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CGT events

A CGT liability will happen only where a defined CGT event occurs.

As at 1 July 2024, there are 54 CGT events.

Each CGT event is relatively self-contained in their respective provisions, and each deals with the following issues:

- How the event arises
- How the capital gain or capital loss is calculated
- When the capital gain or the capital loss arises
- What, if any, are the exceptions to the CGT event

Where more than one CGT event can apply the **most specific** CGT event is to be used.

Summary of CGT events

The CGT events attempt to cover all of the likely transactions that can lead to a capital gain or loss:

Subdiv	Relevant situations	CGT event(s)
104-A	Disposal of CGT assets	A1
104-B	Use and enjoyment of CGT assets (before title passes)	B1
104-C	End of CGT assets	C1 – C3
104-D	Creation of CGT assets	D1 – D4
104-E	Trusts	E1 – E10
104-F	Leases	F1 – F5
104-G	Shares	G1, G3
104-H	Special capital receipts	H1, H2
104-I	End of Australian residency	I1, I2
104-J	Reversal of roll-overs	J1, J2, J4 – J6
104-K	Other CGT events	K1 – K12
104-L	Consolidated groups	L1 – L6, L8

Event A1 – Disposal of CGT asset

Subdivision 104-A – Disposals	
104-10	<p>Disposal of a CGT asset: CGT event A1</p> <p>(1) <i>CGT event A1 happens if you dispose of a CGT asset.</i></p> <p>(2) <i>You dispose of a CGT asset if a change of ownership occurs from you to another entity, whether because of some act or event or by operation of law. However, a change of ownership does not occur if you stop being the legal owner of the asset but continue to be its beneficial owner.</i></p> <p><i>Note: A change in the trustee of a trust does not constitute a change in the entity that is the trustee of the trust (s 960-100(2)). CGT event A1 will not happen merely because of a change in the trustee.</i></p> <p>(3) <i>The time of the event is:</i></p> <p>(a) <i>when you enter into the contract for the disposal; or</i> <i>[remember, contracts do not have to be in writing]</i></p> <p>(b) <i>if there is no contract [e.g. a gift, transfer by deed or operation of law] – when the change of ownership occurs.</i></p> <p><i>Note 1: If the contract falls through before completion, this event does not happen because no change in ownership occurs.</i></p> <p>(4) <i>You make a capital gain if the capital proceeds from the disposal are more than the asset's cost base. You make a capital loss if those capital proceeds are less than the asset's reduced cost base.</i></p> <p><u>Exceptions</u></p> <p>(5) <i>A capital gain or capital loss you make is disregarded if:</i></p> <p>(a) <i>you acquired the asset before 20 September 1985; or</i></p> <p>(b) <i>for a lease that you granted:</i></p> <p>(i) <i>it was granted before that day; or</i></p> <p>(ii) <i>if it has been renewed or extended – the start of the last renewal or extension occurred before that day.</i></p> <p><i>Note 1: You can make a gain if you dispose of shares in a company, or an interest in a trust, that you acquired before that day (CGT event K6).</i></p> <p><i>Note 3: A capital gain or loss made by a demerging entity from CGT event A1 happening as a result of a demerger is disregarded (s 125-155).</i></p> <p>...</p> <p><u>Compulsory acquisition</u></p> <p>(6) <i>If the asset was acquired from you by an entity under a power of compulsory acquisition conferred by an Australian law or a foreign law, the time of the event is the earliest of:</i></p> <p>(a) <i>when you received compensation from the entity; or</i></p> <p>(b) <i>when the entity became the asset's owner; or</i></p> <p>(c) <i>when the entity entered it under that power; or</i></p> <p>(d) <i>when the entity took possession under that power.</i></p> <p><i>Note: You may be able to choose a roll-over if an asset is compulsorily acquired (Subdiv 124-B).</i></p>

Timing of the disposal

<p>Sara Lee [2000] HCA 35</p> <p>Effect of amendments to a contract</p>	<p>Facts</p> <ul style="list-style-type: none">▪ The original contract was entered into on 31 May 1991 and the amending agreement was entered into on 30 August 1991.▪ The amendments included a US\$1m increase in the purchase price and the nomination of a different purchaser.▪ If the disposal took place on 30 August 1991 under the amending agreement, then offsetting losses or deductions would be available to Sara Lee. <p>Held</p> <ul style="list-style-type: none">▪ The date of the original contract was the relevant date. The original agreement had not been rescinded and replaced with the amended agreement: <p><i>42. From 31 May 1991, until completion on 30 August 1991, there was a contractual obligation upon the respondent to dispose of its assets to Roche, or to an entity of the kind referred to in s 12.3 of the agreement. The content of that obligation did not change. The price was varied, as were certain other terms and conditions of the sale, but the agreement of 31 May 1991 was the source of the obligation which the respondent discharged by performance on 30 August 1991.</i></p> <p>...</p> <p><i>49. Where there are two or more contracts which affect the rights and obligations of the parties to a disposal of assets, the identification of the contract under which the assets were disposed of ... requires a judgment as to which of the contracts is properly to be seen as the source of the obligation to effect the disposal. In the present case, that contract is the purchase and sale agreement of 31 May 1991.</i></p>
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Event C1 – Loss or destruction of a CGT asset

Subdivision 104-C – End of a CGT asset	
104-20	<p>Loss or destruction of a CGT asset: CGT event C1</p> <p>(1) <i>CGT event C1 happens if a CGT asset you own is lost or destroyed.</i> <i>Note: This event can apply to part of a CGT asset (s 108-5).</i></p> <p>(2) <i>The time of the event is:</i></p> <ul style="list-style-type: none"> (a) <i>when you first receive compensation for the loss or destruction; or</i> <i>[compensation might include a replacement asset]</i> (b) <i>if you receive no compensation – when the loss is discovered or the destruction occurred.</i> <p>(3) <i>You make a capital gain if the capital proceeds from the loss or destruction are more than the asset's cost base. You make a capital loss if those capital proceeds are less than the asset's reduced cost base.</i> <i>[note, the MVS rules for capital proceeds do not apply to C1 – s 116-25]</i> <i>[the general 50% discount may be available]</i></p> <p><u>Exception for pre-CGT assets</u></p> <p>(4) <i>A capital gain or capital loss you make is disregarded if you acquired the asset before 20 Sep 1985.</i></p> <p>Note</p> <ul style="list-style-type: none"> • Roll-over relief in Subdiv 124-B may displace the operation of event C1 and result in no capital gain or capital loss arising under event. • C1 applies whether or not any capital proceeds by way of compensation, insurance or otherwise were received in respect of the loss or destruction. • If an asset is lost (and C1 applied) and then subsequently found, there appears to be no provision to reverse the capital loss allowed previously. However, there may be a re-acquisition, and as nothing will have been given to re-acquire the asset the MVS rule would apply to give it a market value 1st element cost base. • It is expected that C1 would apply to the loss of an asset due to theft or any other form of misappropriation (presumably the thief would not obtain good title so CGT event A1 would not happen).

