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WORKBOOK

Capital Gains Tax (Part 1 of 2)

22 FEBRUARY 2018

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Overview

- Part 1 of a 2 part series on capital gains tax (CGT)
- Part 1 covers:
  - CGT background
  - CGT key concepts
  - CGT events
  - CGT assets
  - Computation of capital gains & capital losses
- Part 2 will cover more advanced CGT subjects & special topics of interest

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Capital Gains Tax - Internationally

- vast majority of OECD countries have some form of CGT regime in place & are normally either:
  - 'semi-comprehensive': where capital gains taxed at progressive rates same as ordinary income
  - 'semi-dual': where capital gains taxed at a lower, flat tax of rate
- other common features of CGT regimes implemented overseas in OECD countries are:
  - family home excluded;
  - gains taxed on a realisation basis; and
  - capital losses claimed only against capital gains & not ordinary income

Capital Gains Tax - Internationally

OECD studies have found that advantages of CGT regimes generally outweigh disadvantages & that they provide benefits of:

- securing tax revenues
- improving efficiency
- strengthening equity of tax system
- encouraging savings & investment
- simplifying the tax system

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Capital Gains Tax - Australia

- introduced with effect from 20 September 1985 - prior to this date - gains or profits that were 'capital' in character generally not taxed
- Tax Law Improvement Project (TLIP) in early 1990's resulted in:
  - CGT provisions being re-written
  - major changes to fundamental structure of CGT
- re-written provisions now form part of ITAA 97 – general CGT provisions in Part 3-1 & special topics in Part 3-3

Capital Gains Tax - Australia

- important to understand CGT is not a separate tax – 'net capital gain' for an income year included in your assessable income for year
- assessable income includes ordinary income [s 6-5 ITAA 97] & statutory income [s 6-10 ITAA 97]
- statutory income includes net capital gain for an income year [s 102-5 ITAA 97] - tax levied at marginal tax rate of individuals
- net capital losses can be carried forward to offset future capital gains

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Capital Gains Tax: Key Concepts

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Capital Gains Tax - Key Concepts

- a capital gain or capital loss can only arise if a 'CGT event' happens in relation to a 'CGT asset'
- legislative provisions [Division 104 ITAA] contain complete list of CGT events that trigger capital gains or losses
- concept of CGT event fundamental to CGT provisions – if no CGT event happens – no capital gain or loss can be triggered

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Capital Gains Tax - Key Concepts

The provisions for each CGT event explain:

- what has to occur for particular CGT event to be triggered
- timing of particular CGT event
- how to calculate capital gain or loss from particular CGT event
- exceptions to general rules which apply to CGT event

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Capital Gains Tax - Key Concepts

- a 'CGT asset' [s 108-5(1) ITAA 97] is defined as:
  - any kind of property; or
  - a legal or equitable right that is not property
- provisions stipulate ('for avoidance of doubt') - CGT assets [s 108-5(2) ITAA 97] include:
  - part of, or an interest in property or a legal/equitable right that is not property
  - goodwill or an interest in it;
  - an interest in an asset of a partnership;
  - an interest in a partnership that is not an interest in an asset of a partnership

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Capital Gains Tax – Key Concepts

- 'property' not specifically defined for income tax purposes & takes its ordinary meaning, with essential legal characteristics:
  - ownership & possession
  - assignability & alienability
- it follows that 'property' for CGT purposes includes:
  - real property
  - personal property
  - intangible property (legal or equitable rights)

Capital Gains Tax - Key Concepts

- a capital gain or loss you make is disregarded if you acquired the asset before 20 September 1985 ('pre-CGT')
- a CGT asset is normally acquired when contract for the acquisition is entered into
- if no contract exists, asset acquired when vendor stops being the owner of the asset
- no CGT payable where disposal takes place in respect of asset acquired or deemed to have been acquired prior to 20 September 1985

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Capital Gains Tax: CGT Assets

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Capital Gains Tax: CGT Assets

The legislative provisions specifically list a series of examples of CGT assets [s 108 ITAA 97]:

- land & buildings;
- shares in a company & units in a unit trust;
- options;
- debts owed to you;
- a right to enforce a contractual obligation; &
- foreign currency.

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Capital Gains Tax: Not CGT Assets

- assets acquired before 26 June 1992 that do not satisfy definition of ‘asset’ in section 108-5 ITAA 1997
- know-how
- mining, quarrying or prospecting information
- a unit holder’s interest in the property of a unit trust
- a default beneficiary’s interest in a discretionary trust unless acquired for consideration or by way of assignment

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Capital Gains Tax: Exempt Assets

The CGT rules stipulate that capital gains/losses arising from following CGT assets are disregarded:

- cars, motor cycles, or similar vehicles [s 118-5(a) ITAA 97]
- decorations awarded for valour or brave conduct [s 118-5(b) ITAA 97]
- certain collectables & personal use assets [s 118-10 ITAA 97]
- assets used to produce exempt income or NANE income [s 118-12 ITAA 97]

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Capital Gains Tax: Exempt Assets

- shares in a pooled development fund [s 118-13 ITAA 97]
- registered emissions unit or from right to a free carbon unit [s 118-15 ITAA 97]
- trading stock [s 118-25 ITAA 97]
- balancing adjustment events on depreciating assets or assets used wholly for taxable purposes & depreciation deductions claimed [s 118-24 ITAA 97]

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Capital Gains Tax: Joint Tenants

- CGT assets owned as joint tenants treated as if they each owned separate CGT asset constituted by relevant interest in asset
- in other words – as if each party held that interest as a tenant-in-common [s 108-7 ITAA 97]

Note:

A change from a joint tenancy into a tenancy in common in equal shares does *not* trigger a CGT event. This is because there is no change in beneficial ownership of the asset [*TD 13*].

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Capital Gains Tax – Part 1

Discussion Question

Is Bitcoin a CGT asset and how are Bitcoin transactions handled for tax purposes?

