Question 1

The main aim is to analyse the capital gains tax so incurred by Worry Tyres Pty. Ltd., David and John as per the situation given in the question. The CGT repercussions of the above three parties has been dealt with individually and separately below:

- Worry Tyres Pty. Ltd. (Worry):

Worry is a company and a separate legal entity distinct from its shareholders[1]. Its distribution of assets as on 30 June 2010 is as follows:

a) *A house acquired before 20 September 1985 worth $250,000; and*
b) *Other assets acquired after 19 September 1985 worth $350,000.*

The house is a pre-CGT asset purchased by Worry before 20 September 1985[2]. Therefore, any capital gains or losses will be disregarded[3]. The relevant event is E5 which deals with a beneficiary being entitled to a trust property as given under Section 104.75. Section 104.75 also states that if the asset was acquired by the trustee prior to 20th September, 1985, then the capital gain and loss shall be disregarded, which shall be followed in this situation and the capital gain or loss of Worry for the house property shall be disregarded as it was bought prior to September 20th, 1985. Event K6 can be applicable in this case as well, since the asset is a pre CGT asset, but not applicable as Section 104.230 states that the market value of post 1985 assets should be 75% or more of the net value of the company, which is not the scenario in this situation as the value of post 1985 assets is $350,000 out of $600,000 which is equal to 583.3%.

Worry is also in possession of post-CGT assets worth $350,000 in the year 2009-10. On 30 June 2010, Michael, who held the shares in Worry since the date of its incorporation, transferred the beneficial interest on these assets to John on which the capital gain tax event E5 arises, which entails a beneficiary being entitled to a trust asset under Section 104.75, which is John acquiring an interest in the other assets in

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[1] *Charles v FCT* (1945) 90 CLR 598
[2] *Income Tax Assessment Act* S149-10
[3] *Income Tax Assessment Act* Div. 118

this scenario. The section states that if the cost base of asset is more than the market value of the asset at the time, there shall be a capital loss and if it is less, then there shall be a capital gain. However, the capital gain or capital loss for Worry, pertaining to the other assets cannot be ascertained because of the lack of information in the facts. In the immediate situation, the value of the assets so transferred to John is $350,000, however, it is not mentioned the value at which these other assets were acquired. This lack of such information is highly detrimental because the cost base cannot be determined, which is essential as it needs to be subtracted from the capital gain to determine the net capital gain or loss as mentioned in Section 104.75 (3). (Company tax rate need not be mentioned as we cannot ascertain the capital gain or loss in the first place, however, for the sake of information, companies need to pay 30% tax on the net capital gain, however, since the net capital gain cannot be ascertained as the cost base cannot be determined, this information is without fruition. Small business entities: Again, we don't know anything about the turnover of Worry Tyres Pty. Ltd., so, the question of it being a small business entity cannot be answered accurately without basing it on assumptions. Discussions on indexation: Indexation is a method of calculating the CGT by altering the cost base by increasing the amounts of the elements of the cost base by consulting a consumer price index. The cost base cannot be calculated in this scenario as the purchasing value of the asset is not mentioned, thus, the cost base cannot be indexed, leading its mention to be redundant. CGT event K6 and the 75% net value test: Has been mentioned)

- John:

John, on the other hand, is on the receiving end of the assets and owing to this, the value at which he acquired the interest in the assets shall be the base value to be used in determining the value of the cost base. This brings the cost base for the house to be $250,000 and the other assets to be at $350,000.

David and John lived on the property for 5 years without using it to produce assessable income. The relationship between John and David broke down in the year 2015, and in the divorce settlement, John had to transfer the house to David as per the court. Now, this shall amount to a capital loss or gain of some sort, however, as given under Section 118.75 of the Income Tax Assessment Act 1997, any property transferred owing to a breakdown in marriage or relationship after 20 September 1985 shall have its capital loss or capital gain disregarded which is the exact situation occurring in John's case, as a civil union qualifies as a relationship, which is covered under Section 118.75 of this Act.

