extent that a depreciating asset has been used for a non-taxable purpose (for example, used privately).

A capital gain or capital loss is calculated using the UCA concepts of cost and termination value and not those found in the CGT provisions (capital proceeds and cost base).

A CGT event (CGT event K7) happens if a balancing adjustment event occurs for a depreciating asset a taxpayer held, and at some time during the period the depreciating asset was held, it was used for a non-taxable purpose.

A balancing adjustment event most commonly occurs for a depreciating asset if a taxpayer stops holding it (for example, it is sold, lost or destroyed) or stops using it.

Calculating a capital gain or capital loss for a depreciating asset that is not a pooled asset

You make a capital gain if a depreciating asset's termination value is more than its cost. A capital gain from a depreciating asset is calculated as follows:

$$(\text{Termination value} - \text{cost}) \times \frac{\text{sum of reductions}}{\text{total decline}}$$

Sum of reductions is the sum of the reductions in your deductions for the asset's decline in value that is attributable to your use of the asset, or your having it installed ready for use, for a non-taxable purpose. **Total decline** is the decline in value of the depreciating asset since you started to hold it.

You make a capital loss if the depreciating asset's cost is more than its termination value. A capital loss from a depreciating asset is calculated as follows:

$$(\text{Cost} - \text{termination value}) \times \frac{\text{sum of reductions}}{\text{total decline}}$$

EXAMPLE

Larry purchased a truck in August 2001 for $5000. He used the truck 90 per cent for business purposes. The decline in value of the truck up to the date of sale was $2000. Larry disposes of the truck in July 2004 for $7000. Larry calculates his capital gain from CGT event K7 as follows:

$$(\$7000 - \$5000) \times \frac{200}{2000}$$

Capital gain from CGT event K7 = $200

Calculating a capital gain or capital loss for a depreciating asset in a low-value pool

There are separate rules for depreciating assets that have been allocated to a low-value pool.

You make a capital gain if the depreciating asset's termination value is more than its cost. The amount of the capital gain is calculated as:

$$(\text{Termination value} - \text{cost}) \times (1 - \text{taxable use fraction})$$

Taxable use fraction is the percentage of use of an asset that will be for a taxable purpose, expressed as a fraction, that you estimated for the asset when you allocated it to the pool.

You make a capital loss if the depreciating asset's cost is more than its termination value. The amount of the capital loss is calculated as:

$$(\text{Cost} - \text{termination value}) \times (1 - \text{taxable use fraction})$$

Application of CGT concessions

A capital gain from disposal of a depreciating asset may qualify for the CGT discount if conditions for the CGT discount are satisfied. If the CGT discount applies, there is no reduction of the capital gain under the indexation method, as detailed in chapter 2.

The small business CGT concessions do not apply to a capital gain made from the disposal of a depreciating asset as any capital gain only arises in respect of the use of the depreciating asset for a non-taxable purpose (for example, to the extent it is used for private purposes).

Do any CGT exemptions apply to a depreciating asset?

The following exemptions may apply to a capital gain or capital loss made from the disposal of a depreciating asset:

- Pre-CGT assets—A capital gain or capital loss from a depreciating asset is disregarded if the asset was acquired before 20 September 1985.
- Simplified Tax System (STS) assets—A capital gain or capital loss from a depreciating asset is disregarded if you have elected to become an STS taxpayer and you can deduct an amount for the depreciating asset's decline in value under the STS provisions for the income year in which the balancing adjustment event occurred.

- Personal use asset—If a depreciating asset is a personal use asset (that is, one used or kept mainly for personal use and enjoyment), any capital loss from CGT event K7 is disregarded. A capital gain under CGT event K7 from a personal use asset costing $10 000 or less may also be disregarded.
- Collectables—A capital gain from a depreciating asset that is a collectable costing $500 or less may be disregarded.
- Balancing adjustment event and CGT event—A balancing adjustment event that gives rise to a capital gain or capital loss is only included under CGT event K7. However, capital proceeds received under other CGT events—for example, CGT event D1—may still be relevant for a depreciating asset as CGT events are not the equivalent of balancing adjustment events.

Changed treatment of intellectual property

Intellectual property is a depreciating asset for the purposes of the UCA. Under this system, the former special treatment for partial realisations of intellectual property no longer applies.

If you grant or assign an interest in an item of intellectual property, you are treated as if you had stopped holding part of the item. You are also treated as if, just before you stop holding that part, you had split the original item of intellectual property into 2 parts, the part you stopped holding and the rest of the original item. You determine a first element of the cost for each part.

This treatment applies if a licence is granted over an item of intellectual property. To this extent, the treatment of intellectual property is different from other depreciating assets. The grant of a licence in respect of other depreciating assets would result in CGT event D1 (about creating contractual rights) happening.

Partnership assets

Generally, any capital gain or capital loss from a CGT event happening to a partnership asset is made by the partners individually and not the partnership. This rule will not apply where a CGT event happens to a depreciating asset. Under the UCA, a depreciating asset—that is, a partnership asset—is treated as being held by the partnership and not by the individual partners.

Need more information?

For more information about depreciating assets, see the *Guide to depreciating assets*, *Uniform capital allowance system: disposal of a depreciating asset* and *Uniform capital allowance system: low-value pools.*

Where to now?

Chapter 2 in part A explains how to calculate capital gain using the 3 methods (indexation, discount or ‘other’). For more specific directions on how to calculate your capital gain, please go to:

- part B for individuals
- part C for companies, trusts and funds.

CHAPTER 2 How to work out your capital gain or capital loss

This chapter explains how to work out your capital gain or capital loss. There are 3 methods that you can use to work out your capital gain. There is only one way to work out your capital loss.

The *Capital gain or capital loss worksheet* provided at the back of this guide shows the 3 methods of calculating a capital gain: the indexation method, the discount method and the 'other' method. You are not obliged to use this worksheet but you may find it helps you calculate your capital gain or capital loss for each CGT event.

You make a capital loss if your reduced cost base is greater than your capital proceeds—the excess is your capital loss.

NOTE ***New terms***

If there are terms in this chapter that are not familiar to you, refer to *Explanation of terms* at the back of this guide.

3 methods of calculating capital gain

The 3 methods of calculating capital gain are explained and compared in the table below.

The 'other' method is the method you use when neither the indexation nor discount method applies. It applies—for example, to any CGT asset you have bought and sold within 12 months. As a general rule, to calculate your capital gain using the 'other' method, you subtract your cost base from your capital proceeds.

You can use the indexation method to calculate your capital gain for assets you acquired before 21 September 1999 and owned for 12 months or more. This method allows you to increase the amount of your cost base (and reduce your capital gain) by an inflation factor based on increases in the Consumer Price Index (CPI) up to September 1999, see appendix 2.

You can use the discount method to calculate your capital gain for any asset that you have owned for 12 months or more. If you use this method you do not apply the indexation factor to the cost base but you may be able to reduce your capital gain by the CGT discount (50 per cent for individuals and trusts, $33\frac{1}{3}$ per cent for complying superannuation funds). Generally, the discount method does not apply to companies.

In some cases you may be able to choose either the discount method or the indexation method to calculate your capital gain. In this case use the method that gives you the better result.

Capital gain calculation methods

	Indexation method	Discount method	'Other' method
Description of method	Allows you to increase the cost base by applying an indexation factor based on CPI up to September 1999	Allows you to discount your capital gain	Basic method of subtracting the cost base from the capital proceeds
When to use the method	Use for an asset held for 12 months or more if it produces a better result than the discount method. Use only for assets acquired before 21 September 1999.	Use for an asset held for 12 months or more if it produces a better result than the indexation method.	Use when the indexation and discount methods do not apply (for example, if you have bought and sold an asset within 12 months).
How to calculate your capital gain using the method	Apply the relevant indexation factor (see CPI table at appendix 2), then subtract the indexed cost base from the capital proceeds (see worked example for Val on page 16).	Subtract the cost base from the capital proceeds, deduct any capital losses, then reduce by the relevant discount percentage (see worked example for Val on page 16).	Subtract the cost base (or the amount specified by the relevant CGT event) from the capital proceeds (see worked example for Marie-Anne on the next page).

The 'other' method

This is the simplest of the 3 methods. You must use the 'other' method to calculate your capital gain if you have bought and sold your asset within 12 months or generally for CGT events that do not involve an asset. In these cases, the indexation and discount methods do not apply.

EXAMPLE

Calculating a capital gain using the 'other' method

Marie-Anne bought a property for $150 000 under a contract dated 24 June 2001. The contract provided for the payment of a deposit of $15 000 on that date, with the balance of $135 000 to be paid on settlement on 5 August 2001.

Marie-Anne paid stamp duty of $5000 on 20 July 2001. On 5 August 2001, she received an account for solicitors fees of $2000 which she paid as part of the settlement process.

She sold the property on 15 October 2001, the day the contracts were exchanged, for $215 000. Marie-Anne incurred costs of $1500 in solicitors fees and $4000 in agents commission.

As she bought and sold her property within 12 months, Marie-Anne used the 'other' method to calculate her capital gain.

Deposit	$15 000
Balance	$135 000
Stamp duty	$5 000
Solicitors fees for purchase of property	$2 000
Solicitors fees for sale of property	$1 500
Agents commission	$4 000
Cost base (total)	**$162 500**

Marie-Anne works out her capital gain as follows:

Capital proceeds	$215 000
less cost base	$162 500
Capital gain calculated using the 'other' method	**$52 500**

Assuming Marie-Anne has not made any other capital losses or capital gains in the 2001–02 income year and does not have any prior year net capital losses, the net capital gain to be included at item **17** on her tax return is $52 500.

Generally, to use the 'other' method, you simply subtract your cost base (what the asset cost you) from your capital proceeds (how much you sold it for). The amount of proceeds left is your capital gain. For some types of CGT event, a cost base is not relevant. In these cases, the particular CGT event explains the amounts to use.

The indexation method

You can use the indexation method to calculate your capital gain if:

- a CGT event happens to an asset you acquired before 11.45 a.m. on 21 September 1999
- you owned the asset for 12 months or more.

This means that at the time of the CGT event, you can increase each element of the cost base (other than the 3rd element—non-capital costs of ownership) by an indexation factor.

As indexation was frozen as at 30 September 1999, you can index your cost base only up to the September 1999 quarter.

There are some exceptions to the requirement that you must have owned the asset for at least 12 months for indexation to apply. For example, you can use the indexation method:

- if you acquire a CGT asset as a legal personal representative or a beneficiary of a deceased estate. The 12-month requirement is satisfied if the deceased acquired the asset 12 months (or more) before you disposed of it
- if you acquired an asset as the result of a marriage breakdown. You will satisfy the 12-month requirement if the period your spouse owned the asset and the period you have owned the asset are in total equal to or greater than 12 months.

The indexation factor is worked out using the CPI at appendix 2.

For CGT events that occurred after 30 June 1999, the indexation factor is the CPI for the September 1999 quarter (123.4) divided by the CPI for the quarter in which you incurred costs relating to the asset.

If the CGT event happened on or after 21 September 1999, you use this formula:

$$\text{Indexation factor} = \frac{\text{CPI for quarter ending 30.9.99}}{\text{CPI for quarter in which expenditure was incurred}}$$

If the CGT event happened before 21 September 1999, you use this formula:

$$\text{Indexation factor} = \frac{\text{CPI for quarter when CGT event happened}}{\text{CPI for quarter in which expenditure was incurred}}$$

Work out the indexation factor to 3 decimal places, rounding up if the 4th decimal place is 5 or more.

For most assets, you index expenditure from the date you incur it, even if you do not pay some of the expenditure until a later time. However, there is an exception for partly paid shares or units acquired on or after 16 August 1989. If the company or trust later makes a call on the shares or units, you use the CPI for the quarter in which you made that later payment.

The discount method

You can use the discount method to calculate your capital gain if:

- you are an individual, a trust or a complying superannuation fund
- a CGT event happens in relation to an asset you own
- the CGT event happened after 11.45 a.m. on 21 September 1999
- you acquired the asset at least 12 months before the CGT event
- you did not choose to use the indexation method.

In determining whether you acquired the CGT asset at least 12 months before the CGT event, both the day of acquisition and the day of the CGT event are excluded.

EXAMPLE

Sally acquired a CGT asset on 2 February 2001. Sally is entitled to apply the CGT discount if a CGT event happens in relation to that asset on or after 3 February 2002.

In certain circumstances, you may be eligible for the CGT discount even if you have not owned the asset for at least 12 months. For example:

- if you acquire a CGT asset as a legal personal representative or as a beneficiary of a deceased estate. The 12-month requirement is satisfied if the asset was acquired by the deceased:
  - before 20 September 1985 and you disposed of it 12 months (or more) after they died or
  - on or after 20 September 1985 and you disposed of it 12 months or more after they acquired it
- if you acquired an asset as a result of a marriage breakdown, you will satisfy the 12-month requirement if the period your spouse owned the asset and the period you have owned the asset are in total equal to or greater than 12 months, or
- if a CGT asset is compulsorily acquired, lost or destroyed and you acquire a roll-over replacement asset, you will satisfy the 12-month requirement for the replacement asset if the period of ownership of the original asset and the replacement asset is at least 12 months.

Certain capital gains are excluded

The CGT discount does not apply to capital gains from certain CGT events. The full list of CGT events from A1 to K7 is shown in the summary at appendix 1. The CGT discount does not apply to CGT events D1, D2, D3, E9, F1, F2, F5, H2, J2 or J3.

If you make a capital gain from a CGT event that creates a new asset—for example, receiving a payment for agreeing not to do something (entering into a restrictive covenant), you cannot satisfy the 12-month ownership rule so your CGT event does not qualify for the CGT discount.

The CGT discount may be denied:

- if the CGT event that gave rise to the capital gain occurred under an agreement that was made within 12 months of the acquisition of the asset (section 115-30)
- on the disposal of certain shares or trust interests in non-widely held companies and trusts; that is, those with fewer than 300 members
- if an arrangement was entered into for the purposes of claiming the CGT discount under which an ‘income’ asset was converted into a ‘capital’ asset (conversion of income to capital) (part IVA of the *Income Tax Assessment Act 1936*).

Discount percentage

The discount percentage is the percentage by which you reduce your capital gain. You can reduce the capital gain only after you have applied all available capital losses.

The discount percentage is 50 per cent for individuals and trusts, and $33\frac{1}{3}$ per cent for complying superannuation funds.

Choosing the indexation or discount method

For assets you have held for 12 months or more, you may choose to use the indexation method or the discount method to calculate your capital gain. There is no one factor you can use as a basis to select the better option as it depends on the type of asset you own, how long you have owned it, the dates you owned it and the past rates of inflation. It is probably best to calculate your capital gain using both methods to find out which gives you the better result. This is shown below in the worked example for Val and the completed *Capital gain or capital loss worksheet* on the next page.

EXAMPLE

Choosing the indexation or discount method

Val bought a property for $150 000 under a contract dated 24 June 1991. The contract provided for the payment of a deposit of $15 000 on that date, with the balance of $135 000 to be paid on settlement on 5 August 1991.

She paid stamp duty of $5000 on 20 July 1991. On 5 August 1991, she received an account for solicitors fees of $2000, which she paid as part of the settlement process.

She sold the property on 15 October 2001 (the day the contracts were exchanged) for $215 000. She incurred costs of $1500 in solicitors fees and $4000 in agents commission.

Val's capital gain calculated using the indexation method

Deposit × indexation factor $15 000 × (123.4 ÷ 106.0 = 1.164)	=	$17 460
Balance × indexation factor $135 000 × (123.4 ÷ 106.6 = 1.158)	=	$156 330
Stamp duty × indexation factor $5000 × (123.4 ÷ 106.6 = 1.158)	=	$5 790
Solicitors fees for purchase of property × indexation factor $2000 × (123.4 ÷ 106.6 = 1.158)	=	$2 316
Solicitors fees for sale of property (indexation does not apply)		$1 500
Agents commission (indexation does not apply)		$4 000
Cost base (total)		**$187 396**

Val works out her capital gain as follows:

Capital proceeds	$215 000
less cost base	$187 396
Capital gain (Val's total current year capital gain using this method)	**$27 604**

Assuming Val has not made any other capital losses or capital gains in the 2001–02 income year and does not have any prior year net capital losses, her net capital gain using the indexation method is $27 604.

Val's capital gain calculated using the discount method

Deposit	$15 000
Balance	$135 000
Stamp duty	$5 000
Solicitors fees for purchase of property	$2 000
Solicitors fees for sale of property	$1 500
Agents commission	$4 000
Cost base (total)	**$162 500**

Val works out her capital gain as follows:

Capital proceeds	$215 000
less cost base	$162 500
Discount capital gain (Val's total current year capital gain using this method)	**$52 500**
less 50% discount (as Val has no capital losses)	**$26 250**
Net capital gain	**$26 250**

As the discount method provides Val with the better result, she will show the amount worked out using the discount method on her tax return rather than the amount worked out using the indexation method.

The following shows how Val might complete the *Capital gain or capital loss worksheet* using both methods.

Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

CGT asset type or CGT event

- Shares and units (in unit trusts) ☐
- Real estate ☒
- Other CGT assts and any other CGT events[4] ☐
- Collectables[5] ☐

Description of CGT asset or CGT event Val's property at 15 Smith St, Oldtown

Date of acquisition 24/6/1991 **Date of CGT event** 15/10/2001

Elements of the cost base or reduced cost base

	1 Amount	2 Amounts to be deducted for cost base[9]	3 Cost base (1 – 2)	4 Amounts to be deducted for reduced cost base[9]	5 Reduced cost base[9] (1 – 4)	6 Indexation factor[10]	7 Cost base indexed (3 x 6)
Acquisition or purchase cost of the CGT asset[6]	15 000 135 000		15 000 135 000	0 0	15 000 135 000	123.4 ÷ 106.0 123.4 ÷ 106.6	17 460 156 330
Incidental costs to acquire the CGT asset	7 000		7 000	0	7 000	123.4 ÷ 106.6	8 106
Incidental costs that relate to the CGT event[7]	5 500		5 500	0	5 500	1 (no indexation)	5 500
Non-capital costs of ownership of the CGT asset[8]							
Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event							
Capital costs to establish, preserve or defend title to, or a right over, the CGT asset							
	Cost base unindexed		$ 162 500				
		Reduced cost base			$ 162 500		
					Cost base indexed		$ 187 396

Capital gain calculation

Indexation method		**Discount method**		**'Other' method (CGT asset held less than 12 months)**	
Capital proceeds[11]	$ 215 000	Capital proceeds[11]	$ 215 000	Capital proceeds[11]	$
Less: cost base indexed	$ 187 396	*Less:* cost base unindexed	$ 162 500	*Less:* cost base unindexed	$
Capital gain (a)	**$** 27 604	**Capital gain (b)***	**$** 52 500	**Capital gain**	**$**

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

Capital loss calculation

Capital loss	
Reduced cost base	$
Less: capital proceeds[11]	$
Capital loss[12]	**$**

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

How to calculate a capital loss

Generally, you make a capital loss if your reduced cost base is greater than your capital proceeds. The excess is your capital loss.

EXAMPLE

Write-off deduction

Antonio acquired a new income-producing asset on 28 September 1994 for $100 000. He sold it for $90 000 in November 2001. During the period he owned it, he was allowed write-off deductions of $7500. Antonio works out his capital loss as follows.

Cost base	$100 000
less write-off deduction	$7 500
Reduced cost base	$92 500
less capital proceeds	$90 000
Capital loss	$2 500

EXAMPLE

Capital loss (reduced cost base greater than capital proceeds)

In July 1996, Chandra bought 800 shares at $3 per share. He incurred brokerage fees and stamp duty of $100. In December 2001, Chandra sold all 800 shares for $2.50 per share. He incurred brokerage fees of $75. He made a capital loss, calculated as follows.

Calculation of reduced cost base

Date expense incurred	*Description of expense*	*Expense*
July 1996	Purchase price	$2 400
July 1996	Brokers fees and stamp duty	$100
December 2001	Brokers fees and stamp duty	$75
Reduced cost base		$2 575

Calculation of capital loss

Reduced cost base	$2 575
Capital proceeds 800 × $2.50	$2 000
Capital loss	$575

However, the reduced cost base is not relevant for some types of CGT events. In these cases, the particular CGT event explains the amounts to use (see *Summary of CGT events,* appendix 1).

