Special Topic

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Main residence exemption

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Preface

This paper will use a number of case studies to illustrate the practical application of the various aspects of the main residence exemption (MRE) rules in Subdiv 118-B of the *ITAA 1997*. A background section detailing the legislative rules follows the case studies.

Learning objectives

By the end of this session, participants will be able to:

- list the types of accommodation which constitute a 'dwelling'
- explain how to work out the exempt gain where the dwelling is only partially eligible for the MRE
- explain how the exemption is reduced where the dwelling is used for income producing purposes
- outline the choices available under the MRE to a taxpayer who owns multiple dwellings
- explain the implications of foreign residency on the calculation of the MRE.

Currency

This paper is current as at 10 November 2022 and takes into account all relevant developments known to the author at that date.

Acronyms and abbreviations

ABS	Australian Bureau of Statistics
ACT	Australian Capital Territory
ATO	Australian Taxation Office
CGT	Capital gains tax
Commissioner	Commissioner of Taxation
Div	Division
DTA	Double tax agreement
GIC	General interest charge
MRE	Main residence exemption
MYEFO	Mid-Year Economic and Fiscal Outcome
NSW	New South Wales
Para.	Paragraph
RPTR	Real property transfers report
s.	Section or subsection
Subdiv	Subdivision
TAP	Taxable Australian property
TARP	Taxable Australian real property

Technical materials

1. Commonwealth Acts of Parliament and Regulations — the following abbreviations are used throughout this paper:

Income Tax Assessment Act 1936	*ITAA 1936*
Income Tax Assessment Act 1997	*ITAA 1997*
Income Tax (Transitional Provisions) Act 1997	*IT(TP)A 1997*
Tax Administration Act 1953	*TAA*
Family Law Act 1975	*FLA*

2. ATO Taxation Rulings and Determinations

- TD 51W — Capital Gains: What factors are taken into account in determining whether or not a dwelling is a taxpayer's sole or principal residence?
- TD 58W — Income tax: capital gains: is a principal residence exemption available where a dwelling is owned by a family company or family trust?
- TD 92/147 — Income tax: capital gains: how soon after the construction of a dwelling is finished must the dwelling become the main residence of a taxpayer to satisfy the conditions in s. 118-150(3)(a) of the *ITAA 1997*?
- TD 92/158 — Income tax: capital gains: can the following comprise a 'dwelling' and therefore be eligible for exemption as a main residence:

  (i) a structure built underground?

  (ii) a yacht?

  (iii) a tent?
- TD 92/135 — Income tax: capital gains: is the main residence exemption relevant when the proceeds of sale of a dwelling are treated as income under ordinary concepts?
- TR 93/30 — Income tax: deductions for home office expenses
- TR 94/29 — Income tax: capital gains tax consequences of a contract for the sale of land falling through
- TD 95/7 — Income tax: capital gains: does s. 855-45(3) of the *ITAA 1997* prevent a taxpayer from making a choice that s. 118-145 of that Act apply to an overseas dwelling that the taxpayer owned before becoming a resident of Australia?
- TD 97/3 — Income tax: capital gains: if a parcel of land acquired after 19 September 1985 is subdivided into lots ('blocks'), do Parts 3-1 and 3-3 of the *ITAA 1997* treat a disposal of a block of the subdivided land as the disposal of part of an asset (the original land parcel) or the disposal of an asset in its own right (the subdivided block)?
- TD 1999/66 — Income tax: capital gains: what factors should be taken into account in determining the 'amount that is reasonable' in applying s. 118-190(2) of the *ITAA 1997*?
- TD 1999/67 — Income tax: capital gains: if your land (including land on which your dwelling is situated) exceeds 2 hectares, can you select which 2 hectares the main residence exemption in Subdiv 118-B applies to and, if so, how do you calculate any capital gain or capital loss you make on the remainder of your land?

- TD 1999/68 — Income tax: capital gains: is 'adjacent' land in terms of s. 118-120 of the *ITAA 1997* limited to land contiguous to a dwelling?
- TD 1999/69 — Income tax: capital gains: can the term 'dwelling' as defined in s. 118-115 of the *ITAA 1997* include more than one unit of accommodation?
- TD 1999/71 — Income tax: capital gains: does s. 118-190 of the *ITAA 1997* reduce your main residence exemption if part of your dwelling is used by someone else for an income producing purpose?
- TD 2000/14 — Income tax: capital gains: if:
    - you acquire land and a dwelling (dwelling A) on or after 20 September 1985 which you use as your main residence and do not use for income producing purposes; and
    - you subdivide the land into 2 blocks and build another dwelling (dwelling B) on the subdivided vacant land and this dwelling becomes your main residence; and
    - you choose to apply s. 118-150 of the *ITAA 1997* (about building, repairing or renovating a dwelling) for dwelling B; and
    - you sell dwellings A and B;

  are you entitled to the full main residence exemption in Subdiv 118-B for both dwellings?
- TD 2000/15 — Income tax and capital gains tax: what is meant by the phrase 'to the extent that' in s. 118-120(1) of the *ITAA 1997* where it refers to 'land that is adjacent to a dwelling ... to the extent that you used the land primarily for private or domestic purposes in association with the dwelling as if it were a dwelling'?
- PS LA 2005/2 — Penalty for failure to keep or retain records
- TR 2006/14 — Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests
- PCG 2019/5 — Capital gains tax and deceased estates — the Commissioner's discretion to extend the 2-year period to dispose of dwellings acquired from a deceased estate

2. Various ATO Interpretative Decisions — references are included throughout the paper

3. Case law — references are included throughout the paper

4. ATO fact sheets — references are included throughout the paper

All legislative references are to the *ITAA 1997* unless otherwise specified.

Key ideas

Key ideas in this paper

- The main residence exemption (MRE) provides a CGT exemption for a capital gain made by a homeowner upon the disposal of their dwelling.
- The MRE is the tax concession utilised to the highest estimated value of all concessions, according to annual Federal Budget data. An individual taxpayer selling their house may see tax savings of tens or even hundreds of thousands of dollars in this era of record and rapid price growth, especially if they have owned their property for a very long time.
- The legislative rules are contained in Subdiv 118-B of the *ITAA 1997*.
- In applying the MRE, the taxpayer may start with the 'basic case' under which the taxpayer may disregard a capital gain made on the sale of their private home.
- However there are limits to the exemption such that tax is payable to the extent that the taxpayer did not live in the property or used it for non-private purposes.
- The provisions also offer concessional treatment such as:
  - in specific circumstances — allowing a taxpayer to choose which of multiple properties to treat as their main residence that would give the most advantageous outcome
  - recognising that in real life it may not be practical to move into a first home or subsequent home immediately upon settlement, and allowing the exemption to be extended to cover these periods
  - a relaxing of the rules in cases such as inheritance, compulsory acquisition and destruction of the dwelling.
- The specific rules in the MRE legislation need to be individually considered and understood to ensure that the taxpayer avails themselves of the best concession to which they are entitled.
  - As a starting point — it may be simple to decide that the house is a 'dwelling', but to what extent is the land (and associated structures) also eligible for the MRE? And what about a home that is not a traditional house/townhouse/unit/apartment?
  - The execution of the sale contract and the settlement of the sale are usually weeks or months apart. How does this discrepancy impact the capital gain and exemption calculations?
  - The core 'absence rule' is well known amongst the tax community, but when and how does it interact with other rules in situations such as renting the property, inheritance or building a new home?
  - 'Working from home' has been part of many Australians' lives especially in the past few years — this will sometimes but not always reduce the MRE available.
  - What happens to a taxpayer's application of the MRE if they cease or commence Australian tax residency?
- Record-keeping may not be a concern where a full MRE is available, but where there is a tax liability, while the standard two or four year amendment period applies, in practice this could necessitate records dating back to acquisition (including back to 20 September 1985).

Introduction

Housing data snapshot

For most Australians, their residence will be their most expensive purchase in their lifetime, and taking out a home loan amongst the biggest financial decisions they will make. Australian Bureau of Statistics (ABS) Census data[1] reveals that (of 9.8 million households) on Census night in **2021**:

- 31 per cent of households (2.9 million) owned their home outright
- 35 per cent of households (3.3 million) owned their home with a mortgage
- there were 10,852,208 private dwellings
  - separate houses — 70 per cent; townhouses — 13 per cent; apartments — 16 per cent.

The 2021 statistics generally indicate that the rate of home ownership was lower for almost each successive birth cohort (with a few exceptions), with younger individuals having much lower ownership rates than older birth cohorts.[2]

Slightly older ABS data shows that, in **2019–20**[3]:

- **owner occupied dwellings:**
  - comprised 40 per cent of household assets — the largest class of household asset
  - average value $502,500 per household[4]
  - average mortgage $114,700
- **other property:**
  - 23 per cent of households owned other residential and non-residential property, e.g. for rent and holiday homes
  - comprised 15 per cent of household assets
  - average value of $191,000 per household
  - average mortgage $68,100.

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1 ABS, *Housing: Census, 2021*, released 28 June 2022.

2 See AIHW, *Home ownership and housing tenure*, 2 August 2022, Fig. 2.

3 ABS, *Household Income and Wealth, Australia, 2019–20*.

4 To put the significance of the 'main residence' to a family's financial profile in context, the proportion and dollar value attributable to owner occupied dwellings were more than double the next largest household asset class for 2019–20 — superannuation, at 18 per cent of total household assets with an average $229,900 per household.

The ABS data incorporates information from all households including those which purchased property many years ago. As housing prices have risen, Australians are borrowing more. In the latest ABS Lending Indicators data[5], before this year's downturn in house prices and the successive interest rate rises, average loan values hit recent highs in January 2022 of $617,608 nationwide, $803,235 in NSW and $651,364 in Victoria.[6]

For context, ABS data on the mean dwelling prices show the following[7]:

Capital city	December quarter 2021	December quarter 2020	December quarter 2019
NSW	1,207.2	939.7	899.3
Victoria	956.1	785	747.5
Queensland	749.1	556.5	520.3
South Australia	614.3	495	462.6
Western Australia	614.3	538.4	507.5
Tasmania	649.2	475.6	434.5
Northern Territory	489	429.4	435.9
ACT	979.6	757	693.5
Australia	920.1	728.5	691
Total value $b (Aus)	9,901.6	7,724.4	7,212.6
Mean price $'000 (Aus)	920.1	728.5	691.0
Number of residential dwellings '000 (Aus)	10,761.9	10,602.7	10,437.9

A 2019 CoreLogic report revealed that median **house** values in Australia had increased by 412 per cent or **$459,900** over the 25 years from 1993 to 2018 (from $111,524 in 1993). Over the same period, **unit** values increased by 316 per cent or **$392,000** (from $123,840 in 1993).[8] So someone who purchased an 'average' family home in their 20s or 30s who is now looking at selling and downsizing may end up with a capital gain of several hundred thousand dollars.

5 ABS, *Lending Indicators, September 2022.*

6 The average owner occupied loan in September 2022 was $588,441 nationwide, $743,869 in NSW and $599,598 in Victoria.

7 ABS, *House Price Indexes: Eight Capital Cities* for each of the December quarter 2021, December quarter 2020 and December quarter 2019, catalogue no. 6416.0. This ABS series ceased with the December quarter 2021 issue.

8 Aussie, *25 years of housing trends*, 1 February 2019, at: www.aussie.com.au/plan-compare/property-reports/25-years-of-housing-trends-property-market-report.html

Whether the homeowner is an older individual who purchased and paid off their home decades ago and is now interested in realising their house's value in the best possible way to provide for their retirement, or a new entrant into the housing market facing current day house prices who currently needs an average of 14 years to save a 20 per cent deposit[9], or a family changing residences and wishing to keep their existing dwelling for rental income and capital growth — the potential for a tax liability on capital growth realised upon the disposal of the property may play a significant role in deciding the level of financial investment or borrowing the homeowner is willing to undertake, or the timing of a sale.

So homeowners and their tax advisers need to understand the main residence exemption (MRE) rules contained in Subdiv 118-B of the *ITAA 1997*.[10] At the core of the provisions, the 'basic case' allows a taxpayer to sell their home and retain any capital gain tax-free to the extent that they lived in the dwelling as their main residence. No doubt many vendors in the record-breaking 2021 year of property sales availed themselves of the MRE to some extent.

Note

Each year's *Mid-Year Economic and Fiscal Outcome* (MYEFO) contains a listing of the Federal Government's estimated 'tax benchmark variations' which broadly reflect the extent to which a variation is utilised.[11] Consistent with previous years, the MYEFO 2021–22 indicates that the estimated MRE variations carry the highest estimated values out of all of the listed tax concessions and exemptions[12]:

Concession	Estimate $m			
	2021–22	2022–23	2023–24	2024–25
MRE — discount component	25,500	26,500	29,000	28,500
MRE	21,500	22,000	24,000	23,500

9 AFR, Bleby, M., *Housing unaffordability hits grim new peak*, 18 September 2022.

10 The MRE provisions were originally in the *ITAA 1936* and were largely rewritten into the *ITAA 1997* from 1998–99. The *Tax Law Improvement Act (No. 1) 1998*, which received Royal Assent on 22 June 1998 as Act no. 46 in 1998. Amongst other changes, Subdiv 118-B adopted the term 'main residence' which replaced the term 'sole or principal residence' used in the *ITAA 1936*. The rewrite also extended the application of the MRE in various respects.

11 These estimates do not indicate the revenue gain or loss if they were to be abolished by a change of policy, as there may be significant changes in taxpayer behaviour if the variation was removed.

12 MYEFO 2021–22, Table D.1, p. 324.

The MRE rules and this paper

Subdivision 118-B also sets out specific rules which extend the exemption to periods which would not otherwise be eligible under the basic case, including allowing a taxpayer to choose to continue to treat a former dwelling as their main residence in certain circumstances.

However there are also various limitations imposed on the application of the exemption. Primarily, the exemption is reduced to the extent that the owner was absent from the property or was using it for income-producing purposes. The most recently introduced limitation was the legislative amendment passed in December 2019 which retrospectively banned many foreign residents from accessing the MRE to any extent from 9 May 2017 — even if they had previously lived in the Australian dwelling for many years, other than in restricted circumstances requiring compassionate treatment.[13] This significant reform to the MRE was part of a package of reforms announced in the 2017–18 Federal Budget to reduce pressure on housing affordability.

A subsequent initiative to improve housing stock and affordability at the vendor side of the transaction[14] is the downsizer contribution, under which — from 1 July 2018 — homeowners of eligible age[15] may contribute up to $300,000 from the proceeds of sale of their home into superannuation ($600,000 for a couple). While this is not part of the MRE, the extent to which the capital gain on the sale will be tax-free due to the application of the full or partial MRE — and therefore the net proceeds available — must be considered in conjunction with the downsizer rules. For some Australians, the $600,000 contribution limit for a couple who jointly own their home may be all or most of the gross proceeds from sale. As at around May 2021, around 22,000 individuals had already made downsizer contributions before the eligibility was expanded.[16]

The first part of the main body of this paper sets out five case studies which illustrate the practical application of many aspects of the MRE provisions — in particular, eligibility, comprehensive calculations, interaction of multiple rules, extensions and limitations, and making a choice about which dwelling to choose to treat as main residence. The case studies are followed by a background section which details the rules and concepts in Subdiv 118-B for participants who want further explanation.

Regardless of income tax concessions, perhaps providing an entirely tax-free sale, selling a home does come with sometimes extensive costs. These may be directly related to the sale, such as repairs and renovations, and agency commissions, fees for staging, conveyancing and mortgage discharge. The homeowner will also need somewhere else to live which will often take up some or all of the after-tax and after-expenses net proceeds, and the significant impost of state transfer duties[17] and costs of financing a new home must also be considered. These are not generally discussed in this paper but practically they will need to be taken into consideration in deciding whether or when to sell a dwelling and in working out net proceeds and cash flow.

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[13] Schedule 1 to the *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Act 2019* which received Royal Assent on 12 December 2019 as Act no. 129 of 2019.

[14] Various state and federal initiatives have been introduced to assist first homebuyers from the purchase side, including first homebuyer grants and transfer duty concessions, a superannuation saving scheme for deposits, deposit assistance schemes, and homebuyer-government shared equity schemes. This paper focuses on the vendor of a home sale transaction and therefore only the downsizer contribution is discussed.

[15] From 1 July 2022 the eligible age is 60 years old or older. Prior to 1 July 2022 it was 65 years old or older. Proposed legislation to further reduce the eligible age to 55 years old is currently before Parliament.

[16] Federal Budget 2021–22 fact sheet ‘Guaranteeing the Essential Services’, p. 31.

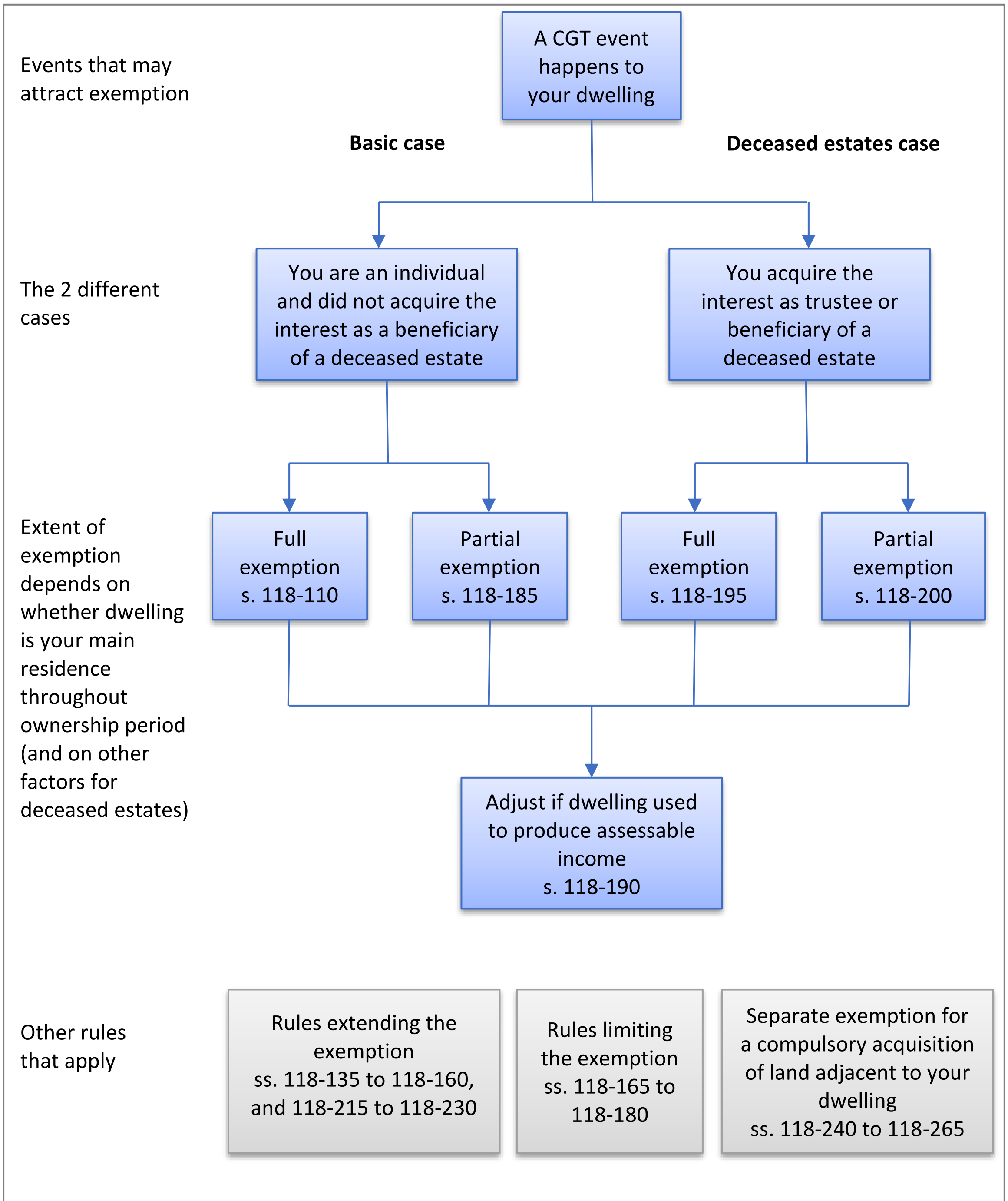
[17] In the most recent development in this area, the *Property Tax (First Home Buyer Choice) Act 2022* (NSW) allows eligible first home buyers the choice to make an annual property tax payment ($400 plus 0.3 per cent of the land value) instead of an upfront payment of duties, for properties with a purchase price of up to $1.5 million. Eligible buyers can effectively access the new NSW scheme from 12 November 2022, although cannot opt in directly until 15 January 2023.

In this paper:

- a reference to a taxpayer’s dwelling also includes a reference to a taxpayer’s ownership interest (which may be a partial interest) in the dwelling unless otherwise stated
- a reference to a capital gain subject to the MRE also includes a reference to a capital loss unless otherwise stated
- it is assumed that the taxpayer is an Australian resident at the time of the disposal or other CGT event, and was an Australian resident throughout their ownership period, unless otherwise stated.

The following diagram sets out a roadmap of the Subdiv 118-B rules. In the background section (at **page 50**) there is a tabular guide with page references to the variations, extensions and limitations to the basic case.

A summary of Subdiv 118-B



Note: The exemption may not be available to a foreign resident

Source: s. 118-105

Case study 1

Using dwelling for income-producing purposes and changing main residence

Issues considered in this case study
▪ Partial MRE calculations — absence from dwelling.
▪ Partial MRE calculations — use of dwelling for income-producing purposes.
▪ Application of the absence rule.
▪ Choosing which dwelling to treat as main residence.
▪ Spouses nominating different main residences.
▪ Building a new dwelling.
▪ Application of the changing main residences rule.
▪ Granny flat arrangements — implications for sale of dwelling.

The facts

Kevin settled on the purchase of a unit on 12 April 2005 for $200,000.

In 2023 he marries Theresa. Kevin and Theresa jointly purchase a larger family home (house 1) for $1,200,000 and settle on the purchase on 12 April 2023. Kevin then rents out the unit. The market value of the unit on 12 April 2023 is $350,000.

In 2031 Kevin and Theresa want to move into another area for the education of their three children, but in order to afford the house they want they need to sell their current home, house 1, and Kevin decides to also sell his unit. House 1 is not used for income-producing purposes at any time.

For simplicity of calculation and comparison, assume that the settlement of the disposals of both the house and the unit occur on 11 April 2032.

Kevin asks his tax agent to work out whether he should treat his unit or house 1 as his main residence for the relevant overlapping period — 12 April 2023 to 11 April 2032.

Note

For illustrative and training purposes, throughout all case studies whole years have been used and leap years have been ignored. In practice, the specific number of days must be calculated.

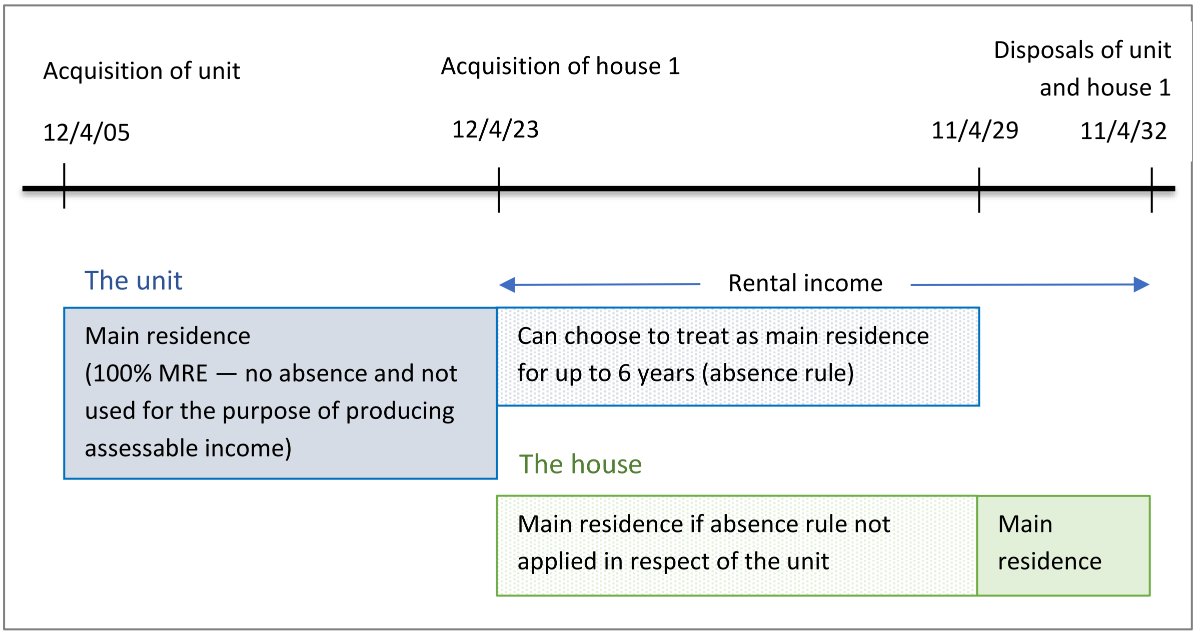
Case study 1 focuses only on the CGT and MRE implications for Kevin. The consequences for Theresa are ignored unless stated otherwise.

Below are the key dates. Also refer to the timeline in each variation of the case study for key dates relating to each variation.

Key date	Event
12 April 2005	Kevin acquires unit for $200,000
12 April 2023	Kevin and Theresa jointly acquire house 1 for $1,200,000
11 April 2032	Kevin disposes of the unit for $900,000 Kevin and Theresa dispose of house 1 for $1,700,000

Variation 1 — Absence from the dwelling

Working out the main residence periods



Capital gain on the sale of the unit

Working out the gross capital gain

Proceeds		$900,000
less: Cost base		
- first element (MV at 12 April 2023)	$350,000	
- second element	$20,000	
- third element	$60,000	
- fourth element	$0	
- fifth element	$0	
		$430,000
Capital gain		$470,000

Capital gain with MRE

Spouses nominating same dwelling or different dwellings as main residence — s. 118-170
The application of the MRE is impacted by whether Kevin and Theresa: ▪ choose one dwelling as the main residence of both of them for a particular period, or ▪ nominate different dwellings as their respective main residences for the period. The relevant period for the purposes of this discussion is 12 April 2023 to 11 April 2029.[18] **1. Both choose the unit** If Kevin and Theresa both choose the unit as their main residence (by operation of the absence rule) for that period: ▪ Kevin can claim full MRE in relation to the unit, but not in relation to his share of the house ▪ Theresa cannot claim MRE in relation to the unit as she does not have an ownership interest in it, but also cannot claim MRE in relation to her share of the house.[19] **2. Both choose the house** If Kevin and Theresa both choose the house as their main residence, they can both claim full MRE in relation to their respective share of the house. Kevin cannot claim MRE in relation to the unit. **3. Nominating different dwellings** If Kevin nominates the unit as his main residence and Theresa nominates the house as her main residence: ▪ the unit is Kevin's main residence for only half of the period — because he owns more than half of the interests in it   ▪ the house cannot be treated as Kevin's main residence for the other half of the period[20] ▪ the house is Theresa's main residence for the entire period — because she does not own more than half of the interests in it. This case study will consider the consequences of 2. and 3.

[18] Under the absence rule, Kevin cannot treat the unit as his main residence after 11 April 2029.

[19] Theresa can choose the unit as her main residence even though she has no ownership interest — see the final example in the ATO fact sheet 'Living separately to your spouse or children' (QC 66032). Theresa has no ownership interest in the unit and therefore she will not make a capital gain on which to claim an exemption. However, in accordance with s. 118-170, she may choose to treat the unit as her main residence which then has an impact on whether Kevin can claim the MRE in relation to the unit for the whole or only half of the relevant period.