<p>TR 95/35</p> <p>Compensation receipts</p> <p>Note: based on former provisions but still relevant</p>	<p><u>Goodwill</u></p> <ul style="list-style-type: none"> ▪ Where the asset that is lost or destroyed is a tangible asset usually the determination of the time of discovery of the loss or the destruction should be relatively straightforward. The position will be less clear if CGT event C1 applies to an asset that is an intangible one such as goodwill. ▪ While it may be arguable whether goodwill can be lost or destroyed, perhaps as a result of adverse publicity or some other fact, the determination of the time at which this occurred may be a difficult exercise. ▪ A temporary fluctuation in the value of goodwill does not represent a loss or destruction of goodwill.
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TD 1999/79

Application of C1

Damaged vs destroyed

Voluntary loss or destruction

- Event C1 (loss or destruction of asset) does not apply if a CGT asset (or part of it) is merely “damaged” as opposed to “lost or destroyed”. Instead, where compensation is received, **cost base reductions** in accordance with TR 95/35 may apply.
- Difference between “damaged” and “destroyed”:
 1. *...The words ‘lost’ and ‘destroyed’ in s 104-20(1) are not defined in the Act and they take their ordinary meaning.*
 6. *Neither of the words ‘lost’ or ‘destroyed’, in the context of CGT event C1, contemplates damage to an asset that does not amount to the asset being lost or destroyed. A CGT asset must be wholly lost – not just damaged – or wholly destroyed – not just damaged – for the circumstances to be covered by CGT event C1. This is not to say, however, that CGT event C1 cannot happen to a discrete and identifiable part of a CGT asset – being a CGT asset in its own right – if the part is wholly lost or wholly destroyed and not just damaged [e.g. destruction of a building which is a discrete part of a broader asset, being the building + land].*
- Event C1 does not apply to a ‘voluntary’ loss:
 2. *...The word in its context in CGT event C1 suggests an involuntary rather than a voluntary act.*
 3. *The word ‘lost’ in s 104-20(1) is wide enough to cover some situations where an asset is confiscated. However, other situations involving confiscation may amount to forfeiture (CGT event C2 – cancellation, surrender and similar endings) or a change of ownership (CGT event A1 – disposal of CGT asset), so that the circumstances of each case determine the relevant CGT event.*
- Event C1 can however apply to ‘voluntary’ destruction:
 4. *...The word in its context in CGT event C1 applies if a CGT asset is destroyed in an involuntary occurrence, such as a natural disaster, or if it happens by the actions of others over which the taxpayer has no control. It also applies if a CGT asset is destroyed in a voluntary occurrence – if, for example, it happens due to a deliberate act of the taxpayer (e.g. a taxpayer might demolish a building in the course of redeveloping a property).*
- Event C1 does not apply to ‘economic’ losses:
 5. *Neither of the words ‘lost’ or ‘destroyed’, in the context of CGT event C1, contemplates an economic loss of a CGT asset.*
- Event C1 can apply to **intangible assets**, although C2 is likely to be more applicable:
 7. *CGT event C1 does not distinguish between tangible and intangible assets. Section 104-20 refers to ‘CGT asset’ and this includes intangible CGT assets.*

<p>TR 1999/16</p> <p>Goodwill and CGT</p> <p>Change of business may eliminate old goodwill, causing CGT event C1</p>	<p>18. <i>A business or the sources of its goodwill may change so much it can no longer be said to be the same business as that previously conducted. In other words the old business ceases and a new business commences. If this happens the goodwill of the original business ceases to exist and a new CGT asset – being the goodwill of the new business – is acquired.</i></p> <p>19. <i>CGT event C1 in s 104-20 (loss or destruction of a CGT asset) happens in the situation in para 18 and the business owner can make a capital loss on the loss or destruction of the goodwill of the old business. Section 116-30 does not apply to deem the receipt of market value capital proceeds for the old goodwill that is lost or destroyed. The new goodwill is acquired when work that resulted in its creation started (Item 1, s 109-10). The acquisition of the new goodwill does not relate back to when the original business was acquired. The new goodwill would have little or no cost base.</i></p>
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<p>AAT Case 9671 [1994] AATA 202</p> <p>C1 capital loss not allowed for voluntary demolition of a building, because the building had no value</p>	<p>Facts</p> <ul style="list-style-type: none"> ▪ The taxpayer purchased land for redevelopment, and demolished a derelict building on the land. ▪ The taxpayer claimed that \$700,000 of the \$800,000 paid for the land related to the building. <p>Held</p> <ul style="list-style-type: none"> ▪ While it was possible for C1 to apply in this situation, the AAT held that at the time of acquisition the building had no value because it was subject to a demolition order. ▪ In addition, the AAT considered that no part of the purchase price could be apportioned to the building. ▪ Therefore, the taxpayer was not allowed a capital loss with respect to the demolition.
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Event C2 – Cancellation, surrender or similar endings

Subdivision 104-C – End of a CGT asset	
104-25	<p>Cancellation, surrender or similar endings: CGT event C2</p> <p>(1) CGT event C2 happens if your ownership of an intangible CGT asset ends by the asset:</p> <ul style="list-style-type: none"> (a) being redeemed or cancelled; or [not buy-backs, which are covered by A1] (b) being released, discharged or satisfied; or (c) expiring; or (d) being abandoned, surrendered or forfeited; or (e) if the asset is an option – being exercised; or (f) if the asset is a convertible interest – being converted. <p>(2) The time of the event is:</p> <ul style="list-style-type: none"> (a) when you enter into the contract that results in the asset ending; or (b) if there is no contract – when the asset ends. <p>(3) You make a capital gain if the capital proceeds from the ending are more than the asset's cost base. You make a capital loss if those capital proceeds are less than the asset's reduced cost base.</p> <p>...</p> <p>(4) A lease is taken to have expired even if it is extended or renewed.</p> <p><u>Exceptions</u></p> <p>(5) A capital gain or capital loss you make is disregarded if:</p> <ul style="list-style-type: none"> (a) you acquired the asset before 20 Sep 1985; or (b) for a lease that you granted: <ul style="list-style-type: none"> (i) it was granted before that day; or (ii) if it has been renewed or extended – the start of the last renewal or extension occurred before that day. <p>Note 1: There are other exceptions if:</p> <ul style="list-style-type: none"> • your lease expires and you did not use it mainly to produce assessable income (s 118-40) • you exercise rights to acquire shares or units (s 130-40) • you acquire shares or units by converting a convertible interest (s 130-60) • you exercise an option (s 134-1) • [the gain or loss is made in relation to a right that relates directly to the breakdown of a relationship between spouses (s 118-75)] <p>Note</p> <ul style="list-style-type: none"> • Exercising an option essentially results in a roll-over. The cost base rolls-over into the asset you acquire under the option (+ other costs, e.g. exercise costs).

