The Tax Institute

Local Tax Club- Melbourne/Geelong

Session 7: Main residence exemption: danger lurks beneath the surface

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1. Overview

The capital gains tax main residence exemption is (arguably) the most generous exemption for post-CGT assets in the income tax legislation. The eligibility requirements are not onerous, and it is available to young and old, rich and poor. However, actions, or inactions, can result in a loss of the exemption, in whole or in part.

Deceptively simple, but often misunderstood, more pages of the *Income Tax Assessment Act 1997* (Cth) are devoted to the capital gains tax main residence exemption (**CGT MRE**) in Subdivision 118-B than in any other Subdivision of Part 3-1 (which includes the core provisions of the CGT rules). This paper looks at some of the traps lurking in the detail of the CGT MRE that can cause the unwary a tax disaster.

The paper discusses the CGT MRE including:

1. the significance of “adjacent land” (including for primary producers);
1. keeping the exemption when demolishing or subdividing the family home;
2. when one dwelling can be two CGT assets;
3. planning for sea and tree changes with two dwellings;
4. the impacts of death and inheritance;
5. the impacts of relationship breakdowns;
6. absences, especially for foreign residents; and
7. the implications of the increasing use of main residences to derive income, including through modern work practices and “side hustles”.

2. Fundamentals and core requirements

The CGT MRE can offer significant tax savings to individuals who structure their affairs prudently. However, the provisions in Subdivision 118-B are extremely prescriptive and, depending on how a dwelling is used through an ownership period, this may result in a loss of the full (or even partial) CGT MRE.

The core fundamentals of which to be aware are:

1. The CGT MRE is generally only available to Australian tax resident individuals. This means companies and trusts cannot avail of the CGT MRE unless it can be substantiated that those entities are mere legal owners of the dwelling, and the individual is absolutely entitled to the asset.

8. So, if there is a difference between legal and beneficial ownership, keep good records and remember that a bare trust does not necessarily enliven absolute entitlement.[1]

9. The CGT MRE only applies to the following CGT events:

CGT event A1: disposal of a CGT asset;

CGT event B1: use and enjoyment before title passes;

CGT event C1: loss or destruction of a CGT asset;

CGT event C2: cancellation, surrender and similar endings;

CGT event E1: creating a trust over a CGT asset;

CGT event E2: transferring a CGT asset to a trust;

CGT event F2: granting a long-term lease;

before 7:30 pm on 9 May 2017 (ACT legal time):

    1. CGT event I1: individual or company stops being a resident; and

    2. CGT event I2: trust stops being a resident trust;

CGT event K3: asset passing to tax-advantaged entity;

CGT event K4: CGT asset starts being trading stock;

CGT event K6: pre-CGT shares or trust interest (except one involving the forfeiting of a deposit); and

10. The sale or transfer needs to be on capital account. It is not uncommon for “Mums and Dads” to decide to demolish their existing dwelling and build a new property, or properties, on that land. Depending on the facts and circumstances, those activities may venture beyond the mere realisation of a capital asset and constitute an isolated profit-making transaction or the sale of trading stock.

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[1] See Draft Taxation Ruling TR 2004/D25 at paragraphs 33 to 40.

11. To qualify for the CGT MRE, there must be a “dwelling.” Section 118-115 ITAA97 defines dwelling as including:

a unit of accommodation that:

1. is a building or is contained in a building;
2. consists wholly or mainly of residential accommodation; and

a unit of accommodation that is a caravan, houseboat or other mobile home; and

any land immediately under the unit of accommodation.

However, except as provided in section-120 ITAA97 (see below), a dwelling does not include any land adjacent to a building.

12. For the dwelling to be a main residence, it needs to be a residence. As outlined in *Koitaki Para Rubber Estates Ltd v FCT*[2], “the place of residence of an individual is determined, not by the situation of some business or property he is carrying on or owns, but by reference to where he eats and sleeps and has his settled or usual abode”.

    It is therefore necessary to show factors of residing in a dwelling, such as location of possessions, registered address under the electoral role, registered address for mailing purposes. Generally, a dwelling is your main residence if:

you and your family live in it;

your personal belongings are in it;

it is the address your mail is delivered to;

it is your address on the electoral roll; and

services such as gas and power are connected.

TD 51 (now withdrawn) includes the following factors:

the length of time the taxpayer has lived in the dwelling;

the place of residence of the taxpayer's family;

whether the taxpayer has moved their personal belongings into the dwelling;

the address to which the taxpayer has their mail delivered;

the taxpayer's address on the electoral roll;

the connection of services such as telephone, gas, and electricity;

the taxpayer's intention in occupying the dwelling.

13. Understanding an individual’s “ownership period” is crucial, particularly if they do not qualify for the full CGT MRE. Under section-125 ITAA97, coupled with section-130 ITAA97, the ownership period generally begins and ends at settlement, and not at the contract dates. This is also

[2] [1941] HCA 13

relevant for assessing the two-year period if a beneficiary of a deceased estate seeks to dispose of the deceased's main residence within two years of death.

The use of the settlement date, rather than contract date, is an exception to the general approach for a disposal or acquisition under a contract.[3]

14. The CGT MRE regime allows taxpayers to make a range of choices when more than one dwelling is owned (for example, which property is chosen as a main residence, which property is chosen as a main residence under the absence rules in section-145 ITAA97, which property is chosen as a main residence under the building/construction rule in section-150 ITAA97);

15. There is no approved form or written election needed to make these choices. Rather, consistent with subsection 103-25(2) ITAA97, the way a taxpayer prepares their income tax returns is sufficient evidence of the making of the choice. However, as income tax returns include minimum details, apart from showing claiming of the CGT MRE, taxpayers should keep documentary evidence of any choices to support their returns.

16. While the CGT MRE allows the taxpayer to make choices, the CGT MRE itself is self-executing. Section 118-110 ITAA97, the core provision, says that a capital gain or loss you make from a CGT event that happens in relation to a CGT asset that is a dwelling or your ownership interest in it "is disregarded" if you are an individual and the dwelling was your main residence throughout your ownership period. That is, if the requirements are satisfied, the capital gain or loss "is disregarded" — taxpayers do not have a choice. For example, if they incurred a capital loss.

    Similarly with deceased estates, section-195 ITAA97 says a capital gain or loss "is disregarded".

[3] See sections 104-10 and 109-5 of the ITAA 1997. An exception to the general approach of settlement date, not contract date for the CGE MRE is for foreign residents that we discus later in this paper.

3. Adjacent Land

Under section-120, a main residence includes “adjacent land” of up to two hectares less the area of the land immediately under the dwelling. Land adjacent to a dwelling is adjacent land to the extent that the land was used primarily for private or domestic purposes in association with the dwelling. Examples of land use primarily for private or domestic purposes include gardening, regular upkeep, the location of a swimming pool, and the storing of trailers.

Generally, the CGT MRE does not apply to a CGT event that happens in relation to adjacent land if that CGT event does not also happen in relation to the dwelling.[4]

TD 92/171 considers that the CGT MRE extends to additional land acquired after the time of acquisition of the residence, as long as the requirements in section sections 118-120 and 118-165 ITAA97 are satisfied, that is:

1. the additional land (including the area of land on which the dwelling is built) is adjacent to that on which the dwelling is situated;

2. the total area of land is not greater than two hectares;

3. the additional land is used primarily for private or domestic purposes in association with the dwelling; and

4. the CGT event that happens in relation to the additional land also happens in relation to the dwelling (or the ownership interest in it).

TD 92/171 includes the following example:

> Tom and Mary purchase a home in 1987 and occupy it as their main residence. The home has never been used for income producing purposes. In 1989, they purchase the vacant block of land that adjoins the land on which their dwelling is situated and construct a private swimming pool. The total of the area of adjacent land and the area of the land on which the home is situated is less than 2 hectares. In 2001, they enter into a contract to sell the home with the adjoining block. A full main residence exemption is available.

The concept of “adjacent land” has particular significance to primary producers because their land typically:

1. serves a dual purpose as being the location of their dwelling as well as where they conduct farming activities; and

2. exceeds two hectares.

Accordingly, to calculate the potential capital gains tax exposure on disposal of the land, a primary producer may need to assess which portion of the land qualifies as “adjacent land” as well as whether any other CGT concessions apply. For example, the CGT discount and / or the CGT small business concessions.

Adjacent land does not need to be contiguous to the dwelling, but proximity is important. As highlighted in TD 1999/68, the further the distance between the land and the land on which a dwelling

[4] Section 118-165 of the ITAA 1997.

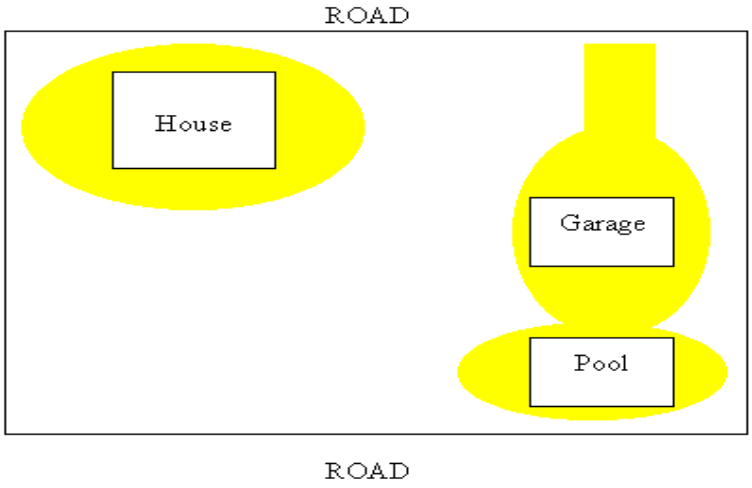
is situated, the less likely it is that the relevant land is "adjacent land" for the purposes of the legislation. Example 2 of TD 1999/68 provides:

> Bob and Lyn own a house in a country town. Lyn owns a horse which she rides in local horse competitions. There is no room for the horse in the backyard of the house, so Bob and Lyn bought a block of land some two street blocks away on which to run the horse. The total area of the land on which the house is situated and the horse yard is less than 2 hectares. The horse yard, which is used by Lyn primarily for private or domestic purposes in association with her house, is considered to be adjacent land for the purposes of section 118–120.