[20] See the final example in the ATO fact sheet 'Living separately to your spouse or children' (QC 66032).

Option 1: Absence rule applied to unit — spouses nominate different dwellings

Applying a partial exemption based on main residence days — s. 118-185 and spouses nominating different main residences — s. 118-170

See **pages 68** and **79**.

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

$$\$470{,}000 \times \frac{6\text{ yrs}}{9\text{ yrs}}$$

Non-main residence days = 12 April 2029[21] to 12 April 2032 plus 3 years of the absence period = 6 yrs

Days in ownership period = 12 April 2023[22] to 11 April 2032 = 9 yrs

Capital gain with partial MRE = $313,333

Option 2: Absence rule not applied to unit — spouses both choose the house

Capital gain = $470,000

Capital gain on the sale of house 1

Working out the gross capital gain

	Gross		Kevin's share	
Proceeds		$1,700,000		$850,000
less: Cost base				
- first element	$1,200,000		$600,000	
- second element	$40,000		$20,000	
- third element	$100,000		$50,000	
- fourth element	$0		$0	
- fifth element	$0		$0	
		$1,340,000		$670,000
Capital gain		$360,000		$180,000

[21] Absence rule applied from 12 April 2023 to 11 April 2029, but Kevin is entitled to the MRE for half of the period (three years) under the spouse nominating different main residences rule. This adds three years to the calculation.

[22] Section 118-192(2).

Capital gain with MRE

Option 1: Absence rule applied to the unit — spouses nominate different dwellings

Applying a partial exemption based on main residence days — s. 118-185

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

$$\$180{,}000 \times \frac{6\text{ yrs}}{9\text{ yrs}}$$

Non-main residence days = 12 April 2023 to 11 April 2029 = 6 yrs

Days in ownership period = 12 April 2023 to 11 April 2032 = 9 yrs

Capital gain with partial MRE = $120,000

Note

Theresa will be entitled to a full MRE in relation to her interest in the house as her interest in the house does not exceed 50 per cent, so she can treat the house as her main residence during her entire ownership period.

Option 2: Absence rule not applied to the unit — spouses both choose the house

The house is treated as Kevin's main residence for his entire ownership period.

Taxable capital gain = $0

Working out whether to apply the absence rule

Kevin should apply the absence rule to the unit for a lower capital gain[23]:

Absence rule — applied to unit	Capital gain — unit	Capital gain — house	Capital gain
Yes	$313,333 page 14	$120,000 page 15	$433,333
No	$470,000 page 14	$0 page 15	$470,000

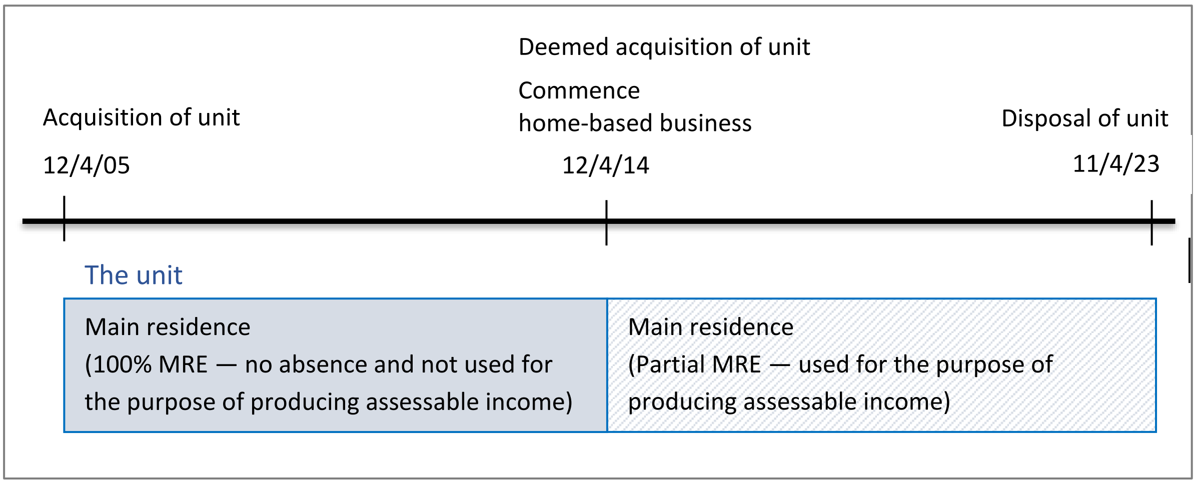
[23] In practice, Kevin would then apply any available capital losses and the general CGT discount.

Variation 2 — Dwelling used for income-producing purposes

In early 2014, while living in the unit, Kevin decides to quit his job and start a home-based business. He spent several months setting up his business, including furnishing and fitting out a part of his home to make it appropriate for his work. Kevin commenced his home-based business on 12 April 2014. For the purposes of this case study it is accepted that Kevin has a 'home office' for the purposes of calculating working from home expenses and that the appropriate deductibility percentage (based on floor area) is 10 per cent.

Kevin sells the unit for $900,000 with a settlement date of 11 April 2023. Kevin and Theresa do not purchase a house before this date. Kevin continues to live in the unit until settlement.

Working out the main residence periods



Capital gain on the sale of the unit

Working out the gross capital gain

Under s. 118-192, Kevin is taken to have acquired the unit when he first started using it for income-producing purposes on 12 April 2014 for market value at that time (see **page 75**). He did not obtain a market valuation at that time, so at the time of sale he obtains a historical valuation from an expert valuer. The valuation is $400,000.

Proceeds		$900,000
less: Cost base		
- first element (market value 12 April 2014)	$400,000	
- second element	$20,000	
- third element*	$60,000	
- fourth element	$0	
- fifth element	$0	
		$480,000
Capital gain		$420,000

* Incurred on or after 12 April 2014, and reduced by amounts which were deductible as home-based business expenses.

Capital gain with MRE

Increasing taxable gain for income-producing use — s. 118-190

See **page 72**.

Kevin's main resident days equals nine years, spanning from the deemed acquisition date of 12 April 2014 and ending 11 April 2023. The unit is Kevin's main residence for this entire period even though he used part of the dwelling for income-producing purposes.

However, Kevin is not entitled to a full MRE even though the unit is his main residence for the entire period. Section 118-190 applies to increase the taxable capital gain by an amount that is reasonable having regard to the extent to which Kevin would have been able to deduct interest incurred on money borrowed to acquire the unit.

In calculating the increase, Kevin can ignore any use of the unit for income-producing purposes during any period that he treats it as his main residence under the absence rule to any extent it was not used to produce income just before it last ceased to be his main residence.

The notional interest deductibility proportion is **10 per cent** (based on floor area).

The increase equals:

$$\$420{,}000 \times \frac{9 \text{ yrs*}}{9 \text{ yrs*}} \times 0.10 = \$42{,}000$$

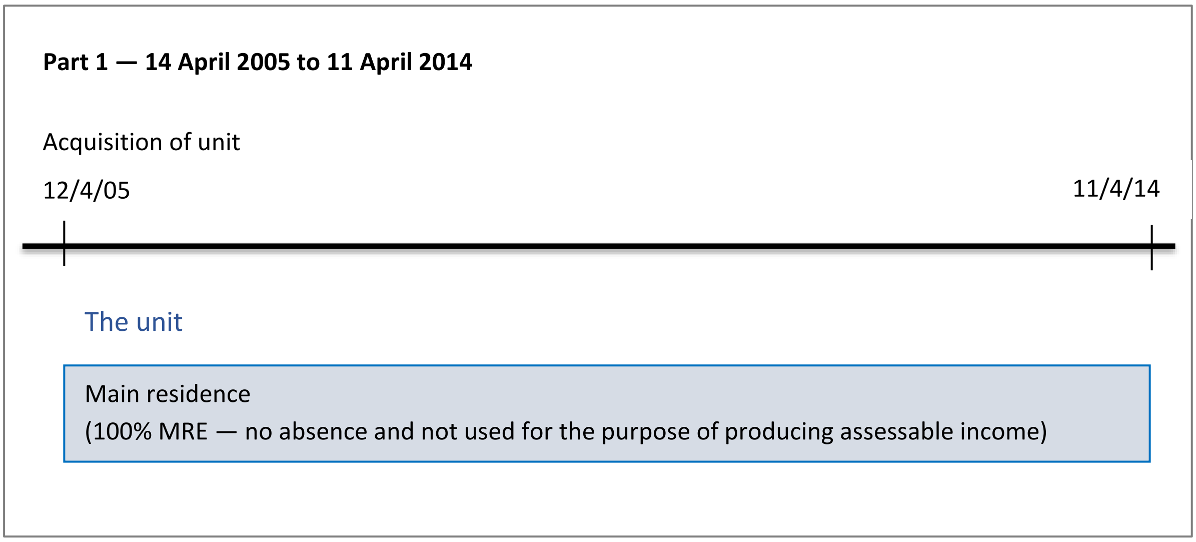
* 12 April 2014 to 11 April 2023 = 9 yrs

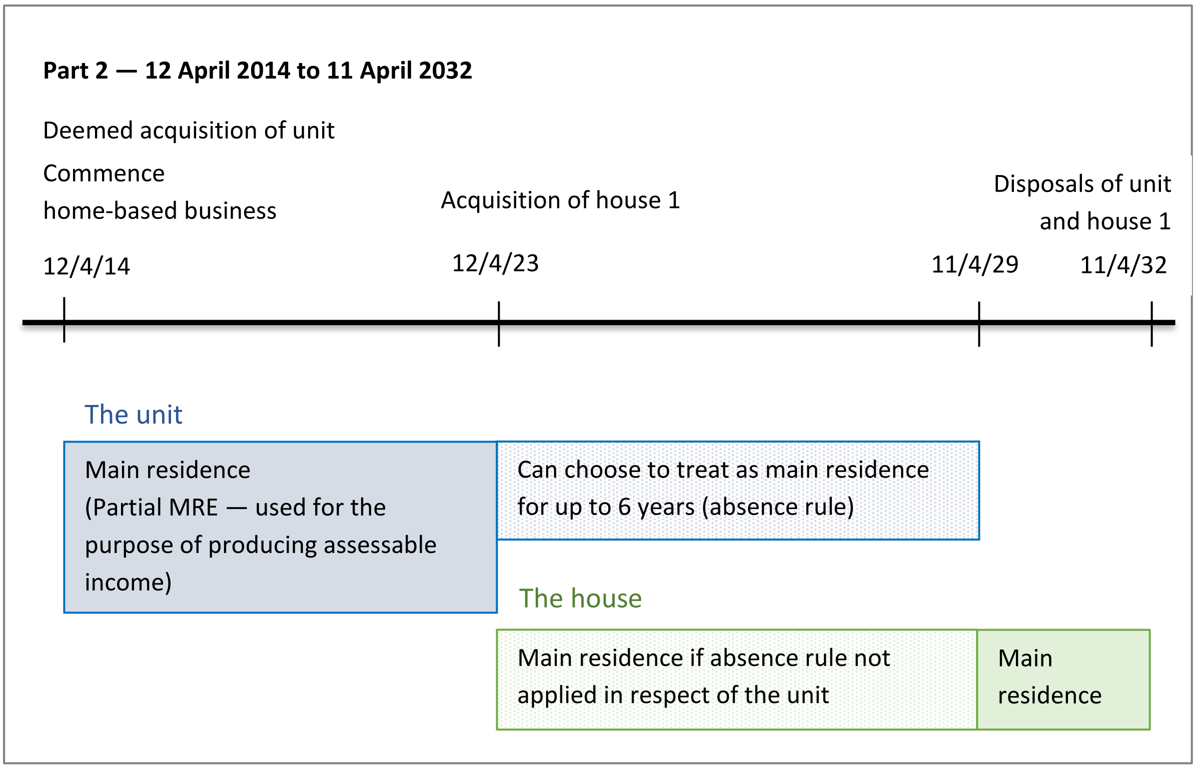
Total capital gain = $42,000

Variation 3 — Combining the absence and income-producing rules

Working out the main residence periods

Assume that Kevin commenced his home-based business in the unit on 12 April 2014 and continued to live in the unit until 12 April 2023 when he moves into the new house.





Capital gain on the sale of the unit

Working out the gross capital gain

Proceeds		$900,000
less: Cost base		
- first element (market value 12 April 2014)	$400,000	
- second element	$20,000	
- third element*	$60,000	
- fourth element	$0	
- fifth element	$0	
		$480,000
Capital gain		$420,000

* Incurred on or after 12 April 2014, and reduced by amounts which were deductible as home office expenses or rental expenses.

Capital gain with MRE

Option 1: Absence rule applied to unit — spouses nominate different dwellings

(i) Applying a partial exemption based on main residence days — s. 118-185

See **page 68**.

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

$$\$420{,}000 \times \frac{6 \text{ yrs}}{18 \text{ yrs}}$$

Non-main residence days = 12 April 2029 to 11 April 2032 plus 3 years of the absence period[24] = 6 yrs

Days in ownership period = 12 April 2014 (per s. 118-192) to 11 April 2032 = 18 yrs

Capital gain with partial MRE = $140,000

(ii) Increasing taxable gain for income-producing use — s. 118-190

See **page 72**.

Section 118-190 applies to increase the taxable capital gain by an amount that is reasonable having regard to the extent to which Kevin would have been able to deduct interest incurred on money borrowed to acquire the unit.

In calculating the increase, Kevin can ignore any use of the unit for income-producing purposes during any period that he treats it as his main residence under the absence rule to any extent it was not used to produce income just before it last ceased to be his main residence.

The notional interest deductibility proportion is **10 per cent** (based on floor area).

The increase equals:

$$\$420{,}000 \times \frac{12 \text{ yrs*}}{18 \text{ yrs}} \times 0.10 = \$28{,}000$$

* 18 yrs – 6 yrs[25]

Total capital gain = $140,000 + $28,000 = $168,000

[24] Absence rule applied from 12 April 2023 to 11 April 2029, but as Kevin is entitled to the MRE for half of the period (three years) under the spouse nominating different main residences rule, three years is added to the non-main residence days.

[25] The capital gain attributable to the six years from 12 April 2026 to 11 April 2032 — which are non-main resident days (i.e. 12 April 2029 to 11 April 2032, plus 50 per cent of the six-year period from 12 April 2023 to 11 April 2029 to which the absence rule is applied — refer to part (i)) which are treated as non-main residence days is already fully taxable. Therefore those six years are excluded from the calculation of the increase.

Option 2: Absence rule not applied to unit — spouses both choose the house

(i) Applying a partial exemption based on main residence days — s. 118-185

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

$$\$420{,}000 \times \frac{9 \text{ yrs}}{18 \text{ yrs}}$$

Non-main residence days = 12 April 2023 to 11 April 2032 = 9 yrs

Days in ownership period = 12 April 2014 to 11 April 2032 = 18 yrs

Capital gain with partial MRE = $210,000

(ii) Increasing taxable gain for income-producing use — s. 118-190

The increase equals:

$$\$420{,}000 \times \frac{9 \text{ yrs*}}{18 \text{ yrs}} \times 0.10 = \$21{,}000$$

* 18 yrs – 9 yrs[26]

Total capital gain = $210,000 + $21,000 = $231,000

[26] The capital gain attributable to the nine years from 12 April 2023 to 11 April 2032 — which are non-main resident days — is already fully taxable as no MRE is available.

Capital gain on the sale of house 1

Working out the gross capital gain

	Gross		Kevin's share	
Proceeds		$1,700,000		$850,000
less: Cost base				
- first element	$1,200,000		$600,000	
- second element	$40,000		$20,000	
- third element	$100,000		$50,000	
- fourth element	$0		$0	
- fifth element	$0		$0	
		$1,340,000		$670,000
Capital gain		$360,000		$180,000

Capital gain with MRE

Option 1: Absence rule applied to the unit — spouses nominate different dwellings

Applying a partial exemption based on main residence days — s. 118-185

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

$$\$180{,}000 \times \frac{6 \text{ yrs}}{9 \text{ yrs}}$$

Non-main residence days = 12 April 2023 to 11 April 2029 = 6 yrs

Days in ownership period = 12 April 2023 to 11 April 2032 = 9 yrs

Capital gain with partial MRE = $120,000

Option 2: Absence rule not applied to the unit

The house is treated as Kevin's main residence for his entire ownership period of his 50 per cent share.

Taxable capital gain = $0

Working out whether to apply the absence rule

Kevin should not apply the absence rule to the unit for a lower net capital gain:

Absence rule — applied to unit	Capital gain — unit	Capital gain — house	Gross capital gain
Yes	$168,000 page 19	$120,000 page 21	$288,000
No	$231,000 page 20	$0 page 21	$231,000 ⇦

Variation 4 — Unit sold within 6 months after purchase of house

When Kevin and Theresa purchase their family home and settle on 12 April 2023, Kevin puts his unit up for sale after doing some renovations and repairs. Kevin does not use the unit for income-producing purposes after he moves out.

Settlement occurs on 11 October 2023. Kevin makes a capital gain of $200,000.

Kevin has an ownership interest in both dwellings concurrently for a period of no greater than six months. Therefore he can treat both dwellings as his main residence for the entire period — 12 April 2023 to 11 October 2023 — during which he owns both dwellings.[27] There is no need to consider the absence rule.

Working out the gross capital gain

Applying the MRE including the changing main residences rule

The unit is treated as Kevin's main residence for his entire ownership period. Therefore there is no taxable capital gain attributable to non-main residence days (ignoring income-producing use).

Increasing taxable gain for income-producing use — s. 118-190

The increase equals:

$$\$200{,}000 \times \frac{9.5 \text{ yrs*}}{9.5 \text{ yrs}} \times 0.10 = \$20{,}000$$

* 9.5 yrs – 0 days

Non-main residence days = 0 days

Days in ownership period = 12 April 2014 to 11 October 2023 = 9.5 yrs

Capital gain with partial MRE = $20,000

Total capital gain = $0 + $20,000 = $20,000

27 Section 118-140.

Variation 5 — Building a new house (house 2)

In May 2031 Kevin and Theresa settle on the purchase of land in their desired suburb. There is an old house on the land. They intend to knock down the old house and build a new house (house 2) to be their family home. The entire process takes 18 months to complete.

They continue living in house 1 during that time.

They move into the newly built house 2 in December 2032. Kevin and Theresa sell house 1 and settle on the sale in February 2033.

Assume that Kevin never owned the unit, and that house 1 was his first property.

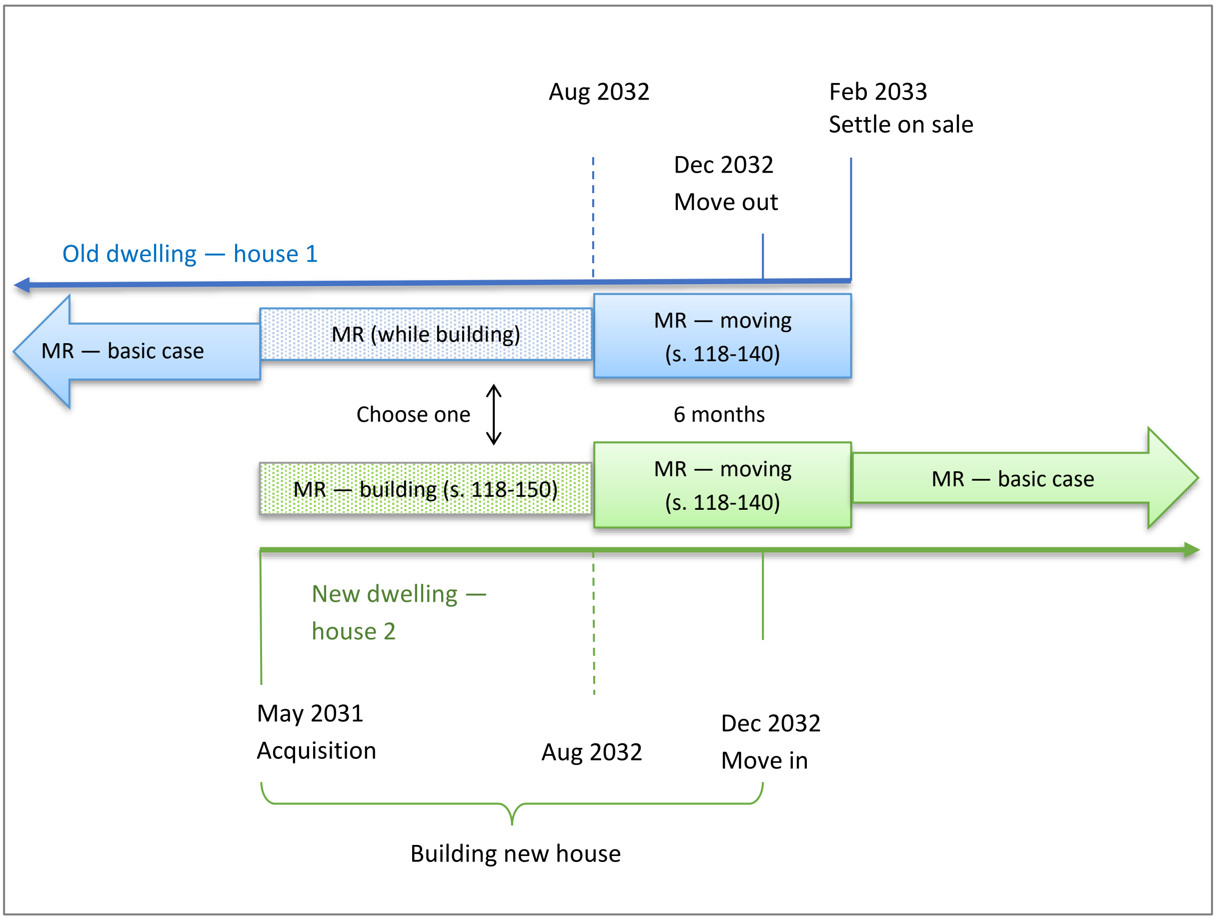
Application of the MRE

Under s. 118-150 (see **page 61**), Kevin may choose to treat house 2 as his main residence from the time of its acquisition in May 2031 so long as it continues to be his main residence for at least three months, i.e. until March 2033. This is because:

- the dwelling becomes his main residence as soon as practicable after the construction is finished
- the amount of time is less than the maximum time limit of four years.

If Kevin makes this choice, no other dwelling can be treated as his main residence for the same period of time — but note s. 118-140.

Under s. 118-140, both dwellings are treated as Kevin's main residence for the period of six months ending when his ownership interest in house 1 ceases (see **page 70**).



Variation 6 — Granny flat in the backyard

Kevin and Theresa struggle to find a suitable new home in their desired area in 2031. It so happens that Theresa's elderly widowed mother, Julia, still lives in the area in Theresa's childhood family home. Julia wants to help them, and feels that the house is too big for her to continue to live in alone. Julia transfers the ownership of the house to Kevin and Theresa for $800,000, which is less than its market value of $900,000, but she makes a capital gain of $600,000 on the post-CGT property.

As part of the arrangement, Kevin and Theresa enter into a binding, written, non-commercial agreement with Julia under which Julia retains a right to accommodation for life or for as long as they own the house.

After taking ownership of the property in April 2032, Kevin and Theresa construct a self-contained granny flat in the backyard for $160,000. Julia lives in a spare bedroom in the main house while the granny flat is being constructed and moves into the granny flat once it is ready. Under the agreement, she does not pay rent or any other fees, but she contributes to utilities bills to reflect her usage.

For the purposes of this case study assume that the arrangement qualifies for the CGT exemption provisions in Div 137 (see **page 82**). Under Div 137, CGT does not apply when the 'granny flat arrangement' is created[28], varied[29] or terminated.

If Kevin and Theresa sell the property in the future, including the granny flat in the backyard, Div 137 has no relevance and the disposal will be subject to the usual CGT and MRE rules.

The granny flat is not used for the purposes of producing assessable income and therefore the partial MRE rules in s. 118-190 will have no application in relation to the granny flat arrangement.

However if Julia moves into an aged care facility and Kevin and Theresa rent out the granny flat at arm's length, then the MRE adjustments for income-producing use will apply.

Other implications

- The capital proceeds market value substitution rule applies such that Julia is taken to have received an amount equal to the market value of the dwelling upon disposal, i.e. $900,000.[30]
- The cost base market value substitution rule applies such that the first element of the cost base in Kevin and Theresa's hands is equal to the market value of the dwelling upon acquisition, i.e. $900,000.[31]
- Julia is entitled to a full MRE in relation to the capital gain and she is also entitled to make a superannuation contribution of up to $300,000 from the proceeds of the sale under the downsizer contribution rules.

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28 CGT event D1.

29 For example, if Kevin and Theresa move house again, they may vary the granny flat arrangement so that it covers Julia living in the new home. Or the arrangement may be varied to include new terms and conditions.

30 Section 116-30.

31 Section 112-20.

Case study 2

An inherited dwelling

Issues considered in this case study
■ Disposal of inherited dwelling within two years of inheritance.
■ Disposal of inherited dwelling later than two years after inheritance.
■ Foreign resident beneficiary.
■ Partial MRE calculations.
■ Income-producing use immediately before death.
■ Individual has a right to occupy the inherited dwelling.

The facts

Megan's grandfather Phillip purchased a house in Brisbane and took possession on 6 September 1986. He moved into it as soon as was practicable. It was his main residence before he moved to Cairns in early September 1995. By that time Phillip owned the house outright and there was no debt. He started renting out the property on 6 September 1995.

Phillip moved back to Brisbane and resumed living in the house on 6 September 2017.

Phillip passed away on **5 September 2022**. Phillip's Will stipulated that legal ownership of the property was to pass to Megan immediately.

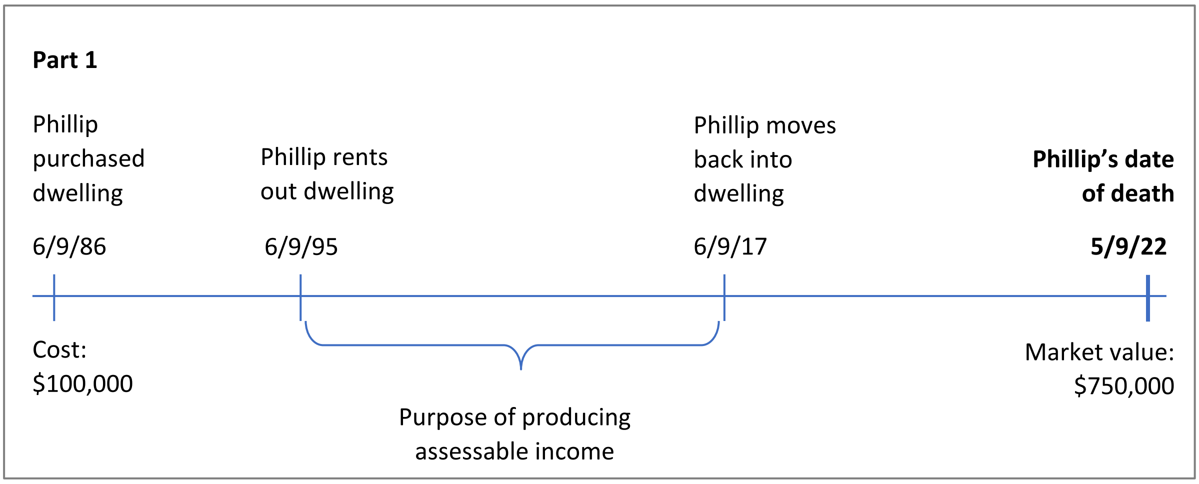
Megan lives in Sydney with her family in a property that she owns and has no intention of moving to Brisbane to live in the house. In the weeks after Phillip's death, she asked her tax agent to explain the potential CGT/MRE implications to her of the following options:

1. Selling the property as soon as practicable.
2. Renting the property out for a long-term lease on an arm's length basis and selling it at a later point in time.
3. Retaining the property as a holiday home for her family's use when they visit Brisbane several times a year to visit relatives, and selling it at a later point in time. She may also list it on AirBnB or another similar platform at peak holiday times for short-term rental if no family members are using it.