However, certain conditions need to be fulfilled for this section be applicable, which are highlighted below from Section 118.75 of the Income Tax Assessment Act, 1997 itself:

b) At the time of the CGT event:

(i) You and your spouse or former spouse are separated; and

(ii) There is no reasonable likelihood of cohabitation being resumed.

From the above requirements, it can be ascertained that the parties to the divorce settlement need to be separated and there should exist no reasonable likelihood for both the parties to resume cohabitation in the future again. If the facts are to be considered, the Family Court decided on 31 March 2016 on a property settlement which hints at the fact that the relationship has broken down irrevocably and the parties shall not continue cohabitation in the future and since the property settlement is being given in the year 2016 and the breakdown of the relationship took place in 2015, it can be safely assumed that the parties were separated at the time of the settlement. Thus, John does not have any capital gains tax liability on house property so transferred to David.

As for the other assets acquired by John, he does not have to pay any capital gains tax on that as well, since he hasn't sold those assets, thus, ruling out the chance of him having any capital gain or loss in the current period of time so mentioned in the facts.

- David:

After the breakdown of the civil union in 2015, the court decided on property settlement in 2016 in which the house is to be transferred to David as given under Section 126.5 of the Income Tax Assessment Act 1997, which allows the roll-over of capital gain and capital loss to the transferee in case of property being transferred from one party to the other due to break down of relationship. The house was transferred to David on 31 March 2016 at a value of $550,000. This value shall serve as the base value at which the asset was acquired by David and shall serve as the cost base of the house property David so received after the separation of John and David.

Further, David sold the said property on 30 March 2017 at $625,000. To calculate the net capital gain, the cost base, which is $550,000, has to be deducted from the selling value, which is $625,000. The difference between the both comes out to be $75,000, which is the base capital gain. Owing to the fact that David had leased 1/10th of the property out as a doctor's surgery and he was using the property as his main residence, he shall have a partial exemption in conjunction with Section 118.110, Section 118.185 and Section 118.190 of the Income Tax Assessment Act 1997. This brings the amount of capital gain payable by him to $7,500, since he is partially exempted from the payment of tax. The capital gain comes out to be $7,500 and it shall be further discounted by 50% owing to the discount method bringing the net capital gain to $3,750. Since the final taxable amount for the year 2016-17 is $3,750, which is in the category of $0-$18,200, the tax payable on this amount comes out to be nil as per the 2016-17 Australian income tax rates decided by the Australian authorities.

For the sale of the stockbroking business, it can be concluded that the business was small business as the turnover never exceeded $2 million (including the year 2019) apart from 2014, which is in compliance with Section 328.110 which states that a business entity is a small business entity if business is being carried out in the current year and the aggregated turnover for the previous year was less than $2 million and the turnover for the current years is also likely to be less than $2 million. Owing to this, David is entitled to certain exemptions. One of these exemptions is the 15-year exemption, which allows for exemption on capital gains tax on sale of active asset (in reference to Section 152.140 which defines an active asset to be an asset which is being used for business purposes at time of the capital gains tax event) if the owner is retiring and the asset was held for at least 15 years. Owing to the lack of information regarding the time period for which the asset was held makes it impossible to calculate the capital gains tax payable on the sale of assets of the stockbroking business. However, the goodwill sold is not exempt as it as a capital gains tax asset as given under Section 108.5 and Section 100.25 and for that capital gains tax shall be paid. The capital gain in this scenario is $5 million owing to the goodwill, which has no exemptions and since the discounted method is not applicable to companies, the net capital gain shall be $5 million. However, since the income tax rates for the year 2010-20 are not available, it cannot be said for certain how much capital gains tax David would have to pay in that year.