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Capital Gains Tax: Personal Use Assets

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Capital Gains Tax: Personal Use Assets

For CGT purposes, a ‘personal use asset’ is [s 108-20(2) ITAA 97]:

- a CGT asset used or kept mainly for personal use or enjoyment
- an option or right to acquire a CGT asset of that kind;
- a debt arising from a CGT event in which the CGT asset was a personal use asset; or
- a debt that arises other than in the course of gaining or producing assessable income or carrying on a business

Note:

A personal use asset does not include [s 108-20(3) ITAA 97]:

- collectables; or
- land, a stratum unit or a building/structure taken to be separate CGT asset

Capital Gains Tax: Personal Use Assets

Whether asset is a personal use asset depends on how asset used/kept by you or your associates & examples include:

- marble floor tiles that were unused after being owned for 7 years that were held for personal use in a property taxpayer lived in [ID 2002/795]
- gold nuggets collected in pursuing a hobby (not in course of carrying on any business or profit-making activity) [ID 2003/451]
- a horse acquired by a taxpayer who races horses as a hobby (not carrying on a business of racing horse) [TR 93/26]

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Capital Gains Tax: Treatment of Personal Use Assets

Exemption for certain assets

- capital gains from personal use assets disregarded where personal use asset acquired for $10,000 or less [s 118-10(3) ITAA 97]

Restricted cost base rules for personal use assets

- third element of cost base (costs of ownership) not included in cost base of personal use assets [s 108-30 ITAA 97]

No losses for personal use assets

- capital losses on personal use assets disregarded & cannot be offset against any capital gains [s 108-20(2) ITAA 97]

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Capital Gains Tax: Sets of Personal Use Assets

- a set of personal use assets taken to be *single* personal use asset
- each disposal from within the set is taken to be a disposal of that single asset if [s 118-25 ITAA 97]:
  - personal use assets are a set; &
  - would ordinarily be disposed of as a set; &
  - are disposed of in 1 or more transactions for the purpose of trying to claim the $10,000 exemption

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Capital Gains Tax: Collectables

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Capital Gains Tax: Collectables

For CGT purposes a 'collectable' is [s 108-10(2) ITAA 97]:

- artwork, jewellery, an antique, a coin or medallion;
- a rare folio, manuscript or book; or
- a postage stamp or first day cover

that is used or kept mainly for the taxpayer's (or an associate's) personal use or enjoyment & also includes [s 108-10(3) ITAA 97]:

- an interest in any asset covered by the above list;
- a debt that arises from any asset covered by the above list, or
- an option or right to acquire an asset covered by the above list

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Capital Gains Tax: Collectables Artwork & Antiques

- the term 'artwork' means [s 995-1(1) ITAA 97]:
  - painting, sculpture, drawing, engraving or photograph;
  - a reproduction of such a thing; or
  - property of a similar description or use
- Commissioner provides guidance on what is an 'antique' for CGT purposes in Taxation Determination TD 1999/40
- an 'antique' must be more than 100 years old at time of disposal [TD 1999/40] - 100 year test not determinative [Richards v Curwen (1977) 3 ALL ER 426]

Capital Gains Tax: Treatment of Collectables

Loss quarantining for collectables

- capital losses from collectables can only be used to offset capital gains from collectables [s 118-10(1) ITAA 97]
- capital losses on collectables can be carried forward & offset against capital gains from collectables in future years [s 108-10(4) ITAA 97]
- unapplied net capital losses from collectables are applied in the order in which they were made [s 108-10(5) ITAA 97]

Capital Gains Tax: Sets of Collectables

- set of collectables also taken to be a single collectable
- each disposal of a collectable within the set is taken to be a disposal of that single asset if [s 108-15 ITAA 97]:
  - collectables are a set; &
  - would ordinarily be disposed of as a set; &
  - are disposed of in 1 or more transactions for purpose of trying to claim $500 exemption

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Capital Gains Tax: Separate CGT Assets

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Capital Gains Tax: Separate CGT Assets Overview

- assets acquired before 20 September 1985 (pre-CGT assets) are exempt from CGT
- common law principle – that fixtures & additions to land (i.e. buildings) forms part of the land
- difficulty when merging ‘pre’ & ‘post’ CGT land and/or capital improvements
- special rules introduced [Subdivision 108-D ITAA 97] – effectively treat certain assets that would otherwise be treated as single assets separately

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Capital Gains Tax: Separate CGT Assets Buildings

Pre-CGT land [s 108-55(2) ITAA 97]

- building/structure constructed on pre-CGT land is taken to be an asset separate of the land:
  - if contract for construction entered into on/after 20 September 1985; or
  - where there is no contract, if construction started on/after 20 September 1985

Post-CGT land [s 108-55(1) ITAA 97]

- building/structure on land acquired on/after 20 September 1985 taken to be separate CGT asset from land if a balancing adjustment provision applies to it

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Capital Gains Tax: Separate CGT Assets Buildings

Note:

Tax Determination TD 98/24 provides guidance on separate assets comprising land & buildings, including how capital proceeds apportioned between the two assets.

A pre-CGT building (located on pre-CGT land) that is relocated onto post-CGT land, becomes part of the post-CGT land, resulting in a single post-CGT asset that comprising of both the land & the building.

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Capital Gains Tax: Separate CGT assets Depreciating assets & adjacent land

Depreciating assets that are part of building/structure

- depreciating assets that are part of building (i.e. plumbing fixtures & fittings) taken to be separate CGT asset from the building/structure [s 108-60 ITAA 97]

Adjacent land

- land acquired on/after 20 September 1985 that is adjacent to land already owned as at 20 September 1985, treated as a separate asset from original land [s 108-65 ITAA 97]
- separate asset treatment applies even if two adjoining titles are amalgamated into one title [CGT Determination TD 8]

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Capital Gains Tax: Separate CGT assets Improvements to pre-CGT assets

- any capital improvement to land (irrespective of when acquired) – treated as separate CGT asset from land if a balancing adjustment provision applies [s 108-70 ITAA 97]
- capital improvements to an asset (not just land/buildings) – separate from assets to which capital improvements were made [s 108-70 ITAA 97] if:
  - asset acquired before 20 September 1985 & disposed of on/after that date; &
  - improvements of a capital nature were made to the asset after asset is acquired; &
  - if capital improvement were a separate asset from asset to which it was made, capital improvement itself acquired on/after 20 September 1985; &
  - if improvement a separate asset from asset to which it was made, cost base of capital improvement (together with any other improvements) is > improvement threshold for income year in which event happens; &
  - amount of cost base of improvement would exceed 5% of capital proceeds from event