Cases where event C2 would apply:

- A share being redeemed or cancelled
- A debt being released, discharged or satisfied
- A contract (or contractual rights) being discharged by way of performance or agreement (*Orica* [1998])
- A lease being abandoned, surrendered or forfeited

Specific examples where it has been determined that event C2 applies:

- On the execution of a deed of release or a deed of settlement (*AAT Case Re Coshott* [2014])
- On the expiry of a restrictive covenant (thereby giving rise to a capital loss) (TD 95/54)
- On the renunciation by a beneficiary of their interest in a discretionary trust (TD 2001/26)
- When a position under a financial contract for differences is closed out (TR 2005/15)
- When an exchange traded option is closed out (ATO ID 2005/165)
- On the termination of an agreement to provide services (ATO ID 2003/105)
- On the discharge of a bankrupt borrower from bankruptcy which results in the release of all provable debts (ATO ID 2003/215)
- On the extinguishment of a debt when a company is deregistered (ATO ID 2004/150)
- On the cancellation of shares under the CA 2001 following the dissolution of a company (TD 2001/27)

<p><i>Orica</i> [1998] HCA 33</p> <p>Contractual rights are assets for CGT purposes</p>	<p>Facts</p> <ul style="list-style-type: none"> ▪ See above. Broadly, Orica paid an amount to MMBW in order for MMBW to assume payment obligations that Orica owed under debentures. <p>Held</p> <ul style="list-style-type: none"> ▪ The rights acquired by Orica to require MMBW to perform the payment obligations were assets for CGT purposes. ▪ There is no reason to confine the meaning of “discharge”, the performance of contractual obligations is a disposal within the terms of that provision.
<p><i>Dulux & Orica</i> [2001] FCA 1344</p> <p>Timing of disposal of contractual rights – they are disposed of when the contract is <u>performed</u> (CGT event C2), not when it is entered</p> <p><i>Distinguished from Sara Lee</i></p>	<p>Facts</p> <ul style="list-style-type: none"> ▪ This case was a flow-on from the HC decision, dealing with: <ul style="list-style-type: none"> ○ The timing of the disposals for CGT purposes (whether it was the time of entering into the assumption agreement, or the time that MMBW actually made the payments) ○ Cost base and indexation issues ▪ Relying on the HC decision, the Commissioner amended Orica's and Dulux's assessments for the 1987, 1988, 1989, 1990, 1994 and 1995 years of income, when the MMBW had made the required payments. The amounts paid by MMBW substantially exceeded the “present values” of these payments as at 6 June 1986 calculated under the Assumption Agreement. The Commissioner assessed these differences as net capital gains.

	<ul style="list-style-type: none"> The taxpayers did not dispute the potential existence of a capital gain, but the time at which relevant disposal was deemed to have occurred. Section 160U(3) provided that where an asset was “disposed of under a contract”, the time of disposal would be taken to have been the time of the making of the contract. Section 160U(4) provided that where the asset was “disposed of otherwise than under a contract”, the time of disposal would be taken to have been at the time when the “change in ownership of the asset” that constituted or gave rise to the disposal occurred. The taxpayers argued that the disposals constituted by the MMBW’s payments took place under contracts, namely the Assumption Agreement, for the purposes of s 160U(3), and as a result the time of the disposal was 6 June 1986, the date the Assumption Agreement was made. <p>Held</p> <ul style="list-style-type: none"> In favour of the Commissioner, the time of disposal was when MMBW actually made the payments: <p><i>If the taxpayers' submission that the disposal of their chose in action against the MMBW took place when the Assumption Agreements were made were accepted, parties who enter into similar contracts would be far worse off because they would be denied the alleviative effect of indexation in respect of the period from contract to payment and pro tanto discharge (in the case of Orica, for example, it would be taken to have made a capital gain of \$36 million in the 1986 year alone). Section 160U should be construed in a manner which allows scope for indexation to operate in the relevant amounts.</i></p>
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Meaning of expiring

<p>TD 1999/76</p> <p>The word ‘expiring’ does not include voluntary terminations</p>	<ul style="list-style-type: none"> The word “expiring” in the context of CGT event C2 (and the expression “expiry of an asset” in the MVS rule) is limited to an expiry by an effluxion or lapse of time. For example, when the specified time period of a lease expires. The expiry of a CGT asset in terms of CGT event C2 (about the cancellation, surrender and similar endings of intangible CGT assets) in s 104-25 is excluded from the MVS rule by s 116-30(3)(a)(i). The purpose of this is to prevent the MVS from applying when the market value of an asset has diminished through the normal course of events to the point where it is nil. For example, on the expiry of a lease agreement. When a lease expires, it has no value. Substituting a market value at the time the asset ends, as if the lease had not expired, would give an inappropriate result. However, before a lease expires it has a value that reflects the remaining term of the lease. If the lease is voluntarily terminated before it expires, it is appropriate to substitute a market value on termination.
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Event D1 – Creating contractual or other rights

Subdivision 104-D – Bringing into existence a CGT asset	
104-35	<p>Creating contractual or other rights: CGT event D1</p> <p>(1) <i>CGT event D1 happens if you create a contractual right or other legal or equitable right in another entity.</i></p> <p>Example: You enter into a contract with the purchaser of your business not to operate a similar business in the same town. The contract states that \$20,000 was paid for this. You have created a contractual right in favour of the purchaser. If you breach the contract, the purchaser can enforce that right.</p> <p>(2) <i>The time of the event is when you enter into the contract or create the other right.</i></p> <p>(3) <i>You make a capital gain if the capital proceeds from creating the right are more than the incidental costs [s 110-35] you incurred that relate to the event. You make a capital loss if those capital proceeds are less.</i></p> <p>Example: To continue the example: If you paid your lawyer \$1,500 to draw up the contract, you make a capital gain of: \$20,000 - \$1,500 = \$18,500.</p> <p>(4) <i>The costs can include giving property (s 103-5). However, they do not include an amount you have received as recoupment of them and that is not included in your assessable income, or an amount to the extent that you have deducted or can deduct it.</i></p> <p><u>Exceptions</u></p> <p>(5) <i>CGT event D1 does not happen if:</i></p> <ul style="list-style-type: none"> (a) <i>you created the right by borrowing money or obtaining credit from another entity; or</i> (b) <i>the right requires you to do something that is another CGT event that happens to you; or</i> (c) <i>a company issues or allots equity interests or non-equity shares in the company; or</i> (d) <i>the trustee of a unit trust issues units in the trust; or</i> (e) <i>a company grants an option to acquire equity interests, non-equity shares or debentures in the company; or</i> (f) <i>the trustee of a unit trust grants an option to acquire units or debentures in the trust; or</i> <p>...</p> <p>Example: You agree to sell land. You have created a contractual right in the buyer to enforce completion of the transaction. The sale results in you disposing of the land, an example of CGT event A1. This means that CGT event D1 does not happen.</p>

CGT event D1 is subordinate to all other CGT events except CGT event H2 (s 102-25).

CGT event D1 does not necessarily operate to tax the creator (e.g. if there are no capital proceeds) and will in any case provide for an acquisition of a CGT asset by the person in whom the right is created.

Situations where D1 might apply:

- A person agreeing not to compete with another person for a specified number of years or within a specified location (i.e. a **restrictive covenant**)
- A person agreeing to enter into an exclusive trade tie agreement with another person
- A person agreeing to endorse the use of particular goods and services
- An agreement to vary a contract, where the variation does not amount to a disposal of the whole or of part of the rights under the contract
- An agreement for the assignment of an expectancy or of a right which is yet to come into existence, such as an agreement to assign interest which may accrue in the future upon an existing loan repayable without notice

The ATO considers CGT event D1 will apply in the following situations:

- The creation of a right to reside in a property for life (TR 2006/14)
- Where a taxpayer receives money or property for withdrawing an objection against a proposed land development, provided the receipt is not for permanent damage to, or reduction in value of, the land (TD 1999/80)
- Where a taxpayer enters an agreement not to take any legal action in relation to the cessation of the payment of an allowance by another entity (ATO ID 2003/353)
- Where a taxpayer grants an easement, profit à prendre or licence over an asset (TD 2018/15 (in which case CGT event D1 happens in priority to CGT event A1))

Sometimes CGT event D1 can be seen to have a **'two-sided operation'** – for example, where each party vests positive rights in the other. For example, where one party grants a licence to another to use some property, and the other person grants a similar right in relation to other property. Or if one party agrees to fund a new entity to make compensation payments provided it itself is funded with a base amount.