For land which is greater than two hectares, TD 1999/67 allows taxpayers to choose which area of land qualifies as adjacent land (in addition to the land over which the dwelling is situated). However, when choosing the land, the land must be used primarily for private or domestic purposes. With primary producers, if the land containing the dwelling is fenced off to (say) 1,000 square metres and the farm is beyond that fence, the MRE would likely only extend to the 1,000 square metres, not two hectares.

In TD 1999/67, the ATO says that, if the selected area of land cannot be separately valued, apportionment of the capital proceeds and cost base should be undertaken on an area basis. Example 2 of TD 1999/67 provides:

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 main residence exemption. This area does not exceed 2 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 2 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.



Does vacant land qualify as "adjacent land?" Arguably yes if the vacant land is used "*primarily for private or domestic purposes in association with the dwelling*". If a taxpayer had evidence the vacant land was used as a place for (say) exercise, personal contemplation, walking a dog, paddocking a pony, etc in association with the dwelling then it seems reasonable that the vacant land could be "adjacent land".

However, if the vacant land was not being used for any purpose, then it is unlikely the vacant land would meet the statutory test. In a different context, the Commissioner considers that vacant land "*not being used for any purpose*" does not fall within the definition of an asset used "*solely for personal use and enjoyment*" under section 152-20 ITAA97 (which concerns the maximum net asset value test

in the small business CGT concessions) because the vacant land is not being used solely for the personal use and enjoyment of the individual.[5]

[5] ATO Interpretative Decision ATO ID 2009/34.

4. When one dwelling can be two CGT assets

4.1 Two buildings on the land

As highlighted above, the CGT MRE applies to a "dwelling," not to "dwelling**s**." What is the circumstance if a taxpayer has more than one unit of accommodation?

Section 118-115 defines "dwelling" as including (among other things) a unit of accommodation that is a building or is contained in a building or consists wholly or mainly of residential accommodation. Subsections 118-120(5) and 118-120(6) extend this to "adjacent structures".

1. subsection 118-120(5): the CGT MRE "applies to an adjacent structure of a flat or home unit (if the same CGT event happens to that structure or your ownership interest in it) as if it were a dwelling"; and

2. subsection 118-120(6): "[a] garage, storeroom or other structure associated with a flat or home unit is an adjacent structure of the flat or home unit to the extent that the structure was used primarily for private or domestic purposes in association with the flat or home unit".

In TD 1999/69, the ATO says that 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. Examples might include a caravan or granny flat.

In TD 1999/69 the ATO says factors relevant in considering whether units of accommodation are used together as one place of residence or abode include:

1. whether the occupants sleep, eat and live in them;

2. the distance between and the proximity of the units of accommodation;

3. whether the units are connected;

4. whether the units are capable of being sold separately;

5. the extent to which the daily activities of the occupants in the units are integrated;

6. how the units are shared by the occupants; and

7. how costs of the units are shared by the occupants.

Example 3 of TD 1999/69 provides:

> William owns a large farming property. He employs his brother Henry to help him. As the house on the farm is not large enough to accommodate both William and Henry's families, Henry and his family sleep in William's caravan at the rear of the property. Both families live and eat in the house and use and enjoy it for their domestic purposes. They all spend most of their daily lives on the farm and in the house. The caravan is connected to electricity from the house.
>
> The caravan and the house are considered to be one dwelling because the activities of the families in them are so integrated that they use them together as one place of residence.

4.2 Building separate to the land

Taxpayers should be conscious of the circumstances of a post-CGT dwelling constructed on pre-CGT land.

Section 108-55(2) ITAA97 provides that a building constructed on pre-CGT land is a separate CGT asset from the land if the taxpayer entered into a contract for the construction of the building on or after 20 September 1985 or, if there is no contract, the construction started on or after that day. This is different to the common law rule about fixtures attaching to the land.

The term “building or structure” is undefined but, based on a plain and ordinary meaning, would include a dwelling. In addition, for the purposes of the CGT rules, a building or structure is taken to be acquired at the time that construction first commenced (not when the land was acquired).

This means that, when there is a disposal of pre-CGT land that contains a post-CGT dwelling, any portion of the dwelling which does not qualify for a full CGT MRE (for instance, because the dwelling is used for income-producing purposes) may be subject to CGT despite being situated on pre-CGT land.

TD 2017/13 confirms that the CGT MRE can apply to any gain that is attributable to the building. However, a full CGT MRE may not be available if the building was the main residence for only part of the period when the taxpayer had an ownership interest in it. TD 2017/13 includes the following example:

> Erica owns pre-CGT land on which she started to build a dwelling on 1 January 2011. The dwelling was completed on 1 January 2016 and Erica moves in immediately. She lives in the dwelling until the settlement of the sale of the property on 1 April 2016.
>
> As the dwelling was Erica's main residence from 1 January 2016 to 1 April 2016, she will qualify for the main residence exemption for that period. She can also choose under subsection 118-150(2) to extend the main residence exemption for the four year period prior to 1 January 2016 as she has met the conditions; the dwelling became her main residence on completion and she resided in it for at least three months.
>
> As the property was Erica's main residence for this three month period, and she makes a choice to apply section 118-150, she will qualify for the main residence exemption for the period from 1 January 2012 to 1 April 2016 (four years and three months). No other dwelling can be treated as Erica's main residence during this period.

Section 118-150, referred to in TD 2017/13, is discussed in more detail later in this paper.

5. Owning two or more dwellings

Taxpayers are generally only able to treat one "dwelling" at a time as their main residence for the purposes of the CGT MRE. This extends to spouses (that is, spouses can only claim a full CGT MRE on a single dwelling, unless they are "living permanently separately and apart" from one another).[6] Section 118-170 ITAA97, which deals with this situation, provides:

> If, during a period, a dwelling is your main residence and another dwelling is the main residence of your spouse (except a spouse living permanently separately and apart from you), you and your spouse must either:
>
> (a) choose one of the dwellings as the main residence of both of you for the period; or
>
> (b) nominate the different dwellings as your main residences for the period.
>
> If you nominate the different dwellings as your main residences for the period, you split the exemption in accordance with below.
>
> If your interest in the dwelling you chose was not, during the period, more than half of the total interests in the dwelling, the dwelling is taken to have been your main residence during the period. Otherwise, the dwelling is taken to have been your main residence for half of the period.
>
> If your spouse's interest in the dwelling your spouse chose was not, during the period, more than half of the total interests in the dwelling, the dwelling is taken to have been your spouse's main residence during the period. Otherwise, the dwelling is taken to have been your spouse's main residence for half of the period.

Section 118-170 includes the following example:

> You and your spouse (who are Australian residents) own a town house as tenants in common in equal shares. You and your spouse also own a beach house as tenants in common, with your interest being 30% and your spouse's 70%. From 1 July 1999, you live mainly in the town house and your spouse lives mainly in the beach house. On 1 July 2000 you and your spouse dispose of both dwellings.
>
> For the period 1 July 1999-30 June 2000 you nominate the town house as your main residence and your spouse nominates the beach house. The town house is taken to be your main residence during the period. The beach house is taken to be your spouse's main residence during half the period.

TD 92/174 illustrates how spouses need to carefully consider which dwelling they are to treat as their main residence (note the example considers the absence choice under section 118-145 which we discuss later in this paper). Specifically:

> A husband and wife own a pre-CGT house which they both occupy. Due to a change in employment, the husband moves to another town and they acquire another (post-CGT) house on 1 July 2000. The husband occupies this house for 2 years during the course of his employment contract. On 1 July 2002, he returns to the pre-CGT house which he then continues to occupy with his wife. The post-CGT house is sold within six years of the husband ceasing to occupy it.
>
> To obtain a full main residence exemption on disposal of the post-CGT house, the husband must make a choice under section 118-145 to treat that house as his main residence for the period 1 July 2002 until disposal. The husband and wife can then choose to treat the post-CGT house as their main residence under paragraph 118-170(1)(a) for the entire period that they owned it.
>
> If the husband does not make the choice under section 118-145, neither would be entitled to an exemption for the period after the husband ceased to occupy the post-CGT house.

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[6] Section 118-170 of the ITAA 1997.

However, a key exception to the above is in section-140 ITAA97 which concerns taxpayers who are moving from one main residence to another. This section affords taxpayers a period of up to 6 months to treat two properties as dwellings for the purposes of the CGT MRE. This may be relevant when settlement of the contract for the disposal of the existing dwelling occurs later than the settlement of the contract for the acquisition of the new dwelling. However, this rule can only apply if:

1. the taxpayer's existing main residence was their main residence for a continuous period of at least 3 months in the 12 months ending when their ownership interest in it ends (that is, settlement); and

2. the taxpayer's existing main residence 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.

This rule automatically applies, taxpayers cannot opt out.

Example 1 in TD 1999/43 highlights how the rule in section-140 interacts with the absence choice under section-145 (discussed later in this paper):

> Anne acquired a dwelling on 1 January 1986 where she lived until she went overseas on 1 January 1997. Anne did not rent the home during her absence.
>
> She acquired another dwelling on 1 February 1998 and moved into that dwelling on her return from overseas on 1 March 1998. Anne disposed of the first dwelling on 1 August 1998.
>
> In accordance with section 118-145, Anne chose to continue to treat the first dwelling as her main residence for the period 1 January 1997 until she disposed of it on 1 August 1998.
>
> In addition, under section 118-140, Anne may treat the second dwelling as her main residence from when she acquired it on 1 February 1998. Under section 118-140, Anne is able to treat both dwellings as her main residence for up to six months, ending when she ceased to have an ownership interest in the first dwelling.

6. Using the dwelling to derive income

6.1 Basic position

Taxpayers who use their dwelling to produce assessable income will generally lose their ability to claim a full exemption from CGT under the main residence rules (subject, perhaps, to the absence rule under section-145 discussed below).

Section 118-185 ITAA97 provides that, if a dwelling was not a person's main residence for the whole time they owned it, the formula below should be used as the starting point to work out the amount of capital gains or losses subject to the MRE:

$$capital\ gain\ or\ loss\ amount \times \frac{non-main\ residence\ days}{days\ in\ ownership\ period}$$

The capital gain or loss amount is the capital gain or loss the taxpayer would have made from the CGT event apart from the application of the MRE.