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Capital Gains Tax: Separate CGT assets Improvements to pre-CGT assets

- improvement threshold for each year published by Commissioner before beginning of income year & is indexed annually
  - improvement threshold for 2017/18 income year is $147,582
  - improvement threshold for 2016/17 income year is $145,401
  - improvement threshold for 2015/16 income year is $140,443
- if there is more than one capital improvement & they are related – treated as one separate CGT asset if their cost bases > threshold

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Capital Gains Tax: Separate CGT assets Improvements to pre-CGT assets

- s 108-80 lists a number of factors to consider when improvements are related to each other
- intangible (non-physical) improvements taken to be capital improvements to which separate asset provisions apply [TD 2017/1]
- similar rules apply to capital improvements to CGT assets for which roll-over may be available [s 108-75, ITAA 97] including:
  - crown leases;
  - prospecting & mining rights;
  - statutory licenses & certain depreciating assets

Capital Gains Tax: Separate CGT Assets Example – TD 98/24

- Jane acquires land with a building on it on 1 March 1999 at a cost of $70,000.
- She pays $25,000 at that time to install air conditioning plant, which is subject to the depreciation provisions of Division 42 & to which balancing adjustment provisions of Subdivision 42-F also apply.
- The plant is installed ready for use for income producing purposes from 1 July 1999 & Jane is entitled to an annual depreciation deduction of $2,250 (i.e. 9% of $25,000 (prime cost)).
- Does the plant classify as a separate asset?

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Capital Gains Tax: Separate CGT Assets Example – TD 98/24

Solution

- Plant is a separate asset from the land & buildings. It must be accounted for separately.
- Building itself is not an asset separate from land, as it is not subject to one of the balancing adjustment provisions & was not constructed on land acquired before 20 September 1985.
- If land had been acquired before 20 September 1985 & building was constructed on it on or after that date, building would be a separate asset.

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Capital Gains Tax – Part 1

Poll Question

An improvement to land is treated as a separate CGT asset from the land:

A. If a balancing adjustment provision applies
B. If the land is a pre or post CGT asset
C. The improvement is capital in nature
D. All of the above
E. None of the above

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Capital Gains Tax: CGT Events

Capital Gains Tax: CGT Events

- a capital gain/loss can only arise when a 'CGT event occurs' – Division 104 sets out all of the CGT Events
- s 104-5 provides a summary table of all events - each CGT event details:
  - how the event arises;
  - how the capital gain/loss is calculated;
  - when the capital gain/loss arises; &
  - whether there are any exceptions to the CGT event
- if more than one event applies generally use event that is most specific to the situation [s 102-25(1) ITAA 97]
- if no CGT event other than D1 & H2 occur - D1 is used before H2

Capital Gains Tax: Categories of CGT Events

CGT Events can be grouped into the following broad categories:

Events	Description
A1	Situations involving the disposal of assets
B1	Situations where an asset is used/enjoyed before title passes
C1 to C3	Situations where an asset comes to an end in some way (e.g. is lost or destroyed)
D1 to D4	Situations where an asset comes into existence in some way (e.g. a right is created)
E1 to E9	Situations involving trusts
F1 to F5	Situations involving leases
G1 to G3	Situations involving shares
H1 to H2	Situations where there are special capital receipts
I1 to I2	Situations where an entity ceases to be Australian resident
J1 to J6	Situations where a rollover is reversed
K2 to K12	Miscellaneous other situations
L1 to L8	Situations involving tax consolidated groups

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Capital Gains Tax:
Commonly Encountered CGT Events

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Capital Gains Tax: CGT event A1
Disposal of a CGT asset

- event occurs if CGT asset is 'disposed of' [s 104-10(1) ITAA 97]
- an asset is 'disposed of' when there is a change in ownership due to an act, event or operation of law [s 104-10(2) ITAA 97] & disposal includes:
  - sale, transfer, gifting, compulsory acquisition of a CGT asset;
  - forfeiture of property/CGT assets under a State or other law;
  - a trustee ceasing to hold a CGT asset in trust & begins to hold in own capacity;
  - deemed disposals (change use of asset so becomes trading stock or if tax exempt entity becomes taxable entity)
- disposal does not include change in legal ownership without a change in beneficial ownership or a mere change of trustees

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Capital Gains Tax: CGT event A1 Disposal of a CGT asset

- generally – time of event is when contract for disposal entered into or if there is no contract – when change of ownership occurs [s 104-10(3) ITAA 97]
- special timing rule for compulsory acquisitions [s 104-10(6) ITAA 97] – if asset acquired under a power of compulsory acquisition conferred by law – time of event is earliest of date when:
  - taxpayer received compensation from the other entity;
  - other entity becomes owner of the CGT asset;
  - other entity entered the CGT asset pursuant to the power of compulsory acquisition; or
  - other entity took possession under that power

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Capital Gains Tax: CGT event A1 Disposal of a CGT asset

- calculation of capital gain/loss [s 104-10(4) ITAA 97]:
  - capital gain from CGT event A1 if capital proceeds > assets cost base
  - capital loss from CGT event A1 if capital proceeds disposal < assets reduced cost base
- exceptions – capital gain/loss on CGT event A1 is disregarded in number of situations including:
  - CGT asset acquired or lease granted/renewed/extended before 20 September 1985 [s 104-10(5) ITAA 97]

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Capital Gains Tax: CGT event C2 Ownership of intangible asset ceases

- event happens if ownership of intangible CGT asset ends by the asset [s 104-25(1) ITAA 97]:
  - being redeemed or cancelled;
  - being released, discharged or satisfied;
  - expiring;
  - being abandoned, surrendered or forfeited;
  - if the asset is an option, by being exercised; or
  - if the asset is a convertible interest, by being converted
- CGT asset comes to end when CGT event C2 happens – no acquisition of asset by another person at that time
- does not require asset to end – just that ownership ends

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Capital Gains Tax: CGT event C2 Ownership of intangible asset ceases

Examples where CGT event C2 was determined to have applied include:

- on execution of deed of release
- expiry of restrictive covenant (giving rise to a capital loss)
- termination of agreement to provide services
- discharge of a bankrupt borrower from bankruptcy resulting in release of all provable debts
- extinguishment of a debt when a company is deregistered

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Capital Gains Tax: CGT event C2
Ownership of intangible asset ceases

Examples where CGT event C2 was determined to have applied include:

- surrender of rights by a lessor with lease surrender payment
- ending of a mining tenement right acquired by a "farmee"
- discharge of contractual rights when contract abandoned
- cancellation of shares under Corporations Act 2001 following dissolution of a company

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Capital Gains Tax: CGT event C2
Ownership of intangible asset ceases

- time of event – when contract results in asset ending entered into or if no contract – when the asset ends [s 104-25(2) ITAA 97]
- calculation of capital gain/(loss) [s 104-25(3) ITAA 97]:
  - capital gain if capital proceeds from the ending > assets cost base
  - capital loss if capital proceeds from the ending < assets reduced cost base
- capital gain/(loss) disregarded if CGT asset acquired or leases that were granted, renewed or extended before 20 September 1985 [s 104-25(5) ITAA 97]

Capital Gains Tax: CGT event D1 Creating contractual or other rights

- triggered when contractual right or other legal/equitable right created in another entity [s 104-35(1) ITAA 97] – subordinate to other CGT events (except H2)
- does not apply to creation of a number of rights [s 104-35(5) ITAA 97]
- time of event is when contract entered into or other right created [s 104-35(2) ITAA 97]
- capital gain/(loss) [s 104-35(3) ITAA 97]:
  - capital gain capital proceeds from disposal > incidental costs
  - capital loss occurs if capital proceeds from disposal < incidental costs

Capital Gains Tax: CGT event D1 Creating contractual or other rights

Examples

- a person agreeing not to compete with another for specified number of years or within a specified location
- a person agreeing to enter into an exclusive trade tie agreement with another person
- a property owner who grants management rights over the property
- the grant of a right to use a trademark

Capital Gains Tax: CGT event D2 Granting, renewing or extending an option

- arises when an 'option' is granted to an entity, or an existing option is renewed or granted [s 104-40(1) ITAA 97]
- 'option' included as an example of a CGT asset in s 108-5(2) but not defined
- time of event is when the option is granted, renewed or extended [s 104-40(2) ITAA 97]
- capital gain/(loss) [s 104-40 (3) ITAA 97]:
  - capital gain if capital proceeds from granting/renewing/disposing option > expenditure incurred in granting/renewing/disposing option
  - capital loss occurs if capital proceeds from granting/renewing/disposing option < expenditure incurred in granting/renewing/disposing option

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Capital Gains Tax: CGT event D2 Granting, renewing or extending an option

- expenditure on granting option can include giving property [s 104-40 (4) ITAA 97]
  - the MV of the property included in cost base
- expenditure on granting option reduced by [s 104-40 (4) ITAA 97]
  - amounts received as a recoupment of that expenditure, unless recoupment amount is or was assessable to the taxpayer or trustee; or
  - any expenditure that is deductible
- no capital gain or loss if option exercised [s 104-40 (5) ITAA 97]

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Capital Gains Tax: CGT event E4 Capital payment from trust

- triggered if beneficiary receives non-assessable payment in respect of trust interest where beneficiary retains ownership of trust interest [s 104-70(1) ITAA 97]
- payment can include giving property [s 104-70(2) ITAA 97]
  - the MV of property used to work out amount of payment
- time of event [s 104-70(3) ITAA 97]:
  - generally just before end of income year in which trustee makes payment
  - if another CGT event happens prior to year-end, relating to trust interest after trustee has made payment – event taken to occur immediately prior to the time of other CGT event

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Capital Gains Tax: CGT event E4 Capital payment from trust

- excluded non-assessable payments, include [s 104-71 ITAA 97]:
  - payments that are NANE income;
  - amounts already assessed to trustee;
  - attributed PSI already included in assessable income;
  - payments repaid by beneficiary;
  - amounts regarded as repayment of all/part of compensation beneficiary has paid to trustee;
  - exempt amounts under small business CGT 15-year exemption
- excluded non-assessable payments do not include amounts for which beneficiary can claim a deduction [s 104-71(2) ITAA 97]
- certain ‘tax-free’ amounts & ‘CGT concession amounts’ are also excluded non-assessable payments [s 104-71(3) & (4) ITAA 97]

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Capital Gains Tax: CGT event E4
Capital payment from trust

- capital gain/(loss) [s 104-70(4) ITAA 97]:
  - capital gain if payments of non-assessable amounts > relevant cost base
  - capital loss cannot be made from this event
- if capital gain – cost base/reduced cost base of unit/trust interest reduced to nil [s 104-70(5) ITAA 97]
- reduced cost base also reduced to nil if non-assessable payment > reduced cost base
- if payment of non-assessable amounts < relevant coast base – cost base reduced to by non-assessable amount & no other CGT consequences arise at time
- cost base adjustments made on annual basis rather than each time there is a payment of a non-assessable amount

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Capital Gains Tax: CGT event E4
Capital payment from trust

Example

- Catherine owns units in the Royal Unit Trust (trust). On 30 June 2017, distribution of $10,000 capital gain made to Catherine from trust made up of:
  - $5000 – attributable to CGT discount (non-assessable)
  - $2500 – attributable to CGT small business 50% reduction (non-assessable)
  - $2500 – net income from capital gain made by trust (assessable)
- for 2016/17 income year Catherine also has capital loss of $2000

What are the CGT implications for Catherine under CGT event E4?