NOTE ***Reduced cost base***

You cannot index a reduced cost base.

EXAMPLE

Applying losses and the CGT discount

Sharni acquired some shares in June 1992 and some units in a unit trust in May 1996. She had a net capital loss of $12 000 from the 2000–01 income year (a prior year) and made a further capital loss of $6000 in August 2001 (the current year).

Sharni sold the shares in July 2001 and made a capital gain of $4000 calculated using the indexation method. She then sold the units during February 2002 and made a capital gain of $22 000 calculated using the discount method.

Sharni may choose to apply her capital losses in any order. However, she must subtract all of her capital losses from her capital gains before applying the CGT discount to any remaining capital gain calculated using the discount method.

She chooses to apply the $6000 current year capital loss firstly against the $4000 gain realised in July 2001, leaving a current year capital loss balance of $2000.

$4000 – $6000 = $2000 capital loss remaining

Sharni then applies the remaining $2000 current year capital loss and the prior year net capital loss of $12 000 (a total of $14 000) against the gain of $22 000 calculated using the discount method.

$22 000 – $14 000 = $8000

She then applies the CGT discount of 50 per cent to the remaining capital gain of $8000.

$8000 × 50% = $4000

This means Sharni's net capital gain for the 2001–02 income year is $4000.

NOTE ***Deducting capital losses***

If Sharni had deducted her capital losses first from her discount capital gains, her net capital gain would have been

[($22 000 – $18 000) × 50% + $4000] = $6000

CHAPTER 3 Keeping records

You must keep records of everything that affects your capital gains and capital losses. There are penalties if you do not keep the records for at least 5 years after the last relevant CGT event. If you make a net capital loss, you may need to keep your records for a longer period—for 5 years after any CGT event where you make a capital gain that you reduce by applying your net capital loss.

Keeping adequate records of all expenditure will help you correctly work out the amount of capital gain or capital loss you have made when a CGT event happens. It will also help make sure you do not pay more CGT than is necessary.

Keeping good records can help your beneficiaries reduce the impact of CGT after you die. If you leave an asset to another person, the asset may be subject to CGT when a CGT event happens to that asset in the future—for example, if your daughter (the beneficiary) sells the house (the asset) you have left her in your will.

What records do you need to keep?

You must keep records of every act, transaction, event or circumstance that may be relevant to working out whether you have made a capital gain or capital loss from a CGT event. It does not matter whether the CGT event has already happened or whether it may happen in the future.

The records must be in English (or be readily accessible or convertible to English) and must show:

- the nature of the act, transaction, event or circumstance
- the day it happened
- who did the act or who were the parties to the transaction
- how the act, transaction, event or circumstance is relevant to working out the capital gain or capital loss.

The following are examples of records you may need to keep:

- receipts of purchase or transfer
- details of interest on money you borrowed relating to this asset
- records of agent, accountant, legal and advertising costs
- receipts for insurance costs and land rates or taxes
- any market valuations
- receipts for the cost of maintenance, repairs or modifications
- accounts showing brokerage fees on shares.

You should also keep records to establish whether you have claimed an income tax deduction for an item of expenditure. In many cases if you have claimed a deduction for an amount it cannot be taken into account for CGT purposes.

Records relating to real estate

Real estate can include the family home, vacant blocks of land, business premises, rental properties, holiday houses and hobby farms.

Even though your family home is usually exempt, if you acquired it on or after 20 September 1985 it is advisable to keep all records relating to the home, just as you would for other items of real estate. If the home ceases to be fully exempt at some time in the future, you will need to know the full cost of the home so that you do not pay more CGT than necessary. If you do not have sufficient records, reconstructing them later could be difficult. See chapter 6 page 41 for details of when your home may not be fully exempt.

You will need to keep a copy of the purchase contract and all receipts for expenses relating to the purchase of the property—for example, stamp duty, legal fees, survey and valuation fees. You will also need to keep all records relating to the CGT event and all relevant expenses—for example, the sale contract and records of legal fees and stamp duty.

Keep a record of capital expenditure on improvements, non-capital costs and capital expenditure on maintaining title or right to the asset that you incurred during your period of ownership. These costs may form part of the cost base in working out whether you have made a capital gain or capital loss at the time the CGT event happens.

Capital expenditure on improvements may include building an extension, addition or improvement, including initial repairs.

Examples of non-capital costs of real estate include interest, rates and taxes, insurance premiums and cost of repairs—for example, replacing broken items. You may include only non-capital costs incurred on ownership of a CGT asset acquired on or after 21 August 1991 and only if you are not entitled to a tax deduction for them.

If the property is your home and you use it to produce income (for example, by renting out part or all of it), you will need to keep records of the period the home is producing income and the proportion of the home you have used to produce income.

If, after 20 August 1996, you use your home for income-producing purposes for the first time, you will be taken to have acquired your home at that time for its market value. You will use this as your acquisition cost to calculate a capital gain or capital loss at the time the CGT event happens. You will still need to keep details of expenses relating to your home after the date it started producing income.

Records relating to shares in companies and units in unit trusts

Most of the records you need to keep to work out your CGT when you dispose of shares in companies or units in unit trusts (including managed funds) will be given to you by the company, the unit trust manager or your stockbroker. It is important for you to keep everything they give you in relation to your shares and units.

These records will generally provide the following important information:

- the date of purchase of the shares or units
- the amount paid to purchase the shares or units
- the date and amount of any calls if shares were partly paid
- the sale price if you sell them
- any commissions paid to brokers when you buy or sell them.

There are special CGT rules for certain shares and units which may affect the records you keep—for example, bonus shares and units, rights and options, and employee shares. See chapter 5 for more information.

Records relating to bonus shares

To be safe, if you have received any bonus shares on or after 20 September 1985, keep all the documents the company gives you.

For any bonus shares issued before 1 July 1987, you need to know when the original shares were acquired. If you acquired them on or after 20 September 1985, you will also need to know what they cost. Flowchart 1 appendix 3 summarises the different rules applying to the treatment of bonus shares.

Keep a record of any amounts you paid to acquire the bonus shares and any amounts taxed as a dividend when they were issued.

Records relating to inheriting an asset

You must keep special records when you inherit an asset as a beneficiary of the estate of a person who died on or after 20 September 1985. If the asset was acquired by the deceased person before 20 September 1985, you need to know the market value of the asset at the date of the person's death and the amount of any relevant costs incurred by the executor or trustee. This is the amount that the asset is taken to have cost you. If the executor or trustee has a valuation of the asset, get a copy of that valuation report. Otherwise you will need to get your own valuation.

If the asset you inherit was acquired by the deceased person on or after 20 September 1985, you need to know full details of all relevant costs incurred by the deceased person and by the executor or trustee. Get those details from the executor or trustee. Even if you inherit a house that was the family home of the deceased person, you need to keep records of costs paid by the deceased person in case you are not able to claim a full exemption for the house after you inherit it.

If, after 20 August 1996, you inherit a house that was the family home of the deceased and it was not regarded as being used to produce income at the time of death, you will be taken to have acquired the house at its market value at the date of death. If the executor or trustee has a valuation of the asset, get a copy of that valuation report. Otherwise you will need to get your own valuation. Make sure you keep details of any other costs you have paid out for the asset since the date you inherited it.

Asset registers

You can choose to enter information from your CGT records into an asset register. Keeping an asset register may enable you to discard records that you might otherwise be required to keep for long periods of time.

If you choose to keep an asset register, transfer the following information to it from the normal records you need to keep for CGT purposes:

- the date of acquisition of an asset
- the cost of the asset
- a description, amount and date for each cost associated with the purchase of the asset (for example, stamp duty and legal fees)
- other information contained in a record that may be relevant in calculating your CGT obligation
- the date the CGT event happened to the asset
- the capital proceeds received when the CGT event happened.

This information must be certified by a registered tax agent or a person approved by the Commissioner of Taxation.

If you use an asset register, you must keep the documents from which you have transferred the information for 5 years from the date the asset register entry in question has been certified. You must keep the asset register entries for 5 years from the date the related CGT event happens or after you have applied any capital loss against capital gains.

For more information about asset registers, get the publication *CGT asset register* from the sources listed at the back of this guide.

Exceptions

You do not need to keep records if, for any CGT event, a capital gain or capital loss is disregarded. For example, you do not need to keep records for a motor vehicle as it is an exempt asset.

It is never too late

If you have acquired assets on or after 20 September 1985 and have not kept records, or your records have inadvertently been destroyed, you can still do something about it.

If you have bought real estate, your solicitor or real estate agent may have copies of most of the records you need. You should be able to get copies if you ask for them.

If you have made improvements to an investment property—for example, if you built an extension, you can ask for a copy of the builder's receipt for payment.

If you have bought shares in a company or units in a unit trust, your stockbroker or investment adviser may be able to supply you with the information you need.

If you receive an asset as a gift and you did not get a market valuation at the time, a professional valuer can tell you what its market value was at the relevant date.

The main thing is to obtain as many details as possible so you can reconstruct your records. You should make sure you keep sufficient records in the future.

CHAPTER 4 Trust distributions

This chapter explains how distributions from trusts (including managed funds) can affect your CGT position. Distributions from trusts can include different amounts but the following 2 types of amounts are relevant for CGT purposes:

- capital gains
- non-assessable payments.

Non-assessable payments mostly affect the cost base of units in a unit trust (including managed funds) but can in some cases create a capital gain. Non-assessable payments do not affect beneficiaries of a discretionary trust.

Managed funds include property trusts, share trusts, equity trusts, growth trusts, imputation trusts and balanced trusts.

NOTE ***New terms***

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

Trustees, including fund managers, may use different terms to describe the methods of calculation and other terms used in this guide. For example, they may use the term 'non-discount gains' when they refer to capital gains worked out using the indexation and 'other' methods.

Capital gains made by trust

STEP 1 EXCLUDE NET CAPITAL GAINS FROM TRUST INCOME ITEM

If you are a beneficiary of a trust, you may be entitled to (or may have received) a share of the net income of the trust which includes some of the trust's net capital gain. In this case, you do not include your share of the trust's net capital gain at item **12 Partnerships and trusts** on your tax return. Instead, you are treated as having a capital gain (or capital gains) worked out, as explained in step 2.

NOTE ***Item 12 on tax return for individuals***

Question **12** in *TaxPack 2002* asks you to exclude net capital gains from the amount of trust income shown at **U** item **12** on your tax return. In your distribution statement, the trust should state the amount(s) of capital gain in your trust distribution.

However, if your statement shows that your share of the trust's net capital gain is more than the overall net amount of your share of the trust's net income, do not exclude the whole capital gain component when you complete item **12** on your tax return. In this situation, you exclude instead only the overall net amount of your share of trust income. You also use only this lesser amount in working out your capital gains.

EXAMPLE

Capital gain greater than share of trust net income

Debra's trust distribution shows that she received $2000 as her share of the net income of a trust.

This is made up of a primary production loss of $5000, non-primary production income of $2000 and a net capital gain of $5000.

At item **12** on her tax return, Debra will show $5000 loss from primary production at **L** and $5000 non-primary production income at **U** .

She excludes only $2000 from item **12** because her share of the net income of the trust ($2000) is less than her share of the net capital gain. The $2000 is the amount Debra uses in working out her net capital gain at **A** item **17** on her tax return.

STEP 2 CAPITAL GAIN YOU ARE TAKEN TO HAVE MADE

If you are a beneficiary who is entitled to a share of a trust net capital gain you are taken to have made the following extra capital gains.

You may be a beneficiary who is entitled to a share of the income of a trust that includes a capital gain reduced by the CGT discount or the small business 50 per cent active asset reduction. In this case, you need to gross up the capital gain by multiplying it by 2. This grossed-up amount is an extra capital gain.

You multiply by 4 your share of any part of the net capital gain from a trust that the trust has reduced by both the CGT discount and the small business 50 per cent active asset reduction. This grossed-up amount is an extra capital gain.

NOTE ***Grossed-up gains***

If you are entitled to any part of the net capital gain from a trust that the trust has not reduced by one of these concessions, then that amount is an extra capital gain.

NOTE
No double taxation

You are not taxed twice on these extra capital gains because you did not include your capital gains from the trust at item **12** on your tax return.

These extra capital gains are taken into account in working out your net capital gain for the income year. You include them at step 2 in part B or part C.

EXAMPLE

Distribution where the trust claimed concessions

Serge is a beneficiary in the Shadows Unit Trust. He receives a distribution of $2000 from the trust. This distribution includes $250 of net income remaining after a $1000 capital gain made by the trustee was reduced by the CGT discount and the small business 50 per cent active asset reduction.

Serge has also made a capital loss of $100 from the sale of shares.

He calculates his net capital gain as follows:

Gross up the share of trust net capital gain ($250) by multiplying by 4	$1000
Deduct capital losses	$100
	$900
Apply the CGT discount of 50 per cent	$450
	$450
Apply the 50 per cent active asset reduction	$225
Net capital gain	**$225**

Serge will show $1000 at H item **17** on his tax return, which is his total current year capital gain.

His net capital gain to be shown at A item **17** on his tax return is $225. He will show a trust distribution of $1750 ($2000 – $250) at U item **12** on his tax return.

NOTE
Applying the concessions

Remember that you must use the same method as the trust to calculate your capital gain.

This means you cannot apply the CGT discount to capital gains distributed to you from the trust calculated using the indexation method or 'other' method.

Also, you can only apply the small business 50 per cent active asset reduction to grossed-up capital gains to which the trust applied that concession.

Non-assessable payments from a trust

It is quite common for a trust to make non-assessable payments to beneficiaries.

If a profit made by the trust is not assessable, any part of that profit distributed to a beneficiary will also be non-assessable in most cases—for example, a share of a profit made on the sale of property acquired by the trust before 20 September 1985.

However, if you receive non-assessable payments from a trust, you need to make cost base adjustments to your units or trust interest. Those adjustments will affect the amount of any capital gain or capital loss you make on the unit or interest (for example, when you sell it). If certain amounts exceed your cost base, you may also make a capital gain equal to that excess in the year it is paid to you.

NOTE
Capital loss

You cannot make a capital loss from a non-assessable payment.

If relevant to you, non-assessable payments may be shown on your distribution statement as:

- tax-free amounts (where certain tax concessions allowed to the trust, means it can pay greater distributions to its unit holders)
- CGT-concession amounts (the trust's CGT discount and capital losses components of any actual distribution)
- tax-exempted amounts (generally made up of exempt income of the trust, amounts on which the trust has already paid tax or income you had to repay to the trust), or
- tax-deferred amounts (other non-assessable payments, including indexation allowed to the trust on its capital gains and accounting differences in income).

Before 1 July 2001, a payment of an amount associated with building allowances was treated as a tax-free amount. Payments on or after that date are treated as tax-deferred amounts.

A CGT-concession amount received before 1 July 2001 was treated in the same way as a tax-deferred amount. From this date, CGT-concession amounts no longer require a cost base/reduced cost base adjustment.

Tax-exempted amount and CGT-concession amounts do not affect your cost base or reduced cost base.

However, if your statement shows any tax-deferred or tax-free amounts, you adjust the cost base and reduced cost base as follows:

- cost base—deduct the tax-deferred amounts from the cost base
- reduced cost base—add the tax-deferred amounts and the tax-free amounts and deduct the total from the reduced cost base.

Generally, you make any adjustment to the cost base or reduced cost base of your unit or trust interest at the end of the income year. However, if some other CGT event happens to the unit or trust interest during the year (for example, you sell your units) you must adjust the cost base or reduced cost base just before the time of that CGT event. The amount of the adjustment is based on the amount of non-assessable payments paid to you up to the date of sale. You use the adjusted cost base or reduced cost base to work out your capital gain or capital loss (see chapter 2 page 13 for more information).

The cost base and reduced cost base adjustments are more complex if you deducted capital losses from a grossed-up capital gain where a capital gain made by the trust was reduced by the small business 50 per cent active asset reduction. If this applies to you, you may need to seek advice from the ATO on how to make the adjustments.

If the tax-deferred amount is greater than the cost base of your unit or trust interest, you include the excess as a capital gain. You can use the indexation method if you bought your units or trust interest before 21 September 1999. However, if you do so, you cannot use the discount method to work out your capital gain when you later sell the units or trust interest.

EXAMPLE

Bob has received a non-assessable amount.

Bob owns units in OZ Investments Fund which distributed income to him for the year ending 30 June 2002. The fund gave him a statement showing his distribution included the following capital gains:

- $100 calculated using the discount method (grossed-up amount $200)
- $75 calculated using the indexation method
- $28 calculated using the 'other' method.

These capital gains add up to $203.

The statement shows Bob's distribution did not include a tax-free amount but it did include:

- $105 tax-deferred amount.

From his records, Bob knows that the cost base and reduced cost base of his units are $1200 and $1050 respectively.

Bob has no other capital gains or capital losses for the 2001–02 income year.

Bob follows these steps to work out the amounts to show on his tax return.

As Bob has a capital gain which the fund reduced under the CGT discount of 50 per cent ($100), he includes the grossed-up amount ($200) in his total current year capital gain.

Bob adds the grossed-up amount to his capital gains calculated using the indexed method and 'other' method to work out his total current year capital gains:

$200 + $75 + $28 = $303

As Bob has no other capital gains or capital losses, and he must use the discount method in relation to the capital gains calculated using the discount method from the trust, his net capital gain is equal to the amount of capital gain included in his distribution from the fund ($203).

Bob completes item **17** on his tax return as follows:

17 Capital gains

Did you have a CGT event during the year? G [ ] NO [X] YES — You must also print X in the YES box at G if you received a distribution of a capital gain from a trust.

Net capital gain A , , 2 0 3 .00

Total current year capital gains H , 3 0 3 .00

Net capital losses carried forward to later income years V , .00

Records Bob needs to keep

The tax-deferred amount Bob received is not included in his income or his capital gains but it affects the cost base and reduced cost base of his units in OZ Investments Fund for future income years.

Bob deducts the tax-deferred amount from both the cost base and reduced cost base of his units as follows:

Cost base	$1 200
less tax-deferred amount	$105
New cost base	**$1 095**
Reduced cost base	$1 050
less tax-deferred amount	$105
New reduced cost base	**$945**

EXAMPLE

Ilena's capital loss is greater than her non-discounted capital gain.

Ilena invested in XYZ Managed Fund. The fund made a distribution to Ilena for the year ending 30 June 2002 and provided her with a statement that shows her distribution included:

- $65 discounted capital gain
- $90 non-discounted capital gain.

The statement shows Ilena's distribution also included:

- $30 tax-deferred amount
- $35 tax-free amount.

Ilena has no other capital gains but made a capital loss of $100 on some shares she sold during the year.

From her records, Ilena knows the cost base and reduced cost base of her units are $5000 and $4700 respectively.

Ilena has to treat the capital gain component of her fund distribution as if she made the capital gain. To complete her tax return, Ilena must identify the capital gain component of her fund distribution and work out her net capital gain.

Ilena follows these steps to work out the amounts to show at item **17** on her tax return.

As Ilena has a $65 capital gain which the fund reduced by the CGT discount of 50 per cent, she must gross up the capital gain. She does this by multiplying the amount of the discounted capital gain by 2:

$65 × 2 = $130

Ilena adds her grossed-up and non-discounted capital gains to work out her total current year capital gains:

$130 + $90 = $220

She shows her total current year capital gains ($220) at **H** item **17** on her tax return.

After Ilena has grossed up the discounted capital gain received from the fund, she subtracts her capital losses from her capital gains.

Ilena can choose which capital gains she subtracts the capital losses from first. In her case, she gets the better result if she:

- first subtracts her capital losses from her non-discounted capital gains: $90 – $90 = $0
- then subtracts any remaining capital losses from her grossed-up gains: $130 – $10 = $120

Ilena applies the CGT discount of 50 per cent to the remaining grossed-up capital gains:

$120 – ($120 × 50%) = $60

Ilena adds up the capital gains remaining after applying the CGT discount. The total is her net capital gain:

$60 + $0 = $60

Ilena completes item **17** on her tax return as follows:

17 Capital gains

Did you have a CGT event during the year? **G** ☐ NO ☒ YES

You must also print X in the **YES** box at **G** if you received a distribution of a capital gain from a trust.