Phillip purchased the property for $100,000. On 5 September 2022, the market value was $750,000. Assume that any CGT event considered in this case study will give rise to a capital gain and not a capital loss.

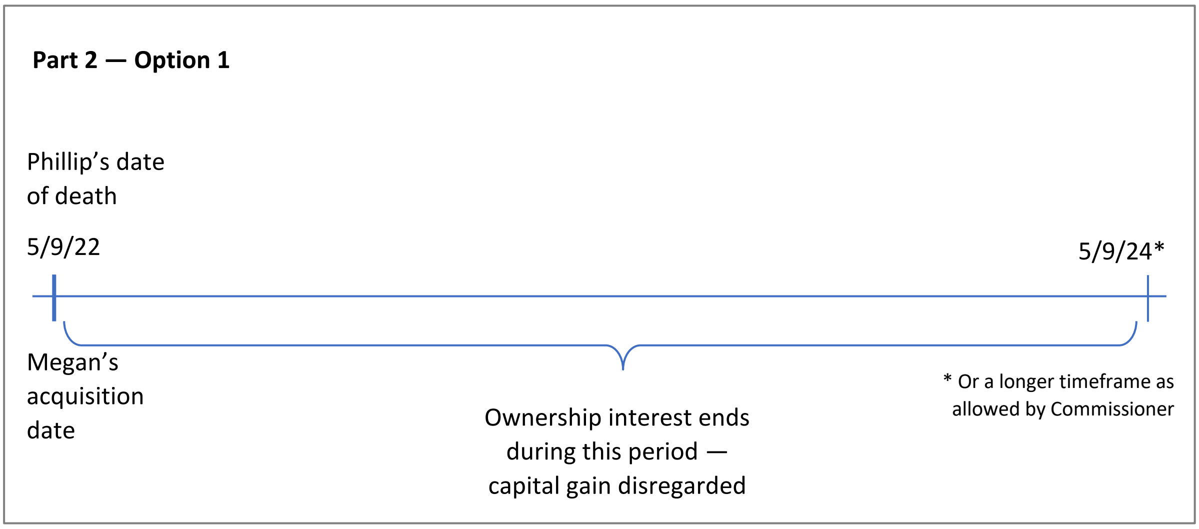
CGT implications for Phillip and executor

Any capital gain that may arise in relation to the dwelling to Phillip upon his death and to the executor of his estate upon the transfer of the property to Megan is disregarded — see **page 90**.



Variation 1 — CGT implications of the three options

Option 1 — Sell as soon as practicable



The capital gain that arises to Megan from CGT event A1 happening in relation to the disposal of the dwelling will be disregarded so long as her ownership interest ends within two years of Phillip's death, i.e. by **5 September 2024**, or within a longer timeframe as allowed by the Commissioner (see **page 84**).

The exemption under s. 118-195 is a full exemption, i.e. the capital gain will be entirely tax-free, so long as the dwelling was Phillip's main residence just before his death — any previous use of it will not be taken into account.

Critical Point

Megan's ownership interest will end when her legal ownership of the dwelling ends. In most cases this will be a date subsequent to the date of CGT event A1 (which happens on contract date). Megan needs to ensure that the **settlement** and transfer of ownership — and not just the execution of the contract — happens within the two-year timeframe.

If Megan is a foreign resident

If Megan is a foreign resident, the answer remains the same, i.e. she will receive a full CGT exemption so long as her ownership interest in the property ends by 5 September 2024 or within a longer time as allowed by the Commissioner. This exemption is not impacted by the beneficiary's residency status.

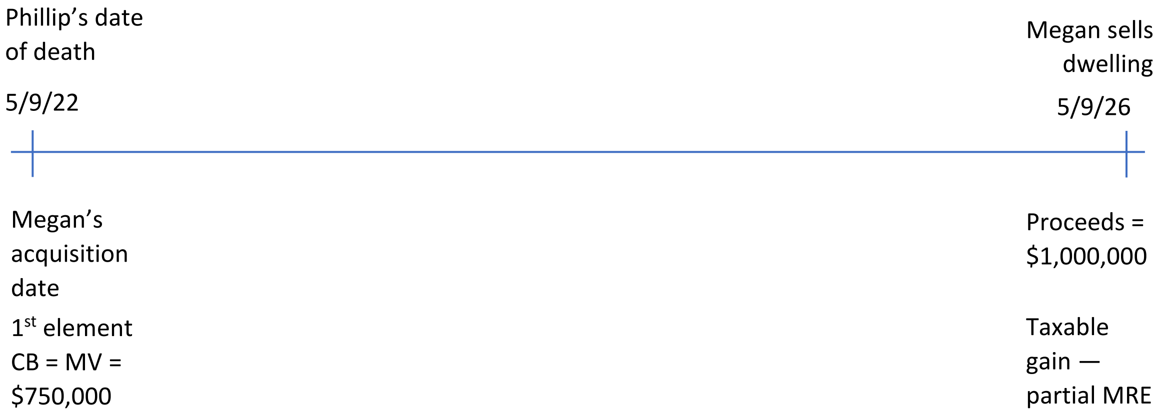
Option 2 — Renting out the property

Note

If Megan transfers ownership of the property within two years, i.e. by 5 September 2024, s. 118-195 will apply. She will be entitled to a full exemption from CGT. Her use of the property to derive rental income is not relevant as her ownership period ends within two years of Phillip's death. Any income-producing use during Phillip's ownership period will also be ignored.

If she does not transfer ownership within two years and the Commissioner does not grant a longer period, a partial exemption will apply (see **page 87**) — see the below calculations.

Part 2 — Options 2 & 3



Working out the capital gain

Megan enters into a contract of sale on 5 September 2026 for a sale price of $1,000,000.

Under s. 128-15, Megan is taken to acquire the property on the date of death, i.e. 5 September 2022. This is despite the fact that it may in practice take some time for the legal paperwork and administrative matters for the ownership transfer to be finalised.

Note

For the purposes of working out whether Megan is eligible for the CGT discount, she is taken to have acquired the property when Phillip acquired it, i.e. 6 September 1986.[32]

The first element of the property's cost base is taken to be equal to its market value on 5 September 2022 (see **page 84**), i.e. $750,000.

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32 Section 115-30 item 4.

Assuming that the property is rented out or available for rent for the entire period of Megan's ownership of it, repairs and maintenance expenditures that are deductible against rental income cannot be included in cost base. However any expenditures on initial repairs to get the house ready for rent are not deductible and can form part of cost base.

Various other costs incurred by Megan personally, such as professional fees incurred in obtaining title to the property and in its disposal, costs of advertising and other sales-related costs, agent commissions etc., total $50,000. Therefore the total cost base at the time of the CGT event A1 on 5 September 2026 is $800,000.

Capital proceeds		$1,000,000
less: Cost base		
- MV at 5 September 2022	$750,000	
- Other cost base elements	$50,000	
		$800,000
Capital gain		$200,000

Taxable capital gain with a partial MRE

Section 118-195 does not apply[33] and therefore the partial MRE rules in s. 118-200 apply (see **page 87**).

Section 118-190(4) states that Megan is to ignore the use of the dwelling to produce assessable income before death if it was Phillip's main residence just before death and was not being used to produce assessable income just before death (unless the absence rule applies).

The interaction of s. 118-190(4) and s. 118-200(4) means that any non-main residence days of Phillip and any period that he used the dwelling to produce assessable income are ignored. Only the non-main residence days and income-producing days after death are included in the partial MRE calculation under s. 118-200.

The capital gain is calculated under s. 118-200 as follows:

$$\text{Capital gain amount} \times \frac{\text{Non-main residence days}}{\text{Total days}}$$

Non-main residence days

The non-main residence days in this case is the sum of:

1. The number of days in Phillip's ownership period when the dwelling was not his main residence = **0 yrs** (s. 118-190(4) — Phillip's previous income-producing use of the dwelling is ignored because it was his main residence just before death and was not used for income-producing purposes).

[33] Megan's ownership interest does not end within two years of Phillip's death, and the dwelling was not the main residence of a specified individual until her ownership interest ends.

2. The number of days from the date of death until Megan's ownership interest ends when the dwelling was not the main residence of: the deceased's spouse, an individual who had a right to occupy the dwelling under the will, or the beneficiary to whom the dwelling passed = 6 September 2022 to 5 September 2026 = **4 yrs**.

Non-main residence days = 0 yrs + 4 yrs = **4 yrs**.

Total days

Total days = number of days from acquisition by Phillip until Megan's ownership interest ends = 6 September 1986 to 5 September 2026 = **40 yrs**

$$\$200{,}000 \times \frac{4 \text{ yrs}}{40 \text{ yrs}} = \$20{,}000$$

If Megan is a foreign resident

If Megan is a foreign resident, she will have no entitlement to the MRE (see **page 51**).

Further, her CGT discount percentage will be nil (see **page 97**).

Megan's taxable capital gain in 2026–27 will be $200,000.

Option 3 — Using the property as a holiday home

If Megan retains the property as a holiday home, perhaps deriving some short-term rental income, the total cost base may be higher than per option 2 because a greater proportion of costs that she incurs will be non-deductible and instead added into the relevant elements of cost base.

Apart from the higher cost base, the calculation of Megan's net capital gain for 2026–27 is the same as for option 2.

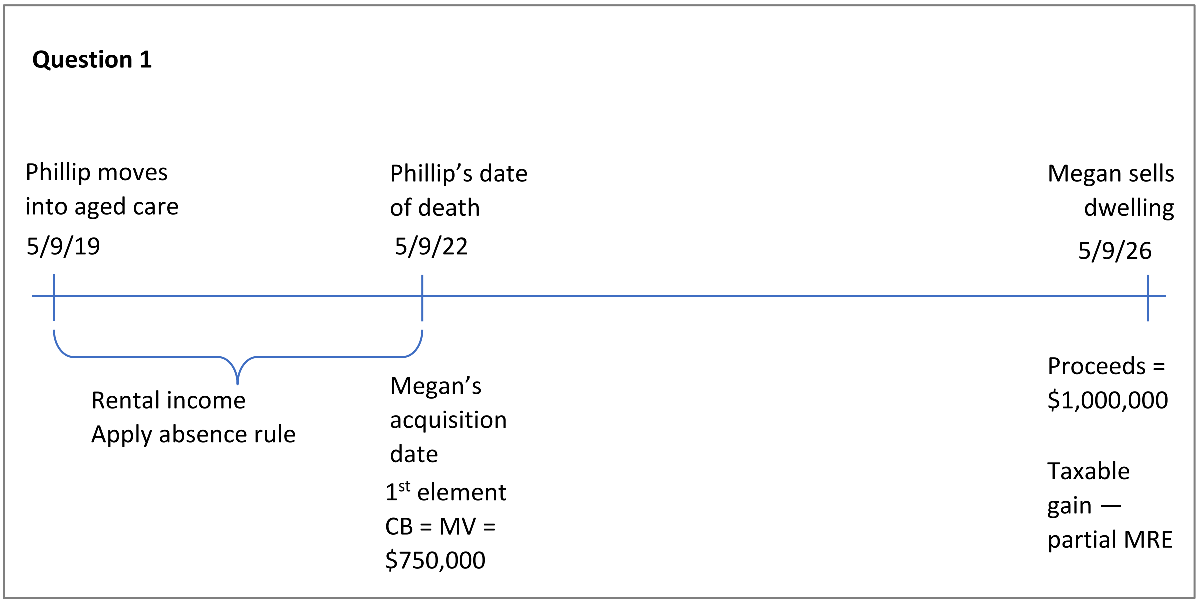
The only exception to this is if Megan decides to live in the property for more than a short holiday, such that it takes on the characteristics of a main residence, and also chooses to treat the Brisbane dwelling as her main residence for that period of time rather than her Sydney residence. If this was to occur then the non-main residence days will be reduced by the number of days that the dwelling is treated as Megan's main residence.

Variation 2 — Phillip moves into aged care

Phillip moved out of the house and into an aged care facility, and the house became available for rent on 6 September 2019. It was genuinely available for rent or rented out until Phillip's death on 5 September 2022.

Megan enters into a contract of sale on 5 September 2026 for a sale price of $1,000,000. All other facts (cost base, etc.) are as per variation 1, option 2 above (see **page 27**).

Question 1



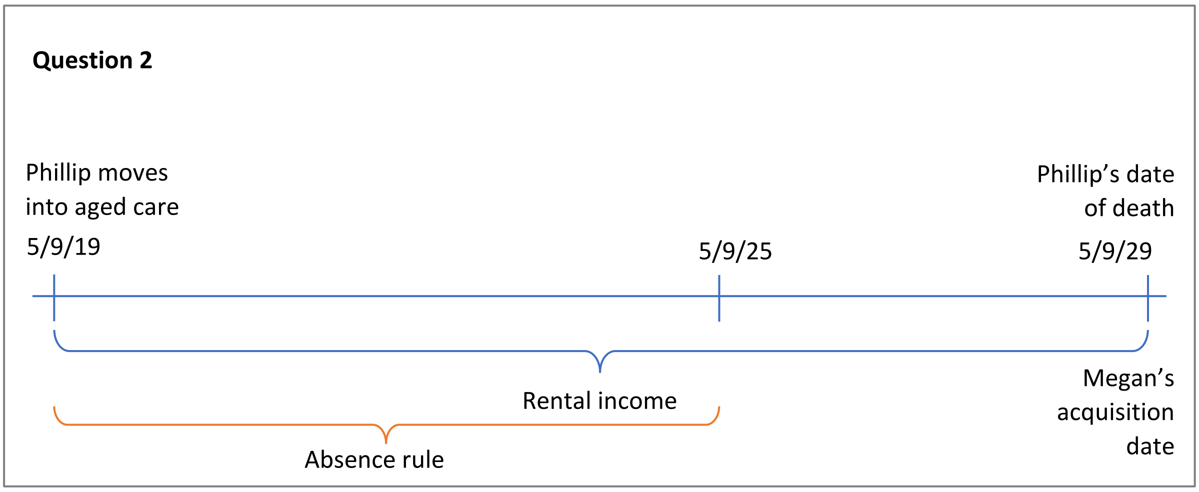
How does the use of the property to produce assessable income just before Phillip's death affect the taxable capital gain calculation, compared to the option 2 outcome?

There is no impact on the option 2 outcome — i.e. the use of the dwelling to produce assessable rental income for the three years before death is ignored — if the absence rule is applied such that the house continues to be Phillip's main residence after he moves out until his death.

Under s. 118-190(4), Megan is entitled to ignore any use of the dwelling for the purpose of producing assessable income before Phillip's death because:

- the dwelling was Phillip's main residence just before his death (in this case, by way of applying the absence rule for the period 6 September 2019 to 5 September 2022)
- the entirety of the use of the dwelling for the purpose of producing assessable income just before the death is ignored because of the application of the absence rule.

Question 2



Is there a different outcome if Phillip passed away on 6 September 2029 — i.e. the house is rented out for 10 years before it passes to Megan upon his death?

Assume that Phillip used part of his home as a place of business since the late 1980s until he moved out in September 1995. Because the first use of the dwelling for the purpose of producing assessable income occurred prior to 7.30 pm, by legal time in the ACT, on 20 August 1996, the special deemed acquisition and cost base rule in s. 118-192 does not apply.

The absence rule can be applied for the six years from 6 September 2019 to 5 September 2025. Megan would not be entitled to ignore the use of the dwelling to produce assessable income for the final four years, from 6 September 2025 to 5 September 2029. Megan would be taken to acquire it on 6 September 2029. As the dwelling is being used for the purpose of producing assessable income just before death, the first element of the cost base in her hands would be equal to the total cost base of the property in Phillip's hands on the date of death.[34]

Substantiation of cost base

When Megan eventually sells the property and works out the capital gain including a partial MRE, she will need to be able to substantiate her calculations of her taxable gain — including the cost base.

Megan can locate the documents which show that the purchase price in 1986 was $100,000, and some conveyancing fees and state duties. However she cannot find evidence of the interest that Phillip paid on the mortgage and other expenditures that would be included in elements of cost base (see **page 64**), such as repairs and maintenance.

Megan requested help from the executor of Phillip's estate. The executor was able to retrieve:

- Copies of Phillip's tax returns from his tax agent and the ATO, which show the expenditures claimed against rental income. These deductible amounts cannot be included in cost base but they reveal various improvements made to the property. From this information Megan is able to extract some undeducted amounts to include in the cost base.
- Mortgage information from the bank, including interest payments and establishment and discharge fees.

Megan and the executor can also locate recent invoices in the house from Phillip's regular plumber, handyman and other tradespeople. From these invoices Megan can select amounts which can be included in cost base elements.

Megan find invoices for recently installed split systems and solar panels — but these depreciating assets are not treated as being part of the dwelling, so she does not take those into account in calculating the cost base.

From all the disparate pieces of information, Megan deduces that apart from the original acquisition cost of $100,000, other expenditures which can be included in elements of cost base total another $200,000. Therefore she is able to reconstruct a substantiated total cost base to Phillip of $300,000. She knows that there are gaps, but the tax agent has made clear to Megan her legal record-keeping and substantiation responsibilities. Accordingly, Megan accepts that the cost base in Phillip's hands when he died was $300,000, and therefore the first element of the cost base in her hands is also $300,000.

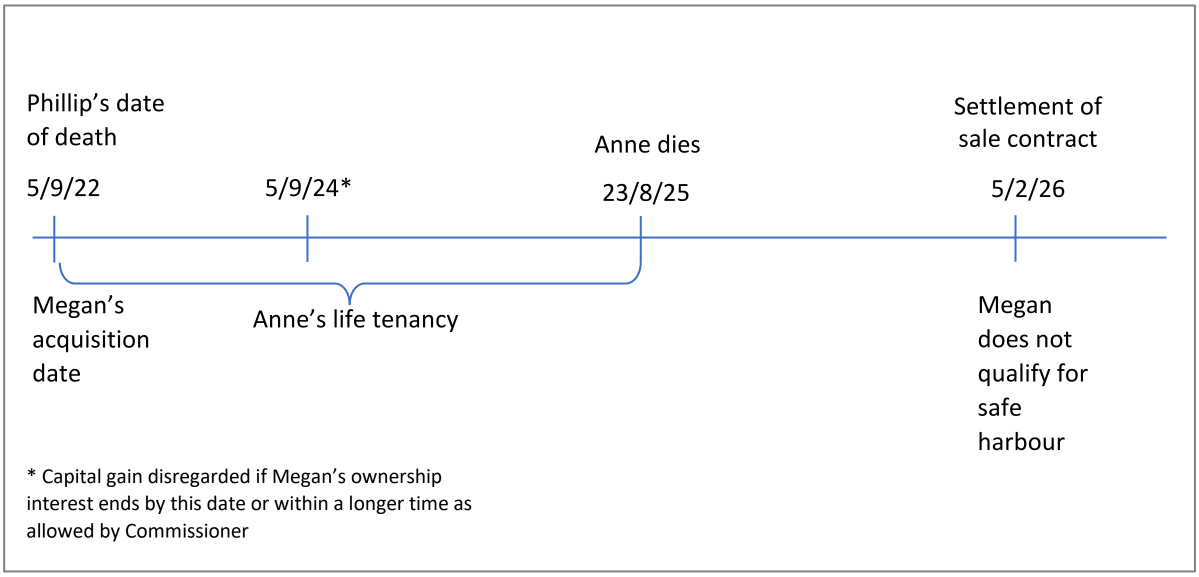
[34] Section 128-15(4) table item 1.

Variation 3 — Aunt has a right to occupy

Phillip's sister and Megan's aunt, Anne, was widowed in early 2021. She sold her home after her husband's death and moved in with Phillip.

Phillip's will provides that the legal ownership of the property is to immediately transfer to Megan. It also confers a right onto Anne to live in the dwelling rent-free until one of several specified events occur, including upon her death.

Anne passes away on 23 August 2025.



Megan intends to sell the property, but she decides to wait until January 2026 to list the property for sale due to several reasons:

- the market in the area has temporarily dipped following some recent winter weather events which caused extensive damage in neighbouring areas
- she wants to undertake some renovations and landscaping to improve the sale price, estimated to be completed in November 2025
- she is concerned about a further lack of interest from buyers in the lead-up to the holiday season after the renovations are completed.

In mid-December 2025 she receives a suitable off-market offer via the real estate agent with whom she was arranging for the property to be listed. The sale settles on 5 February 2026.

Megan is not eligible for the safe harbour in PCG 2019/5. Even though the property settled within 18 months of two years after Phillip's death, she is disqualified from the safe harbour because the following circumstances have been material to the delay in disposing of the property:

- waiting for the property market to pick up
- waiting for refurbishment of the dwelling to improve the sale price.

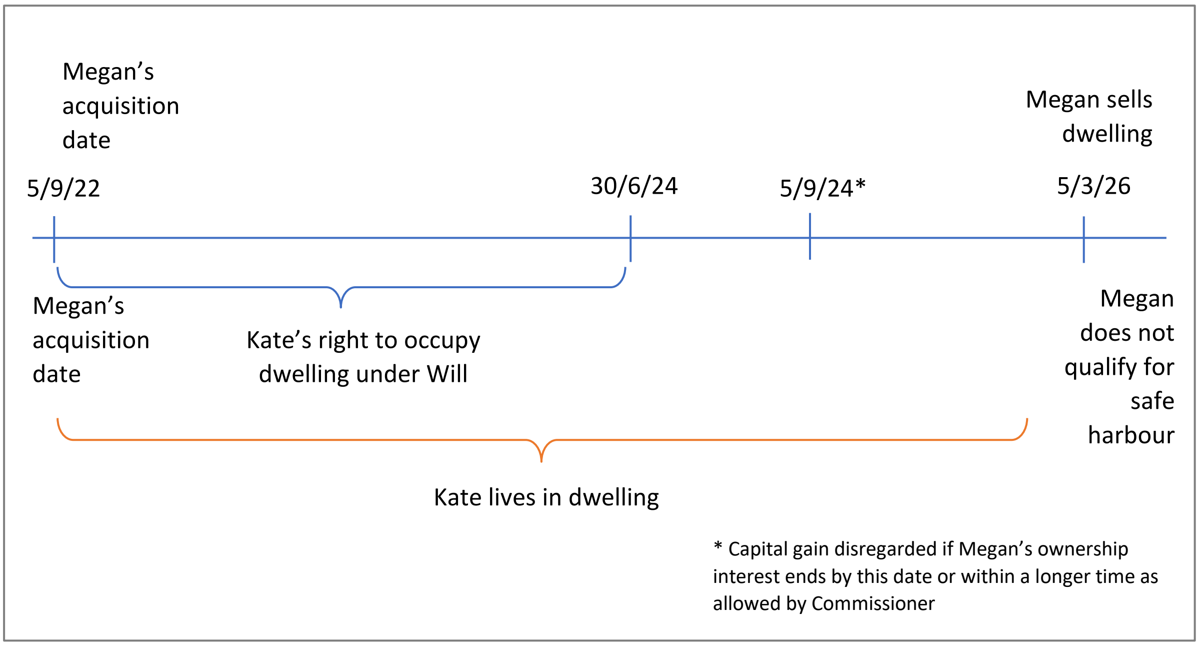
Megan will calculate her taxable gain, with a partial MRE, in accordance with Variation 1, Option 2 above.

If Megan has other extenuating circumstances, she can apply to the Commissioner to exercise his discretion to allow a period longer than two years.

Note

If the house is Anne's main residence until Megan's ownership interest ends, Megan would be able to access the full MRE without needing to rely on satisfying the safe harbour conditions.

Variation 4 — Cousin has a right to occupy



Megan's young cousin Kate moved in with Phillip in early 2020 to attend a university in Brisbane that is a short drive from Phillip's house. Phillip updates his will to give his granddaughter Kate the right to occupy the dwelling rent-free until 30 June 2024.

Kate continues living at the property after Phillip's death. She finishes her undergraduate degree at the end of 2023. She is granted a full scholarship for a full-time two-year postgraduate program at the same university commencing in February 2024 and she works part-time as a university tutor to fund her living costs. Kate comes to an arrangement with Megan to continue living at the house for the duration of her postgraduate degree. She will pay a below-market amount of rent commencing February 2024.

Kate moves out in early 2026 upon completion of her postgraduate program. Megan had listed the house for sale in late 2025 and settlement takes place on 5 March 2026.

Megan is not entitled to a full exemption under s. 118-195. This is because under the will Kate only had a right to occupy the dwelling for a limited period, until 30 June 2024. An exemption is not available for any part of Megan's ownership period that Kate continues to occupy the dwelling in another capacity, i.e. as a tenant.[35]

Megan is also not entitled to apply the safe harbour in PCG 2019/5 as none of the qualifying conditions apply.

A partial exemption is available under s. 118-200. The non-main residence days used in the formula will be the number of days in the period commencing when Kate's right to occupy expired and ending when Megan ceases to own the dwelling — i.e. 582 days (1 July 2024 to 2 February 2026).

35 See ATO ID 2004/882.

Case study 3

The implications of changing residency

Issues considered in this case study
■ Eligibility if taxpayer has a period of foreign residency.
■ Timing of CGT event vs timing when period of ownership ends for MRE purposes.
■ Applicable CGT discount percentage for foreign residents.
■ Record-keeping and other administrative matters.
■ Applying the absence rule multiple times.
■ A life event occurring to a foreign resident.

Facts

Monica owns, and lives in, an apartment in Sydney. She bought it for $400,000 and settled on the purchase on 15 March 2011. She moved into it in April 2011, after some work including new kitchen cabinets, carpeting, painting and installing split systems.

In July 2022 her employer offers her a significant promotion which would require her to move to Singapore to work at the corporate group's regional head office, commencing mid-October 2022. At the time of making these arrangements, the relocation is designed to be permanent and her role in the Singapore office is a permanent ongoing role.

Monica departs Australia on 3 October 2022. For the purposes of this case study assume that Monica is a foreign resident from 3 October 2022.[36]

Below are the key dates. Also refer to the timeline in each variation of the case study for key dates relating to each variation.

Variation 1 — Monica sells the apartment as a resident

Key date	Event
15 March 2011	Monica acquires apartment for $400,000
13 August 2022	Contract for sale of apartment for $800,000 — CGT event A1
21 September 2022	Monica moves out of the apartment
24 September 2022	Monica's ownership interest in apartment ends
3 October 2022	Monica departs Australia and becomes a foreign resident

[36] In practice the residency question may not be clear cut, especially in circumstances where an overseas work placement is intended to be of a limited term, e.g. two years. However it is outside the scope of this paper to fully explore residency issues, so simplistic assumptions will be made for the purposes of focusing the case study solely on the application of the MRE.

Monica seeks advice from her tax agent after signing her new employment contract and is made aware that she will not be able to access any MRE if she was to sell the apartment after she becomes a foreign resident.

Monica decides to sell the apartment while she is still a resident, and use the proceeds (less the remaining mortgage balance and any associated selling costs and CGT) to invest in more liquid investments to give her options for her future life overseas, including taking an extended break from work to travel, or to purchase other property.

The apartment is auctioned on 13 August 2022 and sells under contract for $800,000. Settlement happens on 24 September 2022. Monica moves out of the property on 21 September 2022 and moves in with her parents until she leaves Australia.