Capital Gains Tax: CGT event E4
Capital payment from trust

Solution:

- $10,000 payment reduced by:
  - $2,500 (the assessable gain)
  - $5,000 (the CGT general discount component – item 1 of table in s 104-71(4))
  - $500 (1/4 of Catherine's capital loss of $2,000)

- non-assessable part of distribution for CGT event E4 is $2,000

Capital Gains Tax: CGT event E4
Capital payment from trust

Note:

- non-assessable amount is the 50% small business component after applying the capital loss & CGT concessions at beneficiary level as follows:
  - Catherine reduces $10,000 capital gain from trust to $8,000 after applying $2,000 capital losses
  - $8,000 capital gain then reduced by 50% general CGT discount to $4,000
  - $4,000 capital gain then reduced by 50% small business reduction to $2,000
  - resulting in assessable net capital gain of $2,000

- also results in a non-assessable amount of $200 attributable to CGT small business 50% reduction

Capital Gains Tax: CGT event G3

Liquidator/administrator declares shares/ financial instruments worthless

- event happens when [s 104-145(1) ITAA 97]:
  - shares: where company's liquidator/administrator declares in writing that they have reasonable grounds to believe no likelihood shareholders will receive any further distributions; or
  - financial instruments: where financial instruments issued by, or created in relation to a company are declared (in writing) by company's liquidator/administrator that they have no value or only negligible value

Note:

Financial instruments include debentures, bonds, promissory notes, rights options, loans to the company, futures contracts, forward contracts or currency swap contracts relating to the company [s 104-145(3) ITAA 97].

Capital Gains Tax: CGT event G3

Liquidator/administrator declares shares/ financial instruments worthless

- taken to occur when liquidator/administrator makes the written declaration [s 104-145(2) ITAA 97]
  - no incentive on liquidator/administrator to make such declaration
  - often declaration not made for years – leaving capital losses on worthless shares/financial instruments unrealised

- event G3 does not apply where [s 104-145(5) ITAA 97]:
  - shares/financial instruments acquired before 20 September 1985;
  - shares/financial instruments were revenue assets at time declaration made

Capital Gains Tax: CGT event G3

Liquidator/administrator declares shares/ financial instruments worthless

- event only happens if taxpayer chooses to trigger it & choice made:
  - capital loss arises = reduced cost base of shares/financial instruments at the declaration made [s 104-145(4)ITAA 97]
  - cost base of shares/financial instruments reset to nil for calculation of capital gain/loss when later CGT events happen [s 104-145(5) ITAA 97]
- if no choice made, no capital loss made until share/security disposed of – usually when company is liquidated
- capital gain cannot be made from this event
- choice to trigger event is not available for ESS interests that are forfeited after discount included in assessable income [s 104-145 (7) ITAA 97]

Capital Gains Tax: CGT event G3

Liquidator/administrator declares shares/ financial instruments worthless

Example

- on 25 January 2017 a liquidator declares shareholders of ABC Pty Ltd will not receive distribution of more than 2.5% of their shareholding
- liquidator suggests a loss of 97.5% of shareholders' holding has crystallised during the year
- on 1 April 2017, liquidator makes actual distribution of 1.5% & has reasonable grounds to believe no likelihood further distribution will be made & on 2 April 2017, declaration to that effect made

When does CGT even G3 occur for the shareholders?

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Capital Gains Tax: CGT event G3

Liquidator/administrator declares shares/ financial instruments worthless

Solution:

- declaration on 2 April 2017 crystallises a capital loss for shareholders for purpose of CGT event G3 – on that date no further likelihood any further distribution will be made
- capital loss can be used by shareholders in 2017/18 income year
- declaration on 25 January 2017 does not crystallise the capital loss

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Capital Gains Tax – Part 1

Discussion Question

What do the terms 'liquidator' and 'administrator mean for tax purposes?

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Capital Gains Tax – Part 1

Poll Question

Which of the following gives rise to CGT Event A1 for a CGT asset:

A. A sale

B. A change in legal and beneficial ownership

C. It becomes trading stock

D. All of the above

E. None of the above

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Capital Gains Tax: CGT event H2

Receipt for event relating to a CGT asset

- happens if [s 104-155(1) ITAA 97]:
  - an act/transaction/event occurs in relation to a CGT asset owned by taxpayer; &
  - the act/transaction/event does not result in adjustment being made to assets cost base or reduced cost base
- subordinate to other CGT events & time of event is when relevant act, transaction or event occurs [s 104-155(2) ITAA 97]:
  - capital gain occurs if capital proceeds of CGT event >incidental costs
  - capital loss occurs if the capital proceeds from disposal < incidental costs
- s 104-155(5) lists situations where CGT event H2 does not happen

Capital Gains Tax: CGT event H2
Receipt for event relating to a CGT asset

Example

- Chris, an interior designer works from spacious offices, showrooms, & workshops attached to his home & has space for customer parking on the premises
- Chris has a substantial client base & is well known in the industry. Clients generally visit offices/showrooms to choose styles & approve orders
- on 1 March 2017 the local council commences road works which block the road on either side of Chris' offices/showrooms for 14 weeks – results in no vehicle access for period
- Council voluntarily offers Chris $12,000 as compensation for the inconvenience & loss of access - offer not solicited by Chris in any way - he Chris accepts offer & receives payment on 28 March 2017

Does CGT event H2 apply?

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Capital Gains Tax: CGT event H2
Receipt for event relating to a CGT asset

Solution:

Yes. CGT event H2 happens because:

- goodwill affected by act/event being council blocking access to Chris's premises
- $12,000 payment received as result of that act/event
- money received to compensate for Council's exclusive use of that area

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Capital Gains Tax: CGT event I1
Individual or company stops being an Australian resident

- happens if individual or company stops being Australian resident [s 104-160(1) ITAA 97]
- effect is that subject to certain exceptions, CGT applies to all CGT assets of individual/company
- time of event is when individual or company stops being resident [s 104-160(2) ITAA 97]
- capital gains/losses need to be worked out for every CGT asset owned immediately before taxpayer ceases to be a resident [s 104-160(3) ITAA 97]

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Capital Gains Tax: CGT event I1
Individual or company stops being an Australian resident

A capital gain/(loss) disregarded:

- where asset acquired before 20 September 1985 [s 104-160(5) ITAA 97]
- if relates to taxable Australian property (taxable Australian real property, assets used in carrying on a business in Australia, an option or right to acquire such assets) taxpayer owns just before the event [s 104-160(3) ITAA 97]
- taxable Australian real property & the business assets of a permanent establishment, & options & rights over such assets

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Capital Gains Tax: CGT event I1
Individual or company stops being an Australian resident

A capital gain/(loss) disregarded:

- individual chooses to defer making of capital gain/loss from all CGT assets covered by event until another CGT event happens relating to asset or they become Australian resident again [s 104-165(2)&(3) ITAA 97]
- individual was a temporary resident immediately before they stopped being an Australian resident [s 768-915 ITAA]

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Capital Gains Tax: CGT event J5
Small business rollover, no replacement asset

- purpose is to reverse the benefit of the small business rollover under Subdivision 152-E
- event happens if, by end of replacement asset period [s 104-197(2) ITAA 97]:
  - no replacement asset acquired & no 4th element expenditure incurred in relation to asset; or
  - replacement asset is not an active asset; or
  - if replacement asset is a share or trust interest:
    - taxpayer or a connected entity is not a CGT concession stakeholder in company/trust; or
    - CGT concession stakeholders in company /trust don't have a small business participation percentage in the taxpayer of at least 90%

Capital Gains Tax: CGT event J5
Small business rollover, no replacement asset

- occurs at end of replacement asset period [s 104-197(3) ITAA 97]
  - starts 1-year before
  - ends 2-years after last CGT event in income year for which roll-over obtained
- capital gain equal to previous gain that was rolled-over [s 104-197(4) ITAA 97]

Capital Gains Tax: CGT event L3
Excess tax cost setting amount for retained cost base assets

- generally, head company's cost of retained cost base assets of entity becoming subsidiary member of consolidated/MEC group = joining entity's cost of assets
- potential for aggregate cost of retained cost base assets to exceed the allocable cost amount (ACA) for joining entity – capital gain may be sheltered as result of cost setting process
- in recognition of this, a capital gain may be realised by head company by triggering CGT event L3

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Capital Gains Tax: CGT event L3

Excess tax cost setting amount for retained cost base assets

- CGT event L3 happens if aggregate tax cost setting amounts of all retained cost base assets of an entity that [s 104-510(1) ITAA 97]:
  - becomes a subsidiary member of a consolidated or MEC group; and
  - are taken into account in process of working out the tax cost of reset cost base assets;
  - exceeds the groups ACA for the entity
- time of event is just after entity becomes subsidiary member of group [s 104-510(2) ITAA 97]
- head company makes a capital gain equal to excess [s 104-510(3) ITAA 97]

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Capital Gains Tax: CGT event L5

Negative amount remaining after Step 4 of ACA for a leaving entity

- happens in relation to head company if [s 104-520(1) ITAA 97]:
  - an entity ceases to be a subsidiary member of a consolidated group or MEC group;
  - in working out group's ACA for entity - amount remaining after applying Step 4 is negative
- triggered when entity ceases to be a subsidiary member of the group [s 104-520(2) ITAA 97]
- capital gain/(loss) [s 104-520(3) ITAA 97]:
  - head company makes capital gain equal to the amount remaining after Step 4
  - no capital loss can arise from the event

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Capital Gains Tax: CGT event K6
Pre-CGT shares or trust interest

- CGT event K6 happens if [s 104-230(1) ITAA 97]:
- pre-CGT shares/trust interest is owned;
- a relevant CGT event happens in relation to the shares/trust interest (relevant CGT events - A1, C2, E1, E2, E3, E5, E6, E7, E8, J1 or K3);
- there is no roll-over from other CGT event; &
- just before other CGT event happened, the market value of following is at least 75% of net value of company/trust:
  - market value of property of company/trust (excluding trading stock) acquired on/after 20 September 1985; or
  - market value of interest in company/trust owed through interposed companies or trusts in property (excluding trading stock) that was acquired on or after 20 September 1985

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Capital Gains Tax: CGT event K6
Pre-CGT shares or trust interest

- time of event is when other (non-K6) event happens [s 104-230(2) ITAA 97]
- capital gain is equal to part of capital proceeds from share/trust interest that is reasonably attributable to amount by which market value of relevant post-CGT property is > cost base of that property [s 104-230(6) ITAA 97]
- a capital loss cannot be made under CGT event K6

Note:

The Commissioner considers the application of CGT event K6 in Taxation Ruling TR 2004/18.

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Capital Gains Tax – Part 1

Discussion Question

How is the 75% test satisfied for the purposes of CGT event K6?

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Computation of Capital Gains / (Losses)

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Capital Gains Tax: Computation of gains & (losses)

- generally calculated by taking the difference between capital proceeds from CGT event & cost base/reduced cost base of CGT asset
- normally capital proceeds [s 116-20(1) ITAA 97] from CGT event total of:
  - money received or entitled to receive for CGT event happening; &
  - market value of any other property received or entitled to receive for CGT event happening
- if capital proceeds constitute consideration for taxable supply for GST purposes – capital proceeds *exclude* any GST payable [s 116-20(5) ITAA 97]
- whether you are 'entitled to receive' money or property determined by terms of relevant contract(s)

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Capital Gains Tax: Capital proceeds – modifications

General rule modified in number of circumstances & table in s 116-25 sets out modifications / special rules that may apply to certain CGT events.

Market value substitution [s 116-30 ITAA 97]

- MV of CGT asset substituted as capital proceeds for CGT event if:
  - there are no capital proceeds from the CGT event;
  - some or all of the proceeds cannot be valued [TD 1999/84]; or
  - asset disposed of in a non-arms length dealing.
- MV of asset is generally exclusive of GST [s 960-405 ITAA 97] - number of exceptions to rule to prevent rule applying in inappropriate circumstances [s116-30(2A) – (5) ITAA 97]

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Capital Gains Tax: Capital proceeds – modifications

Market value substitution [s 116-30 ITAA 97] : Example

- on 29 April 2017, on marriage of his son (William), Charles gives his son a house which he acquired for rental purposes in July 2011
- cost base of house in July 2011 was $600,000 & on 29 April 2017 the house is valued at $1m
- capital proceeds for Charles as at 29 April 2017 are $1m, resulting in a capital gain of $400,000 (being capital proceeds of $1m less cost base of $600,000)

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Capital Gains Tax: Capital proceeds – modifications

Apportionment [s 116-40 ITAA 97]

- applies where capital proceeds:
  - relate to more than one CGT event; or
  - to a CGT event & something else
- capital proceeds are so much of payment that is *reasonably attributable* to CGT event