Net capital gain **A** 60.00

Total current year capital gains **H** 220.00

Net capital losses carried forward to later income years **V** .00

Records Ilena needs to keep

The tax-deferred and tax-free amounts Ilena received are not included in her income or her capital gain but the tax-deferred amount affects the cost base and reduced cost base of her units in XYZ Managed Fund for future income years. The tax-free amount affects her reduced cost base.

Ilena reduces the cost base and reduced cost base of her units as follows:

Cost base	$5 000
less tax-deferred amount	$30
New cost base	**$4 970**
Reduced cost base	$4 700
less tax-deferred amount ($30) + tax-free amount ($35)	$65
New reduced cost base	**$4 635**

CHAPTER 5 Investment in shares and units

This chapter explains your CGT obligations if you sold or otherwise disposed of any shares or units in a unit trust (including a managed fund) in 2001–02. For information about distributions from a unit trust in 2001–02, see chapter 4.

> **NOTE** ***Managed fund***
>
> A managed fund is a unit trust. Where we refer to a unit trust in this guide we are also referring to a managed fund.

> **NOTE** ***Listed investment companies***
>
> From 1 July 2001, if a listed investment company (LIC) pays a dividend to you that includes an **LIC capital gain amount**, you may be entitled to a deduction. If you have received such an amount you should refer to the publication *You and your shares* from the sources listed at the back of this guide.

How capital gains tax affects shares and units

For CGT purposes, shares in a company or units in a unit trust are treated in the same way as any other assets.

As a general rule, if you acquire any shares or units on or after 20 September 1985, you may have to pay tax on any capital gain you make when a CGT event happens to them. This would usually be when you sell or otherwise dispose of them. In this case, CGT event A1 would happen. You will find a list of all CGT events at appendix 1.

> **NOTE** ***New terms***
>
> There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

A CGT event might happen to shares even if a change in their ownership is involuntary—for example, if the company in which you hold shares is taken over or merges with another company. This may result in a capital gain or capital loss.

This chapter also deals with the receipt of non-assessable payments from a company (CGT event G1) while chapter 4 deals with non-assessable payments from a trust (CGT event E4). If you own shares in a company that has been placed in liquidation, CGT event G3 explains how you can choose to make a capital loss when the liquidator declares the shares worthless.

There are a number of special CGT rules if you receive such things as bonus shares, bonus units, rights, options or non-assessable payments from a company or trust. Special rules also apply if you buy convertible notes or participate in an employee share scheme or a dividend reinvestment plan.

The rest of this chapter explains these rules and contains examples showing how they work in practice. The flowcharts at appendix 3 will also help you work out whether the special rules apply to you.

If you need more information about how other income tax provisions affect your share investments, get the publication *You and your shares* from the sources listed at the back of this guide.

Identifying shares or units sold

Sometimes taxpayers own shares or units that they may have acquired at different times. This can happen as people decide to increase their investment in a particular company or unit trust. A common question people ask when they dispose of only part of their investment is how to identify the particular shares or units they have disposed of.

This can be very important because shares or units bought at different times may have different amounts included in their cost. In calculating the capital gain or capital loss when disposing of only part of an investment, you need to be able to identify which ones you have disposed of. Also, when you dispose of any shares or units you acquired before 20 September 1985, any capital gain or capital loss you make is generally disregarded.

If you have the relevant records (for example, share certificates), you may be able to identify which particular shares or units you have disposed of. In other cases, the Commissioner will accept your selection of the identity of shares disposed of.

Alternatively, you may wish to use a 'first in, first out' basis where you treat the first shares or units you bought as being the first you disposed of.

In limited circumstances, the ATO will also accept an average cost method to determine the cost of the shares disposed of. This average cost method can be used only when:

- the shares are in the same company
- the shares are acquired on the same day
- the shares have identical rights and obligations
- you are not required to use market value for cost base purposes.

EXAMPLE

Identifying when shares or units were acquired

Boris bought 1000 shares in WOA Ltd on 1 July 1997. He bought another 3000 shares in the company on 1 July 2001.

In December 2001, WOA Ltd issued Boris with a CHESS statement for his 4000 shares. When he sold 1500 of the shares on 1 January 2002, he was not sure whether they were the shares he bought in 2001 or whether they included the shares bought in 1997.

Because Boris could not identify when he bought the particular shares he sold, he decided to use the 'first in, first out' method and nominated the 1000 shares bought in 1997 plus 500 of the shares bought in 2001.

Demutualisation of insurance companies

If you hold a policy in an insurance company that demutualises, you may be subject to CGT either at the time of the demutualisation or when you sell your shares. A company demutualises when it changes its membership interests to shares (for example, the NRMA). There are similar rules if you are a member of a non-insurance organisation which demutualises.

The insurance company may give you an option either to keep your share entitlement or to take cash by selling the shares under contract through an entity set up by the company. If you choose to keep the shares, you will not be subject to CGT until you eventually sell them.

However, if you elect to sell your share entitlement and take cash, you need to include any capital gain on your tax return in the income year in which you entered into the contract to sell the shares, even though you may not receive the cash until a later income year.

The demutualising company will write to all potential 'shareholders' and advise them of the acquisition cost in each instance, sometimes referred to as the 'embedded value'. Even though you did not pay anything to acquire the shares, they have a value that is used for CGT purposes.

Share buy-backs

As a shareholder, you may have received an offer from the company to buy back some or all of your shares in the company. If you disposed of shares back to the company under a buy-back arrangement, you may have made a capital gain or capital loss from that CGT event.

Some of the buy-back price may also be treated as a dividend for tax purposes. The time you make the capital gain or capital loss will depend on the conditions of the particular buy-back offer. It may be the time you lodge your application to participate in the buy-back, or if it is a conditional offer of buy-back, the time the offer is accepted.

If the information provided by the company is not sufficient for you to calculate your capital gain or capital loss, refer to *Recent share transactions* at appendix 4 or to the sources of further information listed at the back of this guide.

EXAMPLE

Buy-back offer

Sam bought 4500 shares in Company A in January 1994 at a cost of $5 per share. In February 2002, Sam applied to participate in a buy-back offer to dispose of 675 shares (15 per cent). Company A approved a buy-back of 10 per cent (450) of the shares on 15 June 2002. The company sent Sam a cheque on 5 July for $4050 (450 shares x $9). No part of the distribution is a dividend.

Sam works out his capital gain for 2001–02 as follows.

If he chooses to use the indexation method:

Capital proceeds	$4 050
Cost base 450 shares × $5 ($2250 × 1.118 including indexation)	$2 515
Capital gain	$1 535

If he chooses to use the discount method:

Capital proceeds	$4 050
Cost base	$2 250
Discount capital gain	$1 800

Sam has no capital losses to apply against this capital gain and decides that the discount method will provide him with the better result. He will include $900 ($1800 × 50%) in his assessable income.

Shares in a company in liquidation

Where a company is placed in liquidation, company law restricts the transfer of shares in the company. This means that, in the absence of special CGT rules, you may not be able to realise a capital loss on shares that have become worthless.

In certain circumstances, you can choose to realise a capital loss on worthless shares prior to dissolution (if you had acquired the shares on or after 20 September 1985). This applies if you own shares in a company and the liquidator declares in writing that there is no likelihood you will receive any further distribution in the course of winding up the company. The liquidator's declaration can still be made after you receive a distribution during the winding-up.

If you make this choice, you will make a capital loss equal to the reduced cost base of the shares at the time of the liquidator's declaration. The cost base and reduced cost base of the shares are reduced to nil just after the liquidator makes the declaration.

These rules do not apply:

- where a company is placed in receivership or is de-listed, or
- to units in unit trusts.

EXAMPLE

The liquidators of HIH Insurance Ltd made a written declaration on 10 October 2001 that they had reasonable grounds to believe that there was no likelihood that the shareholders of HIH Insurance Ltd would receive any distribution in the course of the winding up.

Hillary purchased shares in HIH Insurance Ltd on 1 August 1999. CGT event G3 happened in relation to her shares on 10 October 2001 when the liquidator made the declaration. Hillary chose to make capital losses equal to the reduced cost bases of her shares as at 10 October 2001.

If CGT event G3 has not happened or you have not chosen for it to apply, you may make a capital loss on shares when a court order is given to dissolve the company. Also, if a company is wound up voluntarily, shareholders may realise a capital loss either 3 months after a liquidator lodges a tax return showing that the final meeting of the company has been held, or on another date declared by a court. The cancellation of shares as a result of the dissolution of the company is an example of CGT event C2.

Takeovers and mergers

If a company in which you own shares is taken over or merges with another company, you may have a CGT obligation if you are required to dispose of your existing shares.

In certain circumstances, if you acquire new shares in the takeover or merged company, you may be able to defer paying CGT until a later CGT event happens. For more information, see **Scrip-for-scrip roll-over** on the next page.

Some takeover or merger arrangements involve an exchange of shares. In these cases, when you calculate your capital gain or capital loss, your capital proceeds will be the market value of the shares received in the takeover or merged company at the time of disposal of your original shares.

If you receive a combination of money and shares in the takeover or merged company, your capital proceeds are the total of the money and the market value of the shares you received at the time of disposal of the shares.

The cost of acquiring the shares in the takeover or merged company is the market value of your original shares at the time you acquire the other shares, reduced by any cash proceeds.

To correctly calculate the capital gain or capital loss for your original shares, you will need to keep records (in addition to the usual records) showing the parties to the arrangement, the conditions of the arrangement and the capital proceeds.

As each takeover or merger arrangement will vary according to its own particular circumstances, you need to obtain full details of the arrangement from the parties involved.

EXAMPLE

Takeover

We are assuming with this example that scrip-for-scrip roll-over does not apply (see below).

Desiree owns 500 shares in ABC Ltd. These shares are currently worth $2 each. Their cost base, with indexation, is $1.50.

XYZ Ltd offers to acquire each share in ABC Ltd for one share in XYZ Ltd and 75 cents cash. The shares in XYZ Ltd are valued at $1.25 each. Accepting the offer, Desiree receives 500 shares in XYZ Ltd and $375 cash.

The capital proceeds received for each share in ABC Ltd is $2 ($1.25 market value of each XYZ Ltd share plus 75 cents cash). Therefore, as the cost base of each ABC Ltd share is $1.50, Desiree will make a capital gain of 50 cents ($2 – $1.50) on each share, a total of $250.

The cost base of the newly acquired XYZ Ltd shares is the market value of the shares in ABC Ltd ($2) less the cash amount received ($0.75); that is, $1.25 each or a total of $625 (500 x $1.25).

Scrip-for-scrip roll-over

If a company in which you owned shares was taken over and you received new shares in the takeover company, you may be entitled to scrip-for-scrip roll-over. You may also be eligible for this roll-over if you exchange a unit or other interest in a fixed trust, for a similar interest in another entity.

Scrip-for-scrip roll-over is not available if a share is exchanged for a unit or other interest in a fixed trust, or if a unit or other interest in a fixed trust is exchanged for a share.

You can only choose the roll-over if you have made a capital gain from such an exchange on or after 10 December 1999. Roll-over does not apply to a capital loss.

Roll-over is only available if the exchange is in consequence of an arrangement that results in the acquiring entity (or the wholly owned group of which it is a member) becoming the owner of 80 per cent or more of the original company or trust.

For companies, the arrangement must be one in which all owners of voting shares in the original entity can participate. For trusts, this means all owners of trust voting interests in the original entity or, where there are no voting interests, all owners of units or other fixed interests can participate.

There are special rules if a company or trust has a small number of shareholders or beneficiaries or there is a significant common stakeholder. You will need to seek information from the company or trust about whether the conditions have been satisfied.

The roll-over allows you to disregard the capital gain made from the original shares, units or other interest. You are taken to have acquired the replacement shares, units or other interest for the cost base of the original interest.

You may only be eligible for partial roll-over if you exchange shares, units or interests for similar interests in another entity (replacement interest) plus something else, usually cash.

This is because roll-over applies only to the replacement interest. You will need to apportion the cost base of the original interest between the replacement interest and the cash (or other proceeds not eligible for roll-over).

If your original shares, units or other interests were acquired before 20 September 1985 (pre-CGT), you are not eligible for scrip-for-scrip roll-over. Instead, you acquire the replacement interest at the time of the exchange and the replacement interest is no longer a pre-CGT asset. However, the cost base of the replacement interest is its market value just after the acquisition.

EXAMPLE

Partial scrip-for-scrip roll-over

Gunther owns 100 shares in Windsor Ltd, each with a cost base of $9. He accepts a takeover offer from Regal Ltd which provides for Gunther to receive one Regal share plus $10 cash for each share in Windsor. Gunther receives 100 shares in Regal and $1000 cash. Just after Gunther is issued shares in Regal, each share is worth $20.

Gunther has received $10 cash for each of his 100 Windsor shares and so has ineligible capital proceeds of $1000.

In this case, it is reasonable to allocate a portion of the cost base of the original shares having regard to the proportion that the cash bears to the total proceeds. That is:

$1000 ÷ 3000 × $900 = $300

Gunther's capital gain is as follows:

$1000 Ineligible proceeds (cash)	–	$300 cost base	=	$700 capital gain

Gunther calculates the cost base of each of his Regal shares as follows:

$900 – $300 ÷ 100 = $6

EXAMPLE

Scrip-for-scrip roll-over

Stephanie owns ordinary shares in Reef Ltd. On 29 February 2002, she accepted a takeover offer from Starfish Ltd under which she received one ordinary share and one preference share for each Reef share. The market value of the Starfish shares just after Stephanie acquired them was $20 for each ordinary share and $10 for each preference share.

The cost base of each Reef share just before Stephanie ceased to own them was $15.

The offer made by Starfish Ltd satisfied all the requirements for scrip-for-scrip roll-over.

If roll-over did not apply, Stephanie would have made a capital gain per share of:

$30	–	$15	=	$15
Capital proceeds		cost base		capital gain

Scrip-for-scrip roll-over allows Stephanie to disregard the capital gain. The cost base of the Starfish shares is the cost base of the Reef Ltd shares.

NOTE ***Apportioning the cost base***

As the exchange is one share in Reef Ltd for 2 shares in Starfish Ltd, the cost base of the Reef Ltd share needs to be apportioned between the ordinary share and the preference share.

Cost base of ordinary share: $20 ÷ 30 × $15 = $10

Cost base of preference share: $10 ÷ 30 × $15 = $5

Dividend reinvestment plans

Some companies ask their shareholders whether they would like to participate in a dividend reinvestment plan. Under these plans, shareholders can choose to use their dividend to acquire additional shares in the company instead of receiving a cash payment. These shares are usually issued at a discount on the current market price of the shares in the company.

For CGT purposes, if you participate in a dividend reinvestment plan you are treated as if you had received a cash dividend and then used the cash to buy additional shares.

Each share (or parcel of shares) acquired in this way—on or after 20 September 1985—is subject to CGT. The cost base of the new shares includes the price you paid to acquire them; that is, the amount of the dividend.

EXAMPLE

Dividend reinvestment plans

Natalie owns 1440 shares in PHB Ltd. The shares are currently worth $8 each. In November 2001, the company declared a dividend of 25 cents per share.

Natalie could either take the $360 dividend as cash (1440 × 25 cents) or receive 45 additional shares in the company (360 ÷ 8).

Natalie decided to participate in the dividend reinvestment plan and received 45 new shares on 20 December 2001. She included the $360 dividend in her 2001–02 taxable income.

For CGT purposes, she acquired the 45 new shares for $360 on 20 December 2001.

Bonus shares

Bonus shares are additional shares a shareholder receives as a dividend in whole or in part. You may also pay an amount to obtain them.

If you receive bonus shares on or after 20 September 1985, you may have to pay CGT if you dispose of them. You may have to modify the cost base and the reduced cost base of bonus shares if they are taxed as a dividend.

The table below explains how the timing of your bonus shares affects your CGT.

As a result of changes to the company law and taxation laws, the paid-up value of bonus shares is now generally not taxed as a dividend. An exception to this rule is where you have the choice of being paid a cash dividend or of being issued shares under a dividend reinvestment plan. These shares are treated as dividends and the amount of the dividend is included in your assessable income.

Date	CGT implications of timing of bonus shares
From 20 Sep. 1985 to 30 Jun. 1987 incl.	Many bonus shares issued were paid out of a company's non-taxable capital profits, accumulated in an asset revaluation reserve from a share premium account. These bonus shares are not usually treated as taxable dividends.
From 1 Jul. 1987 to 30 Jun. 1998 incl.	The paid-up value of bonus shares issued is taxed as a dividend unless paid from a share premium account.
From 1 Jul. 1998	The paid-up value of bonus shares issued is not taxed as a dividend unless part of the dividend was paid in cash or paid as part of a dividend reinvestment plan.

There are other, less common circumstances where bonus shares will be taxed as a dividend—for example, where:

- the bonus shares are being substituted for a dividend to give a tax advantage or
- the company directs bonus shares to some shareholders and dividends to others to give them a tax benefit.

Flowchart 1 appendix 3 summarises the different rules applying to different bonus shares issued on or after 20 September 1985.

For more information about bonus shares, refer to the sources of further information listed at the back of this guide.

Bonus shares issued where no amount is taxed as a dividend

If you acquired the original shares on or after 20 September 1985, the acquisition date of bonus shares is the date you acquired the original shares. If an issue of bonus shares relates to both the original shares and the bonus shares, the acquisition date of the additional bonus shares is the date the original shares were issued. The cost of your original shares now covers your bonus shares as well.

The cost base or reduced cost base of the bonus shares is calculated by apportioning the amounts paid for the original shares between the original shares and the bonus shares. Effectively, this results in a reduction of the cost base of the original shares.

For original shares acquired before 20 September 1985, your CGT obligations depend on whether your shares are fully paid or partly paid. Any calls paid on partly paid bonus shares are also included in the cost base or reduced cost base of the bonus shares.

EXAMPLE

Fully paid bonus shares

Chris bought 100 shares in MAC Ltd for $1 each on 1 June 1985. He bought 300 more shares for $1 each on 27 May 1986. On 15 November 1986, MAC Ltd issued Chris with 400 bonus shares from its capital profits reserve, fully paid to $1. Chris did not pay anything to acquire the bonus shares and no part of the value of the bonus shares was taxed as a dividend.

For CGT purposes, the acquisition date of 100 of the bonus shares is 1 June 1985 (pre-CGT). Therefore, the bonus shares are not subject to CGT.

The acquisition date of the other 300 bonus shares is 27 May 1986. Their cost base is worked out by spreading the cost of the 300 shares Chris bought on that date over both those shares and the remaining 300 bonus shares. As the 300 original shares cost $300, the cost base of each share will now be 50 cents.

EXAMPLE

Partly paid bonus shares

Klaus owns 200 shares in MAC Ltd which he bought on 31 October 1984 and 200 shares in PUP Ltd bought on 31 January 1985.

On 1 January 1987, both MAC Ltd and PUP Ltd made their shareholders a one-for-one bonus share offer of $1 shares partly paid to 50 cents. Klaus elected to accept the offer and acquired 200 new partly paid shares in each company. No part of the value of the bonus shares was taxed as a dividend.

On 1 April 1989, PUP Ltd made a call for the balance of 50 cents outstanding on the partly paid shares, payable on 30 June 1989. Klaus paid the call payment on that date. MAC Ltd has not yet made any calls on its partly paid shares.

For CGT purposes, Klaus is treated as having acquired the bonus shares on the date he became liable to pay the call (1 April 1989). The cost base of the bonus shares includes the amount of the call payment (50 cents) plus the market value of the shares immediately before the call was made.

The MAC Ltd bonus shares will continue to have the same acquisition date as the original shares (31 October 1984) and are therefore not subject to CGT. However, this will not be the case if Klaus makes any further payments to the company on calls made by the company for any part of the unpaid amount on the bonus shares. In this case, the acquisition date of the bonus shares will be when the liability to pay the call arises and the bonus shares will then be subject to CGT.

Bonus shares issued where the paid-up value is taxed as a dividend

Where the paid-up value of bonus shares is taxed as a dividend, you may have to pay CGT when you dispose of the bonus shares, regardless of when you acquired the original shares. The acquisition date of the bonus shares is the date they were issued. Their cost base is the amount of the dividend, plus any call payments you made to the company if they were only partly paid.