Monica's tax agent calculates the capital gain to be $300,000, after taking into account all the necessary expenditures incurred upon the purchase and the sale of the apartment to be included in the elements of cost base.

The tax agent determines that Monica is entitled to a full MRE in respect of the capital gain, on the basis that:

- she was a resident for the entirety of her ownership period (i.e. from when she acquired title in March 2011 to the settlement of the sale on 24 September 2022) — see **page 96**.
- she had moved into the apartment as soon as practicable in 2011
- the property has never been used for the purposes of producing assessable income throughout Monica's ownership period
- Monica has not owned any other dwelling or lived anywhere else during her ownership period
- Monica can choose to apply the absence rule so that the dwelling continues to be treated as her main residence between moving out on 21 September and settlement on 24 September 2022.

Therefore Monica retains the entire capital gain of $300,000 tax-free.

Variation 2 — Settlement happens after Monica becomes a foreign resident

Key date	Event
15 March 2011	Monica acquires apartment for $400,000
13 August 2022	Contract for sale of apartment for $800,000 — CGT event A1
21 September 2022	Monica moves out of the apartment
3 October 2022	Monica departs Australia and becomes a foreign resident
11 November 2022	Monica's ownership interest in apartment ends

CGT event A1 happens at the contract date of 13 August 2022. However for the purposes of applying the MRE rules, Monica's 'ownership period' does not end until the settlement of the sale contract.

In Variation 1, her ownership period ends on 24 September 2022 when settlement occurs. She is eligible to treat the property as her main residence up until that date and she can apply a full exemption to the capital gain.

If the settlement period was a longer period — e.g. 60 or 90 days — and all other facts remain the same, then Monica would be a foreign resident on settlement day.

Settlement period of 90 days

With a settlement period of 90 days, the settlement date is 11 November 2022. Monica is a foreign resident on this date.

Does this pose a problem for accessing the MRE?

No. Monica can still access the full MRE despite being a foreign resident at settlement.

Individuals are not eligible for any MRE if they are an 'excluded foreign resident' or a foreign resident who does not satisfy the 'life events test' **at the time of the CGT event** — see **page 96**. CGT event A1 happened on 13 August 2022 upon the signing of the sale contract. At that time Monica was a resident. Therefore it is not necessary to consider whether Monica would fall within either of the ineligible foreign resident categories.

A taxpayer's residency status is not relevant for determining whether a dwelling is their main residence during a particular period of time. Therefore Monica can still choose to apply the absence rule to treat the apartment as her main residence until the settlement day.

Variation 3 — Sale contract entered into after Monica becomes a foreign resident

Key date	Event
15 March 2011	Monica acquires apartment for $400,000
21 September 2022	Monica moves out of the apartment
3 October 2022	Monica departs Australia and becomes a foreign resident
29 June 2025	Contract for sale of apartment for $800,000 — CGT event A1

Monica is unable to find a buyer for her apartment prior to leaving Australia. Her mortgage has been fully paid off by then, and she allows her younger sister to live in it rent-free while she studies a post-graduate degree at a nearby university. Monica enters into a contract to sell the apartment on 29 June 2025. CGT event A1 happens on that date. Monica is a foreign resident at that time.

Monica must consider the Australian CGT rules because the apartment is taxable Australian property (see **page 96**).

Whether Monica is ineligible for the MRE

Monica now needs to consider whether she is eligible for the MRE under the either limb of the foreign resident ineligibility rules — see **page 96**.

Is Monica an excluded foreign resident?

At 29 June 2025, Monica is not an excluded foreign resident as she has not been a foreign resident for a continuous period of more than six years. Therefore she is not ineligible for the MRE under this category of ineligible foreign residents.

Is Monica a foreign resident who does not satisfy the life events test?

At 29 June 2025, Monica has been a foreign resident for a continuous period of six years or less, but none of the specified 'life events' have happened during her period of foreign residency.

Monica is ineligible for the MRE in respect of the $300,000 capital gain.

Matters to consider

The CGT discount

Monica may be eligible for a partial CGT discount because:

- she acquired the property on or before 8 May 2012
- she was a resident on 8 May 2012
- at the time of the CGT event she has owned the property for at least 12 months.

Monica uses the ATO's *CGT discount worksheet* to calculate the discount percentage to which she is entitled and her taxable capital gain (see **page 97**).

Capital gain	$300,000
Discount percentage	40.0%
Taxable capital gain	$180,000

Excerpts from the ATO's CGT discount worksheet (case study variation 3)

Working out your discount testing period

The discount testing period is the period over which the capital gain is accrued. For example, if you owned the asset, the discount testing period starts on the day you acquired the asset and ends on the day of the CGT event. This may be the date you disposed of the asset.

1 Discount testing period start date

Day / Month / Year: 15 / 03 / 2011

If you have a discount capital gain as a beneficiary of a trust:
- for a fixed trust, use the date you became a beneficiary of the trust
- for a trust that is not fixed:
  - if the gain was received because a CGT event occurred to an asset acquired by the trustee of the trust, use the date the CGT asset was acquired. This includes gains you have received directly or indirectly through any interposed trusts that are not fixed.
  - if the gain was received directly or indirectly through one or more interposed trusts and is linked to a capital gain made by a fixed trust, use the most recent date the trust, directly linked to the trust that made the capital gain, became the beneficiary of that trust.

2 Discount testing period end date

Day / Month / Year: 29 / 06 / 2025

If you have a discount capital gain as a beneficiary of a trust, the end date will be the date you received the gain.

3 Calculate the number of days in your discount testing period (include the start and end date) 5000

4 Was the CGT asset acquired *on or before* 8 May 2012?

No [ ] Go to section A.

Yes [X] Go to section B.

Section B: **CGT assets acquired *on or before* 8 May 2012**

18 What was your residency status on 8 May 2012?

Foreign or temporary [ ] Go to step 33.

Australian [X] Read on.

19 Did you have a period of foreign or temporary residency after 8 May 2012?

No [ ] Multiply your discount capital gain by 50%. This is your capital gain amount. You have now finished this worksheet.

Yes [X] Read on.

Australian resident calculation

20 Foreign or temporary residency start date

Day / Month / Year: 03 / 10 / 2022

This date must fall:
- within your discount testing period, and
- after 8 May 2012.

21 Foreign or temporary residency end date

Day / Month / Year: 29 / 06 / 2025

If this date falls after the end date of your discount testing period, use the date you wrote at step 2.

22 Calculate the number of days of foreign or temporary residency 1000

(include the start and end date)

If you had more than one period of foreign or temporary residency during the discount testing period, repeat steps 20 to 22 for each period and then add together the total number of days.

Excerpts from the ATO's CGT discount worksheet (case study variation 3)

CALCULATE YOUR CGT DISCOUNT PERCENTAGE		
23	Transfer the number of days you wrote at step 3.	5000
24	Transfer the number of days you wrote at step 22.	– 1000
25	Take away the number at step 24 from the number at step 23 and write the total.	= 4000
26	Transfer the number of days you wrote at step 3, multiply by 2 and write the total.	5000 × 2 = 10000
27	Divide the number at step 25 by the number at step 26 and write the total.	0.400
28	Multiply the amount at step 27 by 100 and write the total. **This is your CGT discount percentage.**	40.00% Cannot be greater than 50%
APPLY YOUR CGT DISCOUNT PERCENTAGE		
29	Write your discount capital gain.	$300,000
30	Multiply the amount at step 29 by your discount percentage and write the total. **This is the amount of your CGT discount.**	$120,000
31	Take away the amount at step 30 from the amount at step 29 and write the total. **This is your capital gain amount.**	$180,000
32	You have now finished this worksheet.	

Tax liability

Assuming that Monica does not derive any other income in 2024–25 that is assessable in Australia for a non-resident, her tax liability will be $54,000. This is based on a flat rate of 30 per cent for the first $200,000 of taxable income.[37] Foreign residents do not have a tax-free threshold and are not liable to pay Medicare levy.

In practice, Monica is likely to have assessable rental income. The net rental income and any other taxable income up to $20,000 (i.e. $200,000 less $180,000) will also be taxed at a flat rate of 30 per cent. Every $1 of taxable income exceeding $200,000 will be taxed at 45 per cent.

Singaporean tax issues

Monica should seek professional advice in relation to her tax residency status for Singaporean tax purposes, and, based on that status, any Singaporean tax implications that may arise in respect of the disposal of the Australian apartment and any potential application of the Australia-Singapore DTA.[38]

37 Based on the legislated tax cuts from 1 July 2024.

38 A technical consideration of these issues is outside the scope of this paper.

Record-keeping

Monica will need to retain, until at least the end of 2029–30, a lot of information including:

- the proceeds received for the disposal of the apartment
- the cost base of the apartment — see **page 64**
- dates of ceasing Australian residency[39]
- dates for which the apartment was rented or genuinely available for rent, to substantiate any application of the absence rule.

Monica has diligently kept records since she received the overseas job offer, but she has not meticulously kept records throughout the entire period of ownership because:

- she had not envisaged a situation where the apartment would not be her main residence before its disposal
- after the foreign resident MRE ineligibility rules were passed, she did not contemplate that she would become a foreign resident and did not thoroughly understand the rules.

She may have to reconstruct her cost base records to the best of her abilities by acquiring information from numerous sources including:

- real estate agent and conveyancer / solicitor
- bank and credit card records which may show relevant expenditures
- emails containing relevant invoices.

Note

Records are not legally required to be kept in Variations 1 and 2 because the capital gain is disregarded in those scenarios. However it would be prudent for Monica to keep records, in particular flight records to substantiate that she is still a resident at the time of the CGT event.

Foreign resident CGT withholding

The capital proceeds exceed $750,000, so the foreign resident CGT withholding will apply and the purchaser will be obliged to withhold, and remit, 12.5 per cent of the proceeds of sale (see **page 98**). Monica may apply to the Commissioner to vary the withholding rate prior to settlement if the tax liability will be less than the 12.5 per cent amount.

Monica can claim the withheld tax against her liability when she lodges her Australian tax return declaring the capital gain.

[39] Where a taxpayer subsequently recommences residency, they will also need to retain records substantiating the date of resuming residency.

Variations where the apartment is used for rental purposes

In Variation 3, the apartment is not being used for the purposes of producing rental income during Monica's two-year absence before its disposal.

The following variations assume that Monica rents out the apartment when she moves overseas.

Variation 4

If Monica rents out the apartment, s. 118-192 (see **page 75**) does not apply to treat its acquisition time as the time it was first used for income-producing purposes and to reset the cost base to its market value at that time. This is because s. 118-192 only applies if the taxpayer is eligible for a partial MRE. As Monica is a foreign resident when she sells the apartment (and CGT event A1 happens), she is not entitled to any MRE. Therefore the capital gain is calculated based on the increase in value over her entire ownership period and it is entirely assessable.

Monica will be entitled to a partial CGT discount of less than 50 per cent, proportional to her Australian residency during her ownership period and the portion of the ownership period prior to 9 May 2012 (see the calculation worksheet on **page 37**).

Variation 5

Monica resigns from her job and returns to Australia in March 2028. She resumes living in the apartment and becomes a resident again. In August 2035 she moves overseas again and becomes a foreign resident. She then moves back to Australia in February 2040, lives in the apartment and becomes a resident. The property was rented for the duration of each overseas assignment. She enters into a contract to sell the apartment in April 2043.

Monica is eligible for the MRE because she is a resident at the time of the CGT event. She can apply the absence rule for the entirety of both periods during which she rented out the apartment because they were each of a duration of six years or less. If she makes that choice in respect of both rental periods she will be eligible for a full MRE and her capital gain will be tax-free.

The foreign residency ineligibility test is a point in time test applied only at the time of the CGT event, so her previous periods of foreign residency are not taken into account.

However her periods of foreign residency will be taken into account in determining the applicable discount percentage if she is eligible for only a partial MRE under s. 118-185. This may occur if she purchases another dwelling when she returns to Australia and continues to rent out the apartment for a continuous period of greater than six years, or if she stays overseas for longer than six years and rents out the apartment for the entire time. If s. 118-185 applies then her cost base will be adjusted under s. 118-192 to reflect the market value on the date she first used the property to produce assessable income.

Variations 6 and 7 — life event

Variation 6

Monica is married and moves to Singapore with her husband. However he passes away in September 2027. As part of the reorganisation of her affairs after his death, Monica decides to sell the apartment. She enters into a contract to sell the apartment (which she wholly owns in this scenario) on 19 November 2027.

Monica will be eligible to apply the MRE rules because:

- at the time of the CGT event on 19 November 2027, she has been a foreign resident for a continuous period of six years or less
- a 'life event' — her husband's death — happened during her period of foreign residency.

Monica can choose to apply the absence rule for the entire period that she has been absent from the property:

- if she did not use it for income-producing purposes — because there is no time limit
- if she has been renting out the property — because that period is less than the maximum of six years.[40]

Therefore she is eligible for the full MRE and no Australian tax will apply to the capital gain.

Variation 7

Monica's husband passes away in September 2030. As part of the reorganisation of her affairs after his death, she enters into a contract to sell the apartment on 19 November 2030.

At the time of the CGT event A1, Monica has been a foreign resident for a continuous period of more than six years. Therefore the life events test does not apply. She is an excluded foreign resident and is ineligible for the MRE. Whether or not she rented out the apartment is irrelevant.

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[40] Even if she has purchased a dwelling in Singapore, she should make this choice in respect of the Sydney apartment as the Singaporean property will not be subject to Australian CGT upon disposal — with the exception being if she resumes Australian tax residency before selling it.

Case study 4

A ‘dwelling’ that is a mobile home

Issues considered in this case study
▪ A mobile home as a dwelling and a main residence.
▪ Application of the MRE to a capital gain on a mobile home.
▪ Capital loss on a mobile home that is a personal use asset.
▪ CGT implications of working from home.

The facts

Jack and Rose, who are in a de facto relationship and are ‘spouses’ for tax purposes, lived in Sydney in a rental property. In 2017, they started making plans to move to their favourite NSW coastal holiday destination for a few years. In August 2017 they became joint owners of an onsite caravan in a caravan park. They paid $120,000 for the caravan. They also became liable to pay annual site fees to the owner of the caravan park in order to be able to keep their caravan site. Jack and Rose moved into the caravan within two weeks of its acquisition, after finishing up their lease, packing up the house, selling furniture, fitting out and furnishing the caravan etc.

In mid-2020 Jack and Rose decided that it was time to move back to Sydney for various reasons. They vacated the caravan in August 2020 and moved into a rental property in Sydney. The caravan was left onsite in the caravan park and remained covered by the annual site fees.

Initially Jack and Rose intended to keep the caravan for regular holidays, but eventually decided to sell it.

In August 2022 Jack and Rose sold the caravan.

Key date	Event
August 2017	Jack and Rose acquire onsite caravan for $120,000
August 2020	Jack and Rose move out of the caravan
August 2022	Jack and Rose sell the caravan

Variation 1 — Making a capital gain

Even though a caravan is generally a depreciating asset, due to unique contemporaneous circumstances including the shortage of caravans for sale, extremely long lead times for pre-ordered caravans, increased popularity of moving from the city to the coast, and the NSW housing crisis, Jack and Rose achieved a sale price of $140,000. They each made a capital gain of $10,000 (i.e. ($140,000 – $120,000) ÷ 2).[41]

Each taxpayer disregards the capital gain as the full MRE applies, as explained below.

Is the caravan a dwelling? Can it be a main residence?

A caravan is listed in the legislation as an example of a mobile home that constitutes a 'dwelling' that can be eligible for the MRE (see **page 52**).

For the purposes of advancing this case study assume that the circumstances in which Jack and Rose live in the caravan for three years satisfy the ATO's view of when a unit of accommodation is a taxpayer's main residence (see **page 58**).[42]

The land on which the caravan sat was owned by the caravan park owner, and Jack and Rose paid annual fees for the right to use the particular site as well as common area facilities. Therefore there is no land under the unit of accommodation or adjacent land to consider.

Jack and Rose's respective ownership interests in the caravan commence in August 2017 when they obtained legal ownership of it and first had a right to occupy it (see **page 57**).

As Jack and Rose moved into the caravan as soon as practicable, it can be treated as their main residence from the time they acquired it even though they did not live in it for the first two weeks.

Jack and Rose may also apply the absence rule for the two years from August 2020 to August 2022, when they sold the caravan, to continue to treat the caravan as their main residence for that period.

Note

If Jack and Rose rent out their caravan to holiday-makers after they move back to Sydney and before they sell it, they can apply the absence rule for a maximum period of six years from August 2020. Otherwise, if the caravan is not rented out and is merely available for their private holiday use, the absence rule can be applied indefinitely.[43]

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41 For illustrative purposes ignore any other expenditures which may be included in cost base.

42 For example, the caravan contains all the necessary fittings and furniture for a kitchenette, bathroom, sleeping area and lounge area; it has its own dedicated battery power, some gas powered whitegoods and appliances; it is continuously well stocked with food, clothing and consumables for daily life; and Jack and Rose redirected mail to the caravan park address.

43 However, the longer they hold the caravan the more likely it is to make a capital loss, in which case the MRE would be irrelevant as the capital loss would be disregarded as the caravan is a personal use asset.

Variation 2 — Making a capital loss

Assume that in August 2022, Jack and Rose sold the caravan for $100,000. They each make a capital loss of $10,000 (i.e. ($100,000 – $120,000) ÷ 2).[44]

The capital loss is disregarded because the caravan is a personal use asset — see s. 108-20(2). This means that if Jack or Rose makes a capital gain in relation to another asset in 2022–23, they cannot offset it with the notional $10,000 capital loss, and they also cannot carry the capital loss forward to be used in a future income year.

Variation 3 — Working from the caravan

Assume that while living in the caravan, Jack and Rose were both allowed by their employers to work part time remotely. No special modifications were made to the caravan. Their work merely required a laptop and related computer accessories. They worked from the dining table or couch inside the caravan, outdoor dining settings, the caravan park's common areas, or the library in the nearby town.

Not a 'place of business'

For the purposes of this case study it is accepted that no part of the caravan constitutes a 'place of business' of either Jack or Rose.

They were not required to travel for work and their choice to work from the caravan was private in nature as it enabled them to enjoy a particular lifestyle. No part of the caravan was set aside exclusively for work purposes. No part of the caravan was specifically modified, fitted out or furnished, for their work, and they frequently worked outside of the caravan.

Reference

While it is outside the scope of this paper to comprehensively discuss this matter, interested readers may refer to Private Binding Ruling no. 1051445849059 (in which the ATO found that the taxpayer was not using their caravan as a place of business) and TR 93/30 in relation to home office expenses.

As the caravan was not a 'place of business' for any part of the taxpayers' ownership period, no part of any interest (had it been incurred) on a loan to finance its purchase would be deductible in any income year under the home office expenses rules.

Therefore the taxpayers did not need to adjust their acquisition date or cost in calculating their capital gain or loss.

Important

The ATO has stated that where a caravan is more readily identifiable as a private home office used in connection with employment rather than as a place of business, the taxpayer is not entitled to a deduction for the decline in value of the caravan under s. 40-25.[45] That is, the depreciation of the caravan is treated as akin to an occupancy cost rather than a running expense (see **page 72**).

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[44] For illustrative purposes ignore any other expenditures which may be included in reduced cost base.

[45] Private Binding Ruling no. 1051445849059.

Case study 5

Adjacent land

Issues considered in this case study
▪ Application of MRE to adjacent land.
▪ Selling adjacent land before selling dwelling.

The facts

Kelly purchases a house with 10 hectares of land in 2020. For eight years, she uses most of the property for carrying on a business and the remainder of the property, including the land under the house, for her family's private purposes.

In 2028, Kelly receives an extremely good offer to sell the property. In considering whether she should accept the offer, she asks her tax agent to explain the extent to which she will be eligible for the MRE.

Key date	Event
2020	Kelly purchases house with 10 hectares of land
2028	Kelly receives an offer to purchase the property

Application of the MRE rules

The MRE can only apply to a maximum of two hectares of adjacent land, including the land under the dwelling (see **page 55**). Kelly may choose which parts of her property constitute the exempt area. To be eligible, the land must be used primarily for private or domestic purposes in association with the dwelling.

The selected eligible land of up to two hectares will be eligible for the MRE. The remainder of the 10 hectares will not be eligible for any exemption regardless of the extent of private use. However Kelly will be able to claim the 50 per cent discount as she has owned the land for more than 12 months.

Note

She may also be eligible for the small business CGT concessions (if all relevant criteria are met) in relation to the remaining hectares.

Kelly will need to obtain a valuation of the land selected for the MRE and the other land in order to properly allocate the capital proceeds. For example if the exempt area is worth 35 per cent of the total market value, then she can claim the MRE for 35 per cent (rather than 20 per cent) of the capital gain.

Kelly cannot choose two hectares out of the income-producing area because for the two hectares of adjacent land to be eligible for the MRE, it must be used primarily for private or domestic purposes in association with the dwelling. The land that she uses for the purpose of carrying on a business will not satisfy this requirement.

Variation — Sell adjacent land first

Kelly receives an excellent offer to sell three hectares, which includes some of the income-producing land and some of the land used for private purposes. The offer does not cover the house or the land under the house.

If she sells the three hectares of land without selling her dwelling, no MRE applies to the capital gain. This is the case even if part of the land is used for private purposes.

If she subsequently sells the rest of the land, she will be eligible for the full MRE on up to two hectares of adjacent land used primarily for private and domestic purposes in association with the dwelling.

The main residence exemption — basic case

The basic case — s. 118-110

Section 118-110 sets out the 'basic case' under which the taxpayer is entitled to the full MRE. Other provisions in Subdiv 118-B modify the operation of the basic case to reduce the MRE entitlement or to apply the rules to specific situations.

The MRE — expressed as a proportion of the total gain — starts at 100 per cent (i.e. the entire gain is tax-free), and it is reduced to the extent of absence and income-producing use. The capital gain (or loss) is then reduced by the MRE proportion to obtain the taxable gain (or loss).

Gross capital gain × (100% – MRE(%)) = taxable gain

Apply capital losses (if available)

Apply general discount or marriage breakdown roll-over (as applicable)

= Net capital gain

The criteria for eligibility

A capital gain or capital loss a taxpayer makes from a CGT event that happens in relation to a CGT asset that is a dwelling, or the taxpayer's 'ownership interest' in a dwelling, is disregarded if:

- the taxpayer is an individual
- the dwelling was the taxpayer's main residence throughout their 'ownership period'
- the interest did not pass to the taxpayer as a beneficiary in, and they did not acquire it as a trustee of, the estate of a deceased person.

Foreign residents may not be eligible for a full exemption, or in some cases any exemption — see **page 96**.

Critical Point

Section 118-110 does not provide a *choice*, so a taxpayer cannot *choose* whether or not they apply the MRE.[46] If the eligibility criteria are satisfied then the relevant part of the capital gain or loss must be disregarded. However the taxpayer can *choose* to treat a dwelling as their main residence for a period of time during their absence from the dwelling under various modifications to the basic case, covered later in this paper. Practically, this means that the taxpayer cannot disregard a capital loss they make on the disposal of a main residence.

[46] ATO ID 2003/257 (withdrawn). The ATO ID was withdrawn on 3 February 2012 as it is a straight application of the law.

General rule — only one main residence at a time

Subdivision 118-B contains a number of modifications to the basic case which allow a taxpayer to choose to treat a dwelling as their main residence for CGT purposes for a period of time even if they are not living in it during that period of time. The rule of thumb is that only one dwelling can be treated as the taxpayer's main residence at any given point in time, with the exception of the rule that applies when the taxpayer is changing main residences (moving house before selling the existing dwelling). This means that if a choice is made to treat a previous dwelling as main residence for a period of time, the current main residence may be subject to CGT in respect of that period. In these circumstances the taxpayer, assisted by their tax professional, must determine which property will provide the better outcome if elected as the main residence.

Gains and losses on revenue account

A taxpayer may acquire a dwelling for use other than solely as a main residence. For example, the taxpayer may:

- acquire the dwelling for the dual purposes of occupying it and developing it before a subsequent sale — i.e. the taxpayer lives in the dwelling for some time while they renovate it for sale at a profit, or
- be in the business of property development, and although they occupy the dwelling as their main residence, the property is acquired solely with the intention of redevelopment and sale.

In such circumstances, the dwelling would be held on revenue account and the proceeds on sale would constitute ordinary income. TD 92/135 confirms that income from the sale of a dwelling that is assessable under s. 6-5 remains assessable even if a MRE would be available for CGT purposes. The MRE is a CGT exemption only and does not extend to exempt from tax ordinary profits or business income.

Example 1 — Proceeds of sale of dwelling assessable as ordinary income
A builder constructs a spec home in which he and his family reside while construction proceeds on another spec home. Any profit on sale which gives rise to income is fully assessable to the builder even if a main residence exemption is available for CGT purposes. *Source: TD 92/135*

The relevant CGT events

The MRE can only apply in respect of the following CGT events:

A1	Disposal of a CGT asset
B1	Use and enjoyment before title passes
C1	Loss or destruction of a CGT asset
C2	Cancellation, surrender and similar endings
E1	Creating a trust over a CGT asset

E2	Transferring a CGT asset to a trust
F2	Granting a long-term lease
K3	Asset passing to a tax-advantaged entity
K4	CGT asset starts being trading stock
K6	Pre-CGT shares or trust interest (for MRE purposes — except one involving the forfeiting of a deposit)
	Any CGT event that involves the forfeiting of a deposit (i.e. CGT event H1) as part of an uninterrupted sequence of transactions ending in one of the above events subsequently happening.

Modifications to the basic case

Special rules in Subdiv 118-B modify the basic case in s. 118-110 to either extend or limit the application of the MRE:

Extending the MRE	Section reference	Page
Land adjacent to the dwelling	118-120	54
Moving in as soon as practicable	118-135	59
Building, repairing or renovating ▪ Taxpayer dies before moving in	118-150 118-155	61 61
Absence from the dwelling	118-145	69
Moving into substitute dwelling after main residence is compulsorily acquired or destroyed	118-147	70
Changing main residence	118-140	71
Selling vacant land after main residence is accidentally destroyed	118-160	95

Limiting the MRE	Section reference	Page
Using dwelling for the purpose of producing assessable income	118-190	72
Spouses choosing different main residences	118-170	79
Dependent child with different main residence	118-175	80

Limiting the MRE	Section reference	Page
Dwelling acquired in marriage or relationship breakdown ■ Dwelling acquired from company or trust	118-178 118-180	80 82
Dwelling acquired from deceased estate	118-195	84

The core concepts

Who is entitled to the MRE? — s. 118-110

Individuals

In most circumstances only an individual is entitled to claim the MRE. This means that for example if a company owns a property that it allows an individual to use as their main residence, the company cannot claim the MRE. This is the case even if the FBT or Div 7A rules had applied to the provision of accommodation.

The few exceptions to the individual taxpayer rule include where an entity acquires the dwelling in its capacity as the trustee of a deceased estate, a special disability trust (see **page 99**), and a main residence trust.

Absolutely entitled beneficiaries

For CGT purposes, when a beneficiary becomes absolutely entitled to a CGT asset as against the trustee of a trust[47], the asset is treated as being the asset of the beneficiary, instead of being an asset of the trust.[48] If the trustee later sells the asset, any capital gain or loss is made by the individual, not the trustee. Accordingly, the MRE may be available where an individual beneficiary of a trust who is absolutely entitled as against the trustee to the dwelling which is the beneficiary's main residence.[49]

Under a main residence trust (which will not be discussed in this paper), a discretionary trust owns the property, and an individual beneficiary who lives in the property is conferred absolute entitlement in the asset.

