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## Capital Gains Tax Part 2: Overview

Part 1 covered:

- CGT background;
- CGT – key concepts;
- CGT assets;
- CGT events; and
- computation capital gain/(losses)

## Capital Gains Tax Part 2: Overview

Part 2 will cover more advanced topics, including:

- CGT market value;
- arms length dealings;
- certain exemptions & concessions;

## Capital Gains Tax Part 2: Overview

Part 2 will cover more advanced topics, including:

- death;
- trusts;
- international aspects of CGT; &
- farm-in & farm-outs

## Market Value and Arm's Length

## Capital Gains Tax: Market value – general principles

- the term 'market value' used extensively in CGT provisions
- MV 'deemed' in some instances & important to establish when parties not dealing at 'arms length'
- MV not defined - limited definition in ITAA 36 only applies to specified circumstances
- responsibility of taxpayer to determine MV
  - can obtain assistance from qualified advisers
  - may request private ruling on matter

## Capital Gains Tax: Market value – general principles

- if asset is GST 'taxable supply' - MV is GST exclusive value [s 960-405 ITAA 97]
- price that willing but not anxious buyer would have to pay to willing but not anxious seller [*Spencer v Commonwealth* (1907) 5 CLR]

**Note:**

Possible for MV to be *more or less* than the *actual* capital proceeds.

## Capital Gains Tax: Market value – ATO view

ATO publication 'Market valuation for tax purposes' provides guidance on process involved in establishing MV for tax purposes:

- expression given ordinary meaning unless specifically defined or qualified in a particular provision
- MV should be assessed at 'highest' & best use' of asset as recognised in market
- takes into account any potential for a use that is higher than current use - current use may not reflect optimal value

## Capital Gains Tax: Market value – ATO view

- particular valuation methods more appropriate for some valuations than others
- common to use more than one method to cross-check/confirm value derived from primary methods
- valuation process undertaken rather than who conducted it – governs acceptability of valuation

## Capital Gains Tax: Market value – ATO view

- depending on situation – valuation may be undertaken by:
  - registered valuer;
  - member of a recognised professional valuation body;
  - director, for balance sheet purposes; or
  - person without formal valuation qualifications: where assessment based on reasonably objective & supportable data.
- to display objectivity of report - valuer should be independent of interests of party commissioning report

## Capital Gains Tax: Market value Reminder – market value substitution rules

- MV generally substituted as 1st element of cost base/reduced cost base if [s 112-20 ITAA 97]:
  - no expenditure incurred in acquiring CGT asset;
  - some or all of the expenditure cannot be valued; or
  - not dealing at arm's length with other entity.
- MV of asset is generally exclusive of GST [s 960-405 ITAA 97]
- number of exceptions to rule to prevent it applying in inappropriate circumstances [s112-20(3) ITAA 97]

## Capital Gains Tax: Market value

### Reminder – market value substitution rules

**Note:**

The exceptions in s112-20(3) ITAA 97 include (but are not limited to) situations where a taxpayer acquired:

- a right to receive income from a trust for no consideration (which was not acquired by way of assignment)
- a decoration awarded for valour or brave conduct for no consideration
- a contractual or other legal or equitable right resulting from CGT event D1 happening for no consideration
- rights to acquire, shares, units or options under certain circumstances

## Capital Gains Tax: Arm's length

- if parties to acquisition/disposal did not deal at arm's length in connection with transaction – deemed MV consideration may apply [ss 112-20 and 116-30 ITAA 97]
- any connection between the parties & any other relevant circumstances are considered [s 995-1 ITAA 97]

## Capital Gains Tax: Arm's length – common law principles

A number of principles have developed from common law:

- whether parties dealt at arm's length – question of fact
- distinction between 'dealing at arm's length' & an 'arms length relationship'

**Note:**

Parties who are not at arm's length can still deal with each other on arm's length terms on a particular transaction.

## Capital Gains Tax: Arm's length – common law principles

- whether parties dealt at arm's length involves an analysis of manner in which parties to transaction conducted themselves in forming transaction
- at issue is whether parties have acted separately & independently in forming their bargain
- should be assessment of whether parties dealt with each other as arm's length parties would be expected to behave – outcome matter of real bargaining
- relevant to consider nature of relationship between parties - if parties not at arm's length - inference may be drawn did not deal at arm's length



## Capital Gains Tax Part 2

### Discussion Question

How are acquisitions and disposal of 'no goodwill' professional partnerships, trusts and incorporated practices handled for CGT purposes?