The exception to this rule is where you received the bonus shares before 1 July 1987. Their cost base is calculated as if the amount was not taxed as a dividend (see **Bonus shares issued where no amount is taxed as a dividend** on page 31).

EXAMPLE

Cost base of bonus shares

Mark owns 1000 shares in RIM Ltd, which he bought on 30 September 1984 for $1 each.

On 1 February 1997, the company issued him with 500 bonus shares partly paid to 50 cents. The paid-up value of bonus shares ($250) is a taxable dividend to Mark.

On 1 May 1997, the company made a call for the 50 cents outstanding on each bonus share, which Mark paid on 1 July 1997.

The total cost base of the bonus shares is $500, consisting of the $250 dividend received on the issue of the bonus shares on 1 February 1997 plus the $250 call payment made on 1 July 1997.

The bonus shares have an acquisition date of 1 February 1997. If Mark holds the bonus shares for 12 months from that date, when he sells them he can use the indexation method to calculate his capital gain. Indexation for amounts payable to a company on shares in the company can be indexed only from the date of actual payment. In Mark's case, the $250 call payment can be indexed only from the date it was paid (1 July 1997).

However, indexation on the $250 dividend included in his taxable income on the issue of the bonus shares was available from 1 February 1997. This is different from the indexation treatment of amounts paid to acquire assets in other circumstances where indexation is available from the time the liability to make the payment arises. The indexation rules are explained in more detail in chapter 2.

If Mark disposes of the shares after 11.45 a.m. on 21 September 1999, he can calculate his capital gain using either the indexation method or the discount method.

Bonus units

If you have received bonus units on or after 20 September 1985, you may have to pay CGT if you make a capital gain when you dispose of them.

The CGT rules for bonus units are very similar to those for bonus shares. However, these rules do not apply if the bonus units are issued by a corporate unit trust or a public trading trust.

When the unit trust issues the bonus units, they will generally tell you what amount (if any) you have to include in your assessable income. You need to keep a record of that information to work out your CGT obligation when you dispose of them.

Flowchart 2 appendix 3 summarises the rules applying to bonus units issued on or after 20 September 1985.

Bonus units issued where no amount is included in assessable income

If you did not include any amount in your assessable income for the issue of bonus units, the acquisition date of the bonus units is the date you acquired the original units to which they relate.

The table on the next page explains your CGT obligation in these cases.

Original shares acquired before 20 Sep. 1985	CGT implications of fully paid versus partly paid bonus shares
Fully paid shares	If the bonus shares are fully paid, the acquisition date of the bonus shares is the date you acquired the original shares. Therefore, if you acquired the original shares before 20 September 1985, any capital gain or capital loss you make from the sale of the bonus shares is disregarded.
Partly paid shares	With certain exceptions, if the bonus shares were partly paid and you have made a call payment, the acquisition date for the bonus shares is the date when the liability to pay the amount arose. The cost of acquiring them includes their market value just before that date. A copy of a newspaper's stock market listing for that day is an appropriate record. **Exceptions**—For pre-10 December 1986 partly paid up bonus shares, the date of acquisition is the date you acquired the original shares. For post-10 December 1986 partly paid up bonus shares, the date of acquisition is also the date you acquired the original shares, provided you have not paid any amount subsequently (otherwise it becomes the date the liability to pay the amount arose).

EXAMPLE

Unit trusts

Sarah is a unit holder in the CPA Unit Trust. She bought 1000 units on 1 September 1985 for $1 each and 1000 units on 1 July 1996 for $2 each. On 1 March 1997, the unit trust made a one-for-one bonus unit issue to all unit holders. Sarah received 2000 new units. She did not include any amount in her assessable income as a result.

The 1000 new units issued for the original units she acquired on 1 September 1985 are also treated as having been acquired on that date and are therefore not subject to CGT.

However, the 1000 new units issued for the original units she acquired on 1 July 1996 are subject to CGT. Their cost base is worked out by spreading the cost of the original units ($2000) acquired on that date over both the original units and the bonus units. Each of the units therefore has a cost base of $1.

Bonus units issued where an amount is included in assessable income

If you include any amount in your assessable income as a result of the issue of bonus units, their acquisition date is the date they were issued, regardless of when you acquired the original units. The cost base of bonus units is the amount included in your assessable income as a result of the issue of those units, plus any calls you made if they were only partly paid.

Rights or options to acquire shares or units

Acquisition of rights or options and their cost base

If you own shares or units, you may be issued rights or options to acquire additional shares or units at a specified price.

If the rights and options are offered at no cost, you are taken to have acquired them at the same time as you acquired the original shares or units. Therefore, if you acquired the original shares or units before 20 September 1985, any capital gain or capital loss you make from the sale of the rights or options is disregarded.

If you acquired your original shares or units (or rights or options from another entity) on or after 20 September 1985, they are treated much like any other CGT asset and are subject to CGT. This is also the case if you paid the company or trust for them.

Cost base after exercising rights or options to acquire shares or units

Many people decide to exercise their rights or options to acquire new shares or units rather than sell them. No CGT is payable at the time you exercise the rights or options.

Exercising rights or options on or after 20 September 1985

If you exercise them on or after 20 September 1985, some special rules apply for calculating the cost base for shares or units acquired as a result.

You may be in a situation where:

- a company in which you are a shareholder issues you with rights or options to acquire shares, or
- after 28 January 1988, a unit trust in which you are a unit holder issues you with rights or options to acquire units.

If you pay nothing in these situations, the amount included in the cost base or reduced cost base of the shares or units you acquire depends on when you acquired your original shares or units.

Where original shares or units were acquired before 20 September 1985

You may have acquired the original shares or units before 20 September 1985 and paid nothing for the issue of the rights or options. In this case, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is the sum of the market value of the rights or options at the time you exercise them and the amount you pay for the shares or units.

Where original shares were acquired on or after 20 September 1985

The situation is different if you acquired the original shares or units on or after 20 September 1985 and paid nothing for the issue of the rights or options. In this case, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is simply the amount you pay for the shares or units.

You may be in a situation where:

- a company in which you are a shareholder issues you with rights or options to acquire shares, or
- after 28 January 1988, a unit trust in which you are a unit holder issues you with rights or options to acquire units.

If you make a payment in one of these situations, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising your rights or options is the sum of the amount you paid for the rights or options and the amount you pay for the shares or units on exercising the rights or options.

If the original shares or units were acquired before 20 September 1985, the rights or options are taken to have been acquired before that date. This means the first element of the cost base for the shares or units is the sum of the market value of the rights or options at the time you exercise them and the amount you paid for the shares or units. This is the case whether or not you make a payment to the company for the issue of the rights or options.

Different rules again apply if you acquired the rights or options to acquire shares or units from an entity other than the company or unit trust which issued the rights or options—for example, from a shareholder of the company.

If you did not pay anything to acquire the rights or options from another entity, the first element of the cost base or reduced cost base for the shares or units you acquire on exercising them is simply the amount you paid for the shares or units.

If you did pay to acquire the rights or options, the first element of the cost base or reduced cost base of the shares or units you acquire on exercising them is the sum of the amount you actually paid for the rights or options and the amount you paid for the shares or units.

Flowcharts 3 and 4 appendix 3 summarise the different rules applying to the treatment of rights or options to acquire shares or units.

EXAMPLE

Sale of rights

Shanti owns 2000 shares in ZAC Ltd. She bought 1000 shares on 1 June 1985 and 1000 shares on 1 December 1996.

On 1 July 1998, ZAC Ltd offered each of its shareholders one right for each 4 shares owned to acquire shares in the company for $1.80 each. Shanti therefore received 500 rights in total. At that time, shares in ZAC Ltd were worth $2. Each right was therefore worth 20 cents.

Shanti decided that she did not wish to buy any more shares in ZAC Ltd, so she sold all her rights for 20 cents each—a total amount of $100. Only those rights issued for the shares she bought on 1 December 1996 are subject to CGT. As Shanti did not pay anything for the rights, she has made a $50 taxable capital gain on their sale.

The $50 Shanti received on the sale of her rights for the shares she bought on 1 June 1985 is not subject to CGT as those rights are taken to have been acquired at the same time as the shares; that is, before 20 September 1985.

EXAMPLE

Rights exercised

Assume that, in the above example, Shanti wished to acquire more shares in ZAC Ltd. She therefore exercised all 500 rights on 1 August 1998 when they were still worth 20 cents each.

There are no CGT consequences arising from the exercise of the rights.

However, the 500 shares Shanti acquired on 1 August 1998 when she exercised the rights are subject to CGT and are acquired at the time of the exercise.

When Shanti exercised the rights issued for the shares she bought on 1 December 1996, the cost base of the 250 shares Shanti acquired is the amount she paid to exercise each right; that is, $1.80 for each share.

When she exercised the rights for the shares she bought before 20 September 1985, Shanti's cost base for each of the 250 shares she acquired includes not only the exercise price of the right ($1.80) but also the market value of the right at that time; that is, 20 cents. The cost base of each share is therefore $2.

Convertible notes

A convertible note is another type of investment you can make in a company or unit trust. A convertible note earns interest on the amount you pay to acquire the note until the note's expiry date. On expiry of the note, you can either ask for the return of the money paid or convert that amount to acquire new shares or units.

The amount of capital gain or capital loss you make when you convert or dispose of a convertible note is the difference between the cost of the note and the sale price (or value) of the shares or units you received.

If you acquired convertible notes between 20 September 1985 and 10 May 1989 inclusive, these are generally subject to CGT if you make a capital gain or capital loss when you convert or dispose of the notes. However, this is not the case if that capital gain or capital loss is included in other parts of your income or deductions.

If you acquired any convertible notes after 10 May 1989, they will generally not be subject to CGT. Instead, any capital gain or capital loss you make is included under a provision dealing with the disposal of securities.

Conversion of notes to shares

If you convert a convertible note acquired from a company before 20 September 1985 and do not make any further payment to the company on the conversion, the shares you receive are treated as if you acquired them before 20 September 1985. Therefore, any capital gain or capital loss is disregarded.

In all other cases, the shares acquired by the conversion of a convertible note on or after 20 September 1985 will be subject to CGT and the shares are taken to be acquired when the conversion happens.

You may have acquired a convertible note before 20 September 1985 and paid or given something in relation to the conversion. In this case, the cost base of the shares received as a result of the conversion will include the market value of the note at the time of conversion and what you paid or gave.

You may have acquired the convertible note on or after 20 September 1985 and, as a traditional security, the capital gain or capital loss you made on the conversion of the note was already included as income or deductions. In this case, the cost base of the shares is the market value at the time of the conversion.

If you acquired the convertible note on or after 20 September 1985 and it was not a traditional security, the cost base of the shares will include the amount you paid to acquire the note and any amount you paid in relation to the conversion.

Conversion of notes to units

Special rules also apply to convertible notes issued by a unit trust after 28 January 1988 and before 11 May 1989. Any capital gain or capital loss made on their conversion to units in the unit trust is disregarded. Their cost base for future CGT purposes includes both the cost of the convertible note and any further amount payable on the conversion.

Where convertible notes were issued prior to 28 January 1988 and later converted into units, the cost base of the units received should include any amount payable on conversion plus the market value of the note at the time of conversion.

A capital gain or capital loss may arise on conversion of the note (except where notes were acquired before 20 September 1985) depending on the amount of capital proceeds received. The amount of capital proceeds is the value of the units received.

EXAMPLE

Converting notes to shares

David bought 1000 convertible notes in DCS Ltd for $5 each on 1 July 1983. Their expiry date was 1 July 1988, at which time shares in DCS Ltd were worth $10 each.

He decided to convert the notes to shares and no extra payment to the company was required upon conversion. The shares are treated as having been acquired when the notes were acquired (1 July 1983). Any capital gain or capital loss made on the shares is disregarded.

David bought another 1000 convertible notes in DCS Ltd on 1 July 1986. These notes also cost $5 each. On expiry of the notes on 1 July 1999, shares in the company were worth $7 each. David also converted those notes to shares, which are subject to CGT.

As no further amount is payable on conversion of the notes, the cost base of the shares is the $5 originally paid for the note. If David uses the indexation method to calculate his capital gain, he can index the $5 from 1 July 1986 when he became liable to pay the cost of the notes.

Employee share schemes

Some companies encourage employees to purchase shares in the company. If shares are issued to an employee at a discount, the value of the discount is usually included in the employee's taxable income.

For CGT purposes, the cost base of the shares is the amount paid to the company when you acquire them, plus the amount of the discount included in your assessable income under the ordinary tax provisions. These provisions will specify the amount of discount to include.

Different options are open to employees and depending on the nature of the employer's scheme and what options the employee has taken, the cost base of the shares will be affected differently.

You may need to seek advice from the ATO if you need help calculating the cost base of your employee shares and the CGT consequences if you have sold your shares or are thinking about selling them.

EXAMPLE

Employee share plans

Manfred has been employed by MegaCorp Ltd for 13 years. Along with other employees who have been with the company for more than 5 years, he has been invited to participate in the company's employee share scheme. He is offered 100 shares for each year of service.

Manfred agrees to participate and is required to pay $1 per share, a total of $1300. In addition, the company informs Manfred that he must include $325 in his taxable income as the amount of the discount on allotment of the shares. The cost base of the shares for CGT purposes is therefore a total of $1625 ($1300 + $325) or $1.25 per share.

Non-assessable payments

The cost base of shares or units for CGT calculations may need to be adjusted if you receive a non-assessable payment without disposing of your shares or units. A payment or distribution can include money and property.

You need to keep accurate records of the amount and date of any non-assessable payments in relation to your shares and units.

Non-assessable payments from a company (CGT event G1)

Non-assessable payments to shareholders are not very common and would generally be made only where a company has obtained shareholder approval to reduce its share capital—for example, to refund part of the paid-up value of shares to shareholders. Before 1 July 1998, a company needed court approval to reduce its share capital.

If you receive a non-assessable payment from a company (that is, a payment that is not a dividend), you need to adjust the cost base of the shares at the time of the payment. If the amount of the non-assessable payment is not more than the cost base of the shares at the time of payment, the cost base and reduced cost base are reduced by the amount of the payment.

You make a capital gain if the amount of the non-assessable payment is more than the cost base of the shares. The amount of the capital gain is equal to the excess. If you make a capital gain, the cost base and reduced cost base of the shares are reduced to nil. You cannot make a capital loss from the making of a non-assessable payment.

Interim liquidation distributions that are not dividends can be treated in the same way as other non-assessable payments under CGT event G1.

From the 1998–99 income year, interim distributions by a liquidator are not treated in this manner provided the company is deregistered within 18 months of the interim distribution. These payments will form part of the capital proceeds for the ending of the shares.

In preparing a tax return a shareholder may assume that the company will cease to exist within 18 months of an interim distribution, unless advised to the contrary by the liquidator in writing.

EXAMPLE

Non-assessable payments

Rob bought 1500 shares in RAP Ltd on 1 July 1994 for $2 each. On 30 November 2001, as part of a shareholder-approved scheme for the reduction of RAP's share capital, he received a non-assessable payment of 50 cents per share. At that date, the cost base of each share (without indexation) was $2.20.

As the amount of the payment is not more than the cost base (without indexation), the cost base of each share at 30 November 2001 is reduced by the amount of the payment to $1.70 ($2.20 – 50 cents). As Rob has chosen not to index the cost base, he can claim the CGT discount if he disposes of the shares in the future.

Non-assessable payments from a unit trust (CGT event E4)

It is quite common for a unit trust to make non-assessable payments to unit holders. Your CGT obligations in this situation are explained in chapter 4 on page 23.

When you sell the units, you must adjust their cost base or reduced cost base. The amount of the adjustment is based on the amount of non-assessable payments you received during the income year up to the date of sale. You use the adjusted cost base or reduced cost base to work out your capital gain or capital loss.

Using the *Capital gain or capital loss worksheet* for shares

In the examples on the following pages, Tony uses the indexation method, the discount method and the 'other' method to calculate his capital gain so he can decide which method gives him the best result. This example shows you how to complete the *Capital gain or capital loss worksheet* at the back of this guide to calculate your capital gain when you acquire or dispose of shares.

Refer to page 13 in chapter 2 for a description of each method and when you can use each one.

Remember that if you bought and sold your shares within 12 months, you must use the 'other' method to calculate your capital gain. If you owned your shares for 12 months or more, you may be able to use either the discount method or the indexation method, whichever gives you the better result.

Because each share in a parcel of shares is a separate CGT asset, you can use different methods to work out the amount of any capital gain for shares within a parcel. This may be to your advantage if you have capital losses to apply.

For example, Belinda acquired a parcel of 1000 shares on 1 December 1992. She sold them on 31 July 2001. Because she has capital losses, Belinda chooses to work out her capital gain from 460 of her shares using the indexation method. She uses the discount method to work out the capital gain from the other 540 shares.

EXAMPLE

Using all 3 methods to calculate a capital gain

On 1 July 1993, Tony bought 10 000 shares in Kimbin Ltd for $2 each. He paid stockbrokers fee of $250 and stamp duty of $50.

On 1 July 2001, Kimbin Ltd offered each of its shareholders one right for each 4 shares owned to acquire shares in the company for $1.80 each. The market value of the shares at the time was $2.50.

On 1 August 2001, Tony exercised all rights and paid $1.80 per share.

On 1 December 2001, Tony sold all his shares in Kimbin Ltd for $3.00 each. He incurred stockbrokers fee of $500 and stamp duty of $50.

NOTE ***Separate records***

Tony has 2 parcels of shares—those he acquired on 1 July 1993 and those he acquired at the time he exercised all rights, 1 August 2001. He needs to keep separate records for each parcel and apportion the stockbrokers fee of $500 and stamp duty of $50.

The completed *Capital gain or capital loss worksheets* on the following pages show how Tony can evaluate which method gives him the best result.

He uses the 'other' method for the shares he owned for less than 12 months, as he has no choice:

$7500 – $4610 = $2890

For the shares he has owned for 12 months or more, his capital gain using the indexation method would be:

$30 000 – $23 257 = $6743

This means his net capital gain would be:

$2890	+	$6743	=	$9633
('other' method)		**(indexation method)**		**(net capital gain)**

If Tony uses the discount method instead (assuming he has no losses), his capital gain would be:

$30 000 – $20 740 = $9260

He applies the CGT discount of 50 per cent:

$9260 × 50% = $4630

This means his net capital gain would be:

$2890	+	$4630	=	$7520
('other' method)		**(discount method)**		**(net capital gain)**

In this case he would choose the discount method rather than the indexation method, as it gives him the better result (less capital gains).

Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

CGT asset type or CGT event

Shares and units (in unit trusts)	X	Other CGT assts and any other CGT events[4]	
Real estate		Collectables[5]	

Description of CGT asset or CGT event Tony's 2500 shares in Kimbin Ltd—Exercise of rights, given 1.7.2001, exercised 1.8.2001

Date of acquisition 01/08/1993 **Date of CGT event** 01/12/2001

Elements of the cost base or reduced cost base

	1 Amount	2 Amounts to be deducted for cost base[9]	3 Cost base (1 – 2)	4 Amounts to be deducted for reduced cost base[9]	5 Reduced cost base[9] (1 – 4)	6 Indexation factor[10]	7 Cost base indexed (3 × 6)
Acquisition or purchase cost of the CGT asset[6]	4500		4500				
Incidental costs to acquire the CGT asset	110		110				
Incidental costs that relate to the CGT event[7]							
Non-capital costs of ownership of the CGT asset[8]							
Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event							
Capital costs to establish, preserve or defend title to, or a right over, the CGT asset							
	Cost base unindexed		$ 4610				
		Reduced cost base			$		
				Cost base indexed			$

Capital gain calculation

Indexation method		**Discount method**		**'Other' method** (CGT asset held less than 12 months)	
Capital proceeds[11]	$	Capital proceeds[11]	$	Capital proceeds[11]	$ 7500
Less: cost base indexed	$	*Less:* cost base unindexed	$	*Less:* cost base unindexed	$ 4610
Capital gain (a)	**$**	**Capital gain (b)***	**$**	**Capital gain**	**$** 2890

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

Capital loss calculation

Capital loss	
Reduced cost base	$
Less: capital proceeds[11]	$
Capital loss[12]	**$**

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

Capital gain or capital loss worksheet

This worksheet helps you calculate a capital gain for each CGT asset or any other CGT event[1] using the indexation method[2], the discount method[3] and/or the 'other' method. It also helps you calculate a capital loss.

