Date introduced:       22 May 1986
House:                House of Representatives
Presented by:         Hon. Paul Keating, M.P., Treasurer

DIGEST OF BILL

Purpose

To introduce a capital gains tax on the disposal of assets acquired after 19 September and to amend the rules relating to employee share acquisitions.

Background

The tax to be introduced by this Bill was announced as part of the September 1985 Tax Reform Statement. The idea of a capital gains tax was considered by the Aprey Committee in 1974. That body came out in favour of the tax on both equity and efficiency grounds. The Whitlam Labor Government proposed to introduce a capital gains tax but the matter was dropped in 1975.

In the White Paper released by the Government prior to the Tax Summit of July 1985 the question of a capital gains tax was again canvassed. The White Paper noted that Australia was one of the few OECD countries without a capital gains tax and came out in favour of such a tax.

A capital gains tax, in one form or another, exists in many overseas countries including Great Britain, the United States, Japan and Switzerland.

Outline

The Bill will apply to assets, other than the principal residence and cars, acquired on or after 20 September 1985. The capital gain or loss, which will be deductible against gains, will generally be calculated by references to the consideration or market value on disposal.
and the indexed cost base of the asset. Assets passing on death will generally be exempt though a subsequent disposal may attract tax.

**Main Provisions**

For a detailed analysis of the clauses of the Bill refer to the Explanatory Memorandum.

Section 23 of the *Income Tax Assessment Act 1936* (the Principal Act) will be amended to extend the exemption of tax that applies to foreign sourced income where tax has been paid in the country in which the income was derived, to capital gains (clause 6).

Section 26AAC, which deals with the value of shares acquired by employees, will be amended to introduce an alternative method of calculating the value of such shares. The alternative method will apply to rights issued after 19 September 1985 and will apply if the taxpayer so elects. Basically, the taxpayer will be able to include, as income, the difference between the value of the right or share issued and the consideration paid in the year in which the right was acquired (clause 9).

Clause 17 will insert a new section 149A into the Principal Act which will exclude capital gains income from the primary produces income averaging provisions.

A new Part IIIA, titled Capital Gains and Capital Losses, will be inserted into the Principal Act by clause 19.

The Part will apply to all property, including property created or constructed, except motor vehicles of less than one tonne or capable of carrying fewer than nine passengers (proposed section 160A).

'Personal-use assets' is defined in proposed section 160B. They include goods, other than houses or land, kept principally for personal use or enjoyment and debts arising other than in producing assessable income or business. 'Listed personal-use asset' is also defined in proposed section 160B and will be a personal-use asset which the taxpayer acquired for over $100 and which is an artwork, jewellery, rare manuscript or book, a postage stamp, a coin or medallion, an antique or a debt owed in respect of such an asset or an option to acquire such an asset.
A taxpayer will be deemed to have received money or property that is applied for their benefit or in accordance with their directions (proposed section 160D).

When a person will be taken to be an associate of another is defined in proposed section 160E. For an individual other than a trustee they will be: relatives, partners, the spouse and children of partners, trustees where the person can benefit from the trust and companies which follow the person's directions or in which the person can control more than 50 per cent of the votes in that company. Where the taxpayer is a company, other than a trustee company, the associates will be similar to those for a person. For trustees, the associates will be anyone who may benefit under the trust.

Related companies is defined in proposed section 160G. They will be subsidiary companies as defined in that proposed section.

Division 2 of Part IIIA, proposed sections 160L to 160Y, deals with the application of the Part.

The Part will apply to assets acquired and disposed of on or after 20 September 1985 that was owned by a resident (other than a trustee) or a resident trust enable other than assets held as trading stock or the disposal of which is taxed under other provisions of the Principal Act. For non-residents, the Part will apply to the disposal of a taxable Australian asset acquired on or after 20 September 1985 (proposed section 160L).