As a starting point, the individual must have in fact lived in the dwelling for a particular period in order to claim main residence status for that dwelling, but there are a number of concessional rules which may allow a taxpayer to treat a dwelling as their main residence for a period of time in which they did not live in it. Under most of these choices the taxpayer cannot treat two dwellings as their main residence at the same point in time.

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[47] Disregarding any legal disability.

[48] Section 106-50.

[49] TD 58W confirms the ATO's view that while a family company or family trust is usually not a natural person that can qualify for the MRE, where a beneficiary of a trust is absolutely entitled as against the trustee to the dwelling, an exemption may be available to the beneficiary if the dwelling is the principal residence of the beneficiary. The TD was withdrawn on 10 March 2010 as it involves a straight application of the law.

Joint owners

The MRE rules apply to fully or partially disregard a capital gain or capital loss a taxpayer makes from a CGT event that happens in relation to:

- where there is one owner of a dwelling — the owner's CGT asset, being the dwelling
- where there are two or more joint owners of a dwelling — a joint owner's ownership interest in the dwelling.

Both joint tenants and tenants in common are treated the same — i.e. that each taxpayer owns a separate CGT asset being their interest in the dwelling.[50]

For example:

- a husband and wife who own their family home in equal shares as joint tenants — upon the sale of the house, they can both apply the MRE rules to their respective 50 per cent interest in the property
- siblings A, B and C respectively own 40 per cent, 30 per cent and 30 per cent of their shared home as tenants in common — when sibling C sells their 30 per cent share to sibling A, sibling C can apply the MRE to their 30 per cent share.

What constitutes a dwelling — s. 118-115

A 'dwelling' is defined as including a *unit of accommodation* that is:

- a building or is contained in a building, and consists wholly or mainly of residential accommodation, or
- a caravan, houseboat or other mobile home.

The dwelling also includes any land immediately under the unit of accommodation.

The requirement of a unit of accommodation means that vacant land prima facie cannot be a dwelling and therefore cannot be eligible for the MRE. However, a taxpayer who purchases vacant land on which to build their future home can choose to treat the vacant land as their main residence for a maximum period of four years before the build is complete, subject to satisfying certain criteria — see **page 61**.

Note

In a private ruling the ATO has noted that a caravan is a depreciating asset for Div 40 of the *ITAA 1997* purposes.[51] This is likely to also be the case for other types of mobile home such as a houseboat. The definition of a CGT asset in s. 108-5 includes any kind of property and does not preclude a depreciating asset.

The caravan (or other dwelling that is also a depreciating asset) can be subject to CGT and eligible for the MRE.

An anti-overlap rule in s. 118-20 provides that if an amount that is assessable outside of the CGT regime would also be taken into account in working out a capital gain, then the capital gain is reduced by the otherwise assessable amount.

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50 Section 108-7.

51 Private binding ruling no. 1051445849059.

Therefore if the disposal of the caravan (or other depreciable dwelling) gives rises to an assessable balancing adjustment under Div 40 (or Subdiv 328-D), as a result of a partial use for income-producing purposes, then a taxable gain after application of a partial MRE (see **page 72**) may need to be reduced for any double taxed amount.

Specific types of accommodation

In TD 92/158, the ATO sets out its view that the following can be a 'dwelling':

- a structure built **underground**
  - e.g. an underground home at Coober Pedy
  - there is no requirement that a residential building be constructed above the ground
- a **yacht**
  - provided that the level of facilities is such as to make the yacht habitable.

However, in the ATO's view, in most circumstances a **tent** will not be regarded as a substantial structure within the scope envisaged by the definition of 'dwelling'. As the definition connotes a substantial permanent structure, a tent would usually not satisfy this requirement.

One dwelling comprising multiple units of accommodation

TD 1999/69 confirms that, in the Commissioner's view, a 'dwelling' can include more than one unit of accommodation.

Whether two or more units of accommodation are used together as one place of residence or abode for the purposes of the definition of 'dwelling' is a question of fact that depends on the particular circumstances of each case. Factors relevant in considering whether units of accommodation are used together as one place of residence or abode include:

(a) whether the occupants sleep, eat and live in them

(b) the distance between and the proximity of the units of accommodation

(c) whether the units are connected

(d) whether the units are capable of being sold separately

(e) the extent to which the daily activities of the occupants in the units are integrated

(f) how the units are shared by the occupants

(g) how costs of the units are shared by the occupants.

Examples

Scenario	One dwelling or separate dwellings?
A married couple live with their children in a suburban house. The wife's mother lives in a detached, self-contained granny flat in the backyard. The grandmother's daily life is closely integrated with those of the family in the main house, and they all spend considerable time together in each unit of accommodation.	The house and the granny flat are one dwelling, having regard to the proximity of the granny flat and the integration of activities. *Source: Adapted from Example 1 in TD 1999/69*

Scenario	One dwelling or separate dwellings?
A mother and her adult daughter live in adjoining units of a duplex. They have unrestricted access to each other's unit via a connecting door in the garages. Most costs of the duplex are paid separately, except that the mother maintains the whole of the surrounding garden.	Each unit is a separate dwelling, because the mother and the daughter use each unit as a separate place of residence. *Source: Adapted from Example 2 in TD 1999/69*
The owner of a farming property lives with his family in a house on the property. He employs his younger brother to work on the farm. The younger brother and his family sleep in a caravan on the property, which is connected to electricity from the house. Both families otherwise live and eat, and take part in domestic activities, in the main house.	The house and the caravan are one dwelling, because the activities of the families in them are so integrated that they use them together as one place of residence. *Source: Adapted from Example 3 in TD 1999/69*
A married couple own their house and also the neighbouring house. Their two adult, financially independent daughters live in the neighbouring house. The daughters do not pay rent or maintenance costs for the house, but they pay for daily running costs and food costs. They occasionally share a meal with their parents.	Each house is a separate dwelling. *Source: Adapted from Example 4 in TD 1999/69*
The taxpayer owns a property which is registered on two titles for the upstairs area and the downstairs area. The taxpayer occupies the upstairs area as their main residence. The downstairs area is occupied by family members. The taxpayer and their family members access all areas and use the property as one dwelling.	The upstairs and downstairs together constitute one dwelling. *Source: Adapted from Private binding ruling no. 1051802439484*

Adjacent land — s. 118-120

The land adjacent to the dwelling, or part of it, is treated as if it was the dwelling and the MRE will apply to the eligible adjacent land to the same extent as to applies to the dwelling.

Land adjacent to a dwelling is its 'adjacent land' only to the extent that the land was used primarily for private or domestic purposes in association with the dwelling. For example, for a suburban family home this would include the front and back yards.

It is the extent to which the land was used primarily for private or domestic purposes throughout the ownership period that is relevant, not at the time of the CGT event.[52]

[52] TD 2000/15.

Example 2 — Primary use of adjacent land
John buys a home on 2 hectares of land in October 2017. One hectare of land is used continuously to derive income from agistment for four years. For 12 months before John sells the home in October 2022, he ceases to use the land for agistment and uses it privately in association with the dwelling. John is entitled to disregard 20 per cent of any capital gain or capital loss made in respect of the one hectare of land previously used for agistment purposes. This is the extent to which the land has been used primarily for private or domestic purposes in association with the dwelling during the period of ownership. *Source: Adapted from Example in TD 2000/15*

Note

TD 1999/68 confirms that land does not have to be contiguous to (i.e. touching or in contact with) the land on which a dwelling is situated to be 'adjacent' to the dwelling for the purposes of s. 118-120. Examples include where a public access laneway separates a tennis court from the rest of the property, and where a horse yard is situated two street blocks away from the house.

The Determination states that the further the distance between the relevant land and the land on which the dwelling is situated the less likely it is that the relevant land is adjacent land.

Adjacent land limited to two hectares

Generally the maximum area of adjacent land eligible for the MRE is two hectares, less the area of the land immediately under the dwelling. Land outside this area is not eligible for any MRE regardless of its use.

Tip

The ATO allows the taxpayer to choose which two hectares are eligible for the MRE. The two hectares chosen must include the land under the dwelling.[53]

If the selected area of land can be separately valued, the capital gain or capital loss on the remainder of the land is calculated by apportioning the capital proceeds and the cost base or reduced cost base on the basis of the **valuation**. This is particularly relevant if the value of the remainder of the land is of a greater or lesser value than the selected area.

If the selected area of land cannot be separately valued, the capital gain or loss on the remainder of the land may be calculated by apportioning the capital proceeds and the cost base or reduced cost base on an **area** basis.[54]

The amount of the capital gain or loss that is attributed to the remainder of the land must be reasonable in the circumstances.

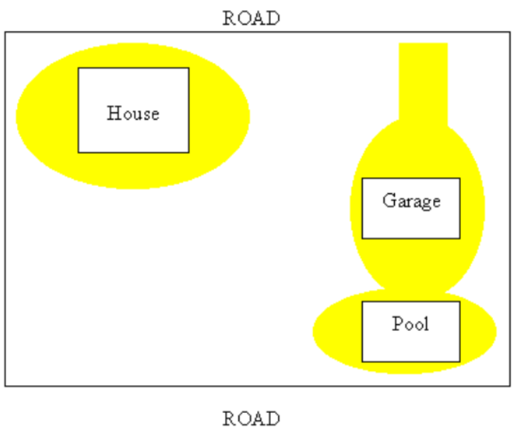
[53] ATO. Home on more than 2 hectares (QC 66037).

[54] TD 1999/67 paras. 3 and 4.

Example 3 — Adjacent land exceeding two hectares — area basis
Fred owns a 10 hectare farming property and he uses four hectares primarily for private or domestic purposes in association with his dwelling. Fred sells the farm for $1,000,000, which includes $200,000 for the farmhouse. The cost base of the entire farm is $600,000, including $160,000 for the farmhouse. Therefore, the cost base attributable to the 10 hectares of land (which includes the land on which the farmhouse is located) is $440,000. Fred's capital gain is $400,000 (i.e. $1,000,000 – $600,000). The cost base attributable to two hectares of the land is $88,000, being two-tenths of the total cost base of the land. The capital proceeds attributable to two hectares of adjacent land are $160,000, being two-tenths of the capital proceeds attributable to the land. Therefore, the capital gain in respect of the two hectares is $72,000 (i.e. $160,000 – $88,000). The capital gain on the farmhouse is $40,000 (i.e. $200,000 – $160,000). Fred may disregard his capital gains of $72,000 (for the two hectares of land) and of $40,000 (for the farmhouse) under the MRE. Therefore, Fred includes in his assessable income a capital gain of $288,000 (i.e. $400,000 – $112,000). *Source: Adapted from Example 1 in TD 1999/67*

Example 4 — Adjacent land exceeding two hectares — valuation basis

Alistair owns a 10 hectare property — see the diagram below:



He has selected the shaded area as the part of the land on which he wishes to claim the MRE. This area does not exceed two hectares and is used primarily for private or domestic purposes in association with Alistair's dwelling.

He sells the property for $500,000. He obtains an opinion from an expert valuer that the value of the two hectares of land and the house is $300,000. The cost base attributable to this part of the property (taking into account improvements since purchase) is $180,000 and the remainder is $120,000.

The capital gain on the total property is $200,000. Alistair disregards $120,000 of the capital gain because it is attributable to his main residence ($300,000 – $180,000). The remaining $80,000 ($200,000 – $120,000) is taxable.

Source: Adapted from Example 2 in TD 1999/67

However, if an earlier CGT event had previously happened in relation to other land that was part of the dwelling's adjacent land at the time of the earlier CGT event (see below), then the maximum area of land covered by the MRE for the current CGT event is the 'maximum exempt area' for the current event and the dwelling (see **page 77**).

Adjacent structures — ss. 118-120(5) and (6)

The MRE also applies to an 'adjacent structure' of a flat or home unit as if it were a dwelling, if the same CGT event that happens to the dwelling also happens to the adjacent structure.

A garage, storeroom or other structure associated with a flat or home unit is an adjacent structure to the extent that it was used primarily for private or domestic purposes in association with the flat or home unit.

The 'ownership period' — s. 118-125

The 'ownership period' of a dwelling is the period on or after 20 September 1985 when the taxpayer had an 'ownership interest' (see below) in:

- the dwelling, or
- land — acquired post-CGT — on which the dwelling is later built.

An 'ownership interest' — s. 118-130

Taxpayer has ownership interest in …	If …
Land	The taxpayer has a legal or equitable interest in it or a right to occupy it
A dwelling that is not a flat or home unit	The taxpayer has a legal or equitable interest in the land on which it is erected, or a licence or right to occupy it
A flat or home unit	Either: ▪ a legal or equitable interest in a stratum unit in it, or ▪ a licence or right to occupy it, or ▪ a share in a company that owns a legal or equitable interest in the land on which the flat or home unit is erected and that gives the taxpayer a right to occupy it (see below)

Important

Section 118-130 is not modified in cases where a dwelling is taken to have been acquired at another time by a provision of the *ITAA 1997*.[55]

[55] See ATO ID 2010/101 (withdrawn). The ATO ID was withdrawn on 21 July 2017 as the relevant guidance can be found in other ATO materials.

When the ownership interest starts (contract situation)

A taxpayer starts to have an ownership interest in land or a dwelling that they acquire under a contract from the time that they obtain legal ownership of it. Generally this would be at the time of settlement and not at the time of signing the contract.

However, if the contract, or a related contract, gives the taxpayer a right to occupy the property at an earlier time, then the ownership interest commences from that earlier time.

When the ownership interest ends (contract situation)

For land or a dwelling where the taxpayer has a contract for the happening of the CGT event, the taxpayer's ownership interest ends when their legal ownership of it ends. Generally this would be upon the settlement of the contract when title transfers to the new owner.

Ownership interest is a share in a company

A taxpayer may have an ownership interest in a dwelling by holding a share in a company that gives the shareholder the right to live in a specific home unit.

The definition of 'ownership interest' includes:

> a share in a company that owns a legal or equitable interest in the land on which the home unit is erected and that gives you a right to occupy it.

The share that gives the taxpayer a right to occupy the home unit is an ownership interest.

When the taxpayer sells the share, the MRE may apply to the capital gain or loss.

When a dwelling is the taxpayer's main residence

The characteristics of a main residence

The legislation does not define 'main residence'.

Generally, the ATO will consider a dwelling to be the taxpayer's main residence if[56]:

- the taxpayer and their family live in it
- the taxpayer's personal belongings are in it
- it is the address to which the taxpayer's mail is delivered
- it is the taxpayer's address on the electoral roll
- services such as gas and power are connected.

The length of time the taxpayer stays in the dwelling and whether they intend to occupy it as their home may also be relevant. However, there is no prescribed minimum period during which a taxpayer must reside in a dwelling.

[56] ATO. Eligibility for main residence exemption (QC 69710).

When the dwelling becomes main residence — s. 118-135

If a dwelling becomes the taxpayer's main residence by the time it was 'first practicable' for them to move into it after they acquire their ownership interest in it, the dwelling is treated as their main residence from the acquisition.

The ATO has provided practical guidance in working out when a dwelling begins to be the taxpayer's main residence.[57]

The ATO considers that a taxpayer's home will be their main residence from the start of their ownership period, provided they move in 'as soon as practicable'.

If there is a delay moving in because of illness or other unforeseen circumstances — the dwelling will still qualify as a main residence, provided the taxpayer moves in as soon as the cause of the delay is removed (e.g. when they recover from the illness).

Example 5 — Moving in as soon as practicable
Li Jing signed a contract to buy a townhouse in March 2022. She took possession when settlement occurred in April 2022. In late March 2022, Li Jing's employer sent her overseas on an assignment for four months. She moved into the townhouse when she returned in late July 2022. Li Jing's overseas assignment was unforeseen at the time she bought the townhouse. She moved in as soon as practicable after settlement of the contract. Therefore, she can treat the townhouse as her main residence from the date she acquired it. If Li Jing treats the townhouse as her main residence for this period, she cannot treat any other property as her main residence (except for a limited time if she is moving house). *Source: Based on the example in ATO fact sheet 'Moving to a new main residence' (QC 66029)*

If the taxpayer cannot move in because the property is being rented to someone else — the property does not become the taxpayer's main residence until they move in.

Chapman and FCT[58] — Delay in moving into dwelling
Facts The Taxpayer, who lived and worked in Kalgoorlie, purchased a residential property some 600 kilometres away in Perth in June 2001. The Taxpayer said that although his *intention* at the time of purchase was to move from Kalgoorlie to Perth and live in the property, he did not do so because: ■ his employer refused to transfer him to Perth ■ if he had left his employment and moved to Perth, he would have had to reimburse his employer for re-location expenses incurred when he moved to Kalgoorlie ■ he did not have the money at the time to do so.

57 ATO. Moving to a new main residence (QC 66029).

58 [2008] AATA 421.

Chapman and FCT[58] — Delay in moving into dwelling
The Taxpayer agreed to allow the vendors to continue to live in the property after settlement while they built their new home. The Taxpayer leased the property to the vendors for six months from 25 June 2001. At the end of this six-month period, the Taxpayer rented the property to other tenants. The Taxpayer's 2002 and 2003 tax returns indicated that the property was rented for 48 weeks in the 2002 income year and for the whole of the 2003 income year. The Commissioner accepted the Taxpayer's contention that he had moved into the Perth property on 23 September 2003. The Taxpayer sold the property on 20 August 2004 but did not declare any capital gain in respect of the disposal in his tax return for the 2004–05 income year. The Taxpayer asserted that TD 51W[59] supported his claim that the property should be treated as his main residence from its acquisition. He particularly relied on para. 2(vii) of TD 51W which stated that 'the taxpayer's intention in occupying the dwelling' is a relevant factor. **Decision** The Tribunal found that the Taxpayer was not entitled to the full MRE because: ■ the Perth property was not his main residence throughout the ownership period ■ s. 118-135 did not apply to treat the Perth property as the Taxpayer's main residence from the date of acquisition because he did not move into the property when it was first practicable to do so ■ the Taxpayer did not show any reasonable cause for his delay in occupying the property. The Taxpayer was legally entitled to move into the Perth property after settlement on 25 June 2001, but chose to rent the property out for over two years. While he intended to move into the property at some time, he only moved into it when it became convenient for him to do so. The Tribunal also noted that: ■ TD 51W also states that 'mere intention' to occupy a dwelling as a sole or principal residence, but without actually doing so, is insufficient to qualify for the MRE ■ the words 'the time it was first practicable' in s. 118-135 should not be read down to mean 'the time it was first convenient'. The exemption in s. 118-135 was designed to take into account the time needed to move into a dwelling (e.g. delays in moving in because of illness or other reasonable cause) but does not apply where a person cannot move into the dwelling because it is being rented out. The Commissioner had correctly calculated the Taxpayer's capital gain to allow a partial exemption based on the dwelling being the Taxpayer's main residence from 23 September 2003.

If the taxpayer had not yet sold their old home — both properties may be treated as the taxpayer's main residence for a period of up to six months ending when the taxpayer ceases to own the former main residence (see **page 96** for details).

[59] TD 51 was withdrawn on 19 May 2010. Subsequent to its publication, the matters with which it deals have been considered by the Tribunal in a number of cases. The decisions in those cases are consistent with the view expressed in the Determination. Relevant guidance has also been included in other ATO materials.

Building, repairing or renovating a dwelling — s. 118-150

A taxpayer can choose to treat a dwelling that they are building, repairing or renovating as their main residence from the time they acquired the ownership interest, if:

- the dwelling becomes the taxpayer's main residence as soon as practicable after the work is finished
- it continues to be their main residence for at least three months.

This maximum time limit for this choice is four years, or a longer time allowed by the Commissioner.

If there was already a dwelling on the land and the taxpayer or someone else had occupied it before the work commenced, the choice starts when the dwelling ceased to be occupied. That is, if a taxpayer rebuilds their existing home, the maximum four-year choice period will not overlap with the main residence period that applies to the dwelling before the work began.

Under this choice, no other dwelling can be treated as main residence at the same time.

TD 92/147[60] sets out the factors that the ATO consider to be relevant in ascertaining whether the construction of a dwelling is finished:

- the date the Certificate of Occupancy (if applicable) is issued
- the date final building inspection approval is given
- the date the dwelling becomes structurally complete
- the connection of services e.g. electricity, gas, etc.

In *Erdelyi and FCT*[61], the taxpayers purchased a vacant block on which they constructed a dwelling. Construction was completed by March 2004. The property was listed for sale in May 2004 and settlement took place on 30 June 2004. The taxpayers claimed that they moved into the dwelling with the intention of living there permanently, including that, because of local vandalism and the theft of tools from the premises, one of the taxpayers took up temporary residence at the house each evening. The Tribunal found that the taxpayers had failed to discharge their burden of showing that the dwelling had been their main residence for the requisite three months. The Tribunal found that the taxpayers:

- moved very little furniture into the house
- consumed far less electricity than would be expected
- could not recall whether they notified relevant authorities of their change of address.

If the taxpayer dies — s. 118-155

Special rules apply where the individual dies:

- after the work began (or the contract for it was entered into) and before the work is finished
- after the work was finished but before it was practicable for the dwelling to become the individual's main residence, or
- during the three-month period during which the dwelling was required to be the individual's main residence.

[60] The Determination contains three practical examples.

[61] [2007] AATA 1388.

The surviving joint tenant/s, or the trustee of the individual's deceased estate, can choose to treat the dwelling as the main residence of the individual when they died, for the shorter of:

- four years before the individual's death, or
- the period commencing when:
  - if there was already a dwelling on the land and someone occupied it after its acquisition — the dwelling ceased to be occupied so that it could be repaired or renovated, or
  - otherwise — when the individual acquired the interest in the land,

  and ending when the individual died.

If the choice is made, no other dwelling can be treated as the deceased's main residence at the same time. The choice cannot be made if the individual was an excluded foreign resident (see **page 96**) just before their death.

Calculating the capital gain

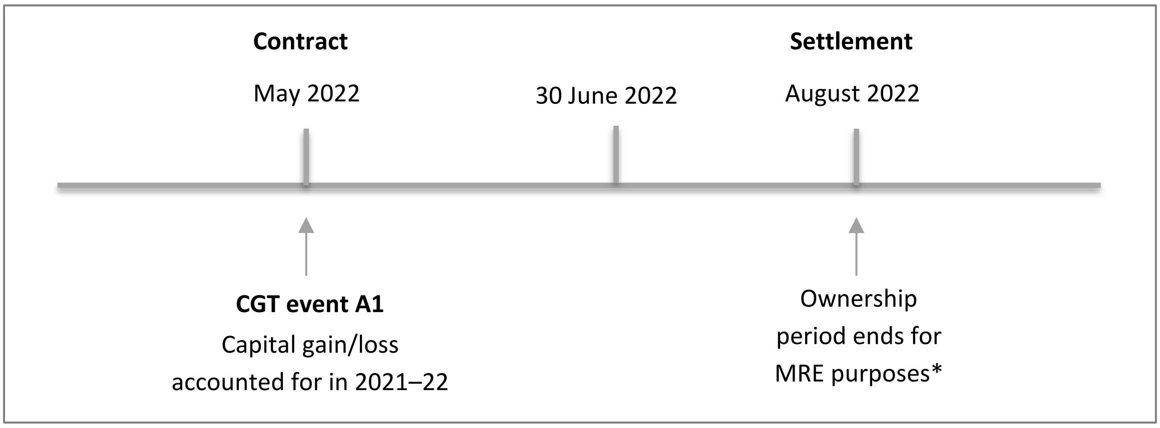
Reference

The ATO has an interaction *Capital gains tax property exemption tool* (QC 18138) to assist taxpayers in working out the exemption to which they are entitled.

Interaction with CGT event A1

Generally, upon the disposal of a dwelling, the time of the CGT event A1 is when the taxpayer enters into the contract for the disposal.[62]

However for the purposes of working out the application of the MRE, the taxpayer's ownership period only ends upon settlement.



* So if the taxpayer moves out of the property in June 2022, the MRE will be reduced — subject to the application of the six-month overlap rule (see **page 71**) — even though CGT event A1 has already happened by the time the taxpayer moves out.

62 Section 104-10(3)(a).

Any fluctuation in market value between CGT event A1 and settlement will not be taken into account in calculating the capital gain or loss. However that timeframe will be taken into account in working out the proportion of the MRE to which the taxpayer is entitled.

If there is no contract for the disposal of the dwelling, for example where the taxpayer transfers it to their adult child, then CGT event A1 happens when the change of ownership occurs[63], which is also when the taxpayer's ownership period ends.

Date of contract and settlement occur in different income years — tax return implications

If the settlement date of a contract of sale of property occurs in a later income year than the income year in which the contract was entered into, the taxpayer has two options concerning the timing of when the resulting capital gain or loss is included in their tax return:

1. the taxpayer may include the capital gain or loss in the tax return for the income year in which the contract is entered into, bearing in mind that the tax return would need to be subsequently amended should the contract of sale not proceed to settlement, or
2. apply the 'wait and see' approach whereby the taxpayer lodges their tax return for the year of the CGT event without disclosing the capital gain. Once settlement occurs in a subsequent income year, they amend their tax return for the year of the CGT event.

In para. 8 of **TR 94/29**, the Commissioner states that where the time of making the contract and settlement of the contract span over more than one income year, while the obligation to declare the capital gain does not arise until the settlement of the contract, a taxpayer may be liable for the payment of interest.

Although each case will be dealt with on its own merits, it would be expected that discretion would be exercised to remit the interest in full where requests for amendment are lodged, and where relevant, self amendments are made, within a 'reasonable time' after the date of settlement.

In most cases, the ATO would consider a period of one month after settlement to be reasonable but there may be circumstances where a taxpayer can establish that a longer period is reasonable.

Although it is not required, a taxpayer who lodges their return before settlement may, for convenience, at that time include in the return the capital gain or loss.

Capital proceeds — Div 116

The capital proceeds from the CGT event are the sum of[64]:

- the money the taxpayer has received, or is entitled to receive
- the market value of any other property the taxpayer has received, or is entitled to receive.

A market value substitution rule applies where the capital proceeds are less than the market value, or no capital proceeds are received, in a non-arm's length arrangement.[65] This could occur, for example, if parents gift their main residence to their adult child for less than market value. If the parents are not eligible for a full MRE this could have significant tax and cashflow issues for them.

Cashflow issues may also arise from sale contracts that span the end of a taxpayer's financial year (typically 30 June) where the taxpayer is not entitled to the full MRE.

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[63] Section 104-10(3)(b).

[64] Section 116-20.

[65] Section 116-30.

Reference

A taxpayer may need to obtain a market valuation of their dwelling for capital proceeds or cost base calculations. Refer to the ATO guide 'Market valuation for tax purposes' (link available at QC 66067).[66]

According to the ATO guide, real property may be valued by a person who is registered or licensed to carry out real property valuations under the relevant State, Territory or Commonwealth legislation.

Cost base

The elements of cost base

The cost base, and reduced cost base, of the dwelling comprise the following elements[67]:

First element	The total of: ▪ the money the taxpayer paid, or is required to pay ▪ the market value of any other property the taxpayer gave, or is required to give.
Second element	Incidental costs incurred to acquire the dwelling or that relate to the CGT event happening to the dwelling. These costs may include, as relevant[68]: ▪ remuneration for the services of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant, legal adviser or recognised tax adviser ▪ costs of transfer ▪ stamp duty or similar ▪ costs of advertising or marketing to find a seller or buyer ▪ costs relating to the making of any valuation or apportionment ▪ for example, where the cost base adjustment for first income-producing use applies, or where there are joint owners ▪ search fees ▪ conveyancing kit ▪ borrowing expenses (e.g. loan application and mortgage discharge fees) ▪ termination fees incurred as a direct result of ownership ending.