## Exemptions and Concessions

## Capital Gains Tax: Exemptions & concessions

- various capital gains/losses arising from CGT events disregarded
- certain exemptions covered in other session (e.g. general CGT exemption & main residence exemption)
- remaining exemptions can be split into following broad categories:
  - exempt assets
  - exempt receipts
  - exempt transactions

## Capital Gains Tax: Exempt assets

- a large number of CGT assets are exempt from CGT
- worth knowing / being familiar with these assets
- more common exempt assets listed below

## Capital Gains Tax: Exempt assets

- cars, motor cycles [s 118-5(1) ITAA 97]
- decoration for valour/brave conduct (recipient did not pay) [s 118-5(2) ITAA 97]
- collectables acquired for \$500 or less [s 118-10 ITAA 97]
- personal use assets acquired for \$10,000 or less [s 118-10 ITAA 97]
- assets used to produce exempt income or NANE income [s 118-12 ITAA 97]

## Capital Gains Tax: Exempt assets

Examples of other 'miscellaneous' exempt assets include:

- shares in a pooled development fund (PDF) [s 118-13 ITAA 97]
- registered emissions unit, right to a free carbon unit or right to receive an Australian carbon credit unit [s 118-15 ITAA 97]
- assets that are trading stock at time of CGT event [s 118-25 ITAA 97]
- financial arrangements (or part of one) subject to Subdiv 250E [s 118-27 ITAA 97]

## Capital Gains Tax: Exempt assets

- CGT event disregarded where also a balancing adjustment event that happens to:
  - depreciating assets used wholly for a taxable purpose
  - where depreciation deductions claimed under Div 40 or Div 328 [s 118-24 ITAA 97]
- capital gain/loss also disregarded if asset held by partnership in which taxpayer is partner, or if taxpayer absolutely entitled to trustee's asset as against trustee

### Note:

A capital gain/loss not disregarded if it:

- happens under CGT event K7 (balancing event for depreciating asset) or J2 (change in relation to replacement asset when small business roll-over claimed); or
- relates to a balancing adjustment event for certain specified depreciating assets

## Capital Gains Tax: Exempt assets

### Example - Balancing adjustment event

- Thomas sells a large item of specialist equipment (a depreciating asset for \$3.5m) – original cost of the equipment was \$1.5m.
- The equipment has a tax written-down value of \$0.5m – means it has attracted capital allowances of \$1m over the years.
- The capital gain of \$2m (\$3.5m-\$1.5m) is exempt [s 118-24 ITAA 97].
- The full gain of \$3m (\$3.5m proceeds – written-down value of \$0.5m) is assessable income under Div 40.

## Capital Gains Tax: Exempt receipts

A capital gains/loss disregarded when compensation/damages received for:

- wrong or injury suffered by taxpayer in occupation [s 118-37(1)(a) ITAA 97]
- wrong, injury or illness suffered personally (or by relative) [s 118-37(1)(b) ITAA 97]

**Note:**

The exemption does not apply where the component that relates to personal injury cannot be determined or estimated from an un-dissected lump sum [TR 95/35].

## Capital Gains Tax: Exempt receipts

**Example – Compensation for personal injury**

- David disturbed 2 escaped convicts breaking into his car & was bashed in the head by them. He suffered serious head injuries & spent 3 months recuperating in hospital. The convicts were captured, found guilty of assault & sent to jail for 2 years.
- Compensation of \$30,000 awarded to David for his pain and suffering resulting from the assault. David's wife, also received \$20,000 to compensate her for loss of enjoyment of life – she had consequently established a fear of driving a car alone.
- Both amounts are exempt as they relate to personal injury suffered by David and his wife [s 118-37(1)(b) ITAA 97].

## Capital Gains Tax: Exempt receipts

### Example – Compensation for work injury

- Wade was employed as a window cleaner. He was seriously injured cleaning windows of a skyscraper. His injuries prevented him from working as a window cleaner ever again.
- Wade received a \$50,000 lump sum payment for the permanent impairment from injury.
- Payment treated as exempt receipt as relates to compensation/damages received for injury suffered by Wade in his occupation [s 118-37(1)(a) ITAA 97]. The compensation is not ordinary income so is also not assessable under s 6-5 ITAA 97.

## Capital Gains Tax: Exempt receipts

- winnings/losses - gambling, games or competition prizes [s 118-37(1)(b) ITAA 97]
  - exemption applies to race bets, tatts lotto, lotto & other such lotteries, raffles & quiz shows [IT 2584]
  - does not apply to capital gain/loss on disposal of CGT asset obtained from gambling or as a prize
- other miscellaneous receipts of money/property/reimbursements [s 118-37 ITAA 97]:
  - certain industry exit grants
  - compensation received under the firearms surrender arrangements
  - certain government incentives

## Capital Gains Tax: Exempt transactions

### Marriage/relationship breakdown settlements

A capital gain/loss made from CGT event C2 happening (rights ending) disregarded [s 118-75 ITAA 97] if:

- capital gain/loss made in relation to a right that directly relates to the breakdown of a relationship between spouses; &
- at the time of the CGT event the spouses involved are separated & there is no reasonable likelihood of cohabitation being resumed
- whether spouses / former spouses have separated for CGT purposes determined by reference to the Family Law Act 1975
  - spouse extends to married couples, same sex & opposite-sex de facto couples

## Capital Gains Tax: Exempt transactions

### Marriage/relationship breakdown settlements

**Reminder: Marriage Breakdown Rollover [Subdiv 126-A ITAA 97]:**

- applies where asset transferred between spouses upon breakdown of marriage/relationship
- various criteria need to be satisfied – key requirement disposal must be made under a court order/award/agreement under Family Law Act 1975 or similar foreign law
- if criteria satisfied, rollover automatically applies – means no CGT liability arises upon transfer of asset to spouse - gain/loss deferred until recipient spouse disposes of asset

## Capital Gains Tax: Exempt transactions

### Testamentary gifts

- capital gain/loss made from following gifts is disregarded [s 118-60 ITAA 97]:
  - a testamentary gift of property that would be deductible under s 30-15 if it had not been a testamentary gift
  - certain gifts of property under the Cultural Gifts Program
- if testamentary gift reacquired for less than market value by deceased estate or an associate of deceased estate/deceased, rules relating to effect of death [s 128-15 ITAA 97] on CGT assets apply [s 118-60(4) ITAA 97]

## Capital Gains Tax: Other exempt transactions

Capital gains/losses that arise from wide range of miscellaneous transactions you should be aware of including:

- expiry of a lease [s 118-40 ITAA 97];
- transfer of stratum units [s 118-42 ITAA 97];
- sale of rights to mine [s 118-45 ITAA 97];
- foreign currency hedging gains & losses [s 118-55 ITAA 97];
- later distributions of PSI [s 118-65 ITAA 97]
- native title & rights to native title benefits [s 118-77 ITAA 97]
- boat capital gains [s 118-80 ITAA 97]



## Capital Gains Tax: Life & general insurance

A capital gain/loss from specified CGT events disregarded if they involve an interest in [s 118-300 ITAA 97]:

- a general insurance policy (policy of insurance that is not a life insurance policy or an annuity instrument [s 995-1 ITAA 97]);
- a life insurance policy (defined by reference to expression of 'life policy' in the Life Insurance Act 1995); or
- an annuity (an instrument that secures grant of an annuity, whether dependent on the life of an individual or not [s 995-1 ITAA 97])

## Capital Gains Tax: Life & general insurance

- exemption only applies to specified CGT events [s 118-300(2)] including CGT events A1, B1, C2, E1, E2, E3, E5, E6, E7, E8, I1, I2, K3
- CGT consequences disregarded [s 118-300(1) ITAA 97]:
  - for the insurer/entity that issued the instrument from CGT events arising from general or life insurance policies that an insurance company issues [Item 1]
  - for the insured arising from CGT events relating to general insurance policies covering property outside of the CGT net [Item 2] i.e. pre-CGT assets, motor vehicles, trading stock, main residence
  - for life insurance company on CGT events arising from a policy of life insurance on the life of an individual or an annuity instrument that provide for liabilities under the policy to be discharged out of complying superannuation assets or segregated exempt assets [Item 6]

## Capital Gains Tax: Specified circumstances exemption applies

- CGT consequences disregard from a CGT event relating to a policy on the life of an individual or an annuity instrument if taxpayer [s 118-300(1) ITAA 97]:
  - is the original beneficial owner of the policy/instrument [Item 3];
  - acquired the interest in the policy/instrument for no consideration [Item 4]; or
  - is the trustee of a complying superannuation entity in the year the CGT event happened [Item 5]

## Capital Gains Tax Part 2

### Discussion Question

What practical aspects of marriage or relationship break-down roll-over relief should be considered?

## Capital Gains Tax Part 2

### Poll Question

In *Ellison v Sandini Pty Ltd* [2018] FCAFC 44, marriage breakdown rollover relief did not apply because:

- A. Assets were transferred FROM a trust
- B. Assets were transferred TO a trust
- C. Sandini was not a party to the marriage
- D. Ellison was not a party to the marriage

## CGT and Death

## Capital Gains Tax: Effect of death

- death does not cause a deemed disposal of assets [s 128-10 ITAA 97]
- s 104-215 ITAA 1997 sets out exception to this rule if the post-CGT asset passes to a beneficiary under a will who is:
  - a tax-exempt entity;
  - a complying superannuation fund; or
  - foreign resident

**Note:**

If asset passes to a foreign resident, CGT event triggered only if asset is not 'taxable Australian property'