CGT asset type or CGT event

- Shares and units (in unit trusts) [X]
- Real estate [ ]
- Other CGT assts and any other CGT events[4] [ ]
- Collectables[5] [ ]

Description of CGT asset or CGT event: Tony's 10 000 shares in Kimbin Ltd

Date of acquisition: 01/7/1993

Date of CGT event: 01/12/2001

Elements of the cost base or reduced cost base

	1 Amount	2 Amounts to be deducted for cost base[9]	3 Cost base (1 – 2)	4 Amounts to be deducted for reduced cost base[9]	5 Reduced cost base[9] (1 – 4)	6 Indexation factor[10]	7 Cost base indexed (3 x 6)
Acquisition or purchase cost of the CGT asset[6]	20 000		20 000			1.124	22 480
Incidental costs to acquire the CGT asset	300		300			1.124	337
Incidental costs that relate to the CGT event[7]	440		440			1	440
Non-capital costs of ownership of the CGT asset[8]							
Capital expenditure to increase the asset's value that is reflected in the state or nature of the CGT asset at the time of the CGT event							
Capital costs to establish, preserve or defend title to, or a right over, the CGT asset							
Cost base unindexed			$ 20 740				
Reduced cost base					$		
Cost base indexed							$ 23 257

Capital gain calculation

Indexation method		**Discount method**		**'Other' method** (CGT asset held less than 12 months)	
Capital proceeds[11]	$ 30 000	Capital proceeds[11]	$ 30 000	Capital proceeds[11]	$
Less: cost base indexed	$ 23 257	*Less:* cost base unindexed	$ 20 740	*Less:* cost base unindexed	$
Capital gain (a)	**$** 6743	**Capital gain (b)***	**$** 9 260	**Capital gain**	**$**

*In choosing between capital gain **(a)** or **(b)**, remember that the CGT discount will not apply to **(a)** but it will reduce the amount of capital gain remaining after capital losses are deducted from **(b)**.

Transfer the capital gain to part A1 of the *CGT summary worksheet*, except for a capital gain from collectables which is transferred to part A2 of that worksheet.

Capital loss calculation

Capital loss	
Reduced cost base	$
Less: capital proceeds[11]	$
Capital loss[12]	**$**

Transfer the capital loss to part B of the *CGT summary worksheet*, except for a capital loss from collectables which is transferred to part A2 of that worksheet.

CHAPTER 6 Main residence

Generally, you can ignore a capital gain or capital loss from a CGT event that happens to a dwelling that is your main residence (also referred to as 'your home').

To obtain full exemption from CGT:

- the dwelling must have been your home for the whole period you owned it
- the dwelling must not have been used to produce assessable income
- any land on which the dwelling is situated must be 2 hectares or less.

If you are not fully exempt, you may be partially exempt if:

- the dwelling was your main residence during only part of the period you owned it
- you used the dwelling to produce assessable income or
- the land on which the dwelling is situated is more than 2 hectares.

Short absences from your home—for example, annual holidays, do not affect your exemption.

NOTE ***New terms***

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

Special rules

There are special rules for a dwelling you acquire as a beneficiary or the legal representative of a deceased estate. These rules are explained in chapter 9.

There are some special CGT rules that are not covered in this chapter that may affect you if your home was:

- destroyed and you receive money or another asset as compensation or under an insurance policy (see chapter 7)
- transferred by you as a result of the breakdown of your marriage (see chapter 8)
- transferred to you as a result of its conversion to strata title or
- compulsorily acquired by an Australian government agency (see chapter 7).

This chapter also does not cover the sale of a rental property, although there is a worked example at appendix 5 showing how to calculate your capital gain or capital loss in this instance. For more information about this and other situations, you may need to contact us. Our contact details are listed at the back of this guide. Alternatively, you may wish to consult your tax adviser.

If you own more than one dwelling during a particular period, only one of them can be your main residence at any one time.

The exception to this rule is if you move from one main residence to another. In this case you can treat 2 dwellings as your main residence for a limited time (see page 48 for more information). Special rules apply if you have a different main residence from your spouse or dependent children (see page 52).

What is a dwelling?

A dwelling can be any building or part of a building that is used wholly or mainly for residential accommodation. Certain mobile homes can also be a dwelling. Examples include:

- a home or cottage
- an apartment or flat
- a strata title unit
- a unit in a retirement village
- a caravan, houseboat or other mobile home.

Any land the dwelling is on is included as part of the dwelling but it only qualifies for the main residence exemption if the land and the dwelling are sold together. Land adjacent to the dwelling may also qualify for exemption (see page 43 for more information).

What is an ownership interest?

In the case of a flat or home unit, you have an ownership interest if you have:

- a legal or equitable interest in a strata title in the flat or home unit
- a licence or right to occupy the flat or home unit, or
- a share in a company that owns a legal or equitable interest in the land on which the flat or home unit is constructed and that share gives you a right to occupy the flat or home unit.

In the case of a dwelling that is not a flat or home unit, you have an ownership interest if you have:

- a legal or equitable interest in the land on which it is constructed, or
- a licence or right to occupy it.

In the case of land, you have an ownership interest if you have:

- a legal or equitable interest in it, or
- a right to occupy it.

An equitable interest may include life tenancy of a dwelling that you acquire—for example, under a deceased's will.

When do you acquire an ownership interest?

For the purposes of the main residence exemption, you have an ownership interest in a dwelling or land you acquire under a contract from the time you obtain legal ownership (unless you have a right to occupy it at an earlier time).

You have legal ownership of a dwelling or land from the date of settlement of the contract of purchase (unless you have a right to occupy it at an earlier time) until the date of settlement of the contract of sale. This period is called your ownership period. If the home is your main residence for the whole of the ownership period and you do not use it to produce assessable income, the home is fully exempt.

EXAMPLE

Full exemption

Frank signed a contract on 14 August 1999 to purchase land from a developer and to have a house constructed on the land. Under the contract, settlement did not occur until construction was completed on 26 October 2000.

Frank moved into the house immediately upon settlement of the contract he had with the developer; that is, on 26 October 2000. He did not have a right to occupy the house at an earlier time under the purchase contract. He signed the contract to sell it on 25 May 2002 and settlement occurred on 20 July 2002. The house was Frank's main residence for the full period he owned it and he did not use any part of it to produce income.

For CGT purposes, Frank is taken to have acquired the land on which the house was constructed on the date he entered into the contract—14 August 1999. However, because the house was Frank's main residence for the whole period between settlement of the purchase contract and settlement of the sale contract, it is fully exempt.

The period between when Frank entered into the purchase contract and actually lived in the house—14 August 1999 to 25 October 2000—is ignored. This is because the relevant dates for the main residence exemption are the settlement dates or if you had a right under the purchase contract to occupy the dwelling at an earlier time, that time until settlement of the sale contract.

Even though the settlement dates are used to calculate the period for which the main residence exemption applies the dates you enter into the purchase and sale contracts are important if your main residence is not fully exempt.

A CGT event occurs when you enter into the sale contract and any capital gain is included on your tax return for the year of income in which the CGT event occurs. The contract date is also relevant for determining what method you can use to work out your capital gain from your main residence.

EXAMPLE

Part exemption

The facts are the same as in the example on the previous page except that Frank rented out the house from 26 October 2000—the date of settlement of the purchase contract—until 2 March 2001.

Frank makes a capital gain of $30 000 on the house. To work out the part of the capital gain that is exempt, Frank must determine how many days in his ownership period the dwelling was not his main residence.

Frank had an ownership interest in the property from settlement of the purchase contract (26 October 2000) until settlement of the sale contract (20 July 2002)—a total of 633 days.

The period between the dates the purchase contract was signed (14 August 1999) and settled (25 October 2000) is ignored. Because the house was not Frank's main residence from 26 October 2000 to 2 March 2001 (128 days), he does not obtain the exemption for this period.

Frank calculates his net capital gain as follows:

Capital gain $\$30\,000 \times \frac{128 \text{ days}}{633 \text{ days}}$

= **taxable portion** $6066

Because Frank entered into the purchase contract before 11.45 a.m. on 21 September 1999 and entered into the sale contract after this time (and he owned the house for at least 12 months), he can choose either the indexation or the discount method to calculate his capital gain. Frank decides to reduce his capital gain by the CGT discount of 50 per cent after applying any capital losses.

Because Frank signed the sale contract on 25 May 2002, the CGT event occurred in the 2001–02 income year, even though settlement occurred in the next income year. Frank shows the capital gain on his 2001–02 income tax return.

Is the dwelling your main residence?

You need to take the following factors into account in working out whether a dwelling is your main residence:

- the length of time you live there—there is no minimum time a person has to live in a home before it is considered to be their main residence
- whether your family lives there
- whether you have moved your personal belongings into the home
- the address to which your mail is delivered
- your address on the electoral roll
- the connection of services (for example, telephone, gas or electricity)
- your intention in occupying the dwelling.

A mere intention to construct or occupy a dwelling as your main residence—without actually doing so—is not sufficient to obtain the exemption.

In certain circumstances, you may choose to treat a dwelling as your main residence even though:

- you no longer live in it (for more information, see **Continuing main residence status after dwelling ceases to be your main residence** on page 49) or
- you are yet to live in it but will do so as soon as practicable after it is constructed, repaired or renovated and you will continue to live in it for at least 3 months (for more information, see **Constructing, renovating or repairing a dwelling on land you already own** on page 51).

Moving into a dwelling

A dwelling is considered to be your main residence from the time you acquired your ownership interest in it if you moved into it as soon as practicable after that time. This would generally be the date of settlement of the purchase contract. This means if there is a delay in moving in because of illness or other reasonable cause, the exemption is still available from when you acquired your ownership interest in the dwelling.

If you could not move in because the dwelling was being rented to someone, you are not considered to have moved in as soon as practicable after you acquired your ownership interest.

As explained earlier, there is a special rule that allows you to treat more than one dwelling as your main residence for a limited time if you are changing main residences (see **Moving from one main residence to another** on page 48).

Land adjacent to the dwelling

The land adjacent to a dwelling is also exempt if:

- during the period you owned it, the land is used mainly for private and domestic purposes in association with the dwelling
- the total area of the land around the dwelling, including the land on which it stands, is not greater than 2 hectares (4.94 acres). If the land used for private purposes is greater than 2 hectares, you can choose which 2 hectares are exempt.

Land is adjacent to your dwelling if it is close to, near, adjoining or neighbouring the dwelling.

If you sell any of the land adjacent to your dwelling separately from the dwelling, the land is not exempt. It is only exempt when sold with the dwelling. There is an exception if the dwelling is accidentally destroyed and you sell the vacant land (see **Destruction of dwelling and sale of land** on page 52).

Any part of the land around a dwelling used to produce income is not exempt, even if the total land is less than 2 hectares. However, the dwelling and any buildings and other land used in association with it remain exempt if you do not use them to produce income.

EXAMPLE

Land used for private purposes

Tim bought a home with 15 hectares of land in November 2000. He uses 10 hectares of the land to produce income and 5 hectares for private purposes. Tim can obtain the main residence exemption for the home and 2 hectares of land he selects out of the 5 hectares that are used for private purposes.

Tim obtains a valuation which states that the home and 2 hectares of land that he has selected are worth $^{2}/_{3}$ of the total value of the property. The relative values of the different parts of the property remained the same between the time of purchase and the time of sale.

Tim entered into a contract to sell the property on 8 May 2002. The capital gain from the property is $15 000. Tim may claim the main residence exemption on the $^{2}/_{3}$ of the capital gain attributable to the house and 2 hectares of land; that is, $10 000.

Because he entered into the contract to acquire the property after 11.45 a.m. on 21 September 1999 and owned it for at least 12 months, Tim reduces his remaining $5000 gain (attributable to the land) by the CGT discount of 50 per cent after applying any capital losses.

Subdivision of land around a dwelling

If you subdivide a block of land, each block that results is registered with a separate title. For CGT purposes, the original land parcel is divided into 2 or more separate assets. Subdividing the land does not in itself change the ownership of the subdivided blocks. Therefore, you do not make a capital gain or a capital loss at the time of the subdivision.

However, you may make a capital gain or capital loss when you sell the subdivided blocks. The date you acquired the subdivided blocks is the date you acquired the original parcel of land and the cost base of the original land is divided between the subdivided blocks on a reasonable basis.

NOTE ***When the profit is ordinary income***

You may have made a profit from the subdivision and sale of land which occurred in the ordinary course of your business or which involved a commercial transaction or business operation entered into with the purpose of making a profit. In this case, the profit is ordinary income (see *Taxation Ruling TR 92/3—Income tax: whether profits on isolated transactions are income*). Any capital gain from the land is reduced by the amount otherwise included in your assessable income.

EXAMPLE

Dwelling purchased before 20 September 1985, land subdivided after that date and house built on subdivided land

In 1983, Mike bought a block of land that was less than 2 hectares. He subdivided the land into 2 blocks in May 2001 and began building a house on the rear block, which he finished in August 2001. He sold the rear block (including the house) in October 2001 for $150 000. Mike obtained a valuation from a qualified valuer who valued the rear block at $70 000 and the house at $80 000. The construction cost of the house was $65 000.

Mike acquired the rear block before 20 September 1985, so it is not subject to CGT. As the new house was constructed after 20 September 1985 on land purchased before that date, the house is taken to be a separate asset from the land. Mike is taken to have acquired the house in May 2001 when he began building it. Mike made a capital gain of $15 000 ($80 000 – $65 000) when he sold the house because he did not use it as his main residence.

As Mike had owned the house for less than 12 months, he used the 'other' method to calculate his capital gain.

EXAMPLE

Dwelling purchased on or after 20 September 1985 and land subdivided after that date

Kym bought a house on a 0.1 hectare block of land in June 2001 for $250 000. The house was valued at $80 000 and the land at $170 000. Kym lived in the house as her main residence. In January 2002, she subdivided the land into 2 blocks of equal size. She incurred $10 000 in survey, legal and subdivision application fees and $1000 to connect water and drainage to the rear block. In March 2002, she sold the rear block for $100 000.

As Kym sold the rear block of land separately, the main residence exemption does not apply to that land. She contacted several local real estate agents who advised her that the value of the front block was $15 000 higher than the rear block. Kym apportioned the $170 000 original cost base into $77 500 for the rear block (45.6 per cent) and $92 500 for the front block (54.4 per cent).

The cost base of the rear block is calculated as follows:

Cost of the land	$77 500
45.6 per cent of the cost of survey, legal and application fees	$4 560
Cost of connecting water and drainage	$1 000
Total	**$83 060**

The capital gain on the sale of the rear block is $16 940. As Kym had owned the land for less than 12 months, she used the 'other' method to calculate her capital gain.

Kym will obtain the full exemption for her house and the front block if they are used as her main residence for the full period she owns them.

Other structures associated with the dwelling

A flat or home unit often includes areas (for example, a laundry, storeroom or garage) that are physically separate from the flat or home unit. As long as these areas are used primarily for private or domestic purposes in association with the flat or home unit for the whole period you own it, they are exempt on the same basis as the flat or home unit is exempt.

However, if you dispose of one of these structures separately from the flat or home unit, they are not exempt.

Part exemption

Main residence for only part of the period you owned it

If a CGT event happens in relation to a dwelling you acquired on or after 20 September 1985 and that dwelling was not your main residence for the whole time you owned it, you obtain only a part exemption.

The part of the capital gain that is taxable is calculated as follows:

$$\text{Total capital gain made from the CGT event} \times \frac{\text{number of days in your ownership period when the dwelling was not your main residence}}{\text{total number of days in your ownership period}}$$

EXAMPLE

Main residence for part of the ownership period

Andrew bought a house under a contract that was settled on 1 July 1990 and moved in immediately. On 1 July 1993, he moved out and began to rent out the house. He did not choose to treat the house as his main residence for the period after he moved out, although he could have done this under the continuing main residence status after dwelling ceases to be your main residence rule (see page 49). The home first used to produce income rule (explained on page 47) does not apply.

This is because Andrew used the home to produce income before 21 August 1996. The contract for the sale of the house was settled on 1 July 2001 and Andrew made a capital gain of $10 000. As he is entitled to a part exemption, Andrew's capital gain is reduced as follows:

$$\$10\,000 \times \frac{2922}{4018} = \$7272$$

As Andrew entered into the contract to acquire the house before 11.45 a.m. on 21 September 1999 but the CGT event occurred after this date, Andrew can choose to use the discount method or the indexation method to calculate his capital gain.

If a dwelling was not your main residence for the whole time you owned it, some special rules may entitle you to a full exemption or extend the part exemption you would otherwise obtain. These rules apply to land or a dwelling if:

- you choose to treat the dwelling as your main residence, even though you no longer live in it (see **Continuing main residence status after dwelling ceases to be your main residence** on page 49)

- you moved into the dwelling as soon as practicable after its purchase (see **Moving into a dwelling** on page 43)
- you are changing main residences (see **Moving from one main residence to another** on page 48)
- you are yet to live in the dwelling but will do so as soon as practicable after it is constructed, repaired or renovated and you will continue to live in it for at least 3 months (see **Constructing, renovating or repairing a dwelling on land you already own** on page 51), or
- you sell vacant land after your main residence is accidentally destroyed (see **Destruction of dwelling and sale of land** on page 52).

Dwelling used to produce income

Usually you cannot obtain the full main residence exemption if you:

- acquired your dwelling on or after 20 September 1985 and used it as your main residence
- used any part of it to produce income during all or part of the period you owned it
- would be allowed a deduction for interest had you incurred it on money borrowed to acquire the dwelling (interest deductibility test).

The interest deductibility test applies regardless of whether you actually borrowed money to acquire your dwelling. You must apply it on the assumption that you did borrow money to acquire the dwelling.

If you run a business or professional practice in part of your home, you would be entitled to deduct part of the interest on money you borrowed to acquire the dwelling if:

- part of the dwelling is set aside exclusively as a place of business and is clearly identifiable as such
- that part of the home is not readily adaptable for private use—for example, a doctor's surgery located within the doctor's home.

If you rent out part of your home, you would be entitled to deduct part of the interest if you had borrowed money to acquire the dwelling.

You would not be entitled to deduct any interest expenses if, for convenience, you use a home study to undertake work usually done at your place of work. Similarly, you would not be entitled to deduct interest expenses if you do paid child-minding at home unless a special part of the home was set aside exclusively for that purpose. In these situations, you would still obtain a full main residence exemption.

You can still obtain a full main residence exemption if someone else uses part of your home to produce income and you receive no income from that person.

When a CGT event happens in relation to the home, the proportion of the capital gain or capital loss that is taxable is an amount that is reasonable having regard to the extent to which you would have been able to deduct the interest on money borrowed to acquire the home.

In most cases this is the proportion of the floor area of the home that is set aside to produce income and the period the home is used to produce income.

EXAMPLE

Renting out part of a home

Thomas purchased a home under a contract that was settled on 1 July 1996 and sold it under a contract that was settled on 30 June 2002. The home was his main residence for the entire 6 years.

Throughout the period Thomas owned the home, a tenant rented one bedroom, which represented 20 per cent of the home. Both Thomas and the tenant used the living room and kitchen which represented 30 per cent of the home. Only Thomas used the remainder of the home. Therefore Thomas would be entitled to a 35 per cent deduction for interest if he had incurred it on money borrowed to acquire his home. The home first used to produce income rule (explained on the next page) does not apply because Thomas used the home to produce income from the date he purchased it.

Thomas made a capital gain of $20 000 when he sold the home. Of this total gain, the following proportion is not exempt:

Capital gain × percentage of floor area = taxable portion

$20 000 × 35% = $7000

As Thomas entered into the contract to acquire the home before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

EXAMPLE

Running a business in part of a home for part of the period of ownership

Ruth bought her home under a contract that was settled on 1 January 1999. She sold it under a contract that was entered into on 1 November 2001 and was settled on 31 December 2001. It was her main residence for the entire 3 years.

From the time she bought it until 31 December 2000, Ruth used part of the home to operate her photographic business. The rooms were modified for that purpose and were no longer suitable for private and domestic use. They represented 25 per cent of the total floor area of the home.