The CGT **general discount** for capital gains is not available in respect of CGT event D1 (s 115-25(3)(a)), because inherently no one had held the CGT asset for any period of time.

With respect to the **MVS rule**:

- The rule does not apply where no capital proceeds are received (s 116-30(3)(b)); however
- Section 116-30(2) will apply to deem market value capital proceeds in circumstances where the parties are not dealing at arm's length (this would probably apply even if there are no capital proceeds so the protection obtained from the exclusion in s 116-30(3)(b) may have limited effect only).

<p>TD 2018/15</p> <p>CGT event D1</p> <p>Easements, profits a prendre and licences</p>	<p>1. CGT event D1 rather than CGT event A1 happens if a taxpayer grants an easement, profit à prendre or licence over an asset. Consequently:</p> <ul style="list-style-type: none"> ○ No part of the cost base of the asset can be taken into account in working out the amount of any capital gain or capital loss that arises from the grant ○ Any capital gain or capital loss from the grant cannot be disregarded merely because the asset was acquired prior to 20 Sep 1985 [i.e. pre-CGT status does not extend to the new contractual right] ○ Any capital gain from the grant is not a discount capital gain ○ No exemption is available under Div 118 if the grant relates to a main residence because CGT event D1 is not one of the events listed in s 118-110(2) that is relevant to that exemption <p>Note: A profit a prendre is an interest that arises by agreement between two parties and relates to the right of one party to enter upon the land of the other and to extract or remove part of the land's substance (e.g. sand, gravel, trees, fish, etc).</p>
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Event E2 – Transferring a CGT asset to a trust

Subdivision 104-E – Trusts	
104-60	<p>Transferring a CGT asset to a trust: CGT event E2</p> <p>(1) <i>CGT event E2 happens if you transfer a CGT asset to an existing trust.</i></p> <p>Note: <i>A change in the trustee of a trust does not constitute a change in the entity that is the trustee of the trust (s 960-100(2)). This means that CGT event E2 will not happen merely because of a change in the trustee.</i></p> <p>(2) <i>The time of the event is when the asset is transferred.</i></p> <p>(3) <i>You make a capital gain if the capital proceeds from the transfer are more than the asset's cost base. You make a capital loss if those capital proceeds are less than the asset's reduced cost base.</i></p> <p>(4) <i>If you are the trustee of the trust and no beneficiary is absolutely entitled to the asset as against you (disregarding any legal disability), the 1st element of the asset's cost base and reduced cost base in your hands is its market value when the asset is transferred.</i></p> <p><u>Exceptions</u></p> <p>(5) <i>CGT event E2 does not happen if you are the sole beneficiary of the trust and:</i></p> <p class="list-item-l1">(a) <i>you are absolutely entitled to the asset as against the trustee (disregarding any legal disability); and</i></p> <p class="list-item-l1">(b) <i>the trust is not a unit trust.</i></p> <p>(6) <i>A capital gain or capital loss you make is disregarded if you acquired the asset before 20 Sep 1985.</i></p>

Event H1 – Forfeiture of deposit

Subdivision 104-H – Special capital receipts	
104-150	<p>Forfeiture of deposit: CGT event H1</p> <p>(1) <i>CGT event H1 happens if a deposit paid to you is forfeited because a prospective sale or other transaction does not proceed.</i></p> <p><i>The payment can include giving property (s 103-5).</i></p> <p>Example: <i>You decide to sell land. Before entering into a contract of sale, the prospective purchaser pays you a 2 month holding deposit of \$1,000. The negotiations fail and the deposit is forfeited.</i></p> <p>(1A) <i>The amount of the deposit is reduced by any part of the deposit that is:</i></p> <p>(a) <i>repaid by you; or</i></p> <p>(b) <i>compensation you paid that can reasonably be regarded as a repayment of all or part of the deposit.</i></p> <p><i>The payment can include giving property (s 103-5).</i></p> <p>(1B) <i>However, the deposit is not reduced by any part of the payment that you can deduct.</i></p> <p>(2) <i>The time of the event is when the deposit is forfeited.</i></p> <p>(3) <i>You make a capital gain if the deposit is more than the expenditure you incur in connection with the prospective sale or other transaction [e.g. lawyer fees in organising the deposit]. You make a capital loss if the deposit is less.</i></p> <p>(4) <i>The expenditure can include giving property (s 103-5). However, it does not include an amount you have received as recoupment of it and that is not included in your assessable income.</i></p> <p>Example: <i>To continue the example above, if you gave a lawyer wine worth \$400 in connection with the prospective sale, you make a capital gain of:</i></p> $\$1,000 - \$400 = \$600$ <p>Note</p> <ul style="list-style-type: none"> • There is no specific reference to land or CGT assets, but we typically see this in land transactions. • CGT event H1 would apply even if the asset that is subject to the deposits is a pre-CGT asset. This is because CGT event H1 applies on its terms and because there is no exception for pre-CGT assets. • For similar reasons, it appears that CGT event H1 would apply to a deposit forfeited in respect of an exempt asset (e.g. motor vehicle), and would not be protected by the MRE. • The general discount also will not apply, because there is no event in relation to a CGT asset (s 115-25). • Where CGT event H1 applies, it may be possible for the taxpayer to satisfy the conditions to access the CGT small business concessions in relation to the capital gain arising from the forfeited deposit. This is because the CGT events happens “in relation to a CGT asset of yours” for the purposes of s 152-10(1)(a), which is one of the preconditions to access the CGT small business concessions.

	<ul style="list-style-type: none"> • In some cases, a forfeited deposit will just be ordinary income (e.g. if transaction entered into in the ordinary course of business). • In theory, C2 could also apply (termination of contract rights) – however H1 will probably be considered the more specific event (per s 102-25). • D1 and H2 will probably not apply in this situation, because those events are prevented from operating where the right / transaction requires you to do something that is another CGT event.
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<p>Brooks [2000] FCA 721 Forfeited deposit</p>	<p>Facts</p> <ul style="list-style-type: none"> ▪ Note this case considered the predecessor to H1 in s 160ZZC(12). ▪ It involved a deposit paid by the purchasers on exchange of sale contracts in relation to a rental property, where the purchasers did not complete and the contract was terminated. <p>Held</p> <ul style="list-style-type: none"> ▪ CGT event H1 will also apply to deposits forfeited under a contract itself (such as the deposit forfeited under a contract for the sale of real estate – or any CGT asset) and not just to deposits forfeited under “pre-contract” negotiations. ▪ The Tax Office issued Addenda to Ruling TR 1999/19 following this decision to clarify its treatment of forfeited deposits.
<p>TR 1999/19 TR 1999/19A CGT treatment of forfeited deposits in real estate transactions “Continuum of events”</p>	<ul style="list-style-type: none"> ▪ CGT event H1 applies to deposits forfeited under a contract of sale for real estate. ▪ However, if the forfeiture occurs within a “continuum of events” constituting a later disposal of the real estate, then the forfeited deposit is not subject to CGT event H1. Instead it will form part of the capital proceeds for the disposal of the real estate (CGT event A1). ▪ In the case where the real estate is a main residence, then the CGT exemption rules would apply, noting the law makes specific provision for the main residence case in s 118-110(2)(b), which states the MRE will apply to “a CGT event that involves the forfeiting of a deposit as part of an uninterrupted sequence of transactions ending in one of the events specified in para (a) subsequently happening”. ▪ Similarly, if the land is pre-CGT, the forfeited deposit will be protected by the pre-CGT status if there is an eventual sale. ▪ Paras 13 and 14 state that this approach will also apply to instalments of the purchase price which are forfeited under the contract and any related damages received by the vendor. ▪ What is a “continuum of events”? <ul style="list-style-type: none"> ○ Will depend on the circumstances ○ The longer the period of time between forfeiture and eventual sale, the more difficult it will be to link the two (2 years is stated as a general rule of thumb)