## Capital Gains Tax: Effect of death Legal personal representative

- any capital gain or capital loss LPR makes if asset passes to a beneficiary is disregarded [s 128-15 ITAA 97]
- an LPR is [s 995-1 ITAA 97]:
  - an executor or administrator of an estate of a person who has died; or
  - a trustee of an estate of a person who is under a legal disability; or
  - a person with general power of attorney granted by another person

## Capital Gains Tax: Effect of death CGT implications to LPR

- ordinary CGT rules apply for any CGT assets LPR sells
- Division 128 only applies to a CGT asset owned by the taxpayer before dying
- if LPR acquires assets ordinary CGT rules apply

**Note:**

If beneficiary is absolutely entitled to the asset there would be no CGT event when the asset was transferred by the LPR to the beneficiary [s 106-50 ITAA 97, TD 93/36]

## Capital Gains Tax: Effect of death CGT assets passing to beneficiary

- if deceased acquired an asset pre-CGT, then beneficiary deemed to have acquired asset at MV on date of death of deceased [s128-15(4) ITAA 97]
- if deceased acquired asset post-CGT, beneficiary deemed to have acquired asset for its cost base or reduced cost base
- exception to the above rules relates to a main residence

## Capital Gains Tax: CGT & effect of death

Time of death	Acquisition date of Deceased	Acquisition date for Beneficiary	Deemed cost base
Pre CGT	Pre CGT	Pre CGT	N/A
Post CGT	Pre CGT	Date of death	Market value at date of death
Post CGT	Post CGT	Date of death (for Div 115 when deceased acquired asset)	Cost base of Deceased

## Capital Gains Tax: CGT & effect of death CGT discount

- pre-CGT assets deemed acquisition at date of death
- post-CGT assets deemed acquisition when the deceased originally acquired the asset
- 12 month period of ownership is from the deemed date of acquisition

## Capital Gains Tax: CGT & effect of death

### CGT main residence exemption

Full exemption from CGT applies where [s 118-195 ITAA 97]:

- dwelling continues to be owned by beneficiary of an estate
- is occupied as a main residence
- or alternatively:
- if beneficiary sells the dwelling within 2 years of the date of death, whether or not they reside in the property, exemption will apply

## Capital Gains Tax: CGT & effect of death

### CGT main residence exemption

Partial exemption from CGT applies where:

- property sold later than 2 years from death & dwelling was not main residence at all times beneficiary owned the property [s 118-200 ITAA 97]
- capital gain/loss generally calculated using following formula [s 118-200(1) ITAA 97]:

*capital gain/loss amount x (non-main residence days / total days)*

**Reminder:**

6 year period of absence rule for main residence can apply provided beneficiary has first made the dwelling their main residence.

CGT TD 51 (withdrawn) set out ATO's view what factors determine a taxpayer's main residence – now included in CGT guide.

## Capital Gains Tax: Deceased estate dwellings

### Non-main residence days

- non-main residence days are the number of days the dwelling was not main residence [s 118-200(2) ITAA 97]
- if dwelling acquired by deceased before 20 September 1985 - number of days from death until ownership ends when dwelling was not main residence of:
  - the spouse of the deceased immediately before their death; or
  - an individual who had a right to occupy the home under the deceased's will; or
  - the beneficiary (if dwelling disposed of as a beneficiary)

## Capital Gains Tax: Deceased estate dwellings

### Non-main residence days

- if dwelling acquired by deceased on or after 20 September 1985 - number of days, as above plus number of days in period of ownership of the deceased when dwelling was not their main residence

**Note:**

The non-main residence days before death of deceased death ignored if [s 118-200(4) ITAA 97]:

- ownership interest acquired by beneficiary/trustee on/after 7.30pm 20 August 1996; &
- just before death, dwelling was deceased's main residence & wasn't being used for income-producing purposes



## Capital Gains Tax: Deceased estate dwellings

### Total days

- if dwelling acquired before 20 September 1985, the number of days from their death until ownership interest disposed of
- if deceased acquired ownership interest on or after 20 September 1985, the number of days in the period from when the deceased acquired dwelling until ownership interest disposed of

## Capital Gains Tax: Deceased estate

### Example

Aldo bought a house in March 1999 & lived in it, as his main residence. He moved into a nursing home in December 2011 & left the house vacant. Despite move, Aldo chose to treat house as main residence.

Aldo died in February 2017 & house passed to his beneficiary, Con who used it as a rental property.

Given that house was Aldo's main residence immediately before his death & not used to produce income, Con can obtain the full exemption for the period Aldo owned it.

## Capital Gains Tax: Deceased estate

### Example

If house rented out by Con & sold 3 years after Aldo's death, taxable capital gain for period from date of Aldo's death until sale unless Commissioner grants Con an extension of time.

If house had been sold within two years of Aldo's death, he could have obtained this exemption.

If Aldo had rented out house after he stopped living in it, he could also have chosen to continue to treat it as his main residence – house treated as his main residence until his death as it was rented for less than six years. If this choice had been made, Con would get an exemption for the period Aldo owned the house.