To summarize, Section 126.5 allowed for the roll-over of the house to David, thus, ensuring he shall pay the capital gains tax when a future capital gains tax event pertaining to the house takes place, which happens on 30th March, 2016. However, since David was using the property for his main residence with 10% of it let out. This allowed for a partial exemption for him, bringing his net capital gain to $3,750, using the discount method. However, since the net capital gain is below $18,200, the tax payable in such a scenario shall be nil as per the tax payable guidelines laid down by the Australian authorities. However, for the year 2019-20, David has a net capital gain of $5 million, the capital gains tax on which cannot be calculated owing to the lack of income tax rates of the year 2019-20.

Answer 2:

Answer 2 aims to solve the capital gains tax dilemma faced by Mr. and Mrs. Lombard who are spouses and have purchased property together. The capital gains tax faced by them over the various years and situations has been high discussed in detail below in an event wise distribution.

- 15th November, 2005:

  On this date, Mr. and Mrs. Lombard acquired the property in Sydney for $600,000 and started residing on the property beginning December 21st, 2005. This leads to Section 118.110 being applied which refers to the main exemption of capital gains tax from a capital gains tax event arising from a property which is used as a main residence. As per Section 118.110:

  *(1) A * capital gain or * capital 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:*

  (a) You are an individual; and

*(b) The dwelling was your main residence throughout your * ownership period; and*

*(c) The interest did not * pass to you as a beneficiary in, and you did not * acquire it as a trustee of, the estate of a deceased person.*

(2) The capital gains tax event has to be relevant (which includes capital gains tax event A1)[4]

For section 118.110 to be applicable, the requirements laid down in the section need to be proved. The first essential of the assesse being an individual is fulfilled as both Mr. and Mrs. Lombard classify as individuals, even though their citizenship status is not mentioned. This section is also applicable as the legislation does not require them to Australian citizens, however, they should not own any other property which functions as a main residence as well. It is also proved that the dwelling did not pass to Mr. and Mrs. Lombard as a beneficiary or as a trustee of the estate of a deceased person as the facts state that the Sydney property was acquired through the means of exchange of contracts which constitutes a sale.

Apart from that, it is also to be proved that the residence qualified as a main residence for Mr. and Mrs. Lombard throughout the ownership period. Although, the facts state that Mr. and Mrs. Lombard did not use the property as their main residence throughout the ownership period, the capital gains tax residence exemption can still be availed if it is established that the Sydney residence was their main residence. However, the Income Tax Assessment Act, 1997 does not define the term main residence in any manner, and owing to his paucity, TD 51 has to be referred to determine whether a property classifies as a main reference. As per TD 51, one of the aspects of determining whether a property is a main residence is the will and intention of the owners' to use the property as a main residence or not. Since Mr. and Mrs. Lombard held a New Year's Party at the Sydney residence on 31st December, 2005, it can be reasonably assumed that they aimed to utilize the Sydney property as their main residence. For the main residence exemption to

4 Section 118.110, Income Tax Assessment Act, 1997

applicable, the date at which the legal interest in the property arises, that date serves to function as the beginning of the residence[5], which in the immediate scenario is 15th November, 2005. Thus, it can be termed to be the main residence of Mr. and Mrs. Lombard.

Further, the capital gains tax event pertaining to the Sydney property shall be the A1 event, which is provided for under Section 104.10. Since the exemption of main residence is only applicable to relevant capital gains tax events, the exemption shall also be available in the case of Mr. and Mrs. Lombard as their capital gains tax event falls under the purview of capital gains tax event A1, which is a relevant capital gains tax event. Thus, all the requirements for the application of the main residence exemption under Section 118.110 have been fulfilled.