66 The ATO recently updated its guidance. The updated guidance was published on 29 September 2022.

67 Section 110-25.

68 Section 110-35.

Third element	Costs of owning the dwelling, including: ■ interest on money borrowed to acquire it ■ costs of maintaining, repairing or insuring it ■ rates and land tax ■ interest on money borrowed to refinance ■ interest on money borrowed to finance capital expenditure incurred to increase the dwelling's value. **Note** The third element is only included if the dwelling was acquired after 20 August 1991. The third element is not included in reduced cost base.
Fourth element	Capital expenditure incurred: ■ the purpose or expected effect of which is to increase or preserve the dwelling's value, or ■ that relates to installing or moving the dwelling. ▪ This may be applicable in the case of a mobile home such as a caravan or houseboat.
Fifth element	Capital expenditure incurred to establish, preserve or defend the taxpayer's title to, or right over, the dwelling. ■ For example this may be relevant where there was a dispute between the beneficiaries of a deceased estate (where the deceased owned the dwelling) or between the parties in a relationship breakdown.

Expenditure excluded from cost base

For a dwelling acquired after 7.30 pm, by legal time in the ACT, on 13 May 1997, the cost base excludes the following amounts[69]:

(a) second and third elements — expenditure that the taxpayer has deducted or could have deducted (e.g. Div 43 deductions where the main residence was previously a rental property)

(b) expenditure that the taxpayer has deducted or could have deducted, except so far as the deduction has been reversed by an amount being included in assessable income (e.g. certain insurance and recoupment amounts)

(c) expenditure for which a recoupment has been received, except so far as the amount is included in assessable income

(d) capital expenditure incurred by another entity that the taxpayer has deducted or could have deducted (e.g. Div 43 deductions inherited from a previous owner, where the main residence was previously a rental property).

[69] Section 110-45. However, (b) and (d) do not apply to expenditure arising before or relating to a period before 7.30 pm, by legal time in the ACT, on 13 May 1997 — s. 110-53.

For a dwelling acquired at or before 7.30 pm, by legal time in the ACT, on 13 May 1997, the cost base excludes the following amounts[70]:

- second and third elements — expenditure that the taxpayer has deducted or could have deducted (e.g. Div 43 deductions where the main residence was previously a rental property)
- expenditure for which a recoupment has been received, except so far as the amount is included in assessable income.

Expenditure excluded from reduced cost base

Amounts which cannot be included in the reduced cost base include[71]:

- expenditure that the taxpayer has deducted or could have deducted (e.g. Div 43 deductions where the main residence was previously a rental property)[72]
- expenditure that the taxpayer could have deducted had the taxpayer used the dwelling wholly for the purpose of producing assessable income
- expenditure for which a recoupment has been received, except so far as the amount is included in assessable income
- non-deductible travel expenses relating to residential rental property (where the main residence was previously a rental property).

Cost base substitution rules

The first element of the cost base and reduced cost base of the dwelling is its market value at the time of acquisition if[73]:

- the taxpayer did not incur expenditure to acquire it
- some or all of the expenditure incurred to acquire it cannot be valued, or
- it was acquired in a non-arm's length transaction.

Some or all of the above may apply where for example the taxpayer had acquired part or all of the property from their parents at non-arm's length terms.

Where a dwelling that was eligible for the full MRE is subsequently used for income-producing purposes, the total cost base and reduced cost base are treated as the market value of the dwelling at the time it was first used to produce assessable income — see **page 75**.

Special cost base modifications apply in relation to interests in dwellings acquired in a relationship breakdown (see **page 81**) or inherited through a deceased estate (see **page 84**).

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70 Section 110-40.

71 Section 110-55.

72 Apart from s. 43-70(2)(h) which excluded from Div 43 deductibility expenditure that qualifies for the heritage conservation rebate.

73 Section 112-20.

Where the owner of a building transfers to the taxpayer the stratum unit which the taxpayer had a right to occupy, and the strata title conversion is eligible for the s. 124-190 CGT roll-over, the first element of the cost base and reduced cost base of the stratum unit in the hands of the taxpayer includes[74]:

- the original building's cost base divided by the number of new strata units[75]
- any amount they paid to acquire it.

CGT discount — Subdiv 115-A

If a taxpayer is not entitled to the full MRE, they will be entitled to the full 50 per cent CGT discount on the capital gain so long as the taxpayer:

- was an Australian resident for the entire ownership period
- owned the dwelling for at least 12 months.

A foreign resident or temporary resident is not entitled to any CGT discount unless they acquired the Australian dwelling on or before 8 May 2012 and/or had a period of Australian residency after that date (see **page 97**).

The 12-month ownership requirement

The day of acquisition and the day of the CGT event are excluded in working out whether the taxpayer has owned the dwelling for at least 12 months before the disposal (or other CGT event).

In some circumstances a taxpayer can count a previous owner's period of ownership in working out if they satisfy the 12-month ownership period, if they acquired the dwelling[76]:

- as a beneficiary or trustee of a deceased estate, if the asset was acquired by the deceased on or after 20 September 1985
- through a marriage or relationship breakdown, or
- as a roll-over replacement for an asset that was lost, destroyed or compulsorily acquired.

These modifications to acquisition date only apply for the purposes of the CGT discount rules and not for the purposes of calculating the capital gain or the MRE.

Where a dwelling that was eligible for the full MRE is subsequently used for income producing purposes, the taxpayer is deemed to have acquired it at the time it was first used to produce assessable income (see **page 75**). Where this applies the taxpayer must have owned the dwelling for at least 12 months from that deemed acquisition date.

A capital gain cannot be discounted if the CGT event occurred under an agreement the taxpayer made within 12 months of acquiring the CGT asset.[77]

A capital gain also cannot be discounted if the cost base was calculated using the indexation method.[78]

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[74] Section 124-190.

[75] Section 124-10(3).

[76] See the relevant items in the table in s. 115-30(1).

[77] Section 115-40.

[78] The indexation method only applies where the dwelling was acquired before 21 September 1999. In most cases the taxpayer will achieve a smaller taxable capital gain by selecting to use the CGT discount rather than indexation of cost base, but this will depend on the circumstances.

A partial exemption — s. 118-185

A partial exemption applies where:

- the dwelling was the taxpayer's main residence for only part of their ownership period
- the dwelling did not pass to the taxpayer as a beneficiary of a deceased estate
- the taxpayer did not acquire the dwelling as a trustee of a deceased estate.

The taxable capital gain or capital loss with the partial exemption is calculated as follows:

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in your ownership period}}$$

'Non-main residence days' is the number of days in the taxpayer's ownership period when the dwelling was not their main residence.

In some situations a taxpayer may be able to choose to treat a dwelling as their main residence for a particular period of time even if they did not live in it during that time — making such a choice would reduce the number of non-main residence days.

The capital gain or loss may be further adjusted if the dwelling was used for income-producing purposes — see **page 72**.

The partial exemption does not apply where the taxpayer was an excluded foreign resident or a foreign resident who does not satisfy the life events test at the time of the CGT event (see **page 96**).

Main residence exemption — special rules

Absence from the dwelling

The absence rule — s. 118-145

After a taxpayer moves out of their main residence, they may choose to continue to treat the dwelling as their main residence as follows:

Circumstance	Absence rule application
The taxpayer uses the part of the dwelling that was their main residence for the purpose of producing assessable income ▪ a special acquisition and cost base rule may apply (see **page 75**)	Maximum period of six years
The dwelling is not used for the purpose of producing assessable income	Indefinitely

The taxpayer cannot treat any other dwelling as their main residence for any period for which they choose to apply the absence rule to their first main residence.

The absence rule only allows the taxpayer to choose to *continue* to treat a dwelling as their main residence (i.e. it was already their main residence) — it does not allow the taxpayer to stop treating it as their main residence, and to then resume treating it as their main residence while still absent from the property.

The six-year maximum period is reset each time the dwelling becomes and ceases to be the taxpayer's main residence, i.e. it is not a lifetime limit.

Example 6 — Six-year absence rule
Gary moved out of his main residence (Property A) in April 2005. He moved interstate, lived in a rental property and rented out Property A for 8.5 years. He returned and moved back into Property A in October 2013. Gary bought a new home (Property B) and moved into it in October 2017. He retained Property A as a rental property. He may potentially move back into Property A in the future depending on his work situation. Gary is entitled to choose Property A as his main residence from April 2005 to April 2011, even though he was living interstate. Property A cannot be his main residence between April 2011 to October 2013. Gary is also entitled to choose Property A as his main residence for a period commencing October 2017 and ending at any time of his choosing but no later than October 2023. If he makes this choice, he cannot treat Property B as his main residence during the same period. If he subsequently sells either Property A or Property B, he would need to consider whether it would be more beneficial to treat Property A or Property B as his main residence during the six-year period from October 2017 to October 2023.

Absence rule for compulsory acquisition and destruction — s. 118-147

Where a taxpayer is absent from their dwelling and is treating it as their main residence under the absence rule (see **page 69**), the absence rule may be modified if the following conditions are met:

1. a 'key event' happens to the dwelling, notably including if the dwelling is destroyed or compulsorily acquired[79]
2. the taxpayer ceases to have any ownership interest in the old dwelling, or the dwelling must be destroyed
3. the taxpayer acquires a replacement dwelling (the substitute dwelling) or vacant land (the substitute land) no later than one year after the end of the income year in which the key event happens, or within further time as allowed by the Commissioner.

Under the modified rule, the taxpayer may choose to treat:

- the substitute dwelling, or
- a dwelling they build on the substitute land within four years after the later of the key event and when the land is acquired,

as their main residence from the later of:

- when the substitute dwelling or land is acquired, or
- one year before the key event happened.

[79] Other key events, listed in s. 124-70(1), includes: a disposal of land over which a mining lease was compulsorily granted and the non-renewable of a lease granted by an Australian government agency.

The modified absence rule applies as follows:

Circumstance	Absence rule application
The taxpayer uses all or part of the substitute dwelling or land for the purpose of producing assessable income ▪ a special acquisition and cost base rule may apply (see **page 75**)	Maximum period of six years
Just before the key event, the taxpayer used all or part of the old dwelling for income producing purposes	The part of the six year period in the absence rule in relation to the old dwelling that has not passed before the key event ▪ i.e. the total of the combined application of the absence rule and the compulsory acquisition rule is six years
The substitute dwelling or land is not used for the purpose of producing assessable income	Indefinitely

No other dwelling can be treated as the taxpayer's main residence at the same time that the subsequent dwelling is treated as their main residence.

Changing main residence — the six-month rule — s. 118-140

When a taxpayer acquires a dwelling that is to become their main residence and they have not disposed of their existing main residence, both dwellings are treated as their main residence for the shorter of:

- six months ending when the taxpayer's ownership interest in the existing main residence ends, or
- the period during which the taxpayer has an ownership interest in both dwellings.

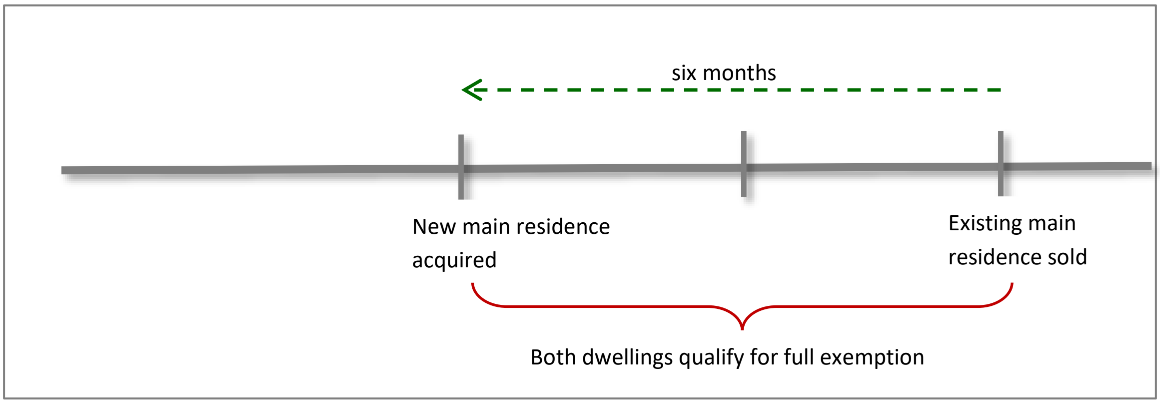
This overlap rule only applies if the taxpayer's existing main residence:

- was their main residence for a continuous period of at least three months during the final 12-month period of their ownership period
- was not used for the purpose of producing assessable income in any part of that 12-month period when it was not their main residence.

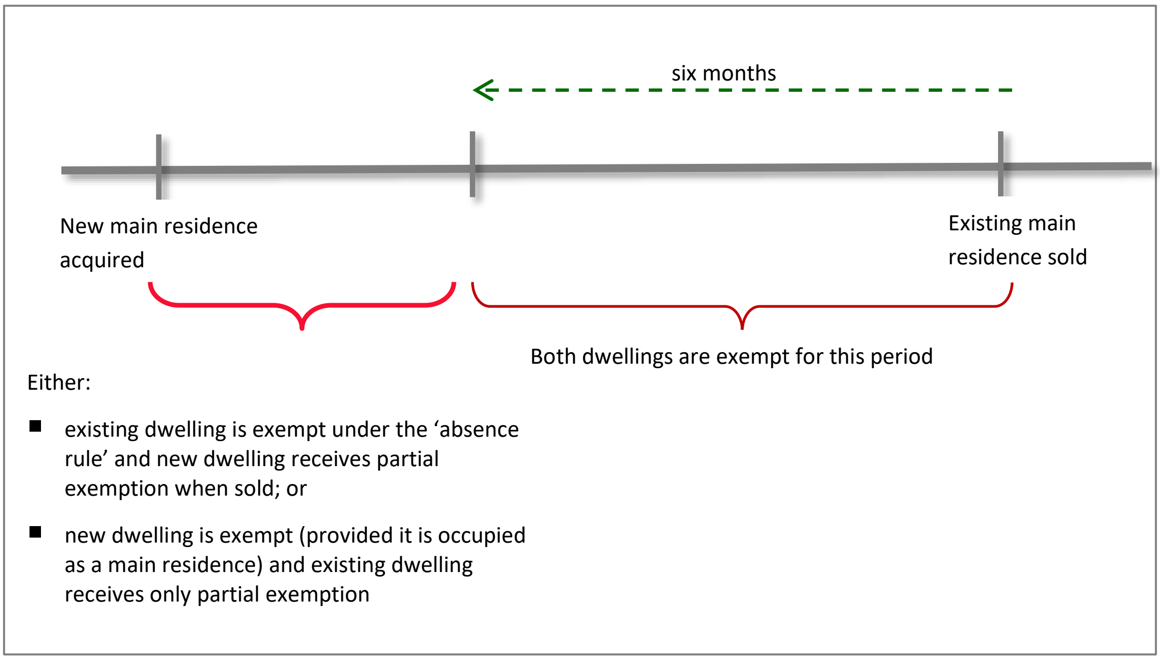
Important

The six-month period is counted from the cessation of the ownership interest, i.e. the taxpayer counts the six months backwards from the settlement on a disposal of the property.

Existing main residence is sold within 6 months of acquiring new one



Existing main residence is sold more than 6 months after acquiring new one



Earning income from the dwelling

A partial exemption — s. 118-190

A partial exemption applies if:

- the dwelling was the main residence of the taxpayer or someone else during a period
- apart from this provision, the taxpayer would not make a capital gain or capital loss, or would make a lesser capital gain or loss than if Subdiv 118-B had not applied
- the dwelling was used for the purpose of producing assessable income during all or a part of that period
- if the taxpayer had incurred interest on money borrowed to acquire the dwelling — they could have deducted some or all of that interest (see below).

The capital gain or capital loss is increased by an amount that is reasonable having regard to the extent to which the taxpayer would have been able to deduct that interest.[80]

The reasonable increase

TD 1999/66 sets out the factors that should be taken into account in determining the 'amount that is reasonable'. If part of a dwelling is used for income-producing purposes, it is usual for the interest deduction to be worked out on an area basis, being the percentage of the total floor area that is used for income-producing purposes. The time that the area has been used for income-producing purposes would also be taken into account.

In some cases it may be more appropriate to work out the interest deduction on some other basis such as a valuation basis. For example, the valuation basis may be appropriate if it can be shown that the value of the income-producing part of the dwelling as a proportion of the value of the entire dwelling is more or less than the proportion of the income-producing part calculated on an area basis.

Example 7 — Determining the amount that is reasonable

Peter owns a home that he lived in since October 2017. In October 2018, after taking a redundancy package, he extended the rear of the home and built a studio for his photography business. He has conducted business from these premises since October 2019. Peter borrowed $70,000 to build the studio. On the basis that the interest on the $70,000 relates solely to the studio, Peter has claimed 100 per cent deduction. In October 2022, Peter sells the property.

Peter is taken by s. 118-192(2) to have acquired it in October 2019 for its market value. Having regard to the market value acquisition cost Peter made a capital gain of $100,000 on the disposal of the property in October 2022.

As the dwelling was Peter's main residence for the whole period from October 2019 (when he is taken to have acquired the dwelling) to October 2022, apart from s. 118-190(2) he would have been able to disregard the $100,000 capital gain, so that he would have made a capital gain of nil.

Section 118-190(2) requires Peter to increase the capital gain that he would have made by an amount that is reasonable having regard to the amount of interest he would have been able to deduct had he borrowed to acquire the whole house, including the studio, and incurred interest. The interest Peter actually incurred on the money he borrowed to build the studio is irrelevant.

Under the hypothetical test, assuming that the studio is 10 per cent of the floor space of the house, the proportion of the hypothetical interest deduction is 10 per cent. Peter would increase the capital gain from nil to 10 per cent of the capital gain made on the disposal of the house (10 per cent of $100,000, being $10,000). No adjustment is made to take account of the use of the property prior to October 2019 because Peter is not regarded as having owned it before that time.

Source: Adapted from Example 2 in TD 1999/66

Some income-producing use not taken into account

If the taxpayer is treating a dwelling as their main residence under the absence rule (see **page 69**) or the absence rule that applies to compulsory acquisitions and destruction (see **page 70**), the calculation of the reasonable increase does not take into account any use of the dwelling for the purpose of producing assessable income to the extent that it was not used for that purpose just before it last ceased to be the taxpayer's main residence.

80 Section 118-190(2).

If the taxpayer inherited the dwelling as a beneficiary in a deceased estate or owned it as the trustee of a deceased estate, then any use of the dwelling for the purpose of producing assessable income is ignored if the dwelling was:

- the deceased's main residence just before their death
- not being used for the purpose of producing assessable income just before the deceased's death.

Example 8 — Application of s. 118-190 — inherited dwelling
Mike acquires a house as a beneficiary in a deceased estate. He rents it out for 12 months and sells it within two years of the deceased's death. Mike can ignore the rental because the MRE rules do not require the house to be his main residence during the two years after the death (see **page 84**).
Source: Adapted from example in s. 118-190(1)

Interest deductibility for a 'home office'

As a general rule, expenses associated with a taxpayer's home are of a private or domestic nature, and are therefore not deductible under s. 8-1. However, it is well-settled law that exceptions to this general rule apply where part of the home is used:

1. for income-producing activities and has the character of a 'place of business', or
2. in connection with the taxpayer's income earning activities — e.g. a room used as a study or home office merely as a matter of convenience.

A portion of mortgage interest is only deductible where an area of the home is a 'place of business'.[81]

Whether an area of a home is a place of business is a question of fact. A place of business is most likely to exist where an area of the home is set aside for carrying on a business by a self-employed person or for use as a taxpayer's sole base of operations for income-producing activities, e.g. where no other location is provided to an employee by an employer.[82]

An area that has been set aside in a home is more likely to have the character of a 'place of business' if the area is:[83]

1. clearly identifiable as a place of business
2. not readily suitable or adaptable for use for private or domestic purposes in association with the home generally
3. used exclusively or almost exclusively for carrying on a business, or
4. used regularly for visits of clients or customers.

However, the existence of any of these factors, or a combination of them, will not necessarily be conclusive. A decision on whether an area has the character of a place of business will depend on the essential character of the area, the nature of the relevant business and any other relevant factors.

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81 Mortgage interest is an 'occupancy cost'. Occupancy costs are only deductible where an area of the home is a place of business. 'Running expenses' are deductible whether there is a place of business, or the taxpayer works from home as a matter of convenience. The part of a home that can be characterised as a place of business loses its domestic character and therefore a broader range of deductions is available.

82 Paragraph 4 of TR 93/30.

83 Paragraph 5 of TR 93/30.

Note

- The absence of an alternative place to conduct income-producing activities has also been a factor which courts have taken into account in determining whether part of a taxpayer's residence is a place of business.
- The factors are also relevant to an employee who works in a home office, however in this case, it is the employer's business which is the relevant business that must be examined.

Income-producing use by someone else

TD 1999/71 confirms that if part of the taxpayer's dwelling is used by someone else (e.g. a spouse, a child, another relative or a business partner) for an income-producing purpose, s. 118-190 does not reduce the MRE to which the taxpayer is entitled — see the following example:

Example 9 — Income-producing use of dwelling by someone other than the taxpayer
David owns a six-bedroom home which he and his wife Sophie have used as their main residence since it was purchased in 1995. Sophie has a physiotherapy practice and the two front rooms of the home are used exclusively by Sophie for her practice. Sophie and David live in the remainder of the home. If David had incurred interest on money borrowed to acquire the home, he could not deduct any of that interest under s. 8-1 because it would not be incurred in gaining or producing his assessable income. Because David would not be entitled to any interest deduction, s. 118-190 does not apply to reduce David's entitlement to a MRE when a CGT event happens in relation to the dwelling. *Source: Example in TD 1999/71*

Cost base adjustment at first use to produce income — s. 118-192

A cost base adjustment rule applies where:

- the taxpayer would get only a partial exemption because the dwelling was used for the purpose of producing assessable income
- that use occurred for the first time after 7.30 pm by legal time in the ACT on 20 August 1996[84]
- the taxpayer would have been entitled to a full exemption if the CGT event had happened just before the first time (the income time) it was used for that purpose.

Section 118-192 can only apply in relation to the start of the first income producing period, but not to subsequent ones even if there is a break between them during which no income was produced.

In calculating the capital gain or loss, the taxpayer is taken to have acquired the dwelling at the income time for its market value at that time.

[84] For dwellings acquired before this time, see s. 118-195 of the *IT(TP)A 1997*.

Note

The cost base adjustment only applies if the dwelling would attract a partial MRE. It does not apply where the dwelling is rented for less than six years and the taxpayer makes a choice under the absence rule to continue to treat it as their main residence during the entirety of that rental period.

If the dwelling passed to the taxpayer as a beneficiary in a deceased estate, or they owned it as the trustee of a deceased estate, and the CGT event did not happen within two years of the deceased's death:

- the taxpayer is treated as having acquired the dwelling as an individual and not as a beneficiary or trustee of a deceased estate
- in applying the partial exemption formula in s. 118-185 — the non-main residence days were the number of days in the taxpayer's ownership period when the dwelling was not the main residence of any of the following:
  - the spouse of the deceased immediately before the death (except a spouse who was living permanently separately and apart from the deceased)
  - an individual who had a right to occupy the dwelling under the will, or
  - a beneficiary to whom the dwelling had passed.

Compulsory acquisitions of adjacent land only — s. 118-245

Section 118-245 sets out how the MRE rules apply where the CGT event happens only to adjacent land but not to the dwelling.

The rules differ according to whether the total adjacent land is two hectares or less, or more than two hectares. The size of the land is measured as the sum of:

- the area of all of the dwelling's adjacent land at the time of the CGT event
- the area of the land immediately under the dwelling
- if s. 118-245 had applied for an earlier CGT event — the reduction in area arising from that event.

These rules do not apply if, at the time the CGT happens, the taxpayer is an excluded foreign resident, or a foreign resident who does not satisfy the life events test (refer to **page 96**).

Note

In a private binding ruling[85], the ATO has confirmed that these rules will apply where certain rights over adjacent land are compulsorily created or varied, e.g. the grant of an easement.

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[85] No. 1012552360275.

Total adjacent land is two hectares or less — s. 118-245(1)

If the total adjacent land is two hectares or less — the capital gain or capital loss is disregarded if:

- the exempt land is all or part of a dwelling's adjacent land at the time of the CGT event
- one of the following applies:
  - the dwelling was the taxpayer's main residence throughout all or part of their ownership period
  - the taxpayer's ownership interest passed to them as a beneficiary in a deceased estate, or
  - the taxpayer owns their ownership interest as the trustee of a deceased estate
- the compulsory acquisition rules in s. 118-250 apply.

Total adjacent land is more than two hectares — s. 118-245(2)

If the total adjacent land is more than two hectares, the MRE only applies to the portion of the land that constitutes the 'maximum exempt area'. Very broadly described, the maximum exempt area is two hectares less the amount of land that has previously been subject to exemption under this provision in relation to a previous CGT event.

The detailed formula for calculating the maximum exempt area for the CGT event in s. 118-255 is set out in the **Appendix** at **page 106**.

Compulsory acquisitions of adjacent land — s. 118-250

Section 118-250 applies to the CGT event and the exempt land where there is a compulsory acquisition of the exempt land by:

- an Australian government agency, or
- an entity under a power conferred by an Australian law,

including after negotiation with the acquirer, or under a surrender of the land, or a conferral of an interest in relation to the land, or the taxpayer's ownership interest not being renewed by a government agency.

Partial exemption — s. 118-260

A partial exemption applies if:

- the dwelling was not a main residence for the relevant period, or
- the dwelling was used for the purpose of producing assessable income during the relevant period.

The capital gain or loss is increased by an amount that is reasonable having regard to the extent that either of the above circumstances applied.

The legislation requires that in calculating a 'reasonable increase', the taxpayer is to have regard to the MRE principles that would apply if the CGT event happened in relation to a dwelling instead of adjacent land.

For example, some potential bases of determining the reasonable increase could include the proportion of ownership days for which the dwelling was not the taxpayer's main residence, or the percentage of the dwelling used to produce assessable income.[86]

Adjacent structures — s. 118-265

Sections 118-245 to 118-260 also apply to an adjacent structure of a flat or home unit in a corresponding way to the way they apply to a dwelling's adjacent land.

[86] In private binding ruling no. 1012552360275, in a situation where the property was the taxpayer's main residence for only part of their ownership period, the capital gain or capital loss with a partial MRE will need to be calculated by applying the following formula: Capital gain or loss amount × (number of non-main residence days / total days in ownership period).

Family matters

Spouse with different main residence — s. 118-170

If, during a period, a taxpayer and their spouse each have a different main residence, then the taxpayer and their spouse must either:

- choose one of the dwellings as the main residence of both of them for the period (despite one of them not living in it), or
- nominate the different dwellings as their respective main residences for the period.

Definition of 'spouse'

For the purpose of this rule, a spouse is as defined in s. 995-1, and excludes a spouse living permanently and separately apart from the taxpayer.

If they nominate different dwellings for a period, they must split the exemption in respect of the period as follows:

Interest owned in dwelling	Exempt for entire ownership period	Exempt for 50% of ownership period
Taxpayer owns **≤ 50%** of dwelling nominated as the **taxpayer's** main residence	✓	
Taxpayer owns **> 50%** of dwelling nominated as the **taxpayer's** main residence		✓
Spouse owns **≤ 50%** of dwelling nominated as the **spouse's** main residence	✓	
Spouse owns **> 50%** of dwelling nominated to be the **spouse's** main residence		✓

Implications

- If a taxpayer chooses to treat one of their dwellings as their main residence for their entire ownership period, they cannot apply the absence rule in s. 118-145 in relation to the other dwelling in order to continue to treat that other dwelling as their main residence, except to the extent that the rule about changing main residences applies.
- Nothing prevents either spouse from nominating the other spouse's dwelling as their main residence so that a full exemption is obtained on the disposal of that dwelling.