Event H2 – Capital receipt relating to a CGT asset

Subdivision 104-H – Special capital receipts	
104-155	<p>Receipt for event relating to a CGT asset: CGT event H2</p> <p>(1) <i>CGT event H2 happens if:</i></p> <ul style="list-style-type: none"> (a) <i>an act, transaction or event occurs in relation to a CGT asset that you own; and</i> (b) <i>the act, transaction or event does not result in an adjustment being made to the asset's cost base or reduced cost base.</i> <p>Example: You own land on which you intend to construct a manufacturing facility. A business promotion organisation pays you \$50,000 as an inducement to start construction early. No contractual rights or obligations are created by the arrangement. The payment is made because of an event (the inducement to start construction early) in relation to your land.</p> <p>Note: This event does not apply if any other CGT event applies (s 102-25).</p> <p>(2) <i>The time of the event is when the act, transaction or event occurs.</i></p> <p>(3) <i>You make a capital gain if the capital proceeds because of the CGT event are more than the incidental costs [s 110-35] you incurred that relate to the event. You make a capital loss if those capital proceeds are less.</i></p> <p><i>[Note: it does not exclude deductible expenditure. This could result in double dipping where incidental costs are taken into account in calculating the capital gain or the capital loss and are also deductible]</i></p> <p>(4) <i>The costs can include giving property (s 103-5). However, they do not include an amount you have received as recoupment of them and that is not included in your assessable income.</i></p> <p><u>Exceptions</u></p> <p>(5) <i>CGT event H2 does not happen if:</i></p> <ul style="list-style-type: none"> (a) <i>the act, transaction or event is the borrowing of money or the obtaining of credit from another entity [however, the lender is still taken to have acquired the debt for CGT purposes]; or</i> (b) <i>the act, transaction or event requires you to do something that is another CGT event that happens to you; or</i> (c) <i>a company issues or allots equity interests or non-equity shares in the company; or</i> (d) <i>the trustee of a unit trust issues units in the trust; or</i> (e) <i>a company grants an option to acquire equity interests, non-equity shares or debentures in the company; or</i> <i>[effectively, any taxing point is deferred until the options end, when CGT event C3 in s 104-30 will apply]</i> (aa) <i>a company grants an option to dispose of shares in the company to the company; or</i> (f) <i>the trustee of a unit trust grants an option to acquire units or debentures in the trust; or</i> (g) <i>a company or a trust that is a member of a demerger group issues new ownership interests under a demerger [Div 125].</i>

This is essentially a 'catch-all' CGT event of last resort, trying to capture anything else that might happen to a CGT asset and from which you get a benefit, where it is not captured by any of the other events / does not result in some sort of cost base adjustment.

Where legal or equitable rights are created in return for capital proceeds (the usual case), CGT event D1 will prevail, so in practical terms the operation of CGT event H2 is limited.

CGT event H2 will not apply if a taxpayer does not receive any capital proceeds in relation to the act, transaction or event. This is because the market value substitution rule (Modification 1 for no capital proceeds) does not apply to CGT event H2 (s 116-25). However, the MVS rule will apply where any of the following modification rules apply:

- Apportionment rule (mod 2)
- Non-receipt rule (mod 3)
- Repaid rule (mod 4)
- Misappropriation (mod 6)

<p>TR 95/35</p> <p>Compensation receipts</p> <p>Example refers to the former provisions, but likely H2 would apply in this situation</p>	<p>Example 10</p> <p>288. <i>Alf is an interior designer who works from spacious offices, showrooms and workshops attached to his home, with space for customer parking on the premises. The business commenced in 1989 and Alf has a substantial client base and is well known in the industry.</i></p> <p><i>Alf's clients generally visit the showrooms to choose styles and approve orders. Early in May 1994 the local council commences road works which block the road on either side of Alf's premises for fourteen weeks. During this time he has no vehicular access to his premises. The council offers Alf \$12,000 as compensation for the inconvenience and loss of access. Alf had not sought any compensation from the council; the offer of \$12,000 was not solicited.</i></p> <p><i>Alf accepts the offer and receives payment on 28 May 1994.</i></p> <p>289. <i>Subsection 160M(7) would apply to assess the capital gain of \$12,000. The elements of the provision are satisfied:</i></p> <ul style="list-style-type: none"> ○ <i>The goodwill has been affected by an act or event (the local council blocking access to Alf's premises);</i> ○ <i>Alf has received \$12,000 as a result of that act or event; and</i> ○ <i>The money was received to compensate for the council's exclusive use of the area.</i>
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Note, the CGT general discount cannot apply to a capital gain arising under CGT event H2 (s 115-25(3)(h)).

H2 does not apply where cost base adjustment

CGT event H2 will not apply where a cost base adjustment has already taken account of the transaction.

For example, TR 95/35 requires a cost base adjustment where **compensation** is received in respect of any permanent damage to a CGT asset.

CGT event H2 will not apply where a taxpayer receives a capital payment and any of the cost base recoupment provisions require a reduction in the cost base of the asset (e.g. ss 110-40(3) and 110-45(3)).

Event K4 – CGT asset becomes trading stock

Subdivision 104-K – Other CGT events	
104-220	<p>CGT asset starts being trading stock: CGT event K4</p> <p>(1) <i>CGT event K4 happens if:</i></p> <ul style="list-style-type: none"> (a) <i>you start holding as trading stock a CGT asset you already own but do not hold as trading stock; and</i> (b) <i>you elect under s 70-30(1)(a) to be treated as having sold the asset for its market value.</i> <p>Note 1: <i>s 70-30(1)(a) allows you to elect the cost of the asset, or its market value, just before it became trading stock.</i></p> <p>Note 2: <i>There is an exemption from CGT if you elect its cost (s 118-25).</i></p> <p>(2) <i>The time of the event is when you start.</i></p> <p>(3) <i>You make a capital gain if the asset's market value (just before it became trading stock) is more than its cost base. You make a capital loss if that market value is less than its reduced cost base.</i></p> <p><u>Exceptions</u></p> <p>(4) <i>A capital gain or capital loss you make is disregarded if you acquired the asset before 20 Sep 1985 [i.e. pre-CGT].</i></p> <p>Note: <i>If the asset converted into trading stock was the taxpayer's main residence, then the main residence exemption under Subdiv 118-B may apply in respect of any capital gain. For business assets converted into trading stock the CGT small business concessions may apply in respect of any capital gain.</i></p>

Event K4 applies if a CGT asset of the taxpayer becomes trading stock and, under the trading stock rules in Div 70, the taxpayer elects for the asset to have been disposed of for its market value (as opposed to its cost).