When she sold the home, Ruth made a capital gain of $8000. The following proportion of the gain is taxable:

Capital gain × percentage of floor area × percentage of period of ownership

= taxable portion

$8000 × 25% × $33^{1}/_{3}$%

= $667

As Ruth entered into the contract to acquire the home before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, she can use either the indexation or discount method to calculate her capital gain.

The home first used to produce income rule (explained below) does not apply because Ruth used the home to produce income from the date she purchased it.

For more information on rental properties (for example, negative gearing and deductions), get the publication *Rental properties* from the sources listed at the back of this guide.

Home first used to produce income

If you start using your main residence to produce income for the first time after 20 August 1996, a special rule affects the way you calculate your capital gain or capital loss.

In this case, you are taken to have acquired the dwelling at its market value at the time it is first used to produce income if all of the following apply:

- you acquired the dwelling on or after 20 September 1985
- you first used the dwelling to produce income after 20 August 1996
- when a CGT event happens in relation to the dwelling, you would obtain only a part exemption because the dwelling was used to produce assessable income during the period you owned it
- you would have been entitled to a full exemption if the CGT event happened to the dwelling immediately before you first used it to produce income.

If a deceased's main residence passed to you as a beneficiary or as trustee of their estate on or after 20 September 1985, you are taken to have acquired the dwelling at its market value at the time it was first used to produce your income only if:

- you first used the dwelling to produce income after 20 August 1996
- when a CGT event happens in relation to the dwelling, you would obtain only a part exemption because the dwelling was used to produce assessable income during the period you owned it
- you would have been entitled to a full exemption if the CGT event happened to the dwelling immediately before you first used it to produce income
- the CGT event did not happen in relation to the dwelling within 2 years of the person's date of death.

NOTE ***Full exemption***

You may have made the choice to treat a dwelling as your main residence after the dwelling ceases to be your main residence (see **Continuing main residence status after the dwelling ceases to be your main residence** on page 49). In this case, if the dwelling is fully exempt, the home first used to produce income rule does not apply.

In working out the amount of capital gain or capital loss, the period before the dwelling is first used by you to produce income is not taken into account. The extent of the exemption depends on the period after that time and the proportion of the home used to produce income. The example on the next page explains this.

EXAMPLE

Home first used to produce income after 20 August 1996

Louise purchased a home in December 1991 for $200 000. The home was her main residence. On 1 November 2000, she started to use 50 per cent of the home for a consultancy business. At that time the market value of the house was $220 000.

She decided to sell the property in August 2001 for $250 000. As Louise had not ceased living in the home, she could not obtain a full exemption under the continuing main residence status after dwelling ceases to be your main residence rule (see page 49). The capital gain is 50 per cent of the proceeds less the cost base.

Percentage of use × (proceeds – cost base) = capital gain

50% × $250 000 – $220 000 = $15 000

Louise is taken to have acquired the property on 1 November 2000 at a cost of $220 000. Because she is taken to have acquired it at this time, Louise is taken to have owned it for less than 12 months and must use the 'other' method to calculate her capital gain.

Moving from one main residence to another

If you acquire a new home before you dispose of your old one, both dwellings are treated as your main residence for up to 6 months if:

- the old dwelling was your main residence for a continuous period of at least 3 months in the 12 months before you disposed of it
- you did not use it to produce assessable income in any part of that 12 months when it was not your main residence
- the new dwelling becomes your main residence.

If you dispose of the old dwelling within 6 months of acquiring the new one, both dwellings are exempt for the whole period between when you acquire the new one and dispose of the old one.

If you disposed of your old home before 1 July 1998, both homes are exempt for a maximum of 3 months.

EXAMPLE

Exemption for both homes

Jill and Norman bought their new home under a contract that was settled on 1 January 2002 and moved in immediately. They sold their old home under a contract that was settled on 15 April 2002. Both the old and new homes are treated as their main residence for the period 1 January to 15 April even though they did not live in the old home during that period.

If it takes longer than 6 months to dispose of your old home, both homes are exempt only for the last 6 months before you dispose of the old one. You obtain only a part exemption when a CGT event happens in relation to your old home.

EXAMPLE

Part exemption for a first home

Jeneen and John bought their first home under a contract that was settled on 1 January 1996 and moved in immediately. It was their main residence until they bought their 2nd home under a contract that was entered into on 2 November 2000 and settled on 1 January 2001.

They retained the first home after moving into the new one but did not use it to produce income. They sold the first home under a contract that was settled on 30 September 2001. They owned this home for a total period of 2100 days.

Both homes are treated as their main residence for the period 31 March 2001 to 30 September 2001, the last 6 months that Jeneen and John owned their first home. Therefore, their first home is treated as their main residence only for the period before they moved into their new home and during the last 6 months before its sale.

The 89 days from 1 January 2001 to 30 March 2001, when it was not their main residence, are taken into account in calculating the proportion of their capital gain that is taxable (89/2100).

Because they entered into the contract to acquire their old home before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and held it for at least 12 months, Jeneen and John can use either the indexation or the discount method to calculate their capital gain.

Continuing main residence status after dwelling ceases to be your main residence

In some cases you can choose to have a dwelling treated as your main residence even though you no longer live in it. You cannot make this choice for a dwelling that you have not first occupied as your main residence.

Therese bought a house under a contract that was settled on 11 March 1993 and rented it out immediately. On 29 June 1996, she stopped renting it out and moved in.

Therese cannot choose to treat the house as her main residence during the period she was absent under the continuing main residence rule because the house was not her main residence before she rented it out. She will only be entitled to a part exemption if she sells the dwelling.

This choice needs to be made only for the income year that the CGT event happens to the dwelling; that is, the year that you enter into a contract to sell it. If you make this choice, you cannot treat any other dwelling as your main residence for that period (except for a limited time if you are changing main residences, see **Moving from one main residence to another** on page 48).

If you do not use it to produce income, you can treat the dwelling as your main residence for an unlimited period after you cease living in it.

If you do use it to produce income, you can choose to treat it as your main residence while you use it for that purpose for up to 6 years after you cease living in it. You are entitled to another maximum period of 6 years each time the dwelling again becomes, and then ceases to be, your main residence. If, as a result of you making this choice, the dwelling is fully exempt, the home first used to produce income rule (explained on page 47) does not apply.

If you are absent more than once during the period you own the home, the 6-year maximum period that you can treat it as your main residence while you use it to produce income applies separately to each period of absence.

EXAMPLE

One period of absence of 10 years

Home ceases to be the main residence and is used to produce income for one period of 6 years

Lisa buys a house after 20 September 1985 but ceases to use it as her main residence for the 10 years immediately before she sells it. During this period, she rents it out for 6 years and leaves it vacant for 4 years.

Lisa chooses to treat the dwelling as her main residence for the period after she ceased living in it, so any capital gain or capital loss she makes on the sale of the dwelling is disregarded. The maximum period the dwelling can continue to be her main residence while it is used to produce income is 6 years. However, while the house is vacant, the period is unlimited, which means the exemption applies for the whole 10 years.

In addition to this, because the dwelling is fully exempt as a result of Lisa making this choice, the home first used to produce income rule (explained on page 47) does not apply.

Home used to produce income for more than one period totalling 6 years

In the 10-year period after Lisa stopped living in the dwelling she rents it out for 3 years, leaves it vacant for 2 years, rents it out for the next 3 years, then once more leaves it vacant for 2 years.

If she chooses to treat the dwelling as her main residence for the period after she ceased living in it, any capital gain or capital loss she makes on selling it is again disregarded. This is because the total period the home was used to produce income during her absence is not more than 6 years.

EXAMPLE

Home ceases to be the main residence and is used to produce income for more than 6 years during a single period of absence

1 July 1990

Ian bought a home in Sydney and used it as his main residence.

1 January 1992

Ian was posted to Brisbane and bought another home there.

1 January 1992 to 31 December 1996

Ian rented out his Sydney home during the period he was posted to Brisbane.

31 December 1996

Ian sold his Brisbane home and the tenant in his Sydney home left.

The period of 5 years from 1992 to 1996 is the first period the Sydney home was used to produce income for the purpose of the 6-year test.

1 January 1997

Ian was posted from Brisbane to Melbourne for 3 years and bought a home in Melbourne. He did not return to his Sydney home.

1 March 1997

Ian again rented out his Sydney home—this time for 2 years.

28 February 1999

The tenant of his Sydney home left.

The period of 2 years from 1997 to 1999 is the 2nd period the Sydney home was used to produce income under the 6-year test.

31 December 1999

Ian sold his home in Melbourne.

31 December 2000

Ian returned to his home in Sydney and it again became his main residence.

28 February 2002

Ian sold his Sydney home.

Ian chooses to treat the Sydney home as his main residence for the period after he ceased living in it. The effect of making this choice is that any capital gains Ian made on the sale of both his Brisbane home in 1996–97 and his Melbourne home in 1999–2000 are not exempt.

Ian cannot obtain the main residence exemption for the whole period of ownership of the Sydney home because the combined periods it was used to produce income (1 January 1992 to 31 December 1996 and 1 March 1997 to 28 February 1999) total more than 6 years.

As a result, the Sydney house is not exempt for the period it was used to produce income that exceeds the 6-year period; that is, one year.

If the capital gain on the disposal of the Sydney home is $50 000, the amount of the gain that is taxable is calculated as follows:

Period of ownership of the Sydney home:

1 July 1990 to 28 February 2002	4 261 days

Periods the Sydney home was used to produce income after Ian ceased living in it:

1 January 1992 to 31 December 1996	1 827 days
1 March 1997 to 28 February 1999	730 days
	2 557 days

First 6 years the Sydney home was used to produce income:

1 January 1992 to 31 December 1996	1 827 days
1 March 1997 to 28 February 1998	365 days
	2 192 days

Income producing for more than 6 years after Ian ceased living in it:

365 days

Proportion of capital gain taxable in 2001–02

$$365 \times \frac{\$50\,000}{3896} = \$4684$$

Because Ian entered into the contract to acquire the house before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and owned it for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

NOTE

21 August 1996 important

The home first used to produce income rule explained on page 47 does not apply because the home was used by Ian to produce income before 21 August 1996.

Home used to produce income and then you cease living in it

If you use any part of your home to produce income before you cease living in it, you cannot apply the continuing main residence status after dwelling ceases to be your main residence rule (see page 49) to that part. This means you cannot obtain the main residence exemption for that part of the dwelling either before or after you cease living in it.

EXAMPLE

Ceasing to live in a home after part of it is used to produce income

Helen purchased a home under a contract that was settled on 1 July 1992 and she moved in immediately. She used 75 per cent of the home as her main residence and the remaining 25 per cent as a doctor's surgery, which she used until 30 June 1996.

On 1 July 1996, she moved out and rented out the home until it was sold under a contract that was settled on 30 June 2002. Helen chose to treat the dwelling as her main residence for the 6 years it was rented out. She made a capital gain of $10 000 when the home was sold.

As 25 per cent of the home was not used as her main residence during the period before Helen ceased living in it, part of the capital gain is taxable, calculated as follows:

$10 000 × 25% = $2500

Because Helen entered into the contract to acquire the house before 11.45 a.m. on 21 September 1999 and sold it after that time, and owned it for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

The home first used to produce income rule does not apply because Helen first used the home to produce income before 21 August 1996 and because she used it to produce income from the time she purchased it.

Constructing, renovating or repairing a dwelling on land you already own

Generally, if you build a dwelling on land you already own, the land does not qualify for exemption until the dwelling becomes your main residence. However, you can choose to treat land as your main residence for up to 4 years before the dwelling becomes your main residence in certain circumstances. If you make this choice, the land is exempt for the period both before construction and after it becomes your main residence.

You can choose to have this exemption apply if you acquire an ownership interest (other than a life interest) in land and you:

- build a dwelling on the land
- repair or renovate an existing dwelling on the land, or
- finish a partly constructed dwelling on the land.

There are a number of conditions that must be satisfied before you can claim the exemption. You must first finish building, repairing or renovating the dwelling and then:

- move into the dwelling as soon as practicable after it is finished
- continue to use the dwelling as your main residence for at least 3 months after it becomes your main residence.

The land, including the dwelling that is being built, renovated, repaired or finished on it, is exempt for the shorter of the following periods:

- the 4-year period immediately before the date the dwelling becomes your main residence or
- the period between the date you acquired the land and the date the dwelling becomes your main residence.

The period of exemption usually starts from the date you acquired the land. However, if after you acquired the land you or someone else occupied a dwelling that was already on the land, the period of exemption starts from the date that dwelling was vacated.

If you make this choice, you cannot treat any other dwelling as your main residence for the period, except for a limited time under the moving from one main residence to another rule (explained on page 48).

Therefore, if you have a dwelling you acquired on or after 20 September 1985 and you live in it while you build your new home, you must decide whether to:

- maintain the exemption for your old home or
- have the exemption apply to the land (including the dwelling that is being built, renovated, repaired or finished on it) for the shorter of:
  - the time from when you acquire the land until the new home becomes your main residence or
  - the 4-year period immediately before the date on which the new home becomes your main residence.

If you acquired your old main residence before 20 September 1985, it is exempt. This means you will benefit from choosing to treat the land on which your new dwelling is to be built, renovated, repaired or finished as your main residence for the relevant dates above.

You cannot choose to have a shorter period of exemption for the new home in order to exempt the old home for part of the construction period.

EXAMPLE

Choosing to claim exemption for the land from the date of construction

Grant bought vacant land on which he intended to build a new home under a contract that was settled on 3 September 1998. He bought his previous home under a contract that was settled on 3 November 1991.

Grant finished building his new home on 8 September 2001. He moved into it on 7 October 2001, which was as soon as practicable after completion. He sold his previous home under a contract that was settled on 1 October 2001.

If Grant wants to, he can:

- treat the new home as his main residence from 3 September 1998
- claim the exemption for his previous home from 3 November 1991 to 2 September 1998.

Both homes are also exempt from 1 April 2001 to 1 October 2001, the date Grant disposed of the old home. This is because the maximum 6-month exemption outlined in the section **Moving from one main residence to another** on page 48 also applies.

If you were to die at any time between entering into contracts for the construction work and the end of the first 3 months of residence in the new home, this exemption can still apply.

If you owned the land as a joint tenant and you die, the surviving joint tenant (or if none, the trustee of your estate) can choose to treat the land and the dwelling as your main residence for the shorter of:

- 4 years before your death or
- the period starting when you acquired the land and ending when you die.

Destruction of dwelling and sale of land

If your home is accidentally destroyed and you then dispose of the vacant land on which it was built, you can choose to treat the land as your main residence.

If you make this choice, the land is exempt from the time your home was destroyed until you dispose of the land, as well as for the period it was used as part of your main residence. The maximum area of land that can be exempt is 2 hectares. You cannot claim the main residence exemption for this period for any other dwelling, except for a limited time if you are changing main residences (see **Moving from one main residence to another** on page 48).

Having a different home from your spouse or dependent child

If you and a dependent child have different homes at a particular time, you must choose one of the homes as the main residence for both of you for the period.

If you and your spouse have different homes at a particular time, you and your spouse must either:

- choose one of the homes as the main residence for both of you for the period or
- nominate the different homes as your main residences for the period.

If you nominate different homes for the period and you own 50 per cent or less of the home you have nominated, you qualify for an exemption for your share. If you own more than 50 per cent, your share is exempt for half the period you and your spouse had different homes.

The same applies to your spouse. If your spouse owns 50 per cent or less of the home they have nominated, they qualify for an exemption for their share. However, if your spouse owns more than 50 per cent of the home, their share is exempt for only half the period you had different homes.

This rule applies if you choose to treat a dwelling as your main residence when you no longer live in it (see **Continuing main residence status after dwelling ceases to be your main residence** on page 49), and this choice results in you having a different main residence from your spouse or a dependent child for a period.

EXAMPLE

Spouses with different main residences

Under a contract that was settled on 1 July 1996, Kathy and her spouse Grahame purchased a townhouse where they lived together. Grahame owns 70 per cent of the townhouse while Kathy owns the other 30 per cent.

Under a contract that was settled on 1 August 1998, they purchased a beach house which they own in equal shares. From 1 May 1999, Kathy lives in their beach house while Grahame keeps living in the townhouse. Grahame nominated the townhouse as his main residence and Kathy nominated the beach house as her main residence.

Kathy and Grahame sold the beach house under a contract that was settled on 15 April 2002. As it is Kathy's home and she owns 50 per cent of it, her share of any capital gain or capital loss is disregarded for the period she and Grahame had different homes (1 May 1999–15 April 2002). As Grahame did not live in the beach house or nominate it as his main residence when he and Kathy had different homes, his share of any capital gain or capital loss is not ignored for any of the period he owned it.

Grahame and Kathy also sold the townhouse under a contract that was settled on 15 April 2002. Because Grahame owns more than 50 per cent of the townhouse, it is taken to have been his main residence for half of the period when he and Kathy had different homes.

If the total capital gain on the sale of the townhouse is $10 000, Grahame's share of the capital gain is $7000 (reflecting his 70 per cent ownership interest). The portion of the gain that Grahame disregards under the main residence exemption is:

$$\$7000 \times \frac{1034 \text{ days*}}{2114 \text{ days**}} = \$3423$$

plus

$$\$7000 \times 50\% \times \frac{1081 \text{ days***}}{2114 \text{ days**}} = \$1789$$

*townhouse was Grahame's home and he and Kathy did not have different homes

**total ownership period

***when Grahame and Kathy had the different homes

The total amount disregarded by Grahame is:

$3423 + $1789 = $5212

As Grahame bought the townhouse before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and owned his share for at least 12 months, he can use either the indexation or the discount method to calculate his capital gain.

Kathy's share of the $10 000 capital gain on the townhouse is $3000, reflecting her 30 per cent ownership interest. The portion she disregards is:

$$\$3000 \times \frac{1034 \text{ days*}}{2114 \text{ days**}}$$

*period before 1 May 1999 when the townhouse was Kathy's home

**total ownership period

As Kathy entered into the contract to buy the townhouse before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and owned her share for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

EXAMPLE

Different main residences

Anna and her spouse Mark jointly purchased a townhouse under a contract that was settled on 5 February 1999 and both lived in it from that date until 29 April 2002, when the contract of sale was settled. Anna owned more than 50 per cent of the townhouse.

Before 5 February 1999, Anna had lived alone in her own flat which she rented out after moving to the townhouse. She then sold her flat and settled the sale on 11 March 2000. Anna chose to treat the flat as her main residence from 5 February 1999 until she sold it under the continuing main residence status after dwelling ceases to be your main residence rule (see page 49).

Because of Anna's choice, Mark had a different main residence from Anna for the period 5 February 1999 to 11 March 2000. Therefore, Mark must either:

- treat Anna's flat as his main residence for that period or
- nominate the townhouse as his main residence for that period.

If he chooses to treat Anna's flat as his main residence, a part of any gain Mark makes when he sells the townhouse will be taxable. He will not obtain an exemption for the townhouse for the period that he nominated Anna's flat as his main residence (that is, 5 February 1999–11 March 2000).

If Mark nominates the townhouse as his main residence, he qualifies for a full exemption on any capital gain he makes when it is sold because he owned 50 per cent or less of it. However, because Mark and Anna have different main residences as a result of Mark's choice, and Anna owns more than 50 per cent of the flat, her gain on the flat will only qualify for a 50 per cent exemption for the period from 5 February 1999 to 11 March 2000. Any capital gain Anna makes on the townhouse is taxable except for the period from 12 March 2000 to 29 April 2002 and the part that is ignored under the moving from one main residence to another rule (see page 48).

Major capital improvements to a dwelling acquired before 20 September 1985

If you acquired a dwelling before 20 September 1985 and you make major capital improvements after that date, part of any capital gain you make when a CGT event happens in relation to the dwelling could be taxable. Even though you acquired the dwelling before CGT started, major capital improvements are considered to be separate CGT assets from the original asset and may therefore be subject to CGT in their own right if they are made on or after 20 September 1985.

If the dwelling is your main residence and the improvements are used as part of your home, they are still exempt. This includes improvements on land adjacent to the dwelling (for example, installing a swimming pool) if the total land, including the land on which the home stands, is 2 hectares or less.

However, if the dwelling is not your main residence or you used the improvements to produce income for any period, the part of any gain that is attributable to the improvements for that period is taxable.