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

Section 118-185 does not apply if the person is an excluded foreign resident or a foreign resident who does not satisfy the life events test (discussed below).

The capital gain or loss after section-185, even if there is no adjustment, may be further adjusted if the dwelling was used to produce assessable income (see 6.2 below). It should be remembered that not all items of income from a dwelling will be assessable income, such as board or lodgings under a domestic family relationship.[7]

6.1.1 Example

Tom bought a dwelling on 1 May 2020 for $1,000,000. He rented it out from the date of purchase to 30 April 2021. He then moved into the dwelling and used it as his main residence until he sold it on 30 April 2022 for $1,500,000.

Tom is not entitled to the full CGT MRE because he did not treat the dwelling as his main residence for the entire period of his ownership. He rented out the dwelling for the first year. So, the capital gain is calculated as follows:

The gross capital gain amount = $500,000

Non-main residence days = 365 days (1 May 2020 to 30 April 2021)

Days in ownership period = 730 days (1 May 2020 to 30 April 2022)

Capital gain subject to tax = $500,000 x (365/730) = $250,000

Since Tom had owned the dwelling for more than 12 months, the 50% CGT discount applies. Therefore, the amount of capital gain subject to tax is $125,000.

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[7] See Taxation Ruling IT 2167.

6.2 Using the dwelling to derive assessable income

Section 118-190 ITAA97 provides that taxpayers can only obtain a partial CGT MRE when they sell a dwelling if they used the dwelling both as their main residence and for the purpose of producing assessable income.

Taxpayers who, while residing in their dwelling:

1. carry on a business in their dwelling;

2. lease a room in their dwelling; or

3. allow guests to stay in their dwelling via platforms such as Airbnb,

should be conscious of this rule.

A taxpayer can only receive a partial exemption if, had they incurred interest on money borrowed to acquire the dwelling, they could have deducted some or all of that interest.[8] This is a hypothetical test which assumes that the taxpayer had borrowed money to acquire the dwelling and incurred interest on the money borrowed.

Furthermore, given the circumstances triggered by COVID-19, taxpayers should consider IT 2673 and whether they may have started treating their main residence as a "place of business":

> An appropriate part of any capital gain or capital loss on the disposal of a dwelling would come within the capital gains provisions in the income tax law where part of the dwelling is used for income producing purposes. Examples include where part of a dwelling is dedicated for use in deriving rental income from tenants and where a doctor's dwelling contains a surgery that is used solely as a place of business and is clearly identifiable as a place of business.
>
> Many other income producing activities may be conducted, in whole or in part, from a dwelling. To take some examples, each of the following activities may be undertaken for reward, namely, children may be cared for by a daycare giver, music or swimming lessons may be given, tutoring or other tuition may be given, and car or television repair services may be provided. In other cases, professional people and self-employed persons might undertake income producing activities from a study or other room of a principal residence merely because it is inconvenient for the work to be done at their normal place of work. The dwelling in each of these instances would only be regarded as being used for the purpose of gaining or producing assessable income where that part of the dwelling used for these activities has the character of a place of business.
>
> Whether a dwelling, or part of it, has the character of a place of business is a question of fact that turns on the particular circumstances of each case but the broad test to be applied is whether a particular part of the dwelling:
>
> (a) is set aside exclusively as a place of business;
>
> (b) is clearly identifiable as a place of business; and
>
> (c) is not readily suitable or adaptable for use for private or domestic purposes in association with the dwelling generally.
>
> (Underling added)

In the context of COVID-19 and post-COVID-19 work-from-home arrangements, the views of the ATO in TR 93/30 are useful. The ATO considers what is a place of business or a private study:

> 5. The following factors, none of which is necessarily conclusive on its own, may indicate whether or not an area set aside has the character of a "place of business" :

[8] Paragraph 118-190(1)(c) of the ITAA 1997.

- the area is clearly identifiable as a place of business;
- the area is not readily suitable or adaptable for use for private or domestic purposes in association with the home generally;
- the area is used exclusively or almost exclusively for carrying on a business; or
- The area is used regularly for visits of clients or customers.

…

11. Paragraph 5 lists some of the factors which may indicate that a part of a home has the character of a place of business. The existence of any of these factors or a combination of them will not necessarily be conclusive in ascertaining the character of an area used as a home office. Rather the decision in each case will depend on whether, on a balanced consideration of:

- the essential character of the area;
- the nature of the taxpayer's business; and
- any other relevant factors,

the area constitutes a "place of business" in the ordinary and common sense meaning of that term.

12. The absence of an alternative place for conducting income producing activities has also influenced a court or tribunal to accept a part of a taxpayer's residence as a place of business. Examples include:

- a self employed script writer using one room of a flat for writing purposes and for meetings with television station staff …;
- an employee architect conducting a small private practice from home …;
- a country sales manager for an oil company whose employer did not provide him with a place to ….

In each of these cases the taxpayer was able to show that, as a matter of fact, there was no alternative place of business, it was necessary to work from home, and that the room in question was used exclusively or almost exclusively for income producing purposes.

13. In circumstances such as those referred to in paragraph 12, a place of business will exist only if:

- it is a requirement inherent in the nature of the taxpayer's activities that the taxpayer needs a place of business;
- the taxpayer's circumstances are such that there is no alternative place of business and it was necessary to work from home; and
- the area of the home is used exclusively or almost exclusively for income producing purposes.

14. The circumstances where part of a home is considered to have the character of a place of business can be contrasted with the more common case where a taxpayer maintains an office or study at home as a matter of convenience (i.e., so that he or she can carry out work at home which would otherwise be done at his or her regular place of business or employment). Examples of this include:

- a barrister who reads client briefs at home;
- a teacher who prepares lessons or marks assignments at home; and
- an insurance agent who maintains client files and occasionally interviews a client in his or her home office.

> In these circumstances the area of the home and the expenses incurred (subject to the exceptions listed below) retain their private or domestic character ....
>
> 15. The expenses that may be associated with a home office or study can be divided into two broad categories. These are:
>
> - Occupancy expenses relating to ownership or use of a home. These include rent, mortgage interest, municipal and water rates, land taxes and house insurance premiums.
> - Running expenses relating to the use of facilities within the home. These include electricity charges for heating/cooling, lighting, cleaning costs, depreciation, leasing charges and the cost of repairs on items of furniture and furnishings in the office.

Lastly, amounts received for board/lodgings in the context of a domestic family relationship may not be assessable income, as highlighted in IT 2167.

To calculate the CGT exposure on dwellings used to derive assessable income, TD 1999/66 provides that, under most circumstances, a floor area basis is appropriate, taking into account the length of time the area has been used for income-producing purposes. That is:

Capital gain	x	Percentage of floor area not used as main residence	x	Percentage of period of ownership that that part of the home was not used as a main residence	=	Taxable portion

TD 1999/66 includes several examples:

> Example 1
>
> John, a carpenter, has lived in his home for 10 years and he owns it. He has used the garage as a workshop for his carpentry business for the whole 10 years. Based on the area of the dwelling occupied by the garage, John estimates the workshop is 20% of the area of the whole dwelling. This is the basis on which John would have claimed an interest deduction if he had a mortgage on the property. John sells the home and makes a capital gain of $25,000 from that CGT event.
>
> Apart from section 118-190, as the dwelling was John's main residence he would have been able to disregard the whole capital gain of $25,000. However, applying subsection 118-190(2), John has a capital gain of $5000 (20% of $25, 000) to be included in his assessable income.
>
> Example 2
>
> Peter owns a home that he lived in since October 1994. In October 1995, 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 1996. Peter borrowed $50,000 to build the studio. On the basis that the interest on the $50,000 relates solely to the studio, Peter has claimed 100% deduction. In October 1999, Peter sells the property.
>
> Because Peter first used his dwelling to produce income after 20 August 1996 he is taken by subsection 118-192(2) to have acquired it in October 1996 for its market value. Having regard to the market value acquisition cost Peter made a capital gain of $10,000 on the disposal of the property in October 1999.
>
> As the dwelling was Peter's main residence for the whole period from October 1996 (when he is taken to have acquired the dwelling) to October 1999, apart from subsection 118-190(2) he would have been able to disregard the $10,000 capital gain, so that he would have made a capital gain of nil.
>
> Subsection 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% of the floor space of the house, the proportion of the hypothetical interest deduction is 10%. Peter would increase the capital gain from nil to 10% of the capital gain made on the disposal of the house (10%

of $10,000, being $1,000). No adjustment is made to take account of the use of the property prior to October 1996 because Peter is not regarded as having owned it before that time.

Example 3

Assume the same facts as in example 2 except that Peter commenced to use the premises for business in April 1996 and made a capital gain of $15,000 on the sale of the property (based on the actual acquisition cost).

In determining his capital gain Peter would take into account the fact that only 10% of the dwelling was used for income producing purposes and the fact that the income producing activity was carried out for only 42 of the 60 months in the period of ownership of the house. His capital gain would be $1,050 (42/60 x $1,500).

Note that the rules only apply to "your" assessable income. So, if a taxpayer allows someone else to use the taxpayer's main residence for their work, the taxpayer can still access a full exemption.[9]

6.3 Special rule in section 118-192 for first use to produce income

Section 118-192 ITAA97 includes a special rule for dwellings first used after 20 August 1996 to produce income. The special rule states that the taxpayer is taken to have acquired the dwelling or their ownership interest when the dwelling was first used to produce income for its market value.

This rule only applies if:

1. the dwelling was used for the purpose of producing assessable income during their ownership period; and
2. that use occurred for the first time after 7.30 pm on 20 August 1996; and
3. the taxpayer would have been entitled to a full main residence exemption before the first time it was used for the purpose of producing assessable income during their ownership period.

Example 2 in TD 1999/66 above shows the application of the special rule when calculating the taxable capital gain. In that example, Peter first used his dwelling to produce income after 20 August 1996. Therefore, he is taken by subsection 118-192(2) to have acquired it in October 1996 for its market value. Having regard to the market value acquisition cost, Peter made a capital gain of $10,000 on the disposal of the property in October 1999.