Disposal and acquisition are dealt with by proposed section 160M. They will occur where there has been a change in ownership of the asset, whether by the doing of an act or the operation of law and includes where a beneficiary becomes absolutely entitled, the cancellation of a debt, the redemption of a debenture and the issuing of shares. Where a resident ceases to reside in Australia, the taxpayer will be deemed to have disposed of all assets other than taxable Australian assets or those acquired before 20 September 1985. The converse will apply when a person or trust commences to reside in Australia (i.e. they will be deemed to have acquired the assets).

Loss or destruction will generally constitute disposal (proposed section 160N).
Proposed section 160P deals with composite assets. Where land was acquired before 20 September 1985 and after that date a building is constructed or the existing building demolished and a new one built, the new building will comprise a separate asset. Improvements of a capital nature made after 20 September 1985 where the indexed cost base of the improvement exceeds $50 000 and that amount exceeds 5% of the consideration on disposal, will also be considered as separate assets.

Indexation of the cost base limit (i.e. the $50 000 figure for improvements) is dealt with by proposed section 160Q. Basically, the sum will be adjusted in accordance with movements in the All Groups Consumer Price Index.

The giving of an asset for security will not constitute disposal (proposed subject 160S).

Proposed section 160T deals with when the disposal of an asset will comprise the disposal of a taxable Australian asset. This will occur when the asset is land, buildings, assets used in running a business, shares in a private Australian company, shares in public companies where, within the past 5 years, the taxpayer was beneficial owner (or an associate of someone who beneficially owned) 10% or more of normal share capital, an interest in a resident partnership or trust estate or a right or option to acquire such an asset.

The time of disposal or acquisition will generally be the time of the making of the contract if the asset passes under a contract or the time of charge of ownership if no contract exists. Where an asset is constructed the time of acquisition will generally be when the construction commenced (proposed section 160U).

A change in the vesting of an asset due to bankruptcy will not constitute disposal (proposed section 160W).

Except for transfers to tax-exempt people (see below) transfers upon death will not constitute a disposal. However, where the asset is sold by a beneficiary, they may be subject to tax. For this purpose, proposed section 160X sets out how the cost base is to be determined. Where the deceased died after 20 September 1985 this will generally be calculated by reference to the indexed cost value at the time of death.
Where an asset passes to a tax-exempt person proposed section 160Y will deem the asset to have been acquired by that person for a consideration equal to the market value at the date of death. The cost base value for the purposes of sale by a beneficiary will be the same as calculated under proposed section 160X.

Division 3 (clauses 160Z to 160ZN) deals with the calculation of capital gains and losses.

Generally, where an asset is disposed of and the consideration exceeds the indexed cost base (see below), a capital gain will have occurred. If the consideration is less than the reduced cost base (see below), a capital loss will have occurred. For non-listed personal use assets, capital gains will be calculated in the same manner. Capital losses in respect of non-listed personal assets are excluded by proposed sub-section 160Z(7) (for the treatment of listed personal assets refer to proposed section 160ZQ below). For assets disposed of within 12 months of acquisition and not taxed under section 26AAA of the Principal Act, the cost base will not be indexed (proposed section 160Z).

Where excess property loan interest exists (i.e. where loan costs exceed rent and the access is generally not deductible due to the abolition of negative gearing for rented domestic premises), such excess may be offset against capital gains arising from the sale of prescribed assets (i.e. land used for rental, a share in a rental property company or an interest in a rental property partnership) (proposed section 160ZA).

Proposed section 160ZB lists a number of assets that will be exempt from the tax. They are compensation and damages payments and gambling losses or gains.

A net capital gain or loss will occur when the gain (or loss) exceeds the capital loss (or gain) incurred in that year and the preceding year (proposed section 160ZC).

Proposed section 160ZD deals with the value of the consideration for disposal of an asset. This will generally be the market value.