Non-receipt [s 116-45 ITAA 97]

- capital proceeds reduced if unlikely that some or all of proceeds not received – only applies if:
  - non-receipt did not arise because of anything you (or an associate) did or did not do; and
  - all reasonable steps taken to obtain unpaid amount paid
- amount of reduction is unpaid amount - if unpaid amount subsequently received – proceeds increased by that amount

Capital Gains Tax: Capital proceeds – modifications

Repaid rule [s 116-50 ITAA 97]

- capital proceeds reduced by any non-deductible amount you have to repay or any compensation you pay that can reasonably be regarded as a repayment of part of them

Assumption of liability rule [s 116-55 ITAA 97]

- capital proceeds increased by amount of any liability by way of security over asset assumed by purchaser under the contract

Capital Gains Tax: Capital proceeds – modifications

Misappropriation [s 116-60 ITAA 97]

- capital proceeds reduced by any amount misappropriated by your agent or employee

- if all or part of misappropriated amount later recouped – proceeds increased by the amount received

- the debt for amount misappropriated is deemed *not* to be a CGT asset

Note:

There is a 4-year period for amending an assessment if the misappropriation is discovered, or a recoupment received, *after* the income tax return for the relevant income year is lodged.

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Capital Gains Tax: Cost base

The cost base of a CGT asset consists of following 5 elements [s 110-25 ITAA 97]:

1st element: acquisition costs

- sum of money paid/required to be paid & MV of property given/required to be given to acquire CGT asset (worked out at time of acquisition)

2nd element: incidental costs

- sum of incidental costs incurred in acquiring asset, or that relate to a CGT event that happens to asset
- incidental costs specifically defined for CGT purposes [s 110-35 ITAA 97]

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Capital Gains Tax: Cost base

2nd element: incidental costs

- incidental costs include (amongst other costs) [s 110-35 ITAA 97]:
  - professional fees (surveyor, auctioneer, valuer, accountants, brokers, agents, consultants or recognised tax advisor)
  - cost of transfer (i.e. legal fees)
  - stamp duty
  - cost of advertising & marketing to find a buyer or seller
  - cost of valuation or apportionment relating to CGT liability

Note:

CGT events D1, E9 & H2 require capital gain/loss to be calculated by reference to incidental costs alone

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Capital Gains Tax: Cost base

3rd element: costs of owning the asset

- sum of non-deductible costs of owning asset (if acquired *after* 20 August 1991)
- these costs may consist of:
  - interest on money borrowed to acquire an asset;
  - interest on money borrowed to refinance borrowings to acquire the asset;
  - interest on money borrowed to finance capital expenditure incurred to increase asset's value;
  - costs of maintaining, repairing and insuring an asset; or
  - if the asset is land, rates and land tax.
- costs not included if there is a capital loss and are not indexed
- costs not included in cost base of collectable [s 108-30 ITAA 97]

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Capital Gains Tax: Cost base

4th element: enhancement expenditure

- amount of any expenditure of a capital nature designed to increase/preserve value of asset or which relates to installing or moving asset
  - includes giving property – market value of property is relevant
- does not apply to expenditure incurred in relation to goodwill [110-25(5A) ITAA 97]
- modified in certain situations involving leases [s 112-80 ITAA 97]
- expenditure does not need to be reflected in state/nature of asset at time of CGT event

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Capital Gains Tax: Cost base

5th element: expenditure to establish, preserve or defend title

- capital expenditure incurred to establish, preserve or defend title to asset or a right over asset

- examples include:
  - legal fees incurred by beneficiary in taking action to establish title to inherited property;
  - costs incurred by executor to obtain probate; or
  - legal fees in settling boundary disputes.

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Capital Gains Tax – Part 1

Discussion Question

Is it possible for costs you incur after a CGT event happens be ‘related to’ that CGT event for the purpose of working out your incidental costs?

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Capital Gains Tax – Part 1

Poll Question

Where there is real bargaining over capital proceeds for the sale of an asset, the market value substitution rule will NOT apply.

A. True

B. False

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Capital Gains Tax: Exclusions from cost base

Following exclusions exist to prevent 'double dipping'

Deductible expenditure [s 110-38 ITAA 97]

- expenditure that has been or can be deductible - excluded from any element of cost base – deduction does not have to be claimed

Recouped expenditure [s 110-40(3) & s 110-45(3) ITAA 97]

- recouped expenditure excluded from cost base of asset, except to extent included in assessable income

Capital Gains Tax: Exclusions from cost base

Specific exclusions

A series of items specifically excluded from any element of cost base [s 110-38(1) to 110-38(7) ITAA 97] including (but not limited to):

- certain losses or outgoings from illegal activities;
- bribes to a public official or foreign public official;
- entertainment expenses;
- certain penalties; or
- certain losses on boats

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Capital Gains Tax: Reduced cost base

- when working out an amount of capital loss from a CGT event – cost base of CGT asset replaced with asset's reduced cost base
- elements identical to cost base elements other than 3rd element – this is replaced with 'assessable balancing adjustments' [s 110-55 ITAA 97]
- an assessable balancing adjustment is any amount that is assessable because of a balancing adjustment (or would be assessable but for relief)
- number of specific items excluded from reduced cost base – largely similar to exclusions from cost base

Capital Gains Tax: Calculating a capital gain

Example 1

- Anne-Marie bought a property for $250,000 under a contract dated 23 June 2017
- contract provided for payment of a deposit of $25,000 on that date, with balance of $225,000 to be paid on settlement on 4 August 2017
- Anne-Marie paid transfer duty of $5,000 on 20 July 2017 & on 4 August 2017, she received an account for solicitor's fees of $2,000 – paid as part of settlement
- Anne-Marie sold property on 16 October 2017 (day contracts exchanged) for $315,000 – incurring legal costs of $1,500 & $4,000 in agent's commission

Capital Gains Tax: Calculating a capital gain

Example 1

	$	$
Capital proceeds		$315,000
Less:		
Cost base		
- Deposit	($25,000)	
- Balance of purchase price	($225,000)	
- Stamp duty	($5,000)	
- Solicitors fees for purchase of property	($2,000)	
- Legal fees for sale of property	($1,500)	
- Agent's commission	($4,000)	
Total cost base		($262,500)
Capital gain of CGT asset		$52,500