## Capital Gains Tax: Deceased estate Assets held by deceased as joint tenants

- assets held by deceased as a joint tenant do not form part of estate – interest automatically divests to other joint tenants [s 125-50 ITAA 97]
- each tenant has a separate vested right to a specific share or portion of an asset when held as tenants in common
- at common law joint tenancy is presumed in the absence of a contrary intention

## Capital Gains Tax: Deceased estate

### Example 1: Joint tenants

- John and Helen bought a CGT asset for \$50,000 as joint tenants in 2010. On 1 May 2017 Helen dies.
- Upon acquisition, both John & Helen taken to have a 50% interest in CGT asset [s 108-7 ITAA 97].
- On date of Helen's death (1 May 2017), John taken to have acquired Helen's interest. If cost base on that day of interest is \$27,000, John taken to have acquired interest for that amount.

### Example 2: Joint tenants

- On 24 July 1985, Daniel & Emma acquired a block of land as joint tenants for \$20,000. Each has a 50% interest in the land.
- On 1 May 2017 Daniel passed away. The market value of the land at that date is \$800,000.
- In addition to her original 50% pre-CGT interest, Emma taken to have acquired Daniel's 50% interest on 1 May 2017 at its market value on that date (\$400,000).

## Capital Gains Tax Part 2

### Discussion Question

What factors determine a taxpayer's main residence?

## Capital Gains Tax Part 2

### Poll Question

While death rollover relief in Division 128 does not apply if an asset is bequeathed to a charitable trust, a capital gain may not necessarily arise:

- A. True
- B. False

## Trusts

## Capital Gains Tax: Trusts

- net capital gain of a trust for an income year is taken into account in calculating the net income/loss of the trust for the income year
- net capital losses of trust is carried forward & may be used to offset capital gains of later income years
- a mere change of trustees of a trust usually will not have CGT consequences [s 104-10(2) ITAA 97]
- subdiv 104-E contains a number of specific CGT events that can happen in relation to trusts

## Capital Gains Tax: CGT events & trusts

CGT Event	Circumstance
E1	Creating a trust over a post-CGT asset
E2	Transferring a post-CGT asset to a trust
E3	Converting a trust to a unit trust
E4	Capital payment for post-CGT trust interest
E5	Beneficiary becoming entitled to a trust asset
E6	Disposal to beneficiary to end an income right
E7	Disposal to beneficiary to end a capital interest
E8	Disposal by beneficiary of capital interest
E9	Creating a trust over future property

## Capital Gains Tax: CGT event E1 | Creating a trust over a post-CGT asset

- happens if taxpayer created a trust over a CGT asset by declaration or settlement [s 104-55(1) ITAA 97]
- event does not happen if [s 104-55(5) ITAA 97]:
  - trust is not a unit trust; &
  - taxpayer is the sole beneficiary that is absolutely entitled to asset as against the trust (ignoring any legal disability)

## Capital Gains Tax: CGT event E1 - Creating a trust over a post-CGT asset

- time of event is when trust over asset is created [s 104-55(2) ITAA 97]
  - trust not created if terms of trust are changed under valid exercise of a power in trust's constituent document, or varied with approval of court
  - trust is created if amendments to trust cause trust to terminate for trust law purposes or if effect of amendment leads particular asset subject to separate charter of rights & obligations [TD 2012/21]
- calculation of capital gain/loss [s 104-55(3) ITAA 97]:
  - capital gain arises if capital proceeds from the creation > assets cost base
  - capital loss arises if capital proceeds from the creation < assets reduced cost base

## Capital Gains Tax: CGT event E1 - Creating a trust over a post-CGT asset

- capital gain/loss disregarded if asset acquired before 20 September 1985 [104-55 (6) ITAA 97]
- if taxpayer is trustee of trust & no beneficiary absolutely entitled to asset against the trustee – 1st element of asset's cost base/reduced cost base is MV asset when trust created [s 104-55(4) ITAA 97]
- roll-over relief may be available where trustee of fixed trust creates new fixed trust over asset & both trusts have same beneficiaries with same entitlements & no material discretionary elements [Subdivision 126-G ITAA 97]

## Capital Gains Tax: CGT event E2 - Transferring CGT asset to a trust

- happens if CGT asset transferred to an existing trust [s 104-60(1) ITAA 97]
- event does not happen if [s 104-60(5) ITAA 97]:
  - trust is not a unit trust; &
  - taxpayer is sole beneficiary that is absolutely entitled to asset as against the trustee.
- time of event is when trust asset is transferred [s 104-60(2) ITAA 97]