- 29th February and 17th March, 2006:

In conjunction with Section 118.110, an option for the main residence exemption is the absence concession provided under Division 118. As per this section, if a dwelling is not being used as a main residence, and if some assessable income is being derived from the dwelling, then the maximum amount of time the dwelling can be termed as a main residence is for 6 years and it is not necessary for the owners to start residing in the property again before the capital gains tax event for this section to be applicable.[6]

Owing to the fact that Mrs. Lombard was posted to Adelaide on 29th February, 2006 and was accompanied by her husband, they had vacated the property, but, as established above it was to still be treated as their main residence. On March 17th, 2006, the Sydney property was let out by Mr. and Mrs. Lombard to Mr. and Mrs. Taffie. Owing to this let out, an assessable income was being derived by Mr. and Mrs. Lombard from the Sydney property which qualified them to avail the main residence exemption read with the absence concessions

[5] Capital Gains Tax Determination Number 51
[6] Section 118.145, Income Tax Assessment Act, 1997

for a period of 6 years. Since the property was let out by them for a period of exactly 9 years, i.e. 17th March, 2006 to 17th March, 2015, the exemption can only be utilised for a period of 6 years and for the remaining 3 years, no exemption shall be granted.

- 31st May, 2006:

  On 31st May, 2006, Mr. and Mrs. Lombard purchased a house in Adelaide for $350,000, however, it is not mentioned anywhere in the facts whether the couple moved into the house to use it as their residence or not. Since it cannot be clearly established whether the main residence shifted to the Adelaide house or not, it shall be safer to assume, that the Adelaide property was just a purchase and was not used for residential purposes and the Sydney property still existed as the property of main residence.

- 31st March, 2014:

  On this day, Mr. Lombard passed away and since both the properties had been bought by Mr. and Mrs. Lombard as joint tenants, the share of Mrs. Lombard in both the properties came up to whole in accordance with Section 128.50. The repercussions of the death of a joint tenant and provides that the remaining joint tenants shall acquire a share in the property and their cost base shall be altered as well with the new share being added to the original cost base[7]. However, since the value of the Adelaide property is not mentioned on the date of death of Mr. Lombard, the cost base of it shall be assumed to be the same i.e. $350,000. However, for the Sydney property, the value has been mentioned and owing to this, the altered cost base of Mrs. Lombard for the Sydney property shall be $675,000.

- 1st June, 2016:

  On this date, Mr. Lombard sold the Adelaide property for $650,000. The cost base of the property is $350,000. As per Section 103.25 outlines the fact that an individual can choose to file his capital gains tax in the year in which the capital gains tax event rises. Owing to this, in the year,

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7 Section 128.50, Income Tax Assessment Act, 1997

2015-16, Mrs. Lombard has a capital gain of $300,000 which shall be discounted by half since she's an individual who has held the asset for more than 12 months, bringing net capital gain to $150,000 which shall entail capital gains tax of $43,447 as per the 2015-16 income tax rates.

- 30th September, 2017:

  On this date, the Sydney property was sold for $1,500,000. The cost base for the same for Mrs. Lombard was $675,000. However, as established above, Section 118.110 read with Section 118.145 allows Mrs. Lombard to utilize the property as her main residence for a period of 6 years beginning from 15th November, 2006. This is to be further be read with Section 118.185 which deals with the procedure to be used to calculate the partial exemption provided in the case in which the property was used a main residence for a part time during the ownership period, which involves taking the actual capital gain and multiplying it with the non-residence days and dividing the number so attained by the total number of ownership days. Also, Section 118.190 is also to be consulted which provides that if the property was giving any assessable income, then the benefit of it shall be added to the capital gain, and the procedure for the same has been laid down. The capital gain prior to the application of these sections is $825,000. After Section 118.185 is applied, the capital gain comes down to $440,076 owing to the partial residential exemption. However, Mrs. Lombard has been acquiring some assessable income from the property in the form of rent and later, carrying out of business. This shall lead to an addition to the capital gain, which causes it to come up to $752,541.4. However, the amount shall again be discounted by half owing to Mrs, Lombard being an individual having held the asset for more than 12 months. The net capital gain shall be $376,270.7 on which the capital gains tax shall be calculated. However, since the income tax rates for the year 2017-18 haven't been released, the exact capital gains tax cannot be ascertained.