6.4 Application of the absence rule under section 118-145

Under section-145, a taxpayer may choose to continue to treat a dwelling that ceased to be their main residence as their main residence. If the taxpayer:

1. uses the dwelling for the purpose of producing assessable income, the maximum period that they can treat it as their main residence while they use it for that purpose is six years. The taxpayer is entitled to another maximum period of six years each time the dwelling again becomes and ceases to be their main residence; or
2. does not use the dwelling for the purpose of producing assessable income, they can treat it as their main residence under this section indefinitely.

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[9] See Taxation Determination TD 1999/71.

For the absence rule to apply, the dwelling must first be used as the taxpayer's main residence before the absence (effectively, the taxpayer must have **ceased** to live in the dwelling).

The absence rule in section-145 does not apply if the dwelling was the main residence because of section 147 ITAA97 (main residence that was compulsorily acquired or destroyed) and ceases to be the main residence because of subsections 118-147(3) and (4).[10]

If the taxpayer chooses to apply the absence rule in section-145, no other dwelling can be treated as their main residence at the same time, except if section-140 (about changing main residences applies).[11]

6.4.1 Example

Fred moved into a dwelling on 1 May 2020. He used the house as his main residence for 3 years and then rented it out for 3 years until 1 May 2026.

Fred has not treated any other dwelling as his main residence during his absence. Under section 118-145, Fred can choose to continue to treat the dwelling as his main residence during the absence because the absence is less than six years.

Fred can make this choice when preparing his income tax return for the income year in which the CGT event happens.

6.4.2 Example

On 1 May 2010, Tom moved into a dwelling and used it as his main residence.

On 30 April 2012, Tom rented out ¼ of the dwelling to be used as a clothing alteration shop.

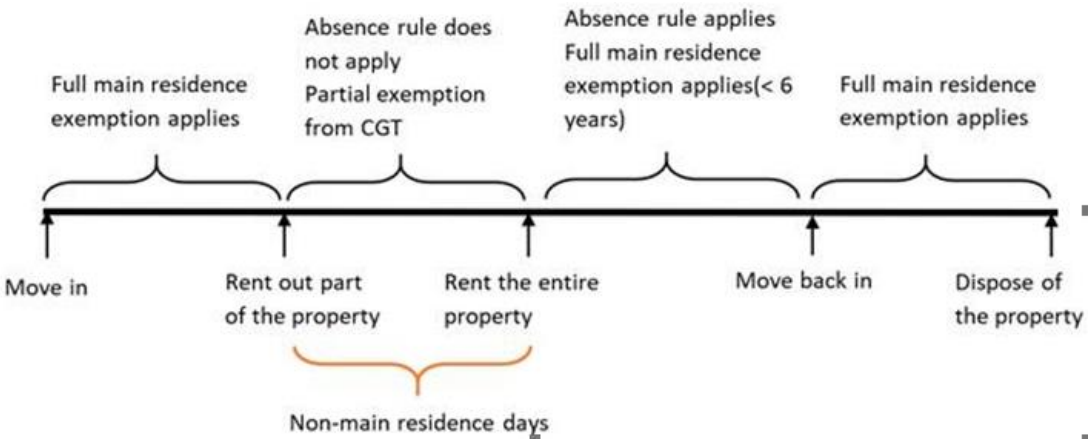
On 30 April 2014, Tom moved out and rented out the whole dwelling to be used as a clothing alteration shop.

On 30 April 2019, the lease ended. Tom moved back into the dwelling and used it for himself as his main residence.

On 30 April 2020, Tom sold the dwelling.

The diagram below shows the timeline and the application of the absence rule:

[10] Subsection 118-145(3A) of the ITAA 1997.
[11] Subsection 118-145(4) of the ITAA 1997.



From 1 May 2010 to 30 April 2012, the full main residence exemption applies since Tom used the whole dwelling as his main residence.

From 1 May 2012 to 30 April 2014, Tom is entitled to a partial exemption under section-185 since he rented out ¼ of the dwelling for the purpose of producing assessable income. The absence rule under section-145 does not apply as Tom did not move out of the dwelling. The dwelling did not cease to be Tom's main residence for that period.

The part of the capital gain that is taxable can be calculated as follows:

$$capital\ gain\ or\ loss\ amount \times \frac{non - main\ residence\ days}{days\ in\ ownership\ period}$$

From 1 May 2014 to 30 April 2019, the absence rule applies since the dwelling ceased to be Tom's main residence. Since the dwelling was used to produce assessable income, the maximum period that Tom can choose to treat it as his main residence is six years. In this case, the full rental period is less than six years, Tom can treat the dwelling as his main residence for the whole period.

From 1 May 2019 to 30 April 2020, the full main residence exemption applies since Tom moved back and used the whole dwelling as his main residence.

Query Tom's cost base of the Property when he calculates the capital gain – is it reset to market value under section-192 at the date that he rents out part of the dwelling, or when he rents out the entirety of the dwelling? It seems that the former case is correct.[12]

The interactions between the absence rule under section-145 and the "first use to produce assessable income" rule under section-192 are highlighted in ATO ID 2003/1112 and ATO ID 2003/1113 (which have since been withdrawn as the views were transposed into other ATO CGT guidance products).

[12] See Private Binding Ruling 1012989015101.

7. Demolition issues

Under Subdivision 118-B, to avail oneself of the MRE, there must be a dwelling. Demolition of a dwelling is regarded as a CGT event and a deemed disposal of the dwelling. Often a taxpayer will not receive any capital proceeds for the demolition, so there is no capital gain for the CGT MRE to apply to (the market value substitution rule does not apply to CGT event C1). The CGT MRE would disregard a capital loss.

However, if the taxpayer then sells the vacant land, or subdivides and sells the new lots, they must account for any capital gain or capital loss they make on the sale. As there is no dwelling on the land, the taxpayer is not entitled to claim a partial exemption for the period when there was a dwelling occupied as their main residence. The MRE will be available if the sale occurs whilst a dwelling that is the taxpayer's main residence remains on the land they sell.

If a taxpayer decides to rebuild after demolishing the dwelling, section-150 provides that the main residence exemption can still be claimed if:

1. the taxpayer makes an election to treat the vacant land as their main residence from the time the demolished dwelling was last occupied by them; and

2. there is no more than four years between the time of last occupation of the demolished dwelling and the time the new dwelling becomes the taxpayer's main residence.

Section 118-150 requires the taxpayer to move into the new dwelling as soon as practicable after construction and to live in the newly constructed dwelling for at least three months.

TD 92/147 includes guidance on determining whether a dwelling becomes a taxpayer's main residence as soon as practical after erection or completion. The following factors are relevant:

1. the date the certificate of occupancy (if applicable) is used;

2. the date final building inspection approval is given;

3. the date the dwelling becomes structurally complete; and

4. the connection of services for example, electricity, gas, etc.

TD 92/147 includes examples that take the above factors into account:

> Example 1: Kim constructs a post-CGT dwelling intended to become Kim's sole or principal residence. A Certificate of Occupancy issues on 1 March 1991 and Kim arranges for furniture and other belongings to be moved in the following day. However, due to flooding, the removalists are unable to carry out their obligations on that date. Kim moves into the dwelling on the earliest possible date after the flooding has subsided. In these circumstances, Kim is taken to have moved into the dwelling as soon as practical after its erection or completion.
>
> Example 2: Erection of Tom's dwelling is due for completion on 1 June 1991. On 1 May 1991, Tom decides to travel overseas for a period of 6 months. He leaves on 15 May 1991. Although the dwelling is completed on 1 June 1991, Tom does not move into the dwelling until his return to Australia in November 1991.In these circumstances, an election that subsection 160ZZQ(5) applies to the dwelling cannot be made as the dwelling has not become Tom's sole or principal residence as soon as practicable after its erection or completion.
>
> Example 3: Erection of Mary's dwelling is due for completion on 1 March 1991. On 11 February 1991, Mary is directed by her employer to go overseas on an assignment for 4 months, leaving on 25 February 1991. The dwelling is completed on 1 March 1991. Mary moves into the dwelling on her return to Australia in mid June 1991. As she is

required by her employer to go overseas, Mary is taken to have moved into the dwelling as soon as practical after its erection or completion.

In the absence of section-150, the MRE does not apply to vacant land until the new dwelling is constructed and used as the taxpayer's main residence.

8. Marriage breakdown issues

8.1 Law

Sections 118-178 and 118-180 ITAA97 enable the CGT MRE to be available to individuals who acquired an interest in a dwelling following a marriage or relationship breakdown. However, for these provisions to be enlivened, it is necessary that the individual acquired their interest in the dwelling because of the CGT roll-over under Subdivision 126-A ITAA97.

Section 118-178 will apply if a taxpayer:

1. acquired an ownership interest in a dwelling from another person ("the former partner") as a result of a CGT event ("the earlier event"); and
2. the former partner acquired the ownership interest on or after 20 September 1985; and
3. there was a roll-over under Subdivision 126-A for the earlier event; and
4. a CGT event ("the later event") happens in relation to the ownership interest.

If section-178 applies, the CGT MRE applies to the later event in the way that it would if:

1. the taxpayer's ownership interest had commenced when their former partner's ownership interest commenced ("the acquisition time"); and
2. from the acquisition time until the time the former partner's ownership interest ended:
    - the taxpayer had used the dwelling in the same way that the former partner used it; and
    - the dwelling had been the taxpayer's main residence for the same number of days as it was their former partner's main residence.

The effect of the above is shown in the following examples in section-178:

> Example 1: Peter (the transferor spouse) is the 100% owner of a dwelling that he uses only as a main residence before transferring it to Susan (the transferee spouse). Susan uses the dwelling only as a rental property.
>
> Susan will be eligible for a partial main residence exemption having regard to how both Peter and Susan used the dwelling if, at the time the dwelling is sold, Susan is an Australian resident.
>
> Example 2: Caroline (the transferor spouse) is the 100% owner of a dwelling that she uses only as a rental property before transferring it to David (the transferee spouse). David uses the dwelling only as a main residence.
>
> David will be eligible for only a partial main residence exemption having regard to how both Caroline and David used the dwelling if, at the time the dwelling is sold, David is an Australian resident.