The cost base for non-listed personal assets is dealt with in proposed section 160ZG. The minimum cost base will be $5000 though where such an asset formed part of another non-listed personal asset and is sold separately the cost base will be proportioned between the assets (proposed section 160ZG).
The cost base of other assets is dealt with in proposed section 160ZH. This proposed section lists the matters to be considered when calculating the cost base (i.e. the consideration on acquisition, incidental costs of acquisition, capital sums spent on improvements that are reflected in the asset, disposal costs and any sum spent in establishing or defending a right to the asset), the indexed cost base (same items but indexed) and the reduced cost base (see proposed section 160ZK below). 

Indexation will be based on movements in the weighted average of the movement in the All Groups Consumer Price Index in the eight capital cities (proposed section 160ZJ).

The reduced cost base will generally be the amount of consideration or expense contained in the cost base less any relevant allowable deduction (proposed section 160ZK).

Division 4 (proposed sections 160ZO to 160Q) deals with the treatment of capital gains and losses.

By proposed section 160ZO net capital gains are to be included in a taxpayer's assessable income. In accordance with proposed section 160ZC capital losses may only be offset against capital gains.

Related companies (i.e. generally subsidiaries) will be able to offset capital losses incurred by one company against the capital gain of the other, related company (proposed section 160ZP).

For listed personal use assets, a capital gain will have occurred where the consideration on disposal exceeds the indexed cost base (or the cost base where disposed of within 12 of acquisition). Listed personal use capital losses may only be offset against listed personal use capital gains (proposed section 160ZQ).

Divisions 5 to 16 deal with the taxation of capital gains and losses for certain specific assets. These provisions follow the general pattern already outlined and will not be further explained in this Digest.

Where assets are transferred upon the breakdown of a marriage and the assets were acquired before 20 September 1985, the transferee will be deemed to have acquired the asset before that date. Where he asset was acquired on or
after that date, the standard cost base provisions will apply for subsequent disposals by the transferee (proposed section 16OZZM).

Transfers to or between wholly owned companies will not be subject to tax, but subsequent disposals may be (proposed section 16OZZN).

Division 18 (proposed section 16OZZQ) will exempt principal residences from the tax. Dwelling is given a wide meaning and will include houses, units, flats, caravans, houseboats, up to 2 hectares of land which the person owns in fee simple or has a lease for not less than 99 years and flats and units which are held in fee simple or on a lease of not less than 99 years or, for flats and units owned by a company, if the person has a share which gives a right to exclusive occupancy.

Generally, only one residence will qualify for this concession though where the taxpayer is charging residences, both residences may be taken as the principal residence for a short period.

Except where the principal residence was used to produce income, capital gains or losses will not be taxable or deductible (proposed sub-section 16OZZQ(12)). Where the residence was used to produce income the amount of capital gain or loss will be determined by the Commissioner having regard to the actual gain or loss and the period it was used to produce income (proposed sub-section 16OZZQ(21)). Where the residence was acquired as a beneficiary, tax will not be payable on disposal by the beneficiary (and losses not deductible) where the taxpayer has used the premises as their principal residence and, if acquired by the deceased after 19 September 1985, was the deceased's principal residence.

Where the residence was not always the taxpayer's principal residence, tax will be payable on any capital gains in accordance with the formula contained in proposed sub-sections 16OZZQ(16) to (20). The formula is based on the amount of gain or loss, the number of days not used as the principal residence and the period owned.

Division 19 (proposed section 16OZZR) will deal with the exemption of goodwill in the sale of a business. Where the taxpayer disposes of a business for less than $1 million (or where there are associated businesses, the package is sold for less than $1 million) and the taxpayer
created the goodwill in the business, the capital gain will
be reduced by one fifth. The exemption will also apply
where the goodwill was created by a deceased, related to a
business commenced on or after 20 September 1985 and passed
to the taxpayer as legal representative or beneficiary.

Proposed section 160ZZU will require people who own
assets after 19 September 1985 to keep records, including
records of the date of acquisition, the date of disposal,
the cost base and the consideration received. A $2000 fine
will be the penalty for a breach of this provision.

For further information, if required, contact the
Economics and Commerce Group.