## Capital Gains Tax: CGT event E2 - Transferring CGT asset to a trust

- calculation of capital gain/loss [s 104-60(3) ITAA 97]:
  - capital gain arises if capital proceeds from transfer > assets cost base
  - capital loss arises if capital proceeds from transfer < assets reduced cost base
- capital gain/loss disregarded if asset acquired before 20 September 1985 [s 104-60(6) ITAA 97]

## Capital Gains Tax: CGT event E2

### Example

- Phil owns post-CGT land which he sells to his brother, Bill acting as trustee for Phil's family trust. Ownership changes from Phil to Bill, the trustee. The land is sold at below-market value.
- CGT event E2 happens as land is transferred to a trust & Phil is aware that that Bill was purchasing the asset in his capacity as trustee of the trust.
- Although CGT event A1 also happens, CGT event E2 is more specific event as parties are connected & the transaction is not at arms length.



## Capital Gains Tax: CGT event E4

- 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

## Capital Gains Tax: CGT event E4

- excluded non-assessable payments, such as [s 104-71 ITAA 97]:
  - payments that are NANE income;
  - amounts already assessed to trustee;
  - attributed PSI already included in assessable income;
- 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]

## Capital Gains Tax: CGT event E4

- 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 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 cost 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

## Capital Gains Tax: CGT event E4

### 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

### Example:

\$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 E5 - Beneficiary becomes entitled to trust asset

- happens if beneficiary becomes absolutely entitled to a CGT asset of a trust as against the trustee [s 104-75 (1) ITAA 97]
- does not happen if trust is a unit trust or a deceased estate
- time of event is when beneficiary becomes absolutely entitled to asset [s 104-75 (2) ITAA 97]

## Capital Gains Tax: CGT event E5 - Beneficiary becomes entitled to trust asset

- trustee makes capital gain/loss [s 104-75(3) ITAA 97]
  - capital gain made if market value of asset at time of event > assets cost base
  - capital loss made if market value of asset at time of event < assets reduced cost base
  
- beneficiary makes capital gain/loss [s 104-75(5) ITAA 97]
  - capital gain made if market value of asset at time of event > cost base of beneficiary's interest in trust capital to extent it relates to the asset
  - capital loss made if market value of asset at time of event < reduced cost base of beneficiary's interest in trust capital to extent it relates to the asset

## Capital Gains Tax: CGT event E5

### Example

- The trustee of the Smith Family Trust (a discretionary trust) resolves that certain shares held by the trust are to be held absolutely for John, with immediate effect.
  
- The shares were acquired in 2006, have a market value of \$50,000 and an indexed cost base of \$40,000.
  
- CGT event E5 happens because John becomes absolutely entitled to the shares as against the trustee.
  
- The time of CGT event E5 is the date of the resolution. The trustee makes a capital gain of \$10,000 (i.e. \$50,000 – \$40,000).

## Capital Gains Tax: CGT events E6 & 7

- triggered if trustee disposes of CGT asset of trust to beneficiary to satisfy all/part of beneficiary's right to trust income or capital [s 104-80(1) & 104-85(1) ITAA 97]
- does not apply to unit trusts or deceased estates
- time of event is when disposal occurs [s 104-80(2) & 104-85(2) ITAA 97]
- capital gain/loss made from CGT events E6 or E7 generally disregarded if asset/right to trust income acquired before 20 September 1985 [s 104-80(6) & 104-85(6) ITAA 97]

## Capital Gains Tax: CGT events E6 & 7

- *trustee* makes capital gain/loss [ss 104-80(3) & 104-85(3) ITAA 97]:
  - capital gain made if market value of asset at time of disposal > cost base of asset
  - capital loss made if market value of asset at time of disposal < reduced cost base of asset
- *beneficiary* makes capital gain/loss [ss 104-80(5) & 108(5) ITAA 97]
  - capital gain made if market value of asset at time of disposal > cost base of beneficiary's right to trust income/capital
  - capital loss made if market value of asset at time of disposal < reduced cost base of beneficiary's right to trust income/capital

## Capital Gains Tax Part 2

### Discussion Question

Is the part of a payment which is a small business 50% reduction amount a non-assessable part under CGT event E4?

## Capital Gains Tax Part 2

### Poll Question

According to TD 2012/21, which of the following will cause a trust resettlement to occur?