A capital improvement is taken to be major if its original cost (indexed for inflation) is more than 5 per cent of the amount you receive when you dispose of the dwelling and the improvement is also over a certain threshold. The threshold increases every year to take account of inflation.

Improvement thresholds for 1985–86 to 2001–02

Income year	*Threshold*
1985–86	$50 000
1986–87	$53 950
1987–88	$58 859
1988–89	$63 450
1989–90	$68 018
1990–91	$73 459
1991–92	$78 160
1992–93	$80 036
1993–94	$80 756
1994–95	$82 290
1995–96	$84 347
1996–97	$88 227
1997–98	$89 992
1998–99	$89 992
1999–2000	$91 072
2000–01	$92 082
2001–02	$97 721

EXAMPLE

Improvement on land acquired before 20 September 1985

Martin bought a home in 1984. On 1 December 1993, he undertook major capital improvements worth $85 000. He sold the home for $500 000 under a contract that was settled on 1 December 2001. At the date of sale, the indexed cost base of the improvements was $98 370.

Of the $500 000 he received for the home, $100 000 could be attributed to the improvements. The improvements were used by Martin to produce income from the time they were finished until the time they were sold with the home.

The home first used to produce income rule (explained on page 47) does not apply to the improvements because they were first used to produce income before 21 August 1996.

Test 1	Is the cost base of the improvements more than 5 per cent of $500 000; that is, $25 000?	**Yes**
Test 2	Is the cost base of the improvements more than the 2001–02 threshold of $97 721?	**Yes**

As the answer to both questions is **Yes** and the improvements were used to produce income, the capital gain on the improvements is taxable. The capital gain is calculated as follows:

Amount of proceeds attributable to the improvements	$100 000
less cost base of improvements indexed for inflation	$98 370
Taxable capital gain	**$1 630**

If the improvements had been used as part of Martin's main residence, this gain would be exempt. However, if the home (including the improvements) had been rented out for one-third of the period, one-third of the capital gain made on the improvements would have been taxable.

As Martin acquired the improvements before 11.45 a.m. on 21 September 1999 and sold the home after that time, and had held the improvements for at least 12 months, he could use either the indexation method (as in the calculation above) or the discount method to calculate his capital gain on the improvements.

When you dispose of the dwelling, the capital gain or capital loss on the major improvements is calculated by taking away the cost base of the improvements from the proceeds of the sale that are reasonably attributable to the improvements:

Capital gain on major improvements = proceeds of sale attributable to improvements − cost base of improvements

You can choose to calculate the capital gain made on the improvements using either the indexation or the discount method if:

- the improvements were made under a contract entered into before 11.45 a.m. on 21 September 1999
- the dwelling was sold after that time
- you owned the improvements for at least 12 months.

If you entered into the contract to make the improvements after 11.45 a.m. on 21 September 1999, you calculate your capital gain using the CGT discount of 50 per cent.

In calculating the amount of capital proceeds to be attributed to the improvements, you must take whatever steps are appropriate to work out their value. If you make an estimate of this amount, it must be reasonable and you must be able to show how you arrived at the estimated amount.

Inherited main residence

If you inherit a deceased person's dwelling, you may be exempt or partially exempt when a CGT event happens in relation to it. The same exemptions apply if a CGT event happens in relation to a deceased's estate of which you are the trustee.

Full exemption

Deceased died before 20 September 1985

As you acquired the dwelling before 20 September 1985, any capital gain you make is exempt. However, major capital improvements you make to the dwelling on or after 20 September 1985 may be taxable (see **Major capital improvements to a dwelling acquired before 20 September 1985** on page 54).

Deceased died on or after 20 September 1985

(a) The deceased acquired the dwelling before 20 September 1985 (it does not matter whether the dwelling was the main residence of the deceased person).

You may have an ownership interest in a dwelling that passed to you as a beneficiary in a deceased estate or you may have owned it as trustee of a deceased estate. In either case, any capital gain or capital loss you make from a CGT event that happens in relation

to the dwelling is disregarded if either of the following applies:

1 you disposed of your ownership interest within 2 years of the person's death. This applies whether or not you used the dwelling as your main residence or to produce income during the 2-year period or
2 from the deceased's death until you disposed of your ownership interest, the dwelling was not used to produce income. For this period, the dwelling must also have been the main residence of one or more of:
   – a person who was the spouse of the deceased immediately before the deceased's death (but not a spouse who was permanently separated from the deceased)
   – an individual who had a right to occupy the home under the deceased's will or
   – you, as a beneficiary, if you disposed of the dwelling as a beneficiary.

The dwelling can be the main residence of one of the above people (even though they may have ceased living in it) if they choose to treat it as their main residence under the continuing main residence status after dwelling ceases to be your main residence rule (explained on page 49).

(b) The deceased acquired the dwelling on or after 20 September 1985.

Any capital gain or capital loss you make when a CGT event happens in relation to a dwelling or ownership interest in a dwelling you inherit will be disregarded if:

- condition 2 in (a) above is met and the dwelling passed to you as beneficiary or trustee on or before 20 August 1996. For this to apply, the deceased must have used the dwelling as their main residence from the date they acquired it until their death and they must not have used it to produce income or
- one of the conditions 1 or 2 in (a) above is met and the dwelling passed to you as beneficiary or trustee after 20 August 1996, and just before the date the deceased died it was their main residence and was not being used to produce income.

A dwelling can still be regarded as the deceased's main residence even though they ceased living in it if they or their trustee chose to treat the dwelling as the deceased's main residence. This may happen if—for example, the person moved to a nursing home. You may need to contact the trustee or the deceased's tax adviser to find out whether this choice was made.

If it was, the dwelling can still be regarded as the deceased's main residence:

- for an indefinite period if the dwelling was not used to produce income after the deceased stopped living in it or
- for a maximum of 6 years after they ceased living in it if it was used to produce income after they ceased living in it.

EXAMPLE

Full exemption

Rodrigo was the sole occupant of a home he bought in April 1990; that is, after 20 September 1985. He did not live in or own another home. He died in January 1999 and left the house to his son, Petro. Petro rented out the house and then disposed of it 15 months after his father died. Petro is entitled to a full exemption from CGT as he acquired the house after 20 August 1996 and disposed of it within 2 years of his father's death.

Part exemption

If you do not qualify for a full exemption from CGT for the home you may be entitled to a part exemption.

You calculate your capital gain or capital loss as follows:

$$\text{Capital gain or capital loss amount} \times \frac{\text{non-main residence days}}{\text{total days}}$$

Non-main residence days

'Non-main residence days' is the number of days that the dwelling was not the main residence.

(a) If the deceased acquired the dwelling before 20 September 1985, non-main residence days is the number of days in the period from their death until settlement of your contract for sale of the dwelling when it was not used to produce income and was not the main residence of one of the following:
   – a person who was the spouse of the deceased (except a spouse who was permanently separated from the deceased)
   – an individual who had a right to occupy the dwelling under the deceased's will or
   – you, as a beneficiary, if you disposed of the dwelling as a beneficiary.

(b) If the deceased acquired the dwelling on or after 20 September 1985, non-main residence days is the number of days calculated under (a) plus the number of days in the deceased's period of ownership when the dwelling was not their main residence.

Total days

(a) If the deceased acquired their ownership interest before 20 September 1985, 'total days' is the number of days from their death until you disposed of your ownership interest.

(b) If the deceased acquired the ownership interest on or after 20 September 1985, total days is the number of days in the period from when the deceased acquired the dwelling until you disposed of your ownership interest.

EXAMPLE

Part exemption

Vicki bought a house under a contract that was settled on 12 February 1994 and she used it solely as a rental property. When she died on 17 November 1997, the house became the main residence of her beneficiary, Lesley. Lesley sold the property under a contract that was settled on 27 November 2001.

As Vicki had never used the property as her main residence, Lesley cannot claim a full exemption from CGT. However, as Lesley used the house as her main residence, she is entitled to a part exemption from CGT.

Vicki owned the house for 1375 days and Lesley then lived in the house for 1471 days, a total of 2846 days. Assuming Lesley made a capital gain of $10 000, the taxable portion is:

$$\$10\,000 \times \frac{1375}{2846} = \$4831$$

As Lesley entered into the contract to purchase the property before 11.45 a.m. on 21 September 1999 and entered into the contract to sell it after that time, and held the property for at least 12 months, she can use either the indexation or the discount method to calculate her capital gain.

There are some situations in which any non-main residence days and total days before the deceased's death are ignored in calculating the capital gain or capital loss. This happens if:

- you acquired the dwelling before 21 August 1996 and during the full period the deceased owned it, the dwelling was their main residence and was not used to produce income or
- you acquired the dwelling after 20 August 1996 and it was the deceased's main residence just before their death and was not being used to produce income at that time.

If you disposed of your ownership interest in the dwelling within 2 years of the person's death, you can ignore the main residence days and total days in the period from the person's death until you dispose of the dwelling if this lessens your tax liability.

Cost to you of acquiring the dwelling

If you acquire a dwelling the deceased had owned, there are special rules for calculating your cost base. These rules apply in calculating any capital gain or capital loss when a CGT event happens in relation to the dwelling.

The first element of the cost base or reduced cost base of a dwelling—its acquisition cost—is its market value at the date of death if either:

- the dwelling was acquired by the deceased before 20 September 1985 or
- the dwelling passes to you after 20 August 1996 and it was the main residence of the deceased immediately before their death and was not being used to produce income at that date.

In any other case, the acquisition cost is the deceased's cost base or reduced cost base on the day they died.

EXAMPLE

Continuing main residence status

Aldo bought a house in March 1995 and lived in it. He moved into a nursing home in December 1996 and left the house vacant. He chose to treat the house as his main residence after he ceased living in it under the continuing main residence status after dwelling ceases to be your main residence rule (explained on page 49).

Aldo died in February 2002 and the house passed to his beneficiary, Con who uses the house as a rental property.

As the house was Aldo's main residence immediately before his death and was not being used to produce income at that time, Con, can obtain a full exemption for the period Aldo owned it.

If Con rented out the house and sold it more than 2 years after Aldo's death, the capital gain for the period from the date of Aldo's death until Con sold it is taxable.

If Con had sold the house within 2 years of Aldo's death, he could have ignored the main residence days and total days between Aldo's death and him selling it—which would have given him exemption for this period.

If Aldo had rented out the house after he ceased living in it and had chosen to treat it as his main residence under the continuing main residence status after dwelling ceases to be your main residence rule (explained on page 49), the house would be considered to be his main residence until his death because he rented it out for less than 6 years.

However, even if this choice had been made, Con would only obtain a part exemption for the period Aldo owned the house because it was being used to produce income just before Aldo died. Con would obtain the exemption for the period Aldo did not use the house to produce income.

Note that even though the deceased was not living in the home at the date of their death, they or their trustee may have chosen to treat it as their main residence. You may need to contact the trustee or the deceased's tax adviser to find out whether this choice was made. If it was, the dwelling can still be regarded as the deceased's main residence:

- for an indefinite period—if the dwelling was not used to produce income after the deceased stopped living in it or
- for a maximum of 6 years after they ceased living in it—if it was used to produce income after they ceased living in it.

If you are a beneficiary, the cost base or reduced cost base also includes amounts that the trustee of the deceased's estate would have been able to include in the cost base or reduced cost base.

Acquisition of a dwelling from a company or trust upon marriage breakdown

If a dwelling is transferred to you from a company or trustee of a trust under a court order as a result of your marriage breakdown, you are treated as having owned the dwelling while it was owned by the company or trustee. However, you cannot obtain the main residence exemption during any part of the period that the company or trustee owned it.

Therefore, if a dwelling is transferred to you by a company or trustee as a result of your marriage breakdown, you will be entitled to the exemption only for the period after it was transferred when it was your main residence. This is calculated by dividing the period after the transfer that it was your main residence by the combined period you and the company or trustee owned it

For more information about CGT assets and marriage breakdown, see chapter 8.

CHAPTER 7 Loss, destruction or compulsory acquisition of an asset

This chapter explains your CGT obligation if your CGT asset is lost, destroyed or compulsorily acquired. Generally, there is no CGT obligation for assets acquired before 20 September 1985 (pre-CGT).

NOTE

New terms

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

There may be a situation where you receive money or another CGT asset (or both) as compensation when you dispose of an asset involuntarily (or under an insurance policy against the risk of such an event happening). In this case, you may be able to choose to:

- defer your liability to pay tax on any capital gain arising on the disposal or
- have any replacement asset treated as a pre-CGT asset if the original asset was acquired before 20 September 1985.

This concession is known as roll-over. It may be available if one of the following events happens:

- all or part of your CGT asset is lost or destroyed
- your CGT asset is compulsorily acquired by an Australian government agency (that is, the Commonwealth, a State, a Territory or one of their authorities)
- you dispose of your CGT asset to an Australian government agency after they serve a notice on you inviting you to negotiate a sale agreement. They must have informed you that, if the negotiations are unsuccessful, the asset will be compulsorily acquired
- a lease (that had been granted to you by an Australian government agency under a Commonwealth, State or Territory law) expires and is not renewed.

This roll-over is not available for plant disposed of after 11.45 a.m. on 21 September 1999 and other depreciating assets from 1 July 2001. Instead, where a depreciating asset is lost or destroyed or an Australian government agency acquires it compulsorily or by forced negotiation, the capital allowances provisions may allow for a balancing charge offset.

This means that rather than including an amount in your assessable income by way of a balancing adjustment, you can offset that amount against the cost of a replacement asset (or assets).

If you choose to take roll-over, you do not need to lodge a written election stating your choice—it will be clear from the way you prepare your tax return.

You cannot choose to defer a capital loss but you can use it to reduce any capital gain made in the current income year or a later year.

From 1 July 2001, for roll-over relief to apply, the replacement asset you acquire cannot become an item of your trading stock nor can it be a depreciating asset.

Time of the CGT event

You need to know the time of a CGT event to work out in which income year a capital gain or capital loss affects your income tax.

If an asset is lost or destroyed and you receive compensation, the time of the CGT event is when you first receive the compensation.

If you do not receive any compensation, the time of the CGT event is when the loss is discovered or the destruction occurred.

If an Australian government agency compulsorily acquires your asset, the time of the CGT event is when:

- you first received compensation from the agency or
- the agency enters the asset (for example, land) or takes possession of it.

If an Australian government agency acquires your asset following negotiation (rather than compulsorily acquiring it), the time of the CGT event is:

- the date the contract to acquire it is made or
- the date of the change of ownership if there is no contract.

If a lease that had been granted to you by an Australian government agency expires and is not renewed, the time of the CGT event is when the lease expires.

If you receive money

If you receive money because a CGT event happens, you can choose roll-over only if:

- you incur expenditure in acquiring another CGT asset or
- part of the original asset is lost or destroyed and you incur expenditure of a capital nature in repairing or restoring it.

You must incur at least some of the expenditure:

- no earlier than one year before the event happens or
- within one year after the end of the income year in which the event happens.

This period may be extended in special circumstances.

EXAMPLE

Roll-over applies

Trish paid for the repair of an asset for which she was compensated after part of it was destroyed on 1 September 2000. Trish's expenditure qualifies for the roll-over concession if it was incurred any time during the period 1 September 1999 to 30 June 2002.

The replacement asset need not be identical to the one it is replacing. However, for roll-over to apply, you must use it in the same business or for the same (or a similar) purpose as the one for which you used the original asset. Also, your replacement asset cannot become an item of trading stock nor can it be a depreciating asset.

EXAMPLE

Roll-over does not apply

Denise receives money when her manufacturing business premises are destroyed. She buys a rental property with this money.

Denise cannot access the roll-over concession because she does not use the rental property for the same or similar purpose as her old business premises.

Consequences of receiving money

If you receive money and choose to obtain a roll-over, the following are the consequences.

Original asset acquired before 20 September 1985

If you acquired the original asset before 20 September 1985, you are taken to have acquired the repaired or replacement asset before that day if:

- you repair or restore it, or
- you replace it:
  - at a cost of no more than 120 per cent of its market value at the time of the event or
  - at any cost, provided it (or part of it) was lost or destroyed by a natural disaster and the replacement asset is substantially the same.

This means you disregard any capital gain or capital loss you make when a later CGT event happens to the repaired or replacement asset.

Original asset acquired on or after 20 September 1985

If you acquired the original asset on or after 20 September 1985, the way roll-over applies will depend on whether the money you received is more or less than the cost of repairing or replacing the asset. If it is more, it also depends on whether the capital gain you make when the event happens is:

- more than that excess or
- less than or equal to that excess.

Money received is more than the cost of repair or replacement

If you do not use all of the money you received to repair or replace the original asset, this affects your CGT obligation. The amount of capital gain you include on your tax return depends on whether the capital gain is more or less than the difference between the amount you received and the cost of the repair or replacement.

If the capital gain is more than that difference, your capital gain is reduced to the amount of the excess. Include this amount on your tax return in the year the event happens. This gain may be eligible for the CGT discount (see chapter 2 for more information).

When a later CGT event happens, the expenditure to include in the cost base of the asset is reduced by the difference between the gain before it is reduced and the excess. This enables you to defer part of your CGT liability until a later CGT event happens.

If the capital gain is less than or equal to the excess (the compensation amount less the cost of the repair or replacement), the capital gain and the expenditure on the repair or replacement are not reduced.

Money received does not exceed the cost of repair or replacement

If the amount of money you received is less than or equal to the expenditure you incurred to repair or replace the original asset, any capital gain is disregarded. The expenditure you include in the cost base of the asset when a later CGT event happens is reduced by the amount of the gain.

EXAMPLE

Money received is less than expenditure incurred

Gerard's business premises were destroyed by fire on 15 March 2002. He received $46 000 in compensation from his insurance company.

It cost him $57 000 to reconstruct the premises, $11 000 more than the amount of compensation he received.

Gerard made a capital gain of $2000 because his cost base apportioned to the building was $44 000 at the time of the fire.

Money received	$46 000
Cost base	$44 000
Capital gain	**$2 000**
Money received	$46 000
Replacement expenditure	**$57 000**
Shortfall	**$11 000**

As the compensation money does not exceed the repair expenditure, the capital gain is disregarded. However, the amount of expenditure that Gerard can include in the cost base of the repaired building is reduced by the amount of the capital gain ($2000) to $55 000.

EXAMPLE

Money received is more than the expenditure incurred

Assume that in the above example, Gerard incurred only $40 000 for repairs and the cost attributed to the building was $30 000.

Money received	46 000
Cost base	30 000
Capital gain	**16 000**
Money received	46 000
Replacement expenditure	**40 000**
Excess	**6 000**

The compensation money ($46 000) is $6000 more than the replacement expenditure ($40 000). The capital gain ($16 000) is $10 000 more than the excess of $6000. The capital gain is reduced to the excess amount of $6000 and Gerard must include this amount as a capital gain in his assessable income on his 2001–02 tax return.

If Gerard is eligible for the CGT discount of 50 per cent, the $6000 excess is Gerard's nominal capital gain. Therefore, Gerard must include $3000 ($6000 × 50%) in the calculation of his net capital gain/capital loss for the 2001–02 income year.

Also, the expenditure he incurred on the replacement asset is reduced by the balance of the capital gain ($10 000) to $30 000. This means $10 000 of the capital gain is deferred.

If you receive an asset

If you receive a replacement asset when the event happens, you can choose a roll-over only if:

- the replacement asset is not a depreciating asset or held as trading stock when you acquire it
- the market value of the replacement asset is more than the cost base of the original asset just before the event happened.

Consequences of receiving an asset

If you choose to obtain a roll-over when you receive a replacement asset, any capital gain you make from the original asset is disregarded. The other consequences are outlined below.

Original asset acquired before 20 September 1985

If you acquired the original asset before 20 September 1985, you are taken to have acquired the new asset before that day.

Original asset acquired on or after 20 September 1985

If you acquired the original asset on or after 20 September 1985, the first element of the cost base or reduced cost base of the replacement asset is taken to be the cost base or reduced cost base of the original asset at the time of the event.

However you may have to recalculate the first element of the cost base of your replacement asset if the cost base of the original asset included an amount of indexation and you are seeking to apply the CGT discount to a capital gain from the replacement asset.