In a common situation where spouses jointly own two homes equally (50 per cent each), they can each choose a different main residence for the period and be entitled to claim the MRE in respect of their interest for the entire period (subject to the usual reductions that may apply where it was used for income generation).

Where the spouses own a property as tenants in common in unequal shares, depending on the proportional interests held in both dwellings it may be preferable for both spouses to nominate one property as their main residence for the entire period to avoid a situation where one spouse may be able to treat a property as main residence for only half of the period. However this would mean that the subsequent disposal of the other property would be eligible for only a partial MRE or no exemption at all. The taxpayers will have to make this decision based on their intentions, and other factors such as relative capital growth.

Example 10 — Spouses nominating main residence
Henry and his spouse Maggie own a town house as tenants in common in equal shares. Henry and Maggie also own a beach house as tenants in common, with Henry's interest being 30 per cent and Maggie's 70 per cent. From 1 July 2021, Henry lives mainly in the town house and Maggie lives mainly in the beach house. On 1 July 2022 Henry and Maggie dispose of both dwellings. For the period 1 July 2021 to 30 June 2022 Henry nominates the town house as his main residence and Maggie nominates the beach house. The town house is taken to be Henry's main residence during the period. The beach house is taken to be Maggie's main residence during half the period. Alternatively, both Henry and Maggie could nominate the town house as their main residence for the entire period — in which case, neither of them will be entitled to claim the MRE in respect of the same period for the beach house. *Source: Adapted from the example in s. 118-170*

Child with different main residence — s. 118-175

Where a taxpayer has a child who is under 18 and is dependent on the taxpayer for economic support, if the taxpayer and the child have different main residences for a particular period, then the taxpayer must choose one of those dwellings as the main residence of both individuals.

This may happen in circumstances where there has been a marriage or relationship breakdown where the child does not exclusively live with the parent, or where a parent works in another city and the child lives in their dwelling with another caregiver.

Marriage or relationship breakdown

Where the roll-over previously applied — s. 118-178

Section 118-178 applies to a CGT event where the taxpayer had acquired the ownership interest in the dwelling from their former partner as a result of a previous CGT event in respect of which a Subdiv 126-A roll-over applied (for a brief background on when the roll-over applies, refer to the **Appendix** at **page 106**).

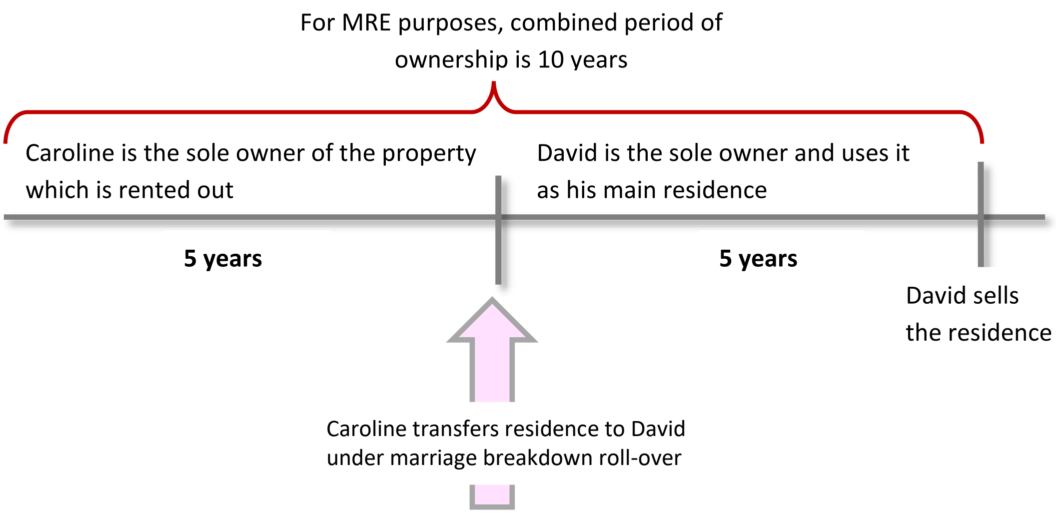
In working out the MRE that applies to the current CGT event, it is assumed that:

- the taxpayer's ownership interest had commenced when the former partner acquired it
- during the former partner's period of ownership:
    - the taxpayer had used the dwelling in the same way that the former partner used it
    - the dwelling had been the taxpayer's main residence for the same number of days as it was the former partner's main residence.

Example 11 — Main residence exemption and marriage breakdown

Caroline (the transferor spouse) is the 100 per cent owner of a dwelling that she used only as a rental property for five years before transferring it to David (the transferee spouse).

David uses the dwelling only as a main residence for five years before selling it. David will be eligible for a 50 per cent MRE having regard to how both Caroline and David used the dwelling.



Source: Example 1.1 of the Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 4) Act 2006

Cost base implications

Where a taxpayer acquired the dwelling, or an interest in the dwelling, in a marriage or relationship breakdown arrangement that was subject to the Subdiv 126-A roll-over, the *first element* of the dwelling's cost base and reduced cost base in the taxpayer's hands is equal to the cost base and reduced cost base (inclusive of all elements) in the hands of the transferor at the time of the transfer.

Incidental or other costs incurred may form other elements of the cost base. While these costs may include conveyancing costs and stamp duty incurred upon the transfer, they will not include general legal costs relating to the relationship breakdown or property settlement.[87]

[87] ATO. Calculating CGT on a rollover asset (QC 66065).

Example 12 — Cost base implications in a marriage breakdown
Darren and Sue jointly owned their family home in equal shares. At the time of acquisition, the cost base for each spouse was $250,000. Darren and Sue divorce. Under a court order, Sue transferred her 50 per cent share to Darren. At this time the market value of the property was $900,000. The disposal of Sue's interest was subject to a roll-over under Subdiv 126-A. Darren sells the dwelling 15 years later, after moving out of it and using it for rental purposes. Darren is only entitled to a partial MRE. In calculating his taxable capital gain, he treats his original 50 per cent interest and the interest he subsequently acquired from Sue as two separate CGT assets. The entire cost base of his original interest is $250,000. The first element of cost base of the subsequently acquired interest is $250,000 — the cost base of this interest may increase if Dave has incurred expenditure in relation to any other elements of cost base.

Acquiring dwelling from company or trust — s. 118-180

A taxpayer may acquire an interest in land or a dwelling from a company or a trustee in the course of a marriage or relationship breakdown.

Where the Subdiv 126-A roll-over was available to the company or trustee, for Subdiv 118-B purposes the taxpayer (i.e. the transferee spouse) is treated as if they owned the land or dwelling when the company or trustee actually owned it. That is, the taxpayer is deemed to have acquired it when the company or trustee acquired it.

However, the dwelling cannot be treated as the taxpayer's main residence during that period. This rule overrides any other provision in Subdiv 118-B.

Granny flat arrangements

The granny flat arrangement provisions in Div 137 of the *ITAA 1997*[88] are not part of the MRE rules in Subdiv 118-B, but they need to be considered in a discussion about the MRE as granny flats and similar structures are often on the same land as the owner's main residence dwelling.

From 1 July 2021, a CGT exemption applies when a qualifying granny flat arrangement is created, varied or terminated. Of particular relevance to this paper is when:

- a granny flat arrangement is terminated upon the sale of the property, including the main residence and the granny flat — in which case the taxpayer and the granny flat tenant all have to move out, or
- a granny flat arrangement is created when, for example, a family downsizes from a single large multi-generational home in which the taxpayer's immediate family and their parent lived, to a smaller home with a granny flat for the taxpayer's parent.

The exemption does not apply to other CGT events relating to the granny flat.

A granny flat arrangement is eligible for the CGT exemption if:

- the owner(s) of the property are individuals
- one or more eligible individuals have an eligible 'granny flat interest' in the property

[88] This section only provides a brief overview of the operation of the granny flat exemption. For more detail see Div 137 and the ATO fact sheet 'Granny flat arrangements and CGT' (QC 66038).

- the owner(s) and the individuals with the granny flat interest enter into a written and binding granny flat arrangement which is not commercial in nature.

An individual has an eligible 'granny flat interest' if they have a right to occupy a property for life under a granny flat arrangement. The interest can be held in any type of property, provided it is a dwelling, and may be in part or all of the property. For example, the granny flat interest can be held in a separate structure in the backyard of the owner's family home, or it could be held in one or more rooms within the main family home.

The individual holding the interest can be anyone, including a family member or friend of the owner of the property. They must either:

(i) have reached pension age, or

(ii) require assistance for day-to-day activities because of a disability.[89]

Example 13 — Interaction with the sale of a main residence
Jim and Joan are of pension age. They live in a home on a large block, which they are struggling to maintain. They decide to sell their home and buy a six-bedroom home in their son, Isaac's, name. The home can accommodate themselves and Isaac's family. Jim and Joan: ■ sell their old home for \$800,000. The sale is exempt from CGT under the MRE ■ buy a new home for \$600,000 ■ transfer the additional \$200,000 to Isaac ■ create a written granny flat arrangement with Isaac. All the requirements of a granny flat arrangement have been met. Therefore, Isaac will have no CGT consequences for granting the granny flat interest to Jim and Joan. Some years later, Isaac and his spouse separate. Isaac sells the six-bedroom family home and buys another home not too far away. ■ Isaac is entitled to the main residence exemption on the six-bedroom home, so there is no CGT when he sells it. ■ Jim, Joan and Isaac move into the new family home and vary their written granny flat arrangement so that it covers the new home. ■ As Jim and Joan are still eligible to enter a granny flat arrangement, there are no CGT consequences for Isaac when the arrangement is varied. *Source: Adapted from the example in ATO fact sheet 'Granny flat arrangements and CGT' (QC 66038)*

[89] ATO fact sheet 'Granny flat arrangements and CGT' (QC 66038) provides guidance in relation to the second requirement. Generally, an individual who is eligible for the disability support pension would meet this requirement. However, the individual does not need to be eligible for the disability support pension to meet this requirement. The individual does not meet the eligibility requirements if they only need assistance due to injuries from which they expect to recover within 12 months.

Death and inheritance

Inherited dwellings — s. 118-195

A capital gain or capital loss is disregarded if[90]:

1. the taxpayer is an individual and the ownership interest passed to them as a beneficiary in a deceased estate, or the taxpayer owned it as the trustee of a deceased estate
2. the deceased was not an excluded foreign resident just before death
3. at least one of the following apply:
   (a) the deceased acquired the dwelling on or after 20 September 1985 and the dwelling was the deceased's main residence just before death and was not then being used for the purpose of producing assessable income[91], or
   (b) the deceased acquired the dwelling before 20 September 1985
4. at least one of the following apply:
   (a) the taxpayer's ownership interest (i.e. settlement) ends within two years of the death, or within a longer period allowed by the Commissioner (see below — PCG 2019/5), or
   (b) the dwelling was, from the deceased's death until the taxpayer's ownership interest ends, the main residence of one or more of:
      (i) the spouse of the deceased immediately before the death (except a spouse who was living permanently separately and apart from the deceased)[92]
      (ii) an individual who had a right to occupy the dwelling under the will[93, 94], or
      (iii) if the CGT event was brought about by the individual to whom the ownership interest passed as a beneficiary — that individual.[95]

A partial exemption under s. 118-200 may apply — see **page 87**.

Section 128-15 sets out the modifications to cost base and reduced cost base in the hands of the beneficiary or legal personal representative who acquires the dwelling:

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90 Only CGT events A1, B1, C1, C2, E1, E2, F2, K3, K4 and K6 (except one involving the forfeiting of a deposit), and a CGT event that involves the forfeiting of a deposit as part of an uninterrupted sequence of transactions ending in one of the specified events.

91 Special rules apply for dwellings acquired before 7.30 pm on 20 August 1996 — see s. 118-195 of the *IT(TP)A 1997*.

92 Disregard if the deceased was an excluded foreign resident just before their death.

93 Disregard if the deceased was an excluded foreign resident just before their death.

94 See TR 2006/14 for the Commissioner's views in relation to the CGT consequences of creating life and remainder interests in property and of later events affecting those interests.

95 Disregard if the individual was an excluded foreign resident at the time of the CGT event.

Dwelling	First element of cost base and reduced cost base
A dwelling, acquired post-CGT, that was the deceased's main residence just before they died if, at that time: ■ the dwelling was not being used for the purpose of producing assessable income ■ they were not an excluded foreign resident	The market value of the dwelling on the day of death
Any other post-CGT dwelling	The cost base and reduced cost base of the dwelling in the hands of the deceased on the day of death
A pre-CGT dwelling	The market value of the dwelling on the day of death **Implications** Although the dwelling loses its pre-CGT status, only any increase in value subsequent to the date of death is taxable.

PCG 2019/5 — the Commissioner's discretion to extend the two-year period

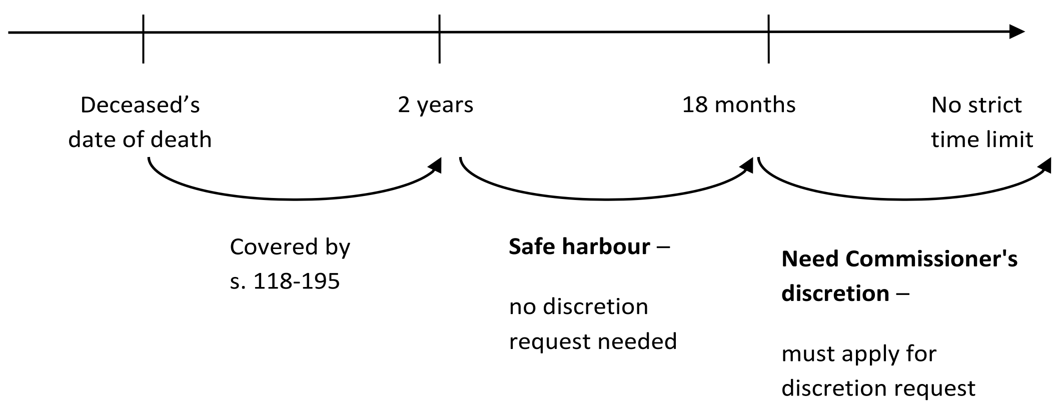
PCG 2019/5 (the Guideline)[96] states that generally, the ATO will allow a longer period where the dwelling could not be sold and settled within two years of the deceased's death due to reasons beyond the taxpayer's control that existed for a significant portion of the first two years.

The Guidelines outlines:

- a safe harbour compliance approach that allows the taxpayer to manage their tax affairs as if the Commissioner had exercised the discretion to allow a longer period
- the factors the ATO will consider when deciding whether to exercise the discretion to extend the 2-year period.

96 The Guideline was updated on 30 September 2022.

PCG 2019/5 operates as follows:



The Guideline contains 10 examples which illustrate how the safe harbour can apply in various situations and how the ATO would approach exercising the discretion.

Safe harbour conditions

A taxpayer can manage their tax affairs as if the Commissioner had allowed a period longer than two years, if their circumstances satisfy the following conditions:

- during the first two years, more than 12 months was spent addressing one or more of the circumstances described below in (i)
- the dwelling was listed for sale as soon as practically possible after those circumstances were resolved (and the sale was actively managed to completion)
- the sale was completed (settled) within 12 months of the dwelling being listed for sale
- if any of the circumstances listed below in (ii) were applicable, they were immaterial to the delay in disposing of the interest
- the longer period for which the taxpayer would otherwise need the discretion to be exercised is no more than 18 months.

(i) Circumstances that took more than 12 months to resolve

One or more of the following circumstances must have taken more than 12 months to address:

- the ownership of the dwelling, or the will, is challenged
- a life tenancy or other equitable interest given in the will delays the disposal of the dwelling
- the complexity of the deceased estate delays the completion of administration of the estate
- settlement of the contract of sale of the dwelling is delayed or falls through for reasons outside of the taxpayer's control, or
- restrictions on real estate activities imposed by a government authority in response to the COVID-19 pandemic.

(ii) Circumstances that cannot be material to delays in disposal

In order to qualify for the safe harbour, none of the following circumstances can have been material to the delay in disposing of the interest:

- waiting for the property market to pick up before selling the dwelling
- waiting for refurbishment of the dwelling to improve the sale price
- inconvenience on the part of the trustee or beneficiary to organise the sale of the dwelling, or
- unexplained periods of inactivity by the executor in attending to the administration of the estate.

Exercising the Commissioner's discretion to extend the two-year period

In considering whether to extend the two-year period, the ATO weigh up all of the factors (both favourable and adverse) having regard to the facts and circumstances of the case. Refer to the Guideline for a discussion of these factors.

A surviving joint tenant — s. 118-197

If the deceased individual and another individual owned ownership interests in the dwelling as joint tenants, the surviving joint tenant is treated as though the deceased's interest had passed to them as a beneficiary in a deceased estate.

Partial exemption for deceased estate dwellings — s. 118-200

A taxpayer gets a partial exemption, or no exemption, if:

- they are an individual and their ownership interest passed to them as a beneficiary in a deceased estate, or they owned it as the trustee of a deceased estate
- s. 118-195 does not apply (i.e. the capital gain or loss is not completely disregarded).

The capital gain or capital loss is calculated as follows:

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Total days}}$$

'Non-main residence days' is the sum of:

- if the deceased acquired the ownership interest on or after 20 September 1985:
  - the number of days in the deceased's ownership period when the dwelling was not the deceased's main residence
  - just before the deceased's death, the deceased was an excluded foreign resident — the number of remaining days in the deceased's ownership period
- the number of days in the period from the death until the taxpayer's ownership interest ends when the dwelling was not the main residence of:

- the spouse of the deceased immediately before the death (except a spouse who was living permanently separately and apart from the deceased)
- an individual who had a right to occupy the dwelling under the will, or
- if the CGT event was brought about by the individual to whom the ownership interest passed as a beneficiary — that individual.

'Total days' is:

Deceased acquired ownership interest …	Total days is the number of days …
Pre-CGT	From the death until the taxpayer's ownership interest ends
Post-CGT	From the acquisition by the deceased until the taxpayer's ownership interest ends

Any non-main residence days and total days in the period from the death until the taxpayer's ownership interest ends are ignored if:

- the deceased acquired the ownership interest on or after 20 September 1985
- the taxpayer's ownership interest ends within two years of the deceased's death, or a longer period allowed by the Commissioner
- the taxpayer gets a more favourable result by ignoring those days
- the deceased was not an excluded foreign resident just before death.

Any non-main residence days before the deceased's death are ignored if:

- the dwelling was the deceased's main residence just before the death
- the dwelling was not being used for the purpose of producing assessable income just before the death, or any use for that purpose just before the death was ignored because of ss. 118-190(3)[97] or (3A)[98]
- the deceased was not an excluded foreign resident just before the deceased's death.

Adjustment for a chain of inheritance — s. 118-205

An adjustment to the partial exemption calculation is necessary if the deceased individual had inherited the dwelling as a beneficiary of a deceased estate, or if they had owned it as the trustee of a deceased estate. The adjustment takes into account the times when the dwelling was the main residence of individuals earlier in the inheritance chain.

The adjustment requires the applicable number of days to be added to the 'total days' and 'non-main residence days' components of the formula.

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97 During any period that the taxpayer continues to treat the dwelling as their main residence under s. 118-145 to the extent that any part of it was not used for that purpose just before it last ceased to be the taxpayer's main residence.

98 During any period that the taxpayer treats the dwelling as their main residence under s. 118-147 to the extent that any part of the old dwelling was not used for that purpose just before the old dwelling last ceased to be their main residence.

Add to 'total days' the fewer of:

- the number of days between 20 September 1985 and the day when the interest was passed to or was acquired as trustee by the most recently deceased
- the number of days between the time when an ownership interest was last acquired on or after 20 September 1985 by an individual, except as a beneficiary in a deceased estate or as trustee of a deceased estate, and the day when the interest passed to or was acquired as trustee by the most recently deceased.

Then, only in relation to the period applicable to the 'total days' adjustment, add to 'non-main residence days' the following:

- the number of days that the dwelling *was not* the main residence of:
  - an individual who owned the dwelling at the time of the individual's death
  - the spouse of the deceased individual immediately before their death (except a spouse who was living permanently separately and apart from the individual)
  - an individual who had a right to occupy the dwelling under a will, or
  - an individual to whom an ownership interest passed as a beneficiary in, or who acquired an ownership interest as trustee of, a deceased estate
- the number of days that the dwelling *was* the main residence of an individual who, just before the individual's death:
  - owned the dwelling
  - was an excluded foreign resident.

Trustee acquiring dwelling under will — s. 118-210

If the trustee of a deceased estate acquires an ownership interest in a dwelling for occupation by an individual under the deceased's will, the following consequences arise upon a CGT event happening.[99] These rules do not apply if the deceased was an excluded foreign resident just before their death.

If a CGT event happens to the interest in relation to the individual and the trustee receives no money or property for it:

- the capital gain or capital loss is disregarded
- the first element of the dwelling's cost base and reduced cost base in the hands of the individual is its cost base and reduced cost base in the trustee's hands at the time of the event
- the individual is taken to have acquired it when the trustee did.

The trustee does not make a capital gain or capital loss if:

- they receive money or property for the CGT event or the event happens in relation to another entity
- the dwelling was the main residence of the individual from the time the trustee acquired the interest until the time of the event.

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[99] Only CGT events A1, B1, C1, C2, E1, E2, E5, F2, K3, K4 and K6 (except one involving the forfeiting of a deposit), and a CGT event that involves the forfeiting of a deposit as part of an uninterrupted sequence of transactions ending in one of the specified events.

However, if the dwelling was the main residence of the individual for only part of that period, the trustee makes a capital gain or capital loss calculated as follows:

$$\text{Capital gain or capital loss amount} \times \frac{\text{Non-main residence days}}{\text{Days in that period}}$$

'Non-main residence days' is the number of days in that period when the dwelling was not the individual's main residence.

Implications for deceased and legal personal representative

When a taxpayer dies, a capital gain or capital loss from a CGT event happening to a CGT asset they owned just before dying is disregarded.[100] There is no need to apply the MRE for the capital gain to be disregarded.

Exceptions apply and CGT event K3 may arise — a capital gain or loss under CGT event K3 is not disregarded.

Any capital gain or capital loss the legal personal representative makes if the dwelling passes to a beneficiary in the deceased estate is also disregarded.[101] Again, there is no need to consider the MRE.

CGT event K3

CGT event K3 happens if an individual dies and their post-CGT dwelling passes to a beneficiary who is an exempt entity (certain charitable and non-profit entities which are tax exempt) or is the trustee of a complying superannuation fund (for example the trustee of their family's SMSF).

CGT event K3 will not happen if the dwelling passes to a foreign resident because the dwelling is taxable Australian property.

A capital gain arises if the market value of the dwelling on the day of death is more than its cost base. A capital loss arises if the market value is less than the reduced cost base.

The MRE rules apply to a capital gain or capital loss that the deceased individual makes under CGT event K3 in the same way that they apply to a gain on a disposal that gives rise to a CGT event A1.

[100] Section 128-10.

[101] Section 128-15(3).

Other technical matters

When something is a separate CGT asset from the land

Usually where a building or other structure (e.g. a dwelling) is situated on land, the structure and the land are considered one CGT asset.[102] However there are some situations where this is not the case.

Post-CGT dwelling on pre-CGT land

A building or structure (e.g. a dwelling) that is constructed on land acquired pre-CGT is taken to be a separate CGT asset from the land, if[103]:

- the contract for the construction was entered into on or after 20 September 1985, or
- if there was no contract — the construction started on or after that day.

Depreciating asset that is part of the building

A depreciating asset that is part of a building or structure is taken to be a separate CGT asset from the building or structure.[104]

For example, if a taxpayer installs air conditioning units, evaporative units or solar panels which are physically attached to the house, these items are not treated as being part of the dwelling as a CGT asset. They are separate depreciating assets. If the taxpayer later sells their home, and a full MRE is not available, these depreciating assets are not taken into account in calculating any capital gain or a partial MRE.

Amalgamated pre-CGT and post-CGT land titles

Land acquired post-CGT that is adjacent to land acquired pre-CGT are taken to remain as two separate CGT assets if the land parcels are amalgamated into one title.

The amalgamation is not a CGT event. There is no capital gain or loss and no need to apply the MRE.[105]

The pre-CGT block will retain its pre-CGT status.

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[102] For example see Note 1 in s. 108-5.

[103] Section 108-55(2).

[104] Section 108-60.

[105] Section 112-25(4)(a).

Example 14 — Amalgamating land titles
Wayne bought a block of land (block 1) on 1 April 1984. He lives in a house on the land. On 1 June 2008, he bought another block (block 2) adjacent to the first one. Wayne merged the titles to the two blocks into one title. In 2019 he moves out of the house and turns it into a rental property. The two blocks are treated as separate assets. The pre-CGT block 1 continues to be exempt from CGT. If he subsequently sells it, there will be no taxable capital gain and he will not need to consider the application of the MRE. If Wayne sells the block 2, he will make a capital gain or loss. MRE cannot apply as the dwelling will not be sold with it. *Source: Adapted from the examples in s. 108-65 and ATO fact sheet 'Subdividing and combining land' (QC 66042)*

Capital improvements to post-CGT land

A capital improvement to land is taken to be a separate CGT asset from the land if it is a depreciable asset.[106] This may include improvements such as fences.

Post-CGT capital improvements to pre-CGT land

In some cases, post-CGT capital improvements to pre-CGT land will be treated as being separate post-CGT assets. This means that when the dwelling is sold, the disposal of these separate assets may give rise to a taxable gain even if the original pre-CGT property is exempt.

This may be applicable where a new house or other unit of accommodation is built on pre-CGT land, or another type of capital improvement is made, such as adding a swimming pool or garage.

A post-CGT capital improvement[107] to pre-CGT land, that is not related to any other capital improvement, is taken to be a separate CGT asset if its cost base when a CGT event happens in relation to the land is[108]:

- more than the improvement threshold for the income year in which the CGT event happened, and
- more than 5 per cent of the capital proceeds from the event.

Post-CGT capital improvements to pre-CGT land that are related to each other are taken to be a separate CGT asset if the total of their cost bases when a CGT event happens in relation to the land is[109]:

- more than the improvement threshold[110] for the income year in which the CGT event happened, and
- more than 5 per cent of the capital proceeds from the event.

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106 Section 108-70(1).

107 That is, a capital improvement that took place under a contract entered into on or after 20 September 1985, or if there is no contract, that started or occurred on or after that day.

108 Section 108-70(2).

109 Section 108-70(3).

110 The improvement threshold is $162,899 for 2022–23 ($156,784 for 2021–22 and $155,849 for 2020–21).

Section 108-80 sets out the factors to consider in deciding whether capital improvements are related to each other.

If an improvement (e.g. the house) is treated as a separate asset, the capital proceeds from the disposal or other CGT event must be apportioned between the original asset and the improvement.[111]

For a detailed practical example, refer to the example in the ATO fact sheet 'Property improvements and additions' (QC 66043).