Section 118-180 is like section 118-178 but applies in situations when a company or trust transfers the dwelling to the individual. An individual who acquires a dwelling in these circumstances will only be able to utilise a partial CGT MRE when they choose to dispose of the dwelling. This is because the days when the company or trust owned the dwelling are ineligible main residence days.

8.2 Practical tips

1. The requirements to avail of the Subdivision 126-A relationship roll-over should be carefully reviewed. ATO guidance products (such as TR 2014/3 and TD 1999/53) and the Full Federal Court case of *Ellison v Sandini Pty Ltd*[13] show that the legislative parameters will be interpreted and administered strictly.

   Furthermore, the time at which the Subdivision 126-A relationship rollover occurs should be reviewed. Before 1998, the Subdivision 126-A relationship rollover was found under former section 160ZZM of the *Income Tax Assessment Act 1936* and was more restrictive than under Subdivision 126-A.

2. In the process of the marital/relationship split, the transferee spouse should obtain from the transferor spouse a written statement confirming how the dwelling has been used by the transferor spouse (that is, as a main residence, use of the six-year absence rule, if the transferor spouse was a foreign resident etc), as this will assist in substantiating eligibility for the CGT MRE in the event of ATO scrutiny.

3. Note that a transfer of a property pursuant to the Subdivision 126-A relationship roll-over qualifies as one of the “life events” under the “life events test.” This means that spouses who are foreign residents for less than six years who transfer a property to their former spouse to which a Subdivision 126-A roll-over applies may still qualify for the full CGT MRE.

8.3 Example

John and Mary are a married couple. They purchased their family home as joint tenants in Melbourne in 1995. In 2015, John and Mary moved to France for the purposes of Mary’s employment. From this moment they started to self-assess as foreign residents of Australia for tax purposes. They decided to rent out the matrimonial home.

In 2020, John and Mary decide to separate. Mary stays in France and John returns to Australia. Mary transfers her interest in the property to John under a Subdivision 126-A rollover. John starts to self-assess as a tax resident of Australia. John does not move back into the property and continues to rent it. In 2022, John sells the Property.

Can John avail of the full CGT MRE?

[13] [2018] FCAFC 44

9. CGT MRE and deceased estates

9.1 Full exemption

A capital gain or loss from a CGT event that happens in relation to a dwelling, or the ownership interest in it, is disregarded if the taxpayer is an individual and the interest passed to the taxpayer as a beneficiary of a deceased estate, or the taxpayer owned the dwelling as the trustee of a deceased estate and under section-195, the following conditions are satisfied:

1. either:

    - the deceased acquired the ownership interest 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 incomes-producing purposes; or

    - the deceased acquired the ownership interest before 20 September 1985, and

4. either:

    - the ownership interest ends within two years of the deceased's death, or within such a longer period allowed by the Commissioner; or

    - the dwelling was, from the deceased's death until the taxpayer's ownership interest ends, the main residence of one or more of the following persons:

    - the spouse of the deceased immediately before the death

    - an individual who had a right to occupy the dwelling under the deceased's will, or

    - if the CGT event was brought about by the individual to whom the ownership interest passed as a beneficiary — that individual.

For this purpose, under section-197 ITAA97, a taxpayer who acquires a dwelling as a surviving joint tenant is treated as acquiring the dwelling as a beneficiary of a deceased estate.

The CGT MRE is not available where at the time of death, the deceased was an excluded foreign resident (see below).

The CGT MRE for beneficiaries and trustees of deceased estates applies only if the interest passed to an individual taxpayer as a beneficiary in a deceased estate, or the taxpayer owned it as a trustee of deceased estate. An "Individual" is defined in section 995-1 ITAA97 to mean a natural person. A CGT asset ''passes'' to a beneficiary in a deceased estate in the way described in section 128-20 ITAA97.

The dwelling must have been disposed of within two years of the deceased's death or used as a main residence as described in one of the ways listed in the table in section-195. If none of the items are applicable, then a full CGT MRE is not available under section-195. A partial CGT MRE may be available under section-200 ITAA97 (see below).

The CGT MRE will only apply where the ownership interest disposed of by the taxpayer is the same as the ownership interest that the deceased held at the time of death.[14]

A full CGT MRE was not available where an individual was granted a right of occupancy under the will for only part of the period from the time of the deceased's death until the dwelling was sold.[15]

9.2 Use for income producing purposes

If the dwelling was used for income-producing purposes, the taxpayer may make a capital gain or loss.[16] However, the use of a dwelling to produce assessable income can be disregarded in the circumstances covered by sections 118-145 and 118-190 (see above).

Section 118-190 applies if the dwelling is the main residence of the taxpayer or of someone else. Subsection 118-190(4) provides that, in those circumstances, any income-producing use before the death of the deceased is ignored if:

1. the interest was acquired by the trustee or beneficiary after 7.30 pm on 20 August 1996 (section 118-195 of the Income Tax (Transitional Provisions) Act 1997);

2. the dwelling was the main residence of the deceased just before death; and

3. the dwelling was not being used for income-producing purposes just before death, or any such use just before death was ignored under subsection 118-190(3) (that is, under the absence rule in section 118-145).

Section 118-192 (see above) contains a special rule which applies when the taxpayer loses the entitlement to a full CGT MRE because the dwelling was used for income-producing purposes for the first time. The taxpayer is taken to have acquired the dwelling or the taxpayer's ownership interest in the dwelling immediately before the first time it was used for income producing purposes for its market value at that time.

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

1. the taxpayer had acquired the interest as an individual and not as a beneficiary or a trustee of a deceased estate. This has the effect that sections 128-15 and 118-210 (dealing with the valuation of acquisitions by beneficiaries and with the calculation of the cost base) do not apply. It also enables section 118-185 to apply; and

2. in applying the section 118-185 formula, the non-main residence days were the number of days in the ownership period when the dwelling was not the main residence of the spouse of the deceased, an individual who had a right to occupy the dwelling under the deceased's will or a beneficiary.

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[14] See *Estate of Jack Reginald Cawthen (Deceased) v FCT* [2008] AATA 1168.
[15] See ATO Interpretative Decision 2004/882 and ATO Interpretative Decision 2006/34
[16] See section 118-190 of the ITAA 1997.

If the CGT event happens within two years of the death of the deceased, any income-producing use by the beneficiary or trustee is disregarded because the CGT MRE under section 118-195 does not require the dwelling to be the beneficiary's main residence during the two years.

However, section 118-192 does not apply to an entity:[17]

1. that acquired an ownership interest in a dwelling as trustee of a deceased estate on or before 7.30 pm on 20 August 1996; or

2. to whom an ownership interest in a dwelling passed as a beneficiary in a deceased estate on or before that time.

Therefore, in relation to deceased estates, section-192 only applies to ownership interests acquired by trustees or beneficiaries after 20 August 1996.

The CGT MRE can still apply where the beneficiary, or trustee of the deceased estate, uses the property for income-producing purposes after the death of the deceased.[18]

9.3 CGT MRE only applies to specified CGT events

The CGT MRE for beneficiaries and trustees of deceased estates only applies in relation to capital gains and losses arising from specified CGT events. Therefore, if a capital gain or loss arises from a CGT event which is not specified in section 118-195, the CGT MRE will not apply. The specified CGT events to which the CGT MRE applies are:

1. CGT event A1: disposal of CGT asset;

2. CGT event B1: use and enjoyment of CGT asset;

3. CGT event C1: loss or destruction of CGT asset;

4. CGT event C2: cancellation, surrender and similar endings;

5. CGT event E1: creating a trust over a CGT asset;

6. CGT event E2: transferring a CGT asset to a trust;

7. CGT event F2: granting a long-term lease;

8. before 7.30 pm on 9 May 2017 (ACT legal time):

    - CGT event I1: individual or company stops being a resident; or

    - CGT event I2 trust stops being a resident trust;

9. CGT event K3: asset passing to tax-advantaged entity;

10. CGT event K4: CGT asset starts being trading stock;

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[17] Section 118-195 of the *Income Tax (Transitional Provisions) Act 1997*.

[18] See Taxation Determination TD 1999/70.

11. CGT event K6: pre-CGT shares or trust interest (except one involving the forfeiting of a deposit); and

12. a CGT event that involves the forfeiting of a deposit as part of an uninterrupted sequence of transactions ending in one of the events listed above subsequently happening.

Section 118-230 ITAA97 expands the list in section-195 to include CGT events E5 (beneficiary becoming entitled to trust asset) and E7 (disposal to beneficiary to end capital interest) that happen from 1 July 2006 in relation to a dwelling held at some time in a special disability trust.

9.4 Partial exemption

Where the taxpayer is an individual and the interest passed to the taxpayer as a beneficiary of a deceased estate, or the taxpayer owned the dwelling as the trustee of a deceased estate and the conditions for a full CGT MRE are not satisfied, either a partial exemption or no exemption will be available.[19] The amount of the capital gain or loss is apportioned by working out the number of non-main residence days as compared to the total ownership days that are relevant for CGT MRE purposes.[20]

Under section-205 ITAA97, the apportionment formula is adjusted where a dwelling is inherited from someone who had previously acquired the dwelling by inheritance. Where the property was acquired by the deceased on or after 20 September 1985 the non-main residence days will also include days where the property was the main residence of an excluded foreign resident.[21]

Under section-210, special rules also apply where, under a deceased person's will, the trustee of the deceased estate acquires an ownership interest in a dwelling for occupation by an individual. Such an acquisition may be in pursuance of the will or under its authority but does not have to be by force of the will nor in strict conformity with it. However, if a trustee acquires an ownership interest in a dwelling during the administration of an intestacy, the trustee does not acquire the interest under the deceased's will because there is no will.[22]

9.5 Extension of two-year period

PCG 2019/5 provides details of the factors considered in exercising the Commissioner's discretion to extend the two-year period with a safe harbour to treat the discretion as being exercised.

Some of the factors the Commissioner may consider in deciding whether to exercise the discretion are set out in PCG 2019/5. The non-exhaustive list is below.