Event K4 is particularly relevant where land is “ventured” into property development activities and becomes trading stock of the taxpayer. In order for the asset to become trading stock it must become an asset of a ‘business’ of the taxpayer. An isolated profit-making venture or commercial transaction that is not a business will not suffice, although in some cases an isolated venture may be a business.

<p>TD 92/124</p> <p>When is land treated as “trading stock”</p>	<ol style="list-style-type: none"> 1. <i>Land is treated as trading stock for income tax purposes if:</i> <ul style="list-style-type: none"> ○ <i>It is held for the purpose of resale; and</i> ○ <i>A business activity which involves dealing in land has commenced.</i> 2. <i>Both the required purpose and the business activity must be present before land is treated as trading stock. The business activity is taken to have commenced when a taxpayer embarks on a definite and continuous cycle of operations designed to lead to the sale of the land.</i> 3. <i>It is not necessary that the acquisition of land be repetitive. A single acquisition of land for the purpose of development, subdivision and sale by a business commenced for that purpose would lead to the land being treated as trading stock.</i>
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Division 70 – Trading stock

Anything that is trading stock, is also inherently a CGT asset (but the reverse is not true).

Key components of the trading stock rules:

- The costs of acquiring items of trading stock are deductible (s 8-1)
- The proceeds from selling trading stock are ordinary income (s 6-5)
- The valuation of trading stock on hand by way of s 70-35 has the effect of:
 - Deferring/reversing the deduction for cost if the item is still on hand at year end
 - Allowing the deduction in the year the item is no longer on handi.e. essentially a “netting off” based on total bought and total sold over the year
- Items of trading stock are CGT assets, but the gain/loss on sale (which is technically an A1 event) is generally disregarded (s 118-25(1)) (because it is already picked up as ordinary income, or a revenue deduction)

Division 70 – Trading stock	
Subdivision 70-A – What is trading stock	
70-10	<p>Meaning of trading stock</p> <p>(1) <i>Trading stock includes:</i></p> <ul style="list-style-type: none"> (a) <i>anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business; and</i> (b) <i>livestock.</i> <p>(2) <i>Trading stock does <u>not</u> include:</i></p> <ul style="list-style-type: none"> (a) <i>a Div 230 financial arrangement; or</i> (b) <i>a CGT asset covered by s 275-105 that:</i> <ul style="list-style-type: none"> (i) <i>is owned by a complying super entity; or</i> (ii) <i>is a complying super asset of a life insurance company.</i> <p>Note</p> <ul style="list-style-type: none"> • Trading stock does not have to be tangible (e.g. shares, crypto).
Subdivision 70-B – Acquiring trading stock	
70-30	<p>Starting to hold as trading stock an item you already own</p> <p><u>General rule</u></p> <p>(1) <i>If you start holding as trading stock an item you already own, but do not hold as trading stock, you are treated as if:</i></p> <ul style="list-style-type: none"> (a) <i>just before it became trading stock, you had sold the item to someone else (at arm's length) for whichever of these amounts you elect:</i> <ul style="list-style-type: none"> • <i>its cost (as worked out under sub (3) or (4));</i> • <i>its market value just before it became trading stock; and</i> (b) <i>you had immediately bought it back for the same amount.</i> <p>Example: <i>You start holding a depreciating asset as part of your trading stock. You are treated as having sold it just before that time, and immediately bought it back, for its cost or market value, whichever you elect (Subdiv 40-D provides for the consequences of selling depreciating assets).</i></p> <p><i>The same amount is normally a general deduction under s 8-1 as an outgoing in connection with acquiring trading stock. The amount is also taken into account in working out the item's cost for the purposes of section 70-45 (about valuing trading stock at the end of the income year).</i></p> <p>Note: <i>Depending on how you elect under para (1)(a), the sale may or may not give rise to a capital gain or a capital loss for the purposes of the CGT provisions. It does not if you elect to be treated as having sold the item for what would have been its cost (see s 118-25(2)). However, it can if you elect market value.</i></p> <p><u>When you must make the election</u></p> <p>(2) <i>You must make the election by the time you lodge your income tax return for the income year in which you start holding the item as trading stock (if you do not make the election by then because you do not realise until later that you started to hold the item as trading stock, you must make the election as soon as is reasonable after realising that). However, the Commissioner can allow you to make it later (in either case).</i></p>

How to work out the item's cost

(3) *The item's cost is what would have been its cost for the purposes of s 70-45 (about valuing trading stock at the end of the income year) if it had been your trading stock ever since you last acquired it.*

(4) *However, if you last acquired the item for no consideration, its cost is worked out using this table:*

Item	In this case:	The cost is:
1	<i>you acquired the item during or after the 1998-99 income year, and the acquisition involved a CGT event</i>	<i>the item's market value when you last acquired it</i>
2	<i>you acquired the item before or during the 1997-98 income year, and the acquisition involved a disposal of the item to you within the meaning of former Part IIIA (CGT rules) of the ITAA 1936</i>	<i>the item's market value when you last acquired it</i>
3	<i>your acquisition of the item involved the item:</i> <i>(a) devolving to you as someone's legal personal representative; or</i> <i>(b) passing to you as a beneficiary in someone's estate;</i> <i>and, if a CGT event had happened in relation to the item just before you started holding it as trading stock, a capital gain or capital loss could have resulted that would have been taken into account in working out your net capital gain or net capital loss for the income year of the event</i>	<i>(a) if the person died during or after his or her 1998-99 income year – the dead person's cost base for the item just before his or her death; or</i> <i>(b) if the person died before or during his or her 1997-98 income year – the dead person's indexed cost base (within the meaning of former Part IIIA (CGT rules) of the ITAA 1936) for the item just before his or her death (but worked out disregarding former s 160ZG (which affects the indexed cost base for a non-listed personal use asset))</i>
4	<i>any other case where you last acquired the item for no consideration</i>	<i>a nil amount</i>