EXAMPLE

Asset received

Jon acquired land after 19 September 1985 that the State Government compulsorily acquired on 14 July 2001. The cost base of the land at the time it was compulsorily acquired was $180 000. As compensation, Jon received another piece of land with a market value of $200 000.

Because the market value of the replacement land was greater than the cost base of the original land just before it was compulsorily acquired, the capital gain Jon made on the disposal of the original land is disregarded. Jon is taken to have paid $180 000 to acquire the replacement land (that is, the cost base of the original land at the time it was compulsorily acquired).

If you receive both money and an asset

If you receive both money and an asset and choose to take a roll-over, the requirements and consequences are different for each part of the compensation.

EXAMPLE

Money and an asset received as compensation

The State Government compulsorily acquires land Kris bought in 2001. Its cost base at the time was $150 000 but Kris received compensation worth $160 000.

Half of the total compensation is money ($80 000) and half is replacement land (market value $80 000). Therefore, the cost base of the original land attributable to each part of the compensation is $75 000 (50% × $150 000). Kris bought additional replacement land for $82 000.

The total capital gain is $10 000 which is capital proceeds of cash and property totalling $160 000 less the cost base of $150 000. Half of this capital gain can be attributed to the money and half to the asset (the replacement land).

The money Kris received as compensation is less than the amount he paid to buy the additional land. He can therefore disregard the $5000 of the capital gain that is attributable to the money compensation. The expenditure on the additional land is reduced by $5000, so the first element of its cost base is only $77 000.

As the market value of the replacement land is more than that part of the cost base of the original land, Kris can choose to take roll-over relief and disregard the capital gain of $5000 relating to the land.

As a result, the value of the replacement land ($75 000) forms the first element of its cost base, not its market value ($80 000) when it was acquired.

Consequences of receiving both money and an asset

You need to separately determine what happens in relation to the replacement asset and the money, having regard to the proportion of the original asset attributable to each type of compensation.

The rules are then applied separately to the money and to the asset.

Indexation or CGT discount

If a CGT event happens to the replacement asset (for example, a later disposal), you may be able to use the indexation method or the discount method to calculate your capital gain. This applies only if the periods of ownership of the original asset and the replacement asset add up to at least 12 months. For indexation to apply, you must have acquired the asset before 21 September 1999.

CHAPTER 8 Marriage breakdown

Read this chapter if your legal or de facto marriage ended on or after 20 September 1985 and:

- you transfer an asset to or receive an asset from your spouse, or
- a company or trustee of a trust transfers an asset to you or your spouse.

NOTE ***New terms***

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

When we talk about 'your spouse', this includes your de facto spouse, while 'transfer of an asset' includes disposing of an asset to the transferee spouse or 'creating' an asset in their favour.

The term 'transferee spouse' refers to the spouse to whom an asset is transferred, while the 'transferor' is the person (or a company or the trustee of a trust) who transfers an asset to the transferee spouse.

As a general rule, CGT applies to all changes of ownership of assets on or after 20 September 1985. However, if you transfer an asset to your spouse as a result of a marriage breakdown, there is automatic roll-over in certain cases (you cannot choose whether or not it applies).

This roll-over allows the transferor spouse to disregard a capital gain or capital loss that would otherwise arise. In effect, the one who receives the asset (the transferee spouse) will make the capital gain or capital loss when they dispose of the asset. If you are the transferee spouse, the cost base and other attributes of the asset are transferred to you.

You must keep all relevant records, as explained in chapter 3.

Conditions for marriage breakdown roll-over

For the roll-over conditions to be met, a CGT event must happen because of:

- an order of a court or court order made by consent under the *Family Law Act 1975* or a similar law of a foreign country
- a maintenance agreement approved by a court under section 87 of that Act or a similar agreement under a foreign law, or
- a court order under a State, Territory or foreign law relating to de facto marriage breakdowns.

Please note that maintenance agreements registered under section 86 of the *Family Law Act 1975* are excluded.

Relevant CGT events

For roll-over to apply, one of the following events must happen. The transferor:

- disposes of an asset to the transferee spouse (CGT event A1)
- enters into an agreement with the transferee spouse under which:
  - the right to use and enjoy a CGT asset passes to them
  - title in the asset will or may pass to them at the end of the agreement (CGT event B1). There is no roll-over if title in the CGT asset does not pass to them when the agreement ends
- creates a contractual or other right in favour of the transferee spouse (CGT event D1)
- grants an option to the transferee spouse or renews or extends an option granted to them (CGT event D2)
- owns a prospecting or mining entitlement, or an interest in one, and grants the transferee spouse a right to receive income from operations carried on by the entitlement (CGT event D3)
- is a lessor and grants, renews or extends a lease to the transferee spouse (CGT event F1).

There is no roll-over for the transfer of trading stock.

Consequences of roll-over

Where you transfer the asset

Where you transfer the asset, the consequences of roll-over are:

- *for assets acquired before 20 September 1985*: any capital gain or capital loss is disregarded
- *for assets acquired on or after 20 September 1985*: marriage breakdown roll-over enables you to disregard any capital gain or capital loss you make from the CGT event that involves you and the transferee spouse.

Where the asset is transferred to you

Assets acquired before 20 September 1985

If a CGT asset, including a share of a jointly owned asset, was transferred to you because of the breakdown of your marriage and it was acquired by the transferor before 20 September 1985, you are also taken to have acquired the asset before that date. Any capital gain or capital loss you make when you later dispose of the asset will be disregarded.

However, if you make a major capital improvement to that asset after 20 September 1985, you may be subject to CGT when a CGT event happens to that asset (see **Other capital improvements to pre-CGT assets** on page 5).

Assets acquired on or after 20 September 1985

The rules are different if the asset was acquired by the transferor on or after 20 September 1985. In this case, if you receive the CGT asset (or a share of a jointly owned asset) and there is a marriage breakdown roll-over, you are taken to have acquired the asset (or share of the asset) at the time it was transferred from your spouse (or the company or trustee).

To calculate your capital gain or capital loss when a later CGT event happens, the first element of your cost base or reduced cost base will be the same as that of your spouse (or the company or trustee) at the time of the transfer.

If the transferor' s cost base includes an amount of indexation you may later have to recalculate the first element of your cost base to exclude that amount if you want to apply the CGT discount to your capital gain.

Transfer costs incurred by your spouse (or the company or trustee)—for example, conveyancing fees and stamp duty are included in the cost base.

If you acquired the asset from your spouse (or the company or trustee) before 11.45 a.m. on 21 September 1999, you may be able to use the indexation method when calculating your capital gain. This can only apply if the total ownership period of you and your spouse (or the company or trustee) is 12 months or more.

If you acquired the asset after 11.45 a.m. on 21 September 1999, you cannot use the indexation method when calculating your capital gain but you may be able to use the discount method. You will make a discount capital gain if the combined period of ownership of the asset for you and your spouse is 12 months or more.

Collectables or personal use assets remain collectables or personal use assets when they are transferred from your spouse (or the company or trustee) in the case of a marriage breakdown roll-over. For information about collectables and personal use assets, see **What is a CGT asset?** on page 3.

As explained earlier, there are several instances where your spouse (or a company or trustee) may create an asset in your favour. The table below explains how to calculate the first element of your cost base or reduced cost base of that asset in each case.

CGT event	Cost base or reduced cost base
Creating contractual or other rights (D1)	Incidental costs incurred by the transferor that relate to the event
Granting an option (D2)	Expenditure incurred by the transferor to grant the option
Granting a right to income from mining (D3)	Expenditure incurred by the transferor to grant the right
Granting a lease (F1)	Expenditure incurred by the transferor on the grant renewal or extension of the lease

You are taken to have acquired the asset at the time specified by the CGT event. For example, for CGT event D1, you acquire the asset at the time you enter into the contract or if there is no contract, the time the right is created. For more information, see *Summary of CGT events,* appendix 1.

CGT assets transferred by a company or trust

If a CGT asset is transferred to a transferee spouse by a company or a trustee of a trust, adjustments are required to the relevant cost base or reduced cost base of interests in the company or trust. These may be shares (or indirect interests in shares) in the company, units in a unit trust and other interests in the trust. They are reduced in value by an amount that reasonably reflects the fall in their market value as a result of the transfer of the CGT asset.

EXAMPLE

Transfer of assets from a legal or a de facto marriage

Danny and Claudia jointly owned the following assets immediately before their marriage breakdown:

Asset	*When purchased*	*Cost*
The family home	January 1985	$75 000
Holiday house	December 1988	$65 000
Shares in a company	March 1999	$35 000

On their divorce in October 2001, the Family Court approved the couple's voluntary asset agreement and made an appropriate court order by consent.

Claudia received the family home. Because it was acquired by the couple before 20 September 1985, she is taken to have acquired both her original interest in the home and Danny's share before that date. Claudia will not have to pay tax on capital gains when she sells the home.

Danny has no CGT obligation in relation to the transfer to Claudia of his share in the family home.

Danny received the shares and the holiday house which did not become his home.

Although the couple acquired these assets after 20 September 1985, Claudia's capital gain from the transfer of her share of these assets to Danny is disregarded under the marriage breakdown roll-over.

Danny is taken to have acquired Claudia's share of these assets at the time of transfer for her relevant cost base. If he were to sell the holiday home or the shares, he would calculate his capital gain or capital loss in respect of his original interest and the interest he acquired from Claudia.

Danny can choose to apply the indexation method or the discount method to work out the amount of any capital gain from his original interest because it was acquired before 21 September 1999.

Because he acquired Claudia's interest after that date he can only choose the discount method to work out any capital gain in relation to it. However, in applying the 12-month ownership test for the purposes of the CGT discount, he can take into account the period that Claudia owned the interest.

Danny will have to ensure that the cost base of the interest that he acquired from Claudia does not include any amount of indexation.

Special rules apply to marriage breakdown roll-overs involving a controlled foreign corporation or certain non-resident trusts.

For more information, refer to the sources listed at the back of this guide.

Main residence

If the CGT asset transferred in a marriage breakdown roll-over is your home, you may be entitled to an exemption from CGT for the period the home was your main residence (see chapter 6 for more information).

Where there is no court approval

If you and your spouse divide your property by some means other than by a court order or an agreement approved by the court, normal CGT rules apply—not the rules explained in this chapter. You must include on your tax return for that year any capital gain or capital loss you make on the transfer of a CGT asset. The spouse to whom the asset is transferred is taken to have acquired the asset at the time of transfer.

Special rules may apply if the amount paid by one spouse for property owned by the other is greater or less than the market value of the property and they are not dealing at arm's length. In these cases, for CGT purposes, they are taken to have paid or received the market value of the property.

CHAPTER 9 Assets of a deceased estate

If you are a deceased person's legal personal representative or a beneficiary of a deceased estate, you should read this chapter to find out about the special CGT rules that apply.

NOTE

New terms

There may be terms in this chapter that are not familiar to you. Refer to chapter 1 in part A for more information or to *Explanation of terms* at the back of this guide.

When a person dies, the assets that make up their estate can:

- pass directly to a beneficiary (or beneficiaries) or
- pass directly to their legal personal representative (for example, their executor) who may dispose of the assets or pass them to the beneficiary (or beneficiaries).

A beneficiary is a person entitled to assets of a deceased estate. They can be named as a beneficiary in a will or they can be entitled to the assets as a result of the laws of intestacy (when the person does not make a will).

A legal personal representative can be either:

- the executor of a deceased estate (that is, a person appointed to wind up the estate in accordance with the will) or
- an administrator appointed to wind up the estate if the person does not leave a will.

Capital gain or capital loss on death disregarded

There is a general rule that CGT applies to any change of ownership of a CGT asset, unless the asset was acquired before 20 September 1985 (pre-CGT).

There is a special rule that allows any capital gain or capital loss made on a post-CGT asset to be disregarded if, when a person dies, an asset they owned passes:

- to their legal personal representative or to a beneficiary, or
- from their legal personal representative to a beneficiary.

Exceptions to this rule

A capital gain or capital loss is not disregarded if a post-CGT asset owned at the time of death passes from the deceased to a tax-advantaged entity or to a non-resident. In these cases, a CGT event is taken to have happened in relation to the asset just before the person dies. The CGT event will result in:

- a capital gain if the market value of the asset on the day the person dies is more than the cost base of the asset or
- a capital loss if the market value is less than the asset's reduced cost base.

A 'date of death return' should be lodged (for the period from the start of the income year to the date of the person's death) showing any capital gain or capital loss. It is the trustee of the deceased estate, not the beneficiary, who pays tax on any net capital gain.

Tax-advantaged entity

A tax-advantaged entity is:

- a tax-exempt entity (for example, a church or charity) or
- the trustee of:
  - a complying superannuation fund
  - a complying approved deposit fund or
  - a pooled superannuation trust.

Any such capital gain or capital loss can be disregarded if the gain results from a testamentary gift of property (that is not land or a building) to a public library, a museum or an art gallery in Australia. This also applies to a testamentary gift to the Australiana Fund (under the Cultural Bequests Program), as long as the Minister for Communications, Information Technology and the Arts certifies that the gift meets the specific requirements of the program.

Non-resident beneficiary

If a non-resident is a beneficiary of a deceased's post-CGT asset, any capital gain or capital loss is not disregarded if:

- the deceased was an Australian resident when they died
- the asset does not have the necessary connection with Australia.

Examples of assets that have the necessary connection with Australia include:

- real estate located in Australia
- shares in an Australian resident private company.

Assets which pass to the beneficiary or legal personal representative

Main residence

Special rules apply if the asset was the person's main residence (see **Inherited main residence** on page 55).

Other assets

In administering and winding up a deceased estate, a legal personal representative may need to dispose of some or all of the assets of the estate. Assets disposed of in this way are subject to the normal rules and any capital gain the legal personal representative makes on the disposal is subject to CGT.

Similarly, it may be necessary for the legal personal representative to acquire an asset (for example, to satisfy a specific legacy made). Any capital gain or capital loss they make on disposal of that asset to the beneficiary is subject to the normal CGT rules.

If a beneficiary sells an asset they have inherited, the normal CGT rules also apply.

Acquisition of asset

If you acquire an asset owned by a deceased person as their legal personal representative or beneficiary you are taken to have acquired the asset on the day the person died. If that was before 20 September 1985, any capital gain or capital loss you make from the asset will be disregarded.

Cost base of asset

If the deceased person acquired their asset before 20 September 1985, the first element of your cost base or reduced cost base (that is, the amount taken to have been paid for the asset) is the market value of the asset on the day the person died.

If, before they died, a person made a major improvement to a pre-CGT asset on or after 20 September 1985, the improvement is not treated as a separate asset.

The beneficiary or legal personal representative is taken to have acquired the improved asset when the person died. Although the deceased used to treat the asset and the improvement as separate assets, the beneficiary or legal personal representative now treats them as one asset.

If a deceased person acquired their asset on or after 20 September 1985, the first element of your cost base or reduced cost base is taken to be the cost base (indexed where relevant) or reduced cost base of the asset on the day the person died.

If the deceased's cost base includes an amount of indexation, you may later have to recalculate the first element of your cost base to exclude that amount if you want to apply the CGT discount to your capital gain.

Expenditure incurred by a legal personal representative

As a beneficiary, you can include in your cost base (or reduced cost base) any expenditure the legal personal representative (for example, the executor) would have been able to include in their cost base if they had sold the asset instead of distributing it to you. You can include the expenditure on the date they incurred it.

For example, if an executor incurs costs in confirming the validity of the deceased's will, these costs form part of the cost base of the estate's assets.

Choosing the indexation method or the discount method

If you become the beneficiary (or legal personal representative) of a deceased estate on or before 11.45 a.m. on 21 September 1999, there are 2 ways of calculating your capital gain. You can use either the indexation method or the discount method, whichever gives you the better result.

As a general rule, elements of the estate's cost base of an asset can be indexed if you own the asset for at least 12 months before disposing of it. If you receive an asset from an estate, the 12-month period is calculated from the time the deceased acquired the asset, not from the date of their death.

If you acquired the asset on or before 11.45 a.m. on 21 September 1999 but dispose of the asset after that time, you may choose to either index the cost base or claim the CGT discount.

However, the CGT discount is only available if you are an individual, a trust or a complying superannuation entity.

For the CGT discount to apply, you must have acquired the asset at least 12 months before disposing of it. For the purposes of this 12-month ownership test, you are taken to have acquired the asset at one of the following times:

- for pre-CGT assets, the date the deceased died
- for post-CGT assets, the date the deceased acquired it.

EXAMPLE

Transfer of an asset from the executor to a beneficiary

Maria died on 13 October 2000 leaving 2 assets: a parcel of 2000 shares in ABC Ltd and a vacant block of land. Giovanni was appointed executor of the estate (the legal personal representative).

When the assets are transferred to Giovanni, any capital gain or capital loss is disregarded. Giovanni disposes of (sells) the shares to pay Maria's outstanding debts. As the shares are not transferred to a beneficiary, any capital gain or capital loss on this disposal must be included on the tax return for Maria's deceased estate.

When all debts and tax have been paid, Giovanni transfers the land to Maria's beneficiary, Antonio, and pays the conveyancing fee of $5000. As the land is transferred to a beneficiary, any capital gain or capital loss is disregarded. The first element of Antonio's cost base is taken as Maria's cost base on the date of her death. Antonio is also entitled to include in his cost base the $5000 Giovanni spent on the conveyancing.

EXAMPLE

Indexation and CGT discount

Leonard acquired a property on 14 November 1998 for $26 000. He died on 6 August 1999 and left the property to Gladys. She sold the property on 6 July 2001 for $40 000. The property was not the main residence of either Leonard or Gladys.

Although Gladys acquired the property on 6 August 1999, for the purpose of determining whether she had owned the property for at least 12 months, she was taken to have acquired it on 14 November 1998 (the day Leonard acquired it).

At the time of disposal, Gladys is taken to have owned the property for more than 12 months. As she acquired it before 11.45 a.m. on 21 September 1999 and disposed of it after that date, Gladys could choose to index the cost base. However, if the discount method gave her a better result, she could choose to claim the CGT discount.

If Gladys chose the discount method she would have to exclude from the first element of her cost base the amount that represented indexation that had accrued to Leonard up until the time he died.

Collectables and personal use assets

A post-CGT collectable or personal use asset is still treated as such when you receive it as a beneficiary in, or the legal personal representative of, the estate.

Joint tenants

If 2 or more people acquire a property asset together, it can be either as joint tenants or as tenants in common.

If one of the joint tenants dies, their interest in the property passes to the surviving joint tenant(s). It is not an asset of the deceased estate.

If a tenant in common dies, their interest in the property is an asset of their deceased estate. This means it can be transferred only to a beneficiary of the estate or be sold (or otherwise dealt with) by the legal personal representative of the estate.

For CGT purposes, if you are a joint tenant, you are treated as if you are a tenant in common owning equal shares in the asset. However, if one of the other joint tenants dies, on that date their interest in the asset is taken to pass in equal shares to you and any other surviving joint tenants, as if their interest is an asset of their deceased estate and you are beneficiaries.

The cost base rules relating to other assets of the deceased estate apply to their interest in the asset or the equal share of it which passes to you and any other surviving joint tenants.

For the indexation and discount methods to apply, you must have owned the asset (or your share of it) for at least 12 months. As a surviving joint tenant, for the purposes of this 12-month test, you are taken to have acquired the deceased's interest in the asset (or your share of it) at the time the deceased person acquired it.

EXAMPLE

CGT and joint tenants

Trevor and Kylie acquired land as joint tenants before 20 September 1985. Trevor died in October 2001. For CGT purposes, Kylie is taken to have acquired Trevor's interest in the land at its market value at the date of his death.

Kylie holds her original 50 per cent interest as a pre-CGT asset, and the inherited 50 per cent interest as a post-CGT asset which she is taken to have acquired at its market value at the date of Trevor's death.

If Kylie sold the land within 12 months of Trevor's death, she would qualify for the CGT discount on any capital gains she makes on her post-CGT interest. She qualifies for the CGT discount because, for the purposes of the 12-month ownership test, she is taken to have acquired Trevor's interest at the time when he acquired it, which was before 20 September 1985.

Prior year net capital losses

If the deceased had any unapplied net capital losses when they died, these cannot be passed on to you as the beneficiary or legal personal representative for you to offset against any net capital gains.