<u>Factors favouring a longer period</u>

The factors that favour a longer period include:

1. the ownership of the dwelling, or the will, is challenged;

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19 See subsection 118-200(1) of the ITAA 1997.
20 See subsection 118-200(2) of the ITAA 1997.
21 See subsection 118-205(4) of the ITAA 1997.
22 See Taxation Determination TD 1999/74.

2. a life or other equitable interest given in the will delays the disposal of the dwelling;

3. the complexity of the deceased estate delays the completion of administration of the estate;

4. settlement of the contract of sale of the dwelling is delayed or falls through for reasons outside of the taxpayer's control; and

5. restrictions on real estate activities imposed by a government authority in response to the COVID-19 pandemic.

Factors weighing against a longer period

The factors that weigh against a longer period include:

1. waiting for the property market to pick up before selling the dwelling;

2. waiting for refurbishment of the dwelling to improve the sale price;

3. inconvenience on the part of the taxpayer to organise the sale of the house; and

4. unexplained periods of inactivity by the executor in attending to the administration of the estate.

Other factors not relevant for the safe harbour

Other factors that are not relevant for the safe harbour include:

1. the sensitivity of the taxpayer's personal circumstances and/or of other surviving relatives of the deceased;

2. the degree of difficulty in locating all beneficiaries required to prove the will;

3. any period the dwelling was used to produce assessable income; and

4. the length of time the taxpayer held the ownership interest in the dwelling.

PCG 2019/5 includes a safe harbour to allow taxpayers up to 12 months, in addition to the two-year period, to dispose of the dwelling if they satisfy all of the following conditions, as if the discretion to extend the two-year period had been exercised:

1. in the first two years, more than 12 months was spent addressing one or more of the factors under “Factors favouring a longer period” above;

2. the dwelling was listed for sale as soon as possible after those circumstances were resolved (and the sale was actively managed to completion);

3. the sale completed (settled) within six months of the dwelling being listed for sale;

4. if any of the factors listed under “Factors weighing against a longer period” above were applicable, they were immaterial to the delay in disposing of the taxpayer's interest; and

5. the longer period for which the taxpayer would otherwise need the discretion to be exercised is no more than 12 months.

9.6 Special disability trusts

Under section-222 ITAA97, the CGT MRE is available after the death of the principal beneficiary of a special disability trust where the intended recipient of the residence disposed of the dwelling within two years of the death and the dwelling was not used to produce assessable income. A partial CGT MRE may be available to the trustee in the event that the property was used to produce assessable income prior to the principal beneficiary's death.

10. CGT MRE changes for foreign residents

10.1 Background

The Government's Housing Affordability Package was announced on 9 May 2017 as part of the Federal Budget 2017–18.[23]

The policy to deny the CGT MRE to taxpayers who — at the time of the CGT event (that is, when they enter into a contract to sell a dwelling that has been their main residence) — are a foreign resident or non-resident for tax purposes (hereafter referred to as simply 'foreign resident') — was announced in the following brief terms:

> The Government will extend Australia's foreign resident capital gains tax (CGT) regime by: … denying foreign and temporary[24] tax residents access to the CGT main residence exemption from 7:30pm (AEST) on 9 May 2017, however existing properties held prior to this date will be grandfathered until 30 June 2019; …

After a chequered legislative history following the Budget announcement in 2017, the *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Act 2019* (the **MRE Act**) was enacted on 12 December 2019 as Act No. 129 of 2019 and applies from 9 May 2017 (subject to a transitional rule).

This paper does not consider the Australian individual tax residency rules. TR 2023/1 gives the ATO's views on the individual residency tests.

10.2 Amendments from 9 May 2017

10.2.1 Foreign resident individuals

By amending section 118-110, the core provision, the MRE Act removed the entitlement to the CGT MRE for foreign resident individuals as follows:

1. Individuals who are an excluded foreign resident[25] at the time that the CGT event happens to a dwelling in which they have an ownership interest are not entitled to the CGT MRE for any part of the exemption that arises from their use of the dwelling.

   The CGT MRE is denied where the dwelling:

   - is held by an individual who is an excluded foreign resident or is a foreign resident who does not satisfy the life events test (see below);

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[23] This section of the paper draws on the paper, "Latest legislative developments in property" (2021) by Neil Brydges and Robyn Jacobson of The Tax Institute. Any errors in updating are by the authors alone.

[24] The Government announced on 18 December 2017, as part of the Mid-Year Economic and Fiscal Outlook 2017–18, that following consultation the Government amended the proposal so that 'temporary tax residents' who are Australian residents would be unaffected. This ensures that only Australian tax residents, including temporary residents, can access the CGT MRE. So, only foreign residents are affected by this measure.

[25] An 'excluded foreign resident' is a foreign resident who has been a foreign resident for a continuous period of more than six years: subsection 118-110(4) of the ITAA 1997.

- was, or was taken to be, the individual's main residence for the whole[26] or part[27] of the ownership period; and
- the interest did not pass to the individual as a beneficiary in, or as trustee of, the estate of a deceased person.

2. The CGT MRE is also denied if the individual is a foreign resident at the time the CGT event happens to part of their individual ownership interest because of a compulsory acquisition.[28]

For capital gains from CGT event A1, the time of disposal is when the contract for sale of the property is entered into.[29]

Example — Main residence exemption denied

Vicki acquired a dwelling in Australia on 10 September 2010, moving into it and establishing it as her main residence as soon as it was first practicable to do so.

On 1 July 2018 Vicki vacated the dwelling and moved to New York. Vicki rented the dwelling out while she tried to sell it. On 15 October 2020 Vicki finally signs a contract to sell the dwelling with settlement occurring on 13 November 2020. Vicki was a foreign resident for taxation purposes on 15 October 2020.

The time of CGT event A1 for the sale of the dwelling is the time the contract for sale was signed, that is 15 October 2020. As Vicki was a foreign resident at that time, she is not entitled to the main residence exemption in respect of her ownership interest in the dwelling.

***Note:** This outcome is not affected by:*

- *Vicki previously using the dwelling as her main residence; and*
- *the absence rule in section 118-145 that could otherwise have applied to treat the dwelling as Vicki's main residence from 1 July 2018 to 15 October 2020 (assuming all of the requirements were satisfied).*

Example 1.2 of the EM

10.2.2 Exemption for certain life events

Under subsection 118-110(5), a foreign resident will be able to continue to access the CGT MRE for CGT events concerning certain life events if:

1. they have been a foreign resident for no more than six years at the time of the CGT event; and
2. they satisfy the 'life events test', which requires that during the person's period of foreign residency, one of the following specified circumstances occurred:

the person or their spouse had a terminal medical condition that existed at any time during that period of foreign residency;

the person's child has had a terminal medical condition that existed at any time during that period of foreign residency, and that child was under 18 years of age at at least one such time;

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[26] Subsection 118-110(3) of the ITAA 1997.

[27] Subsection 118-185(3) of the ITAA 1997. Refer to Example 1.4 of the Explanatory Memorandum of the MRE Act (**EM**) which illustrates denial of the partial CGT MRE.

[28] Subsection 118-245(3) of the ITAA 1997. Refer also to Example 1.5 of the EM.

[29] This is different to most aspects of the 'main residence exemption' in Subdivision 118-B of the ITAA 1997 that uses the 'ownership period' as defined in section 118-30 of the ITAA 1997 that looks to the settlement date.

the person's spouse, or child who was under 18 years of age at death, died during that period of foreign residency; or

the CGT event happens because of separation or divorce.

Terminal medical condition

A person will satisfy this element of the life events test if, during all or part of the period of a person's foreign residency, either they, their spouse or their child had a 'terminal medical condition'.[30]

For a child of the foreign resident, it is necessary that during at least part of the period of foreign residency where the child was suffering from a terminal medical condition, the child was under 18 years of age.

Death

A person will satisfy this element of the life events test if, during a person's period of foreign residency, their spouse, or their child who is under 18 years of age at the time of their death dies.

Divorce or separation

A person will satisfy this element of the life events test if the CGT event occurs because of a matter referred to in a paragraph of section 126-5(1) ITAA97 (which provides a CGT roll-over for certain assets transferred between spouses because of a marriage or relationship breakdown) involving the person or their spouse (or former spouse).

If the CGT event has not occurred because of one of the matters in subsection 126-5(1), then the person is not able to access the CGT MRE even if the matter has occurred during their period of foreign residency.

Example — Main residence exemption – life events test

Joan acquired a dwelling on 7 February 2015, moving into it with her spouse John and establishing it as their main residence as soon as it was first practicable to do so. Joan and John are residents of Australia at the time of the purchase of the property.

In 2020, they retire to live in the Bahamas and acquire a new residence there. They become foreign residents at this time. They rent out their former Australian residence after they leave Australia, and it is not maintained as their main residence in the rental period.

In 2021, John dies, and Joan decides to sell their former residence. As Joan has been a foreign resident for less than six years at the time of entering into the CGT event for the sale and her spouse has passed away during the period of her foreign residency, she is entitled to a partial main residence exemption for the sale of the residence based on the period that it was her main residence.

Example 1.8 of the EM

In the above example, Joan satisfies the life events test. Accordingly, because she had not made a choice under section-145, only a partial exemption is available to Joan because she (and John) acquired a new residence overseas. Had Joan not acquired a new residence overseas but instead rented a residence overseas, then because she satisfies the life events test, she would have been entitled to a full exemption because under section-145 she had made the choice which allows her to

[30] A 'terminal medical condition' has the meaning given by regulation 303-10.01 of the *Income Tax Assessment Regulations 1997*. This requires, amongst other things, that two medical practitioners, jointly or separately, have certified that the illness, or injury, the affected person suffers from is likely to result in their death within 24 months of the certification.

continue to treat the former residence as her main residence for up to six years after it ceases to be her main residence.[31]

10.2.3 Where a foreign resident disposes of a dwelling acquired from a deceased person who was a resident

If the deceased was an Australian resident

Under paragraph 118-195(1A)(b), where a foreign resident disposes of a dwelling acquired from a deceased person who was a resident of Australia, the CGT MRE will continue to be available for the period attributable to the period:

1. during the deceased person's lifetime when they used the dwelling as their main residence;
2. that occurs within two years of the deceased's death (or within the further time allowed by the Commissioner); and
3. following the deceased's death where the dwelling was the main residence of an individual who:

was the spouse of the deceased immediately before their death; and/or

had a right to occupy the dwelling under the deceased's will.