- A. The trustee validly adds beneficiaries
- B. The trustee validly excludes particular beneficiaries
- C. The trustee validly sets aside one asset for a particular beneficiary
- D. The trustee validly extends the vesting date

# International

## Capital Gains Tax: International aspects of CGT - Australian tax residents

- Australian residents for income tax purposes are assessable on worldwide capital gains
- a foreign income tax off-set may be available for foreign tax paid on a foreign gain
- certain capital gains by Australian residents on assets owned in foreign jurisdictions exempt in Australia, including:

## Capital Gains Tax: International aspects of CGT - Australian tax residents

- gains on depreciating assets, provided asset used 100% for taxable purpose & capital allowance deductions claimed in respect of asset
- gains derived by an Australian resident company on an asset that
  - is not taxable Australian property; &
  - which is used wholly/mainly for purpose of producing foreign income; &
  - in carrying on a business at or through a PE of the company in a foreign country [s 885-35 ITAA 97]
- some capital gains by an Australian resident may be exempt from tax in source jurisdiction due to a double tax agreement (DTA)

## Capital Gains Tax: International aspects of CGT Participation exemption

- capital gains / losses made from sale of shares in foreign company disregarded to extent foreign company has an underlying *active* business [s 768-510 ITAA 97]
- conditions – Australian resident company must [s 768-505 ITAA 97]:
  - make capital gain/loss from specified series of CGT events relating to share in foreign resident company;
  - the shares were not eligible finance shares or widely distributed finance shares;
  - hold the shares throughout a 12 month period in the two years before CGT event; &
  - have a total voting percentage (direct and indirect) in a foreign company of 10% or more



## Capital Gains Tax: International aspects of CGT Participation exemption

- Invest Co (Australian-resident) acquired shares in Target Co (foreign-resident that operates an active business) on 1 January 2015, giving Invest Co a direct voting percentage of 40% in Target Co. On 1 January 2016, Invest Co disposed of 40% interest in Target Co so that, at that date, it no longer held any shares in Target Co.
- On 1 July 2016, Invest Co acquired 5% of shares in Target Co, which it subsequently disposed of on 31 December 2016. Invest Co satisfies both the minimum shareholding (10%) & timing requirements (12-months) in relation to its shareholding in Target Co from 1 January 2015 to 31 December 2016.
- Invest Co eligible for CGT reduction for both 1 January 2016 & 31 December 2016 disposals even though no shares held in Target Co between 2 January 2016 and 30 June 2016.

## Capital Gains Tax: International aspects of CGT - Foreign residents

- foreign residents only subject to CGT in Australia on 'taxable Australian property' (TAP) [s 855-10 ITAA 97]
- foreign residents not subject to CGT on pre-CGT TAP
- CGT discount not available to foreign residents in respect of capital gains accrued on 8 May 2012 - applies to:
  - all foreign residents: individual, company and trustees of foreign trusts
  - temporary residents: made in personal capacity, not in capacity as trustee of a trust

## Capital Gains Tax: Taxable Australian property (TAP)

1. taxable Australian real property (directly held);
2. indirect Australian real property interests (other than interests in category 5);
3. business assets used in an Australian PE a foreign resident (other than assets in category 1, 2 or 5);
4. options or rights over category 1-3 assets; &
5. assets where a CGT gain or loss deferred when entity ceases to be Australian resident.

## Capital Gains Tax: Taxable Australian real property (TARP)

The term 'taxable Australian real property' (TARP) means [s 855-20 ITAA 97]

1. real property situated in Australia; &
2. mining, quarrying or prospecting rights where minerals, petroleum or quarry materials are situated in Australia

The statutory provisions [s 855-25 ITAA 97] stipulate that for an interest to be an indirect Australian real property interest, it must meet the non-portfolio interest test & the principal asset test.

## Capital Gains Tax: The non-portfolio interest test

- the 'non-portfolio interest test' means the interest in an entity (whether foreign or Australia) must be at least 10%
- the non-portfolio interest test is satisfied if a foreign entity (together with its associates) holds a 'direct participation interest' of at least 10% at:
  - the time of CGT Event; or
  - throughout a 12 month period beginning no earlier than 24 months before the time of the CGT event & ending no later than the time of CGT event
- a 'direct participation interest' is total interest entity directly holds in another entity & is defined according to the type of entity in which an interest is held

## Capital Gains Tax: Principal asset test

- the principal assets test involves MV of entity's assets being 'principally attributable' to Australian real property
- the principal asset test uses MV of an entity's assets in which a membership interest is held
- if more than 50% of the MV the entity's total assets is attributable to Australian real property then the membership interest is an indirect Australian real property interest
- where there is more than one interposed entity - value of each interposed entity's taxable & non-taxable assets determines whether membership interest passes principal asset test

## Capital Gains Tax: CGT withholding tax on foreign residents

- 12.5% withholding tax applies to purchasers of certain real property & related interests where property acquired from foreign resident vendor
- rules apply to acquisition of an asset made under a contract entered into on or after 1 July 2016
- applies to TARP, indirect Australian real property interests or options / rights to acquire these property or interests
- obligation triggered where any vendor of the relevant property is a *foreign resident* [ATO: LCR 206/6]
- administrative penalties in TAA are on point when there is a failure to withhold

## Capital Gains Tax: CGT withholding tax on foreign residents

No obligation to withhold where:

- transaction involves TARP & certain indirect Australian real property interests < \$750K [\$2m for property acquired pre 1 July 2017]
- transaction conducted through an approved stock exchange or a crossing system
- an arrangement already subject to an existing withholding obligation
- a securities lending arrangement
- transactions involving vendors who are subject to formal insolvency or bankruptcy proceedings

## Capital Gains Tax: CGT withholding tax on foreign residents

- where TARP or company title interest - vendor *assumed* to be foreign resident unless vendor obtains clearance certificate from Commissioner - that they are resident
- clearance certificates to be provided by vendor to purchaser *before* settlement to ensure that withholding made
- for indirect Australian real property interest & rights to acquire TARP or indirect Australian real property interest - withhold where purchaser knows or reasonably believes vendor foreign resident
- vendor may make a declaration they are resident & this should be provided to the purchaser before settlement - penalties making false or misleading declarations

## Capital Gains Tax: CGT withholding tax on foreign residents

- vendor or purchaser may apply for a variation of amount of withholding obligation – Commissioner's notice of variation provided to purchaser *before* settlement
- reasons for seeking a variation - pre-CGT assets; CGT roll-over or exemption is claimed and liability < 12.5% of proceeds & any non-monetary consideration
- specific on-line ATO administrative arrangements include:
  - clearance certificate application form for Australian residents
  - variation applications for foreign residents & other parties to a transaction
  - purchaser payment notifications

## Capital Gains Tax: International aspects of CGT - Change of residence

- CGT event I1 & I2 apply if cease to be an Australian resident
  - CGT event I1 – individual or company stops being an Australian resident
  - CGT event I2 – trust stops being a resident trust
- Subdiv 768-R deals with temporary residents becoming Australian residents
- Subdiv 855-B deals with foreign residents becoming Australian residents

## Capital Gains Tax: CGT event I1

- 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]
- capital gain/loss disregarded in range of circumstances including:
  - where asset acquired before 20 September 1985 [s 104-160(5) ITAA 97];
  - 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]

## Capital Gains Tax: CGT event I1

### Example

- Stu has been an Australian resident all his life & ceases to be resident on 30 July 2013. Land in New Zealand is the only asset that he owns on that date
- On 18 February 2017, Stu disposes of the land.
- If Stu makes a choice under s 104-165(2), he's not treated as having disposed of his land on 30 July 2013. Instead, land deemed to have necessary connection with Australia until immediately after it is disposed of & capital gain/loss made at time land disposed of, being 18 February 2017.

## Capital Gains Tax: CGT event I2 - Trust ceasing to be a resident

- happens if trust stops being a resident trust for CGT purposes [s 104-170(1) ITAA 97] & time of CGT event I2 is when the trust stops being a resident trust
- capital gain/loss needs to be worked out separately for each CGT asset owned immediately before trust ceases to be a resident trust for CGT purposes [s 104-170(3) ITAA 97]
  - capital gain arises if market value of asset when trust ceases to be a resident trust > assets cost base [s 104-170(4) ITAA 97]
  - capital loss arises if market value of asset when trust ceases to be a resident trust < assets cost base [s 104-170(4) ITAA 97]

## Capital Gains Tax: Residence of a trust

- a unit trust is a resident trust for CGT purpose for an income year if [s 995-1 ITAA 97]:
  - any property of the trust is situated in Australia or the trust carries on a business in Australia, &
  - the central management and control of the trust is in Australia or Australian residents hold more than 50% of the beneficial interests in the income or property of the trust.
- a trust that is not a unit trust is a resident trust for an income year if, at any time during the income year:
  - a trustee is an Australian resident; or
  - the central management and control of the trust is in Australia.

## Capital Gains Tax: Temporary resident becomes Australian resident

- if temporary resident ceases to be a temporary resident but remains an Australian resident – special rules apply to each CGT asset owned just before they cease to be a temporary resident & which is not TAP [s 768-955 ITAA 97]:
  - first element of cost base & reduced cost base is market value of asset at that time
  - CGT provisions apply to asset as if temporary resident acquired asset at time they ceased to be a temporary resident
- only applies to assets acquired on or after 20 September 1985
- does not apply to ESS interests where deferred taxing point of interest has not occurred yet

**Reminder:**

The capital gains & losses of a temporary resident treated as if made by a non-resident.



## Capital Gains Tax: Individual, company or trust becoming a resident

- deemed to have acquired all assets (other than TAP & assets acquired before 20 September 1985) at time of becoming a resident [s 855-45(3) ITAA 97]
- assets deemed to have been acquired at MV at time they became a resident [s 855-45(3) ITAA 97]
- capital gains accrued before becoming Australian resident protected from Australian CGT
- CGT discount not available if asset that is not TAP is sold within 12 months of taxpayer becoming a resident

Thank you for your attention.



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