Subdivision 70-C – Accounting for trading stock at the start or end of the income year	
70-35	<p>Include the value of trading stock in working out income and deductions</p> <p>(1) <i>If you carry on a business, you compare:</i></p> <ul style="list-style-type: none"> (a) <i>the value of all your trading stock on hand at the start of the income year; and</i> (b) <i>the value of all your trading stock on hand at the end of the income year.</i> <p>(2) <i>Your assessable income includes any excess of the value at the end of the income year over the value at the start of the income year.</i></p> <p>(3) <i>On the other hand, you can deduct any excess of the value at the start of the income year over the value at the end of the income year.</i></p>
Subdivision 70-D – Assessable income arising from disposals of trading stock	
70-110	<p>You stop holding an item as trading stock but still own it</p> <p>(1) <i>If you stop holding an item as trading stock, but still own it, you are treated as if:</i></p> <ul style="list-style-type: none"> (a) <i>just before it stopped being trading stock, you had sold it to someone else (at arm's length and in the ordinary course of business) for its cost; and</i> (b) <i>you had immediately bought it back for the same amount.</i> <p>Example 1: <i>You are a sheep grazier and take a sheep from your stock to slaughter for personal consumption. You are treated as having sold it for its cost. This amount is assessable income, just like the proceeds of sale of any of your trading stock.</i></p> <p><i>Although you are also treated as having bought the sheep for the same amount, it would not be deductible because the sheep is for personal consumption.</i></p> <p>Example 2: <i>You stop holding an item as trading stock and begin to use it as a depreciating asset for the purpose of producing your assessable income. You are treated as having sold it for its cost. This amount is assessable income, just like the proceeds of sale of any of your trading stock.</i></p> <p><i>You are also treated as having bought the item for the same amount, which is relevant to working out the item's cost for capital allowance purposes (Subdiv 40-C) and the item's cost base for CGT purposes (Div 110).</i></p> <p>...</p> <p>Note</p> <ul style="list-style-type: none"> • The amount of the deemed sale (i.e. the cost) needs to be included as ordinary assessable income (s 6-5). • The amount of the deemed repurchase (i.e. also the cost) will be the 1st element of cost base for CGT purposes (Item 1, s 112-97). • The time of acquisition for CGT purposes is when you stop holding the asset as trading stock (Item 11, s 109-60).

<p><i>Kurts Development</i> [1998] FCA 1037</p> <p>Cost of land as trading stock</p> <p>Costs incurred in subdividing land</p>	<p>Facts</p> <ul style="list-style-type: none"> ▪ The taxpayer was a property developer which acquired undeveloped land and converted it into subdivided lots for the purpose of sale. ▪ A portion of the land acquired was required to be converted into public infrastructure (roads, parks, sewerage, drainage etc), ownership of which eventually reverted to the Crown. In addition, certain external costs were incurred on neighbouring public land and structures not owned by the taxpayer, but which would assist in the provision of services to the taxpayer's subdivided lots, and otherwise for work done by the local authority in relation to the subdivision. ▪ The issue was whether the costs incurred in developing the public infrastructure (including the cost of land used for that purpose), and the external costs, formed part of the cost of the subdivided lots for trading stock purposes, and therefore part of the value of the taxpayer's trading stock on hand at year end, even after the infrastructure land became separately identifiable. <p>Held</p> <ul style="list-style-type: none"> ▪ The infrastructure land was never a separate article of trading stock in its own right. One form of trading stock, the raw land acquired, was merely converted into a different form of trading stock, the subdivided lots. All costs incurred in creating those individual lots must be regarded as part of their cost price. ▪ The tribunal erred in law in concluding that the costs incurred in developing the public infrastructure and also the external costs must be apportioned to determine which expenses relate directly to the individual subdivided lots.
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Event K7 – Balancing adjustments for depreciating assets

Event K7 applies to the capital gain or capital loss made on a depreciating asset to the extent that the depreciating asset was used for a non-taxable (that is, a non-income-producing) purpose.

It fills the gap to capture the profit or loss made on a depreciating asset that is otherwise not subject to the capital allowance provisions in Div 40.

Note also, the exemption in s 118-24 for depreciating assets does not apply to CGT event K7.

Subdivision 104-K – Other CGT events	
104-235	<p>Balancing adjustment events for depreciating assets: CGT event K7</p> <p>(1) <i>CGT event K7 happens if:</i></p> <ul style="list-style-type: none">(a) <i>a balancing adjustment event occurs for a depreciating asset [defined in s 40-30] you held; and</i>(b) <i>at some time when you held the asset, you used it, or had it installed ready for use, for:</i><ul style="list-style-type: none">(i) <i>a purpose other than a taxable purpose [defined in s 40-25]; or</i>(ii) <i>the purpose to which ss 40-27(2)(a) and (b) relate (about second-hand assets in residential property).</i> <p>(1A) <i>However, sub (1) does not apply if:</i></p> <ul style="list-style-type: none">...(b) <i>there is roll-over relief for the balancing adjustment event under s 40-340 of this Act; or</i>... <p>(2) <i>The time of CGT event K7 is when the balancing adjustment event occurs [see s 40-295].</i></p> <p>(3) <i>Any capital gain or capital loss is worked out:</i></p> <ul style="list-style-type: none">(a) <i>under s 104-240; or</i>(b) <i>under s 104-245 if the depreciating asset was allocated to a low-value pool.</i> <p><u>Exceptions</u></p> <p>(4) <i>A capital gain or capital loss you make is disregarded if:</i></p> <ul style="list-style-type: none">(a) <i>the depreciating asset covered by sub (1) ... is a pre-CGT asset; or</i>(b) <i>you can deduct an amount for the asset under Div 328 (about small business entities) for the income year in which the balancing adjustment event occurred.</i>

104-240

Working out capital gain or loss for CGT event K7: general case

Capital gain

- (1) You make a capital gain if the termination value of the depreciating asset covered by s 104-235(1) ... is more than its cost. The amount of the capital gain is:

$$\left[* \text{ Termination value} - * \text{Cost} \right] \times \frac{\text{Sum of reductions}}{\text{Total decline}}$$

where:

“sum of reductions” is the sum of:

- (a) if the depreciating asset is covered by s 104-235(1) – the reductions in your deductions for the asset under ss 40-25 and 40-27 [i.e. the reductions required for non-taxable use];

...

“total decline” is the decline in value of the depreciating asset since you started to hold it.

...

Note 2: The CGT concepts of cost base and capital proceeds are not relevant for this event.

Capital loss

- (2) You make a capital loss if the cost of the depreciating asset covered by s 104-235(1) ... is more than its termination value. The amount of the capital loss is:

$$\left[* \text{Cost} - * \text{ Termination value} \right] \times \frac{\text{Sum of reductions}}{\text{Total decline}}$$

Modifications

- (3) In applying sub (1) or (2), reduce the termination value of the depreciating asset by so much of an amount misappropriated by your employee or agent (whether by theft, embezzlement, larceny or otherwise) as represents an amount applicable to you under:

(a) item 8 of the table in s 40-300(2); or

(b) item 1, 3, 4 or 6 of the table in s 40-305(1);

in relation to the balancing adjustment event.

- (4) If you later receive an amount as recoupment of all or part of the amount misappropriated, the amount applicable under sub (3) is increased by the amount received.

- (5) Section 170 of the ITAA 1936 does not prevent the amendment of an assessment for the purposes of giving effect to this section for an income year if:

(a) you discover the misappropriation, or you receive an amount as recoupment of all or part of the amount misappropriated, after you lodged your income tax return for the income year; and

(b) the amendment is made at any time during the period of 4 years starting immediately after you discover the misappropriation or receive the amount.

	<p>Note</p> <ul style="list-style-type: none"> The “termination value” is defined in s 40-300. Generally, it consists of amounts that a taxpayer receives, or is taken to have received, in relation to the asset under a balancing adjustment event (analogous to capital proceeds).
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A capital gain under event K7 may be eligible for the CGT general discount. This is provided that the capital gain was calculated using the cost of the depreciating asset (s 115-20(1)(b)).

However such a capital gain would not be eligible for the CGT small business concessions, because the capital gain arises from the non-income producing use of a depreciating asset.

Division 40 – Capital allowances

Depreciating assets are inherently capital assets, but the tax system allows a deduction to reflect the decline in the value of the asset where it is used for a taxable purpose (s 40-25).