However, any additional component of the CGT MRE that an excluded foreign resident beneficiary accrued (that is, from occupying the dwelling) is denied.

Refer to example 1.6 of the EM, where an excluded foreign resident beneficiary inherits a main residence from a deceased person who was an Australian resident at the time of their death.

If the deceased was an excluded foreign resident at the date of death

Under paragraphs 118-195(1)(c) and 118-195(1A)(a), the part of the CGT MRE accrued by the deceased in respect of the dwelling is not available to the beneficiary.

Beneficiaries continue to be entitled to the CGT MRE for any part of the exemption that they accrue (if they are not a foreign resident at the time the CGT event occurs). To ensure that no part of the CGT MRE of the deceased is included, the following apply when calculating a capital gain or loss:

1. the first element of the dwelling's cost base and reduced cost base for the beneficiary is the cost base of the deceased, immediately before the deceased's death;
2. a surviving joint tenant of a dwelling is not able to treat the dwelling as the deceased's main residence where that dwelling was being built, repaired or renovated if the deceased was a foreign resident at the time of their death; and
3. apportionment occurs on a day's basis based on "non-main residence days" to "to days", with the number of days the deceased person held the ownership interest in the dwelling treated as 'non-main residence days'.[32]

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[31] Note, if John had not died, and Joan sold the (rented-out) residence in Australia then the main residence exemption would not be available despite the rule in section 118-145 as there was not a life event at the time of CGT event (the sale).

[32] See subsections 118-200(2), (3) and (4), subsection 118-205(4), item 3 of the table in subsection 128-15(4), and section 128-50 of the ITAA 1997. See also Example 1.7 of the EM, where a resident beneficiary inherits a dwelling from a foreign resident deceased person.

The CGT MRE will not apply if the deceased was an excluded foreign resident at the time of their death; and

1. the beneficiary who inherits the ownership interest was a foreign resident at the time when the CGT event happens; or

2. the trustee of the deceased estate acquired a dwelling after the deceased person's death for an individual to occupy under the terms of the will, and the dwelling was later disposed of by the trustee.[33]

Australian residency ends

The MRE Act also amended the CGT MRE, so it does not apply if CGT event I1 or I2[34] occurs to an ownership interest in a dwelling.[35]

10.2.4 Marriage or relationship breakdown

The authors discuss below an issue relating to the impact of the changes to the CGT MRE for foreign residents on taxpayers who have a marriage or relationship breakdown and there is a later sale of a dwelling that was their main residence, in circumstances where a property is transferred under the family law settlement and the transferor subsequently becomes a foreign resident.

CGT roll-over on marriage or relationship breakdown under current law

The Subdivision 126-A roll-over is discussed earlier in this article.

Under section-178, an individual who acquires an ownership interest in a dwelling that was the subject of a Subdivision 126-A roll-over must consider, in addition to their own use of the dwelling, how their former spouse used the dwelling. If either of the individuals used the property other than as their main residence (that is, for a taxable purpose), then there may only be a partial CGT MRE available on sale. If the dwelling was used solely as the main residence by the individual and their former spouse from when the former spouse acquired the dwelling, then a full CGT MRE is available.

Impact of changes

The MRE Act is silent on the interaction between subsections 118-110(3) and 118-178, so it is unclear how the measures impact a resident individual selling the dwelling whose former spouse is a foreign resident at the time of the CGT event. It is possible that the individual selling the property could be adversely affected by the measures despite the fact that they are a resident at the time of the CGT event.

Assume that:

1. the resident spouse sells a dwelling in Australia which was transferred from their former spouse under a family law settlement;

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[33] See subsection 118-210(6) of the ITAA 1997.

[34] CGT events I1 and I2 may occur if an individual or trust stops being a resident of Australia for taxation purposes. The amendments ensure consistent application of the CGT MRE, whether a foreign resident has an ownership interest in a dwelling that is real property or a mobile home.

[35] See paragraphs 118-110(2)(a), 118-195(2)(a) and 118-210(5)(a) of the ITAA 1997.

3. the property is eligible for a CGT roll-over under section 126-5;

4. the resident spouse continues to treat the dwelling as their main residence until they sell it;

5. the former spouse is a foreign resident at the time the CGT event happens to the resident.

There are two interpretations:

1. The CGT event does not happen to the foreign resident former spouse, so there is no impact on their main residence days — accordingly, the resident spouse can consider the main residence days of their foreign resident former spouse and would be eligible for a full CGT MRE on the sale of the property; or

2. notwithstanding the CGT event does not happen to the foreign resident former spouse, they are a foreign resident at the time the CGT event happens to the resident, so the main residence days of the foreign resident former spouse are zeroed out as if they had never lived there — in this case, when the resident spouse sells the property, they will be eligible for only a partial exemption.

This second outcome is an extraordinary one, given that:

1. para 1.22 of the EM[36] states:

> Individuals who are Australian residents for taxation purposes at the time a CGT event occurs to a dwelling are not affected by this measure.

2. the resident may not even know whether their former spouse is a foreign resident at the time of the CGT event[37];

3. existing family law settlements would not have taken these measures and this outcome into account;

4. it would be difficult to negotiate a future family law settlement and quantify the tax impact so an equitable settlement could be reached, to consider the contingency that the former spouse may, one day and following the family law settlement, be a foreign resident at the time the resident spouse sells the property.

10.2.5 Application and transitional provisions

The amendments to the CGT MRE generally apply to CGT events happening on or after 7:30pm on *9 May 2017*. However, under transitional rules, the amendments do not apply in relation to a capital gain or loss from a CGT event that happened on or before *30 June 2020*,[38] if an individual held an ownership interest in the dwelling to which the CGT event related at all times from immediately before 7:30pm on 9 May 2017 until immediately before the CGT event happened.[39]

Similar transitional rules apply to deceased estates and special disability trusts.

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[36] Paragraph 1.22.

[37] Even if the individual was aware that their former spouse was working overseas when they sold their home, they may not be privy to the residency status of their former spouse at that time.

[38] This was originally proposed to be 30 June 2019 but was extended to 30 June 2020.

[39] Section 118-110 of the *Income Tax Transitional Provisions Act 1997.*

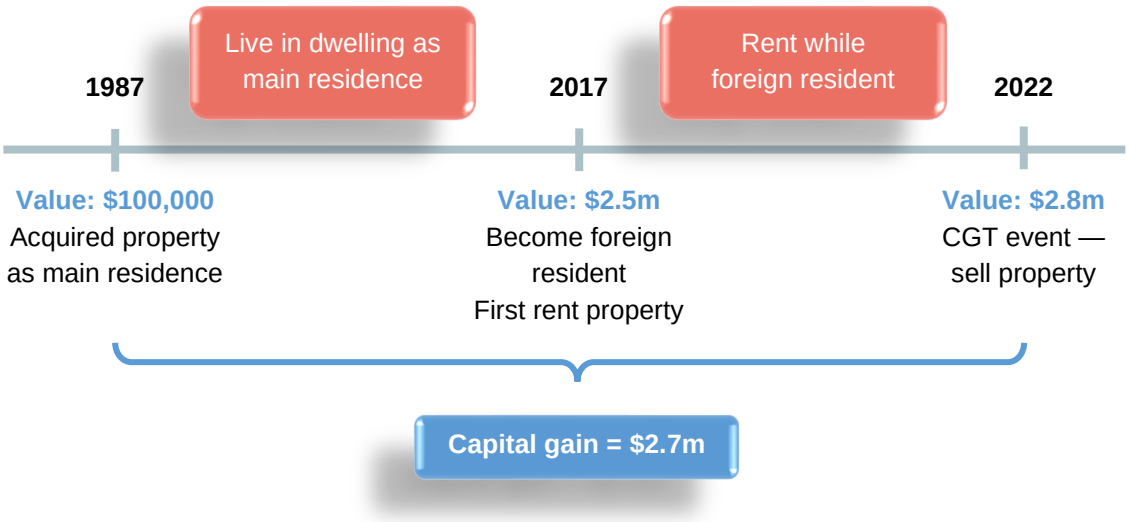
10.3 Case study: effect of foreign resident changes to the CGT MRE

10.3.1 Facts

An Australian resident taxpayer, Mike, has always been a resident for tax purposes. He bought a dwelling in Australia on 1 July 1987 for $100,000 and used it as his home; it has never been rented out, and the dwelling has always been his main residence. On 30 June 2017, having decided to accept a job overseas, Mike reallocated offshore for an indefinite period and became a foreign resident. At that time, Mike's home was worth $2.5 million.

Mike decides to stay overseas. Five years later, on 30 June 2022, he sells the dwelling that, prior to moving overseas, had been his home for 30 years. Because Mike is a foreign resident at the time of the CGT event, and Mike did not satisfy the life events test, he is not entitled to the CGT MRE — at all. So, he will have a taxable capital gain of $2.7 million.

This may be depicted as follows:



10.3.2 Tax implications

Mike *cannot*:

- claim a partial CGT MRE for the number of days he lived in the dwelling;
- continue to treat the dwelling as his main residence after he vacates it (under the absence rule in section-145) — which would otherwise allow him to continue to treat the dwelling as his main residence indefinitely if the property is not used for an income-producing purpose or for up to six years if he rents it out; or
- if he had decided to rent the property in 2017 when he left Australia — reset/uplift the cost base of the dwelling to its market value on the date he first began to rent it (where that use occurs for the first time after 20 August 1996) under section-192.

This is because all these concessions are contained in the CGT MRE rules and rely on the taxpayer being entitled to claim a partial CGT MRE — and Mike is not entitled to any CGT MRE.

Third element ownership costs

Had Mike instead acquired the dwelling after 20 August 1991, he would be entitled to include ownership costs, such as rates, repairs, maintenance, insurance and interest expenses, in the cost base of the property. But Mike never kept records of these costs because he did not think it was necessary; everyone knows that the sale of a dwelling that is your main residence is not subject to CGT. Mike could not have foreseen all those years ago that the government would propose to retrospectively deny him the CGT MRE, causing the sale of his home to be taxable in the future based on his circumstances.