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Capital Gains Tax: Calculating a capital gain

Example 2

- Brent travelled interstate in February 2007 to inspect a number of properties & incurred travel/accommodation costs
- on 1 July 2007, he purchased one of the properties, a residential rental property for $150,000 of which $6,000 was attributable to depreciating assets
- he also paid $20,000 for pest & building inspections, stamp duty & solicitors fees

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Capital Gains Tax: Calculating a capital gain

Example 2

- in next few years, Brent incurred $33,000 of following expenses on property:
  - interest on money borrowed $10,000
  - rates & land tax $8,000
  - deductible (non-capital) repairs $15,000
- Brent made major structural improvements to the property on 1 October 2016 which cost $30,000
- on 1 February 2017 he sold the property for $500,000 of which $4,000 was attributable to depreciating assets. $12,500 was paid to real estate agent on the sale
- this is Brent's only capital gain for the 2016/17 income year & he has no capital losses to offset from the 2016/17 income year or previous years

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Capital Gains Tax: Calculating a capital gain

Solution:

- $33,000 of expenses cannot be included in cost base as Brent was able to claim a deduction for them - he can claim a capital works deduction of $255 ($30,000 x 2.5% x 124 / 365) for the major structural improvements
- Brent's cost base is $206,245:
  - purchase price (excluding depreciating assets): $144,000
  - pest & building inspections, stamp duty & solicitors fees on purchase: $20,000
  - capital expenditure on improvements ($30,000) *less* capital works deduction ($255): $29,745
  - real estate agents fees on sale of property: $12,500
- capital proceeds (excluding depreciating assets) are $496,000
- Brent makes a capital gain of $289,755 - he decides the discount method will give best result which results in capital gain of $144,887 [$289,755 x 50% = $144,877]

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Capital Gains Tax: Calculation of net capital gain/(loss)

- net capital gain for income year included in assessable income [s 102-5(1) ITAA 97]
- every CGT event has own rules for determining whether capital gain/loss arisen from the event & how its calculated
- method statement in s 102-5(1) sets out 5-steps required to calculate net capital gain for an income year

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Capital Gains Tax: Net capital gain 5-step method statement

1. capital gains made during year reduced by capital losses made during year
2. reduce remaining capital gains by unused net capital losses from previous years
3. apply CGT discount (if applicable) to any capital gains that remain
4. apply to any gains that remain, CGT small business concessions (if applicable)
5. amount of capital gain remaining is 'net capital gain' for the income year & included in assessable income

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Capital Gains Tax: General CGT discount

An assessable capital gain is reduced by the CGT discount if the following conditions are satisfied:

1. entity is an eligible taxpayer i.e.:
   - an individual;
   - a complying superannuation entity;
   - a trust; or
   - a life insurance company in certain circumstances.
2. CGT event happened on or after 21 September 1999
3. capital gain not calculated by reference to an indexed cost base

Capital Gains Tax: General CGT discount

4. CGT asset was held for at least 12 months [s 115-25 ITAA 97]

5. the CGT event was not an ineligible CGT event [s 115-25 (3) ITAA 97]

6. integrity measures do not deny the discount
   - CGT discount not available for a gain from a CGT event that occurs under an agreement which is made within 12 months of acquiring the asset [s 115-40 ITAA 97]
   - CGT discount denied in situations where value of equity that is being disposed of is represented by newly acquired assets [s 115-45 ITAA 97]

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Capital Gains Tax: General discount

Example

- John sold an asset on 2 February 2017 which he acquired on 2 February 2016
- whether John acquired asset at least 12 months before CGT event depends on whether there is a clear year between:
  - 2 February 2016 (date of acquisition); and
  - 2 February 2017 (date of CGT event)
- a clear year starting on 3 February 2016 (date of acquisition excluded) ends at 2 February 2017
- there is not at least 12 months between relevant dates – John cannot apply CGT discount to his capital gain
- if John had sold asset on 3 February 2017 – capital gain would have been a discount capital gain

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Capital Gains Tax: Calculation of net capital gain/loss

Example

- Mei-Ling bought 400 shares in TKY Ltd in October 2002 for $15,000 and sold them for $23,000 in February 2017
- the sale is a CGT event (CGT event A1 – disposal of CGT asset)
- she also has un-utilised capital loss of $1,000 from prior income years
- as shares bought after 21 September 1999 cannot use indexation, but as shares owed for > 12 months, can use discount method – her capital gain is:

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Capital Gains Tax: Calculation of net capital gain/loss

Example

Mei-Ling's capital gain under discount method is:

Capital proceeds	**$23,000**
Less: Cost base	($15,000)
Total capital gain	$8,000
Less: Net capital loss	($1,000)
Capital gain (before CGT discount)	$7,000
Less: CGT discount	($3,500)
Equals: capital gain	**$3,500**

Capital Gains Tax: Rate of tax on net capital gain

- individuals
  - net capital gain included in assessable income & taxed at marginal rate
- trusts & superannuation funds
  - net capital gain taxed at rate applicable to trust or superannuation fund
- company
  - net capital gain included in company's taxable income & taxed at company rate

Capital Gains Tax: Net capital losses

- net capital loss will arise when total capital losses for current year > total capital gains for current year [s 102-10 ITAA 97]
- not deductible & cannot be offset against revenue income in calculating taxable income [s 102-10(2) ITAA 97]
- must be 'quarantined' & carried forward to reduce or eliminate any future capital gains
- must be applied in order they were made (earlier years first) [s 102-15(1) ITAA 97]
- only be applied to extent not already been utilised [s 102-15(2) ITAA 97]

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Capital Gains Tax: Interaction with other provisions

Relationship with assessable income

- capital gain from CGT event *reduced* to extent amount already included in assessable income or exempt income under another provision [s 118-20 ITAA 97]
- if capital gain does not exceed amount included in assessable income - capital gain reduced to nil – can not be reduced to create capital loss [s 118-20(2) ITAA 97]
- if the capital gain exceeds amount included in assessable income, only excess taxed as capital gain [s 118-20(3) ITAA 97]

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Thank you for your attention.

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