Section 40-285 then provides for a “balancing adjustment” when a depreciating asset is disposed of, which (similar to the CGT rules) captures the gain / loss on disposal.

Because Div 40 provides for these treatments, typically the CGT rules are not required, and are disregarded (s 118-24).

However, the CGT rules become relevant (via event K7), where a depreciating asset is used (wholly or partly) for a **non-taxable purpose**.

Division 40 – Capital allowances	
Subdivision 40-B – Core provisions	
Note: CGT assets have “cost base” while depreciating assets have “cost”.	
40-25	<p>Deducting amounts for depreciating assets</p> <p><u>You deduct the decline in value</u></p> <p>(1) <i>You can deduct an amount equal to the decline in value for an income year (as worked out under this Div) of a depreciating asset that you held for any time during the year.</i></p> <p>...</p> <p><u>Reduce deduction if attributable to a non-taxable purpose</u></p> <p>(2) <i>You must reduce your deduction by the part of the asset's decline in value that is attributable to your use of the asset, or your having it installed ready for use, for a purpose other than a taxable purpose.</i></p> <p>...</p> <p><u>Exception for low-value pools</u></p> <p>(5) <i>Sub (2) ... does not apply to depreciating assets allocated to a low-value pool.</i></p> <p><i>Despite sub (1), you can continue to deduct an amount equal to the decline in value for an income year (as worked out under this Div) of such an asset even though you do not continue to hold that asset.</i></p> <p><u>Meaning of taxable purpose</u></p> <p>(7) <i>...a taxable purpose is:</i></p> <p>(a) <i>the purpose of producing assessable income;</i></p> <p>...</p>
40-30	<p>What is a depreciating asset</p> <p>(1) <i>A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used, except:</i></p> <p>(a) <i>land; or</i></p> <p>(b) <i>an item of trading stock; or</i></p> <p>(c) <i>an intangible asset, unless it is mentioned in sub (2).</i></p> <p>(2) <i>These intangible assets are depreciating assets if they are not trading stock:</i></p> <p>...</p> <p>(c) <i>items of intellectual property;</i></p> <p>(d) <i>in-house software;</i></p> <p>(e) <i>IRUs [indefeasible right-of-use];</i></p> <p>...</p> <p>(3) <i>This Div applies to an improvement to land, or a fixture on land, whether the improvement or fixture is removable or not, as if it were an asset separate from the land.</i></p> <p>Note 1: <i>Whether such an asset is a depreciating asset depends on whether it falls within the definition in sub (1).</i></p>

	<p>Note 2: This Div does not apply to capital works for which you can deduct amounts under Div 43 (s 40-45(2)).</p> <p>(4) Whether a particular composite item is itself a depreciating asset or whether its components are separate depreciating assets is a question of fact and degree which can only be determined in the light of all the circumstances of the particular case.</p> <p>Example 1: A car is made up of many separate components, but usually the car is a depreciating asset rather than each component.</p> <p>Example 2: A floating restaurant consists of many separate components (like the ship itself, stoves, fridges, furniture, crockery and cutlery), but usually these components are treated as separate depreciating assets.</p> <p>(5) This Div applies to a renewal or extension of a depreciating asset that is a right as if the renewal or extension were a continuation of the original right.</p> <p>...</p>
Subdivision 40-D – Balancing adjustments	
40-285	<p>Balancing adjustments</p> <p>(1) An amount is included in your assessable income if:</p> <ul style="list-style-type: none"> (a) a balancing adjustment event occurs for a depreciating asset you held and: <ul style="list-style-type: none"> (i) whose decline in value you worked out under Subdiv 40-B; or (ii) whose decline in value you would have worked out under that Subdiv if you had used the asset; and (b) the asset's termination value is more than its adjustable value just before the event occurred. <p>The amount included is the difference between those amounts, and it is included for the income year in which the balancing adjustment event occurred.</p> <p>Note 1: The most common balancing adjustment event is where you sell the depreciating asset.</p> <p>...</p> <p>(2) You can deduct an amount if:</p> <ul style="list-style-type: none"> (a) a balancing adjustment event occurs for a depreciating asset you held and: <ul style="list-style-type: none"> (i) whose decline in value you worked out under Subdiv 40-B; or (ii) whose decline in value you would have worked out under that Subdiv if you had used the asset; and (b) the asset's termination value is less than its adjustable value just before the event occurred. <p>The amount you can deduct is the difference between those amounts, and you can deduct it for the income year in which the balancing adjustment event occurred.</p> <p>...</p> <p>(3) The adjustable value of a depreciating asset you hold after this section applies to it is then zero.</p> <p>...</p>

40-290	<p>Reduction for non-taxable use</p> <p>(1) You must reduce the amount (the balancing adjustment amount) included in your assessable income, or the amount you can deduct, under s 40-285 for a depreciating asset if your deductions for the asset have been reduced under s 40-25.</p> <p>(2) The reduction is:</p> $\frac{\text{Sum of reductions}}{\text{Total decline}} \times \text{Balancing adjustment amount}$ <p>where:</p> <p>“sum of reductions” is the sum of:</p> <ul style="list-style-type: none"> (a) the reductions in your deductions for the asset under s 40-25; and (b) if there has been roll-over relief for the asset under s 40-340 – the reductions in deductions for the asset for the transferor or an earlier successive transferor under s 40-25; and (c) if you hold the asset as the legal personal representative of an individual – the reductions in deductions for the asset for the individual under s 40-25. <p>“total decline” is the sum of:</p> <ul style="list-style-type: none"> (a) the decline in value of the depreciating asset since you started to hold it; and (b) if there has been roll-over relief for the asset under s 40-340 – the decline in value of the asset for the transferor or an earlier successive transferor; and (c) if you hold the asset as the legal personal representative of an individual – the decline in value of the asset for the individual. <p>(3) You must further reduce the amount included in your assessable income, or the amount you can deduct, under s 40-285 for a depreciating asset (the current asset) if:</p> <ul style="list-style-type: none"> (a) the asset's cost (for you) was worked out under s 40-205 (cost of a split depreciating asset) or s 40-210 (cost of merged depreciating assets); and (b) you used the depreciating asset from which the current asset was split, or a depreciating asset that was merged into the current asset, or had it installed ready for use, for a purpose other than a taxable purpose. <p>(4) The further reduction is such amount as is reasonable having regard to the extent of the use referred to in para (3)(b).</p>
40-295	<p>Meaning of balancing adjustment event</p> <p>(1) A balancing adjustment event occurs for a depreciating asset if:</p> <ul style="list-style-type: none"> (a) you stop holding the asset; or (b) you stop using it, or having it installed ready for use, for any purpose and you expect never to use it, or have it installed ready for use, again; or (c) you have not used it and: <ul style="list-style-type: none"> (i) if you have had it installed ready for use – you stop having it so installed; and (ii) you decide never to use it. <p>Note: A balancing adjustment event occurs under s 40-295(1)(a) when you start holding a depreciating asset as trading stock.</p> <p>...</p>

	<p>(3) <i>However, a balancing adjustment event does not occur for a depreciating asset merely because you split it into 2 or more depreciating assets or you merge it with one or more other depreciating assets.</i></p>
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Note: *A balancing adjustment event will occur if you stop holding part of a depreciating asset.*