If Mike is unable to substantiate his third element ownership costs, he would not be able to include an estimate of these amounts in the cost base of the property, thereby increasing his taxable capital gain.

Contrast this with a taxpayer who acquires a dwelling after these changes are enacted with the knowledge that, under the rules, there is a possibility that they will not be entitled to the CGT MRE — they would be able to prospectively retain all relevant cost base records from the date of acquisition to minimise their eventual taxable capital gain.

CGT event I1 not applicable

CGT event I1 (s 104-160 ITAA97) happens when an individual stops being an Australian resident, causing a deemed disposal of their CGT assets at their market value and allows the taxpayer to choose to defer the tax on these assets.

However, CGT event I1 does not happen when Mike stops being an Australian resident, because CGT event I1 applies only to CGT assets that are not *taxable Australian property*[40]— in this case, Mike's dwelling continues to be *taxable Australian property* and therefore still is within the Australian CGT regime.

What about the CGT discount?

Mike will have a taxable capital gain of $2.7 million, without access to any CGT MRE. Is he entitled to any CGT discount as a foreign resident? Foreign residents have not been entitled to the CGT discount since 8 May 2012.

Under section 115-115:

- as Mike became a foreign resident after 8 May 2012, he is entitled to a reduced discount, based on the number of days he was a resident. (The law requires the calculation to be performed based on the number of days but for illustrative purposes and simplicity, years have been used here instead.) So, given that Mike was a resident for 30 years out of 35 years of ownership, he will be entitled to a CGT discount of 42.85% instead of the full 50% discount.

- had Mike become a foreign resident before 8 May 2012, he would be entitled to apportion the CGT discount by applying it only to that part of the capital gain which had accrued to 8 May 2012 by figuring out the market value of the property on 8 May 2012. On the facts as given, Mike did not become a foreign resident until 2017, so this market value rule is not available to him.

[40] See section 855-15 of the ITAA 1997.

10.3.3 Variations to facts

What if Mike moves back to Australia?

If Mike moves back to Australia after 30 June 2020 and re-establishes himself as a resident, then sells the dwelling, he would not be a foreign resident *at the time of the CGT event* and he would be entitled to the CGT MRE. So, he could access a partial CGT MRE, the absence rule in section-145 and the cost base-market value deeming rule in section-192 as applicable.

However, para 1.23 of the EM accompanying the MRE Act explains that the general anti-avoidance rules in Part IVA may be applied to arrangements that have 'been entered into by a person for the sole or dominant purpose of enabling that person or another person to obtain the [CGT MRE].'

What if Mike dies while he is overseas?

If Mike dies while he is overseas, his interest in the dwelling will pass to the beneficiaries (simply referred to in this paper as 'the beneficiary') of his deceased estate in accordance with the wishes set out in his will.

Assume that Mike dies on 10 June 2024, and Mike's beneficiary sells the property on 15 October 2024.

Mike is an excluded foreign resident at the time of his death

As Mike is an excluded foreign resident at the time of his death, any part of the CGT MRE that Mike has accrued is not available to the beneficiary. This means that, despite Mike residing in the property for 30 years as a resident and because he was an excluded foreign resident when he died, his beneficiary may not be able to claim any CGT MRE — it will depend on their residency status at the time of the CGT event.

If the beneficiary is a resident at the time of the CGT event (that is, when they sell the property), they will be entitled to the CGT MRE that accrues in respect of their ownership interest, but not that of Mike.

If the beneficiary is a foreign resident at the time of the CGT event, they will not be entitled to any CGT MRE; not for the period that Mike resided in the dwelling, nor for the period following his death. This is irrespective of the beneficiary's use of the dwelling or the beneficiary's residency status throughout the ownership period. This means that, if the deceased was an excluded foreign resident at the time of death, and the beneficiary is a foreign resident at the time of the CGT event, no CGT MRE is available to the beneficiary.

If Mike had died before 30 June 2023, he would not have been an excluded foreign resident at the time of his death, and there would have been a life event (his death). Therefore, the CGT MRE would have been available up to the time of Mike's death.

Mike was a resident at the time of his death

Had Mike been a resident at the time of death (that is, he re-established his residency before he died and was not a foreign resident at the time of death), the CGT MRE accrued by Mike will continue to be available to his beneficiary to the extent of:

- the period during Mike's lifetime that he used the dwelling as his main residence;
- the period that occurs within two years of Mike's death (or within such longer period allowed by the Commissioner); and
- the period following Mike's death where the dwelling was the main residence of Mike's spouse (assuming he had one) immediately before his death and/or an individual who had a right to occupy the dwelling under Mike's will, regardless of the residency status of that spouse or individual.

However, the beneficiary — to whom the ownership interest in the dwelling passed under the will (but falling short of having a right to occupy the dwelling under the will) — is denied any component of the CGT MRE that is attributable to the period following death when they lived in the dwelling as their main residence if they are a foreign resident at the time of the CGT event.

So, to summarise, if Mike's beneficiary is:

- a resident at the time of the CGT event — they continue to be entitled to the CGT MRE for any part of the exemption that they accrue (the cost base for the beneficiary will be Mike's cost base immediately before his death);
- a foreign resident at the time of the CGT event — they will be denied any part of the CGT MRE that they accrued.

Is the CGT MRE available to a beneficiary of a deceased estate who inherits the dwelling?

At time of CGT event, the beneficiary is a …	At time of death, the deceased is a resident	At time of death, the deceased is an excluded foreign resident
Resident	✓ CGT **MRE available***	In relation to the deceased's period of ownership ✗ In relation to the period following the date of death ✓*
Foreign resident	✓ CGT **MRE available*** but only in relation to: ▪ the period before the date of death during which the dwelling was the deceased's main residence*; and ▪ the period within two years of the date of death^; and ▪ the period after the date of death where the dwelling was the main residence of the deceased's spouse and/or an individual who had a right to occupy the dwelling under the deceased's will.	✗ CGT **MRE not available**

	✗ **CGT MRE not available** in relation to the period following the above

* Subject to normal CGT MRE rules.

^ Or within such longer period allowed by the Commissioner.

Foreign resident beneficiary inherits main residence from a deceased person who was not an Australian resident at time of death

Varying the facts from earlier, Mike acquired the dwelling on 1 July 1987, moving into it and establishing it as his main residence as soon as it was first practical to do so. He continued to reside in the property until he became a foreign resident on 30 June 2017. He still owned the dwelling when he died on 10 June 2024.

Sarah, Mike's daughter, inherited the dwelling following Mike's death. Upon inheriting the dwelling, Sarah rented it out. It was not her main residence at any time. On 15 October 2024, Sarah signs a contract to sell the dwelling and settlement occurs on 15 December 2024.

Sarah resides in France and is a foreign resident for the whole of the time she has an ownership interest in the dwelling.

Sarah is not entitled to any CGT MRE for the ownership interest that she has in the dwelling at the time she sells it. Specifically, she is not entitled to any CGT MRE for the period:

- 1 July 1987 until 30 June 2017 — which Mike accrued while he used the dwelling as his main residence because Mike was an excluded foreign resident at the time of his death so any part of the CGT MRE that Mike accrued is not available to Sarah;
- 1 July 2017 to 10 June 2024 — when the property was rented by Mike while he was overseas because as an excluded foreign resident he cannot access the absence rule in section 118-145;
- 10 June 2024 until 15 December 2024 — which Sarah accrues in respect of the dwelling because she is a foreign resident on 15 October 2024, the day on which she signs the contract to sell her ownership interest (the time of CGT event A1).

Foreign resident beneficiary inherits main residence from a deceased person who was an Australian resident at time of death

Varying the facts from earlier, Mike acquired the dwelling on 1 July 1987, moving into it and establishing it as his main residence as soon as it was first practical to do so. He continued to live in the property, and it was his main residence until his death on 10 June 2024. Mike was at no time a foreign resident.

Sarah, Mike's daughter, inherited the dwelling following Mike's death. Upon inheriting the dwelling, Sarah rented it out. It was not her main residence at any time. On 12 November 2026, Sarah signs a contract to sell the dwelling and settlement occurs on 12 December 2026.

Sarah lives in France and is a foreign resident for the whole of the time she has an ownership interest in the dwelling.

Sarah is entitled to a partial CGT MRE for the ownership interest that she has in the dwelling at the time she sells it, being the exemption that accrued while Mike used the dwelling as his main residence (1 July 1987 until 10 June 2024). She is not entitled to any CGT MRE that she accrued in respect of the dwelling (10 June 2024 until 12 December 2026). This is because she was a foreign resident on

12 November 2026, the day on which she signs the contract to sell her ownership interest (the time of CGT event A1).

It should be noted that Sarah will need to apply section-200 to work out the amount of the capital gain or loss from the sale of her ownership interest in the dwelling.

If Sarah had instead sold the dwelling on or before 10 June 2026, she would have been entitled to a full CGT MRE. This is because the whole of the CGT MRE would have, or would be taken to have, accrued from Mike's use of the residence. This includes the two-year period following Mike's death.

Adapted from Example 1.6 of the EM

What if Mike returns to Australia to die?

Assume that, in February 2024, Mike is diagnosed with a terminal medical condition. He decides to return to Australia for medical treatment and to be close to his family and friends. Mike returns to Australia but is immediately confined to a hospital bed, where he spends the next four months until his death.

While in hospital, Mike, as part of attending to his estate planning and financial affairs, may arrange to sell the property before he dies on 10 June 2024. Alternatively, he may still own the dwelling at the time of his death.

If Mike is a resident at the time of the CGT event or his death, he is entitled to the CGT MRE, including the absence rule under section-145. But, if he is an excluded foreign resident at the time of the CGT event or his death, he is not entitled to any CGT MRE.

Assume that, immediately on Mike's return to Australia, he is transferred to a hospital and dies without ever moving back into his home. Has Mike become a resident again, or is he still a foreign resident at the time of the CGT event or his death? This is a question of fact, but it may be problematic to establish that Mike has re-established his residency simply by virtue of his presence in Australia while he seeks medical treatment.

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