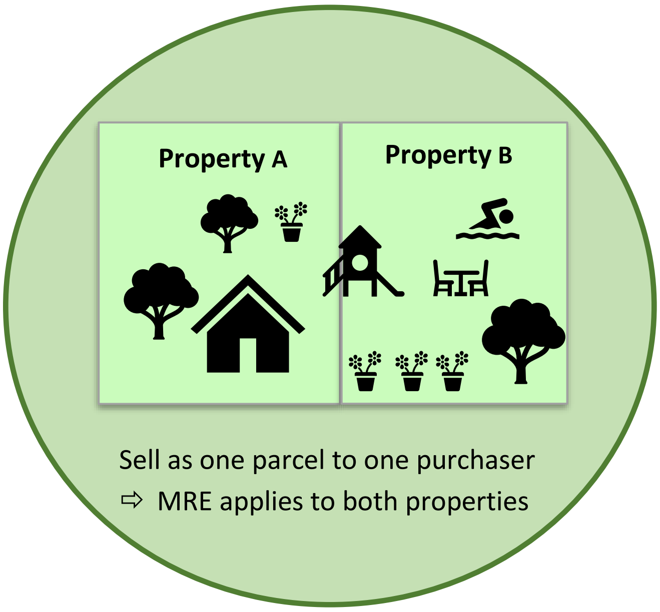
How the MRE applies to the disposal of adjoining titles

The rules extending the MRE to adjacent land do not require that all of the adjacent land is on a single title. Where the taxpayer's dwelling is on one property, and the taxpayer also owns an adjoining property on a separate title, the MRE will extend to the adjacent land on the adjoining property under the usual MRE rules, so long as the properties are sold as one parcel, with the dwelling, to the same purchaser.

Example 15 — Selling two adjacent titles
Tony purchased Property A and signed a building contract for the construction of a domestic residence shortly after. On completion of the home Tony moved into the dwelling with his spouse and used it as his main residence. Tony later purchased an adjacent block of land, Property B, and since then, the two properties have been used for domestic purposes and share a common rear boundary. After acquiring property B, some structures including a garage were constructed and were used in conjunction with the dwelling. The garage was not a separate unit of accommodation. The dwelling was Tony's main residence and there was no business conducted from the property, and it was not used to produce income. The combined properties were listed for sale as one parcel. Tony is entitled to the MRE on the sale of Property B. As Tony disposed of adjacent land (including Property B) to the same person and at the same time as he disposed of his main residence, the exemption extends to the adjacent land.

[111] Section 116-40.

Example 15 — Selling two adjacent titles



Source: Private binding ruling no. 1051561437840

Subdividing the family home

A taxpayer may subdivide the land on which their family home is situated.

For CGT purposes, the subdivided land will become two (or more) separate CGT assets. the disposal of a subdivided block is treated as the disposal of an asset in its own right, and not as a disposal of part of an asset (being the original block of land).[112]

The subdivision is not a CGT event.[113] That is, the taxpayer does not need to calculate capital gains and losses or to consider the MRE when the original block is split.

The MRE exemption will only apply to the disposal of the block which has the family home on it. Even if the taxpayer builds a unit of accommodation on the newly created block, they will not be eligible for the MRE in respect of that dwelling unless they actually live in it before the sale.

The subdivided blocks are taken to have been acquired by the owner of the original land parcel when that original parcel was acquired.[114]

The cost base of the original property is divided between the subdivided blocks on a 'reasonable basis'.[115] TD 97/3 states that approaches that are appropriate in the circumstances may include an area basis or relative market value basis.

[112] TR 97/3 para. 1.

[113] Section 112-25(2).

[114] Section 109-5(1).

[115] Section 112-25(3).

Example 16 — Subdivision of land — reasonable allocation of costs
John subdivides his post-CGT land into two new blocks with a view to selling one and retaining the other. He incurs the following costs: survey fees; legal fees; subdivision application fees; and cost of connecting electricity and water only to the subdivided block to be sold. John includes all of these costs in the relevant cost base of the block to be sold. The ATO considers that this is not a reasonable apportionment. It is reasonable to apportion the survey, legal and subdivision application fees over both blocks. If the blocks are of unequal market value, an apportionment of costs in proportion to the market value of the blocks would usually be a reasonable apportionment. As the cost of connecting the electricity and water relates only to the block to be sold, it would be reasonable to attribute this cost solely to the cost base of this block. A reasonable apportionment of the cost of the land itself can usually be achieved on an area basis if all the land is of similar market value or on a relative market value basis if this is not the case. *Source: Example 2 in TD 97/3*

Further references

- TD 2000/14 — the CGT consequences of subdividing and building on vacant land.
- TaxBanter's Special Topic *Banter's backyard* — tax issues for subdividing a taxpayer's main residence.

Destruction of dwelling and sale of land — s. 118-160

If the dwelling that is the taxpayer's main residence is accidentally destroyed and a CGT event happens in relation to the land on which it was built without the taxpayer erecting another dwelling on the land, for example if the land is sold, the taxpayer can make a choice to treat the land as if it is their main residence and had not been destroyed.

This choice is only available in circumstances where the dwelling was accidentally destroyed; it does not apply where the taxpayer chooses to demolish the dwelling.

For the period for which the choice is made, no other dwelling can be treated as the taxpayer's main residence, except under s. 118-140 (changing main residences).

However, this does not apply to a CGT event that happens in relation to land, or a garage, storeroom or other structure (under the adjacent land rules) if the CGT event does not also happen in relation to the dwelling.[116]

[116] Section 118-165.

Foreign resident and international taxation considerations

Whether a foreign resident is subject to CGT on disposal of Australian dwelling

A foreign resident is not subject to Australian tax on a capital gain or capital loss unless the CGT asset is 'taxable Australian property' (TAP). TAP includes 'taxable Australian real property' (TARP), which includes 'real property situated in Australia'.[117]

The expression 'real property' is not defined in the Tax law. As discussed on **page 52**, a 'dwelling' for Subdiv 118-B purposes is defined and includes 'a caravan, houseboat or other mobile home'. The foreign resident taxpayer may need firstly to consider whether their particular Australian mobile home would be TAP and therefore subject to Australian tax before needing to decide whether they are eligible for the MRE.

If a particular mobile dwelling is not TARP then it may still be TAP if the taxpayer had earlier chosen to disregard a capital gain or loss in respect of the asset on ceasing to be an Australian resident under CGT event I1.[118]

Categories of foreign residents who are ineligible for the MRE — s. 118-110(3)

The MRE is not available to a taxpayer who, at the time of the CGT event, is either:

- an 'excluded foreign resident', or
- a foreign resident who does not satisfy the 'life events test'.

These rules apply to the sale of a property on or after 7.30 pm (AEST) on 9 May 2017. A transitional rule allowed foreign residents to claim the MRE where the dwelling was acquired at or before 7.30 pm (AEST) on 9 May 2017 and was sold on or before 30 June 2020.

Implications

A foreign resident at the time of the CGT event who satisfies the life events test, or a taxpayer who is a resident at the time of the CGT event but who had been a foreign resident for part of the ownership period, may be eligible for the MRE. However if they have a taxable capital gain arising from a partial exemption, they will not be entitled to the full 50 per cent general CGT discount (and potentially entitled to no CGT discount) — see **page 97**.

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[117] See ss. 855-10, 855-15 and 855-20.

[118] Under CGT event I1, a taxpayer makes a capital gain or capital loss on any non-TAP CGT assets that they own just before they cease to be an Australian resident. However an individual taxpayer may choose to disregard the capital gain or capital loss, in which case the asset is treated as TAP until a CGT event happens or the taxpayer again becomes a resident.

Excluded foreign resident

A taxpayer is an excluded foreign resident at a particular time if, at that time[119]:

- they are a foreign resident
- they had been a foreign resident for a continuous period of more than six years.

Life events test

A taxpayer satisfies the life events test, at the time a CGT event happens, if[120]:

- at that time, they had been a foreign resident for a continuous period of six years or less
- any of the following applies:
  - the taxpayer or their spouse has had a terminal medical condition that existed at any time during that period of foreign residency
  - the taxpayer's child has had a terminal medical condition that existed at any time during that period of foreign residency, and the child was under 18 years of age at some time during that period
  - the taxpayer's spouse, or their child who was under 18 years of age, has died during that period of foreign residency, or
  - the CGT event happens because of a matter which is relevant for the marriage breakdown CGT roll-over involving the taxpayer and their spouse (or former spouse).[121]

Reduction of CGT discount for foreign and temporary residents

The general CGT discount is not available to foreign residents and temporary residents who acquired their dwellings after 8 May 2012.[122]

The discount is available but may be reduced if the taxpayer[123]:

- acquired the dwelling on or before 8 May 2012, and/or
- had a period of Australian tax residency after 8 May 2012.

In very broad terms, the applicable discount percentage will reflect the proportion of the ownership period during which the taxpayer was an Australian resident, and with adjustments made to preserve the discount for a period of ownership on or before 8 May 2012. For a summary of how the discount rules operate, see the **Appendix** at **page 107**.

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[119] Section 118-110(4).

[120] Section 118-110(5).

[121] These matters are referred to in s. 126-5(1): a court order under the *Family Law Act 1975* (FLA) or under a relevant state, territory or foreign law; a maintenance agreement under the *FLA* or a corresponding agreement under foreign law; a binding financial agreement under the *FLA* or a corresponding foreign law; an award made in an arbitration under the *FLA* or a corresponding foreign law; something done under a binding written agreement under a relevant state, territory or foreign law.

[122] These rules only apply to CGT events that occur after 8 May 2012.

[123] See ss. 115-105 and 115-115.

Reference

For a detailed CGT discount percentage calculation worksheet, refer to the ATO's 'CGT discount worksheet' (NAT 4151-02).

International double taxation considerations

An Australian tax resident is subject to the CGT rules in respect of any dwelling they own in a foreign country, and they can apply the MRE rules to any such dwelling that they sell.

Foreign — and temporary — tax residents are subject to CGT, including the MRE rules, on the disposal of an Australian dwelling that constitutes TAP. However they will not be subject to Australian CGT on the disposal of a dwelling located overseas, unless it is TAP due to an earlier choice made under CGT event I1.

Where the taxpayer is a resident of one country and the dwelling is located in the other country, a double tax agreement (DTA) between the two countries may potentially apply to the disposal.

Each of Australia's bilateral DTAs may differ, but generally there will be an 'alienation of property' article which allocates taxing rights over income received from the disposal of property.

Depending on the applicable DTA, or if there is no DTA, even if the taxpayer is eligible for the MRE which reduces or eliminates Australian CGT on the disposal they may potentially still be exposed to a tax liability in the foreign country. Further, a capital gain on the disposal of a property may need to be calculated differently in different countries.

In most circumstances where an amount is double taxed, a credit or offset is claimable in the country of residence for tax paid in the other country. In Australia, the foreign income tax offset claimable is limited — very broadly, the cap represents the Australian tax liability on the total of their double taxed amounts. So if an Australian resident is eligible for the MRE in Australia but has paid foreign tax on the disposal of the property, they may not be able to claim much, if any, of the foreign tax paid.

Foreign resident capital gains withholding

The foreign resident capital gains withholding regime in Subdiv 14-D of Schedule 1 to the *TAA* applies to taxpayers disposing of certain assets, including real property, from 1 July 2016. The purchaser is obliged to withhold at the rate of 12.5 per cent of the capital proceeds. There is an exemption for real property where the contract price is less than $750,000.

A resident vendor can avoid the withholding by obtaining from the ATO a clearance certificate, which in broad terms declares that that the vendor is an Australian resident, and providing it to the purchaser prior to settlement.

A foreign resident vendor may apply for a variation of the withholding rate if the 12.5 per cent is higher than the expected rate of the actual tax liability, such as where the vendor is entitled to a partial or full MRE.

The main residence status of the property has no impact on the application of these rules. Withholding tax which is remitted which exceeds the actual tax liability on the capital gain will be refunded to the vendor when they lodge their return.

An overseas main residence

When a taxpayer becomes an Australian resident, special rules apply to an overseas dwelling that they own just before they become a resident[124]:

- the taxpayer is taken to acquire the property at the time they become a resident
- the first element of the cost base and reduced cost base of the property is taken to be its market value at the time the taxpayer becomes a resident.

However, the taxpayer's 'ownership period' for the purposes of calculating the MRE entitlement begins at the time when they obtain legal ownership (see **page 57**). This is not modified by the change of residency deemed acquisition rules.

Therefore even if the taxpayer does not live in the overseas dwelling after they commence Australian residency, they may nevertheless be eligible for a partial MRE when they sell it.

Note

TD 95/7 confirms that a taxpayer can apply the absence rule in s. 118-145 in relation to an overseas dwelling that has ceased to be their main residence before they became a resident.

Special disability trusts

The trustee of a trust that is or has been a special disability trust may be eligible for the MRE to the extent that the dwelling is the main residence of the individual who is or has been the principal beneficiary of the trust.[125]

Another beneficiary may be eligible for an exemption if the dwelling is distributed to that other beneficiary at or after the principal beneficiary's death.

The rules also apply to the exemption about compulsory acquisitions of adjacent land (see **page 76**).

This exemption will not apply if the principal beneficiary is an excluded foreign resident or a foreign resident that does not satisfy the life events test (see **page 96**).

[124] Section 855-45.

[125] The provisions are contained in ss. 118-215 to 118-230.

Administrative matters

Record keeping

Division 121 sets out the CGT record keeping rules.

The general rule is that a taxpayer must keep records of every act, transaction, event or circumstance that can reasonably be expected to be relevant to working out a capital gain or capital loss from a CGT event.

However, there is an exception to the record keeping requirement in respect of any capital gain or capital loss that is to be disregarded (except because of a roll-over, such as the marriage breakdown roll-over).[126]

In a situation where a taxpayer is eligible for the full MRE and disposes of the entire property in one disposal, the exception would apply such that there is no legal obligation to keep records relating to that property. The taxpayer may of course choose to keep records, for example to show that the property is eligible for the full MRE on application of the changing main residences rule, or the absence rule.

A taxpayer will not be exempt from the record keeping requirement where they are only entitled to a partial exemption.

While a taxpayer is living in their main residence, it may be prudent to keep records in case circumstances change and the property is no longer eligible for the full MRE upon its eventual disposal. For example, the taxpayer may eventually acquire another main residence and/or use the main residence for income producing purposes.

If the dwelling was acquired pre-CGT, it will be exempt from CGT regardless of whether it is used for income producing purposes or remains as the taxpayer's main residence — unless the taxpayer adds a capital improvement post-CGT, for which records need to be kept.

[126] Section 121-30.

The ATO suggests that the following records are kept:

Property (generally)	▪ acquisition and related expenses, including: ▪ purchase contract ▪ stamp duty ▪ legal fees ▪ settlement statement ▪ survey and valuation fees ▪ disposal and related expenses, including: ▪ the sale contract ▪ sale settlement statement ▪ legal fees ▪ sales commission ▪ costs of ownership, including: ▪ interest ▪ rates ▪ land taxes ▪ insurance premiums ▪ the cost of repairs ▪ capital expenditure on improvements, such as extensions or additions
Using main residence to produce income (rent or business income)	▪ expenses during the time the taxpayer produced income ▪ the proportion of the property used to produce income ▪ market value of the property at the time it was first used to produce income (after 20 August 1996)
Inherited dwellings	▪ relevant costs incurred by the taxpayer, the deceased former owner and the trustee or executor ▪ the market value of the dwelling at the time the deceased died
Records held by former spouse (property transferred in a marriage breakdown scenario)	▪ how and when the former spouse acquired the property ▪ the property's cost base when it was transferred ▪ the extent to which the former spouse used the property to produce income ▪ the number of days the property was the former spouse's main residence

The taxpayer must retain the records for five years after it becomes certain that no CGT event (or no further CGT event) — for which the records could reasonably be expected to be relevant — can happen.

For example, if the entire property is sold in one disposal, the retention period is five years after that CGT event A1. If some adjacent land is sold or half of the dwelling is transferred to a spouse or relative, then records relating to the property will have to be retained until five years after the remainder of the property is sold.

It is not necessary to retain records if the Commissioner notifies that the taxpayer does not need to retain them.

Penalties for not keeping adequate records

A taxpayer is liable to an administrative penalty of 20 penalty units[127] if they do not retain records relating to the CGT event as required by the law — s. 288-25 of Schedule 1 to the *TAA*.

Because of the exception for disregarded capital gains and losses, these penalties can only apply if records are not kept where there is a partial or no entitlement to the MRE, including where the taxable gain is subject to the Subdiv 126-A roll-over. It is not required by law to keep records where there is a full MRE.

However taxpayers may not have retained adequate records even if their capital gain is partially taxable, for various reasons which may include that:

- they did not contemplate the possibility that they would one day live elsewhere without selling the property
- they did not contemplate the possibility that they would use part or all of the property for income-producing purposes
- they did not know that there is a two-hectare limit for adjacent land
- they became a foreign resident and did not sell the property by 30 June 2020
- they were simply unaware of the specific rules and had assumed that they would receive a full exemption.

PS LA 2005/2 provides guidance to ATO officers on the administration of s. 288-25, including a consideration of whether it would be appropriate to remit all or part of the penalty.

The Commissioner has an unfettered discretion to remit all or part of a penalty. While each case will be considered on its merits, the Practice Statement sets out some relevant matters to consider in making a remission decision:

- whether the ATO is satisfied that the taxpayer has reported the correct tax liability
- the amount of the penalty is not a valid reason for remission alone in the absence of *specific reasons* why it would be unjust in the taxpayer's circumstances.

The ATO should not usually consider:

- behaviour or situations unrelated to the relevant record-keeping obligation, such as the taxpayer becoming ill after the failure to keep records occurred
- whether there is a capacity to pay the penalty.

[127] A penalty unit is currently equal to $222 (legislation is currently before Parliament proposing to increase it to $275 from 1 January 2023). The administrative penalty is currently $4,440 ($5,500 from 1 January 2023).

The Practice Statement states:

- a taxpayer that makes no attempt to keep records or deliberately destroys records will not usually receive any remission of the penalty
- where the ATO cannot verify that the taxpayer is reporting the correct tax liability from the records kept, the penalty will not usually be remitted in full, however a partial remission may be considered
- the penalty will usually be remitted in full where the ATO is satisfied that the taxpayer is reporting the correct tax liability
- the penalty will usually be remitted in full where the taxpayer has made a reasonable and genuine attempt to comply, but the records have been lost or destroyed in circumstances outside the taxpayer's control, and the taxpayer has reconstructed the records to the best of their ability
- where the taxpayer is liable to a record-keeping penalty and a shortfall penalty for the same tax obligation, the ATO may remit part or all of the penalty if retaining both penalties would produce an unjust result, such as where the errors were unintentional and the penalties significantly exceed the actual tax shortfall.

How to deal with lost records

The ATO has also produced some non-binding website guidance in relation to lost records. For missing CGT records, the ATO suggests that the taxpayer may ask their solicitor or real estate agent for a copy of purchase records.[128]

The taxpayer may also be able to access records held by the ATO. Previous years' tax returns may include information that may be relevant to determining a partial MRE, including:

- previous Div 43 capital works deductions
- the basis on which deductions were calculated for a home-based business or for renting out part of the dwelling (note the interest deductibility test in the partial MRE calculation — see **page 72**)
- dates of ceasing residency and becoming a resident again
- dates on which a property commenced to be used for rental purposes or for a home-based business.

Land tax and utilities records may also provide relevant dates.

Apart from solicitors, conveyancers and real estate agents, other third parties which may hold relevant information or records may include mortgage providers, surveyors, or parties contracted to build or renovate the dwelling.

The ATO states on its website that if a taxpayer 'in difficult circumstances' cannot prove claims made in tax returns because their records have been lost or destroyed, it can still accept the claim if it is not reasonably possible to get the original or replacement documents.[129]

128 ATO. Acquiring CGT assets (QC 66015).

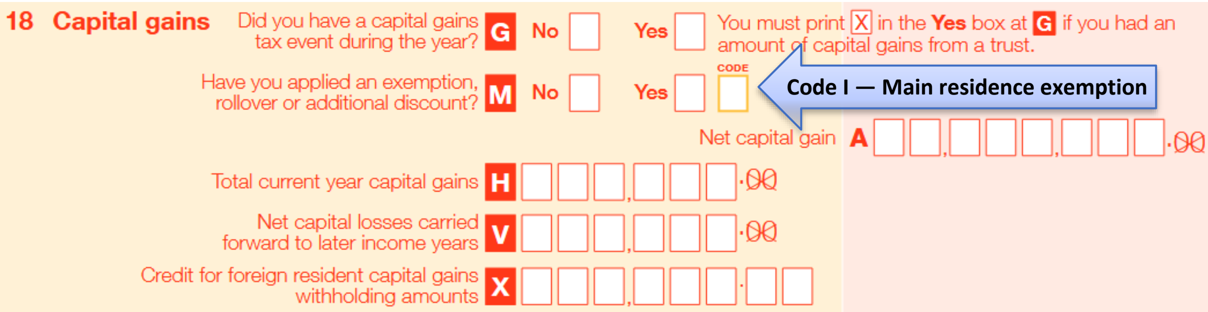
129 ATO. Reconstructing your tax records (QC 67545).

Note that this concessional approach is offered in the context of assistance available to taxpayers 'in difficult times', including a natural disaster or personal crisis. While the ATO may well apply this approach — and/or remit penalties for failing to keep records — to taxpayers not in these circumstances, taxpayers cannot take advantage of this approach to circumvent the record-keeping rules in order to claim a greater MRE than they are actually entitled.

Tax return disclosures

The taxpayer makes the choice to apply the MRE, including a choice to apply the absence rule, in the way they prepare their income tax return.[130]

An individual must disclose the CGT event arising from the sale of their property in their annual tax return. This is the case even if the MRE is applied to the entire gain and there is no assessable amount. The taxpayer also has to disclose if the MRE applies.


18 Capital gains

Did you have a capital gains tax event during the year? G No Yes

You must print X in the Yes box at G if you had an amount of capital gains from a trust.

Have you applied an exemption, rollover or additional discount? M No Yes CODE

Code I — Main residence exemption

Net capital gain A .00

Total current year capital gains H .00

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

Credit for foreign resident capital gains withholding amounts X

Real property transfers reporting regime

State and territory revenue collection agencies and titles offices are obliged to submit a *Real property transfers report* (RPTR) to the ATO on a quarterly basis[131] about transfers of freehold or leasehold interests in real property in their state or territory.[132] This regime commenced on 1 July 2016.

The information required includes:

- property details, including land title information, property address and other descriptors
- transactional information, including transfer price, contract date and settlement date
- identity data of the purchaser/transferee and vendor/transferor, including:
  - name, address and date of birth for individuals
  - name, address and Australian business number (ABN), Australian company number (ACN) or Australian Registered Body Number (ARBN) for non-individuals
  - foreign identity details.

[130] Sections 103-25 and 118-145(4).

[131] Reporters can choose to provide the required data monthly.

[132] See item 3 in the table in s. 396-55 of Schedule 1 to the *TAA*.

The ATO uses the RPTR for a number of reasons including:

- supporting voluntary compliance by providing taxpayers with information about CGT events
- making the information available through pre-filling
- improve compliance for CGT
- improve the integrity of the foreign resident CGT regime.

Note

The ATO undertook a data matching program for the period 20 September 1985[133] to 30 June 2017.[134] Property transaction data was obtained from the revenue offices of every state and territory. The data acquired will continue to be required until all properties have been transferred within the RPTR legislative reporting regime, potentially upwards of 60 years. The ATO has received a seven year exemption from the usual data destruction requirements and it is expected the ATO will continue to seek exemptions on a rolling seven year basis until all real property has transferred to the reporting regime.

133 To determine a CGT liability real property transaction history dating back to 20 September 1985 is required. Collecting data back to 1985 does not change the ATO's general compliance approach of reviewing CGT events within the standard period of review.

134 During the 2016–17 financial year, the ATO identified over 5,431 cases where real property dealings were not treated correctly and which raised an additional $65 million in revenue.

Appendix

Background — Subdiv 126-A roll-over

Subdivision 126-A provides a marriage or relationship breakdown roll-over which may apply to the transfer of a CGT asset, including a dwelling, from one spouse to the other.

The roll-over only applies if:

- the transfer results from a specified type of court order or other formal agreement made under the *FLA* or under another relevant law
- the spouses are separated and there is no reasonable likelihood of cohabitation resuming
- the transfer is for reasons directly connected with the marriage or relationship breakdown.

The transferor spouse disregards any capital gain or loss arising from an eligible transfer. If the transferor would have been entitled to the full MRE then there is no tax saving. However if they are not eligible for a full MRE, they will never be subject to a tax liability.

The transferee spouse essentially inherits the ownership history of the dwelling from the transferor.

If the transfer of the dwelling is made under a private agreement that is not one of the specified types, then the roll-over does not apply and the usual CGT and MRE rules apply. Market value substitution rules for proceeds and cost base may also apply to the transferor and transferee respectively if they did not deal at arm's length.

Maximum exempt area

The maximum exempt area for the CGT event is worked out under s. 118-255 as being two hectares less the amount calculated as follows:

Step 1 Identify each earlier CGT event (if any) that:

(a) happened in relation to land that was part of the dwelling's adjacent land at the time of the earlier CGT event, or happened in relation to their ownership interest in that land at that time

(b) resulted in the taxpayer losing rights to the substantial use and enjoyment of that land either completely or for at least 10 years,

for which the taxpayer made a capital gain or capital loss that was wholly or partly disregarded because of the application of s. 118-245(2).

Step 2 For each of the earlier CGT event covered by step 1, work out the area of the exempt land for that application of s. 118-245(2).

Step 3 Add the results from step 2 to the area of the land immediately under the dwelling.

CGT discount for foreign and temporary residents

The CGT discount rules in Subdiv 115-B apply as follows:

		Asset acquired	
		On or before 8 May 2012	**After 8 May 2012**
Residency	**Foreign/temporary resident at time of CGT event**		
	Period of Australian residency since 8 May 2012 (foreign/temporary resident on 8 May 2012)	If taxpayer has obtained market valuation as at 8 May 2012 — can choose to apply discount to gain accrued up to 8 May 2012. Otherwise — apportion discount based on residency/non-residency periods.	No entitlement to discount.
	No period of Australian residency since 8 May 2012 (foreign/temporary resident on 8 May 2012)	If taxpayer has obtained market valuation as at 8 May 2012 — can choose to apply discount to gain accrued up to 8 May 2012. Otherwise — no entitlement to discount.	No entitlement to discount.
	Australian resident at time of CGT event		
	Period of foreign/temporary residency since 8 May 2012	Apportion discount based on residency/non-residency periods.	Apportion discount based on residency/non-residency periods.
	No period of foreign/temporary residency since 8 May 2012	Full entitlement to discount.	Full entitlement to discount.

The formulae for calculating the appropriate apportioned discount are as follows:

Periods starting after 8 May 2012	$$\frac{\text{Number of days during discount testing period}^{135}\text{ that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$
Periods starting before 8 May 2012 — Australian resident on 8 May 2012	$$\frac{\text{Number of days in discount testing period} - \text{Number of apportionable days}^{136}\text{ that you were a foreign resident or temporary resident}}{2 \times \text{Number of days in discount testing period}}$$
Periods starting before 8 May 2012 foreign/temporary resident on 8 May 2012 and choose market value method	If [market value less cost base on 8 May 2012] ≥ discount capital gain: 50%. If [market value less cost base on 8 May 2012] < discount capital gain: $$\frac{\text{Excess } \mathit{[MV\ less\ CB]} + \dfrac{\text{Shortfall [discount capital gain less excess]} \times \text{Number of apportionable days that you were an eligible resident}^{137}}{\text{Number of apportionable days}}}{2 \times \text{Amount of the discount capital gain}}$$

[135] The period starting on the acquisition date and ending on the day of the CGT event.

[136] Days after 8 May 2012 during the discount testing period.

[137] An Australian resident who is not a temporary resident.