

November 1990

## Capital Gains Tax Consequences of Property Settlements upon Divorce and Separation

Julie Cassidy  
*Bond University*

Follow this and additional works at: <http://epublications.bond.edu.au/rlj>

---

### Recommended Citation

Cassidy, Julie (1990) "Capital Gains Tax Consequences of Property Settlements upon Divorce and Separation," *Revenue Law Journal*: Vol. 1 : Iss. 2 , Article 3.  
Available at: <http://epublications.bond.edu.au/rlj/vol1/iss2/3>

This Journal Article is brought to you by the Faculty of Law at [ePublications@bond](mailto:ePublications@bond). It has been accepted for inclusion in Revenue Law Journal by an authorized administrator of [ePublications@bond](mailto:ePublications@bond). For more information, please contact [Bond University's Repository Coordinator](#).

---

# Capital Gains Tax Consequences of Property Settlements upon Divorce and Separation

## **Abstract**

Until recent times, the Australian taxation system did not generally treat as assessable gains in the nature of capital. With the introduction of Part IIIA into the Income Tax Assessment Act 1936, however, capital gains are now taxed for the first time on a comprehensive basis. The new provisions purport to have a wide scope, affecting nearly all aspects of human relations and business. This extensive operation requires all lawyers, not only taxation lawyers, to have at the very least a basic grasp of these provisions. This article is directed at the capital gains tax implications of family law property settlements.

## **Keywords**

capital gains tax, cgt, divorce, property settlements

# CAPITAL GAINS TAX CONSEQUENCES OF PROPERTY SETTLEMENTS UPON DIVORCE AND SEPARATION



by **Julie Cassidy**

LLB (Hons)

Assistant Professor

School of Law

Bond University

*Until recent times, the Australian taxation system did not generally treat as assessable gains in the nature of capital. With the introduction of Part IIIA into the Income Tax Assessment Act 1936, however, capital gains are now taxed for the first time on a comprehensive basis. The new provisions purport to have a wide scope, affecting nearly all aspects of human relations and business. This extensive operation requires all lawyers, not only taxation lawyers, to have at the very least a basic grasp of these provisions. This article is directed at the capital gains tax implications of family law property settlements.*

## Introduction

The potential scope of capital gains tax legislation (contained in Part IIIA of the Income Tax Assessment Act 1936) requires all lawyers to advise their clients as to its possible impact upon every transaction which either changes or gives rise to a disposal of an 'asset', 'right' or 'interest'. The legislation also requires greater emphasis to be placed on the need to keep detailed records as a means of accurately determining a taxpayer's tax liability. Particularly since the introduction of the new system of self assessment, lawyers must keep records of costs and transactions and advise clients as to their own responsibilities in this regard. Records will now have to be kept beyond the normal seven year period; being maintained for at least seven years after the final disposal of an asset. A practitioner's failure to advise a client in this regard will possibly be just as negligent as ill advice on the substantive impact of the capital gains tax provisions contained in Part IIIA. For this reason it is necessary to consider both the substantive and administrative effects capital gains tax will have on family law and practice.

The provisions of Part IIIA are complex and their reach uncertain. This is particularly so given the present dearth of relevant Australian authorities. While some assistance can be gained from Canadian and United Kingdom experience, whether this will be adopted in Australia will depend upon many factors, including a background of common law and established lines of reasoning. This renders some of this discussion

rather speculative, but it is better to be aware of the question marks hovering over the application of the legislation, than to be completely blind as to its potential impact.

For family law practitioners, the 'transaction' most commonly affected by the legislation is the property settlement following divorce and/or separation. When advising clients as to the form settlement arrangements should take, and the consequences of such arrangements, it will be important to bear Part IIIA in mind. A detailed analysis of every aspect of the capital gains tax provisions would fill volumes. This article will only consider those aspects particularly important to family settlements. This examination is broken up into two parts. As it is impossible to predict the types of assets and transactions involved in each property settlement, the first part of this article will provide general principles which extend and qualify the basic definitions governing the application of Part IIIA.

Detailed consideration is also given to the calculation of a capital gain or loss upon the disposal of an asset. This raises many questions, such as whether family law litigation costs can be included in the 'cost' of an asset. Such questions are crucial to the accurate determination of the true cost of an asset and thus whether a capital gain or loss arises.

For family law practitioners, s 160ZZQ, exempting certain transfers of the principal residence, and s 160ZZM and s 160ZZMA, purporting to exempt certain transfers made pursuant to an order under the Family Law Act 1975, provide the most important aspects of Part IIIA.

As the 'exemptions' provided by s 160ZZQ, s 160ZZM and s 160ZZMA are limited, the general provisions of the capital gains tax legislation will still affect many settlements and, in the process, have a considerable impact upon property settlements and the practise of family law.

## **Powers and practices of the Family Court in respect of property/maintenance determinations**

In a paper<sup>1</sup> presented to the South Australian Division of the Taxation Institute of Australia, O'Loughlin sets out a brief summary of the basic principles governing the division of matrimonial property:

- 1 There is no fixed entitlement of either spouse to any property arising out of the status of marriage.
- 2 All of the property of the parties to the marriage is relevant to the inquiry. It is not only the property which may loosely be called a family asset which is relevant, but also business or other property.
- 3 The contribution to the acquisition and preservation of any particular asset can be either financial or non-financial. There is no presumption of equality of financial and non-financial contribution.
- 4 The first step is to consider the relative merits or significance of the financial and non-financial contributions. This is a retrospective process; ie it has regard to the history of the parties' financial dealings.

---

1 ST O'Loughlin, 'Family Law Settlements' at 2.

- 5 That consideration will enable the judge to determine whether a 'global' or an 'asset by asset' approach should be taken.
- 6 The global approach involves a consideration of all financial resources and a determination of an appropriate apportionment of the whole 'cake'.
- 7 The asset by asset approach involves a determination of the respective contributions of the parties to each asset.
- 8 The court will then take a prospective view of the matter which involves taking into account the respective needs of each partner for the future (ie what resources are required in order to maintain each partner for the rest of their respective lives . . .).

In exercising its discretion and making the subsequent orders determining property rights as between the parties, the court may use a number of powers conferred under the Family Law Act 1975.

The relevant sections include:

- 1 Section 74, which allows the court to make orders for the provision of maintenance. Such maintenance orders may not only call for the making of periodic monetary payments, but may also affect the parties' rights to real property.<sup>2</sup>
- 2 Section 79, which gives the court power to make such orders it thinks appropriate altering the interests of the parties to the marriage in both real and personal property.<sup>3</sup>
- 3 Section 80 which provides the court with a variety of powers affecting the financial and property rights between the parties. These include the power to make an order requiring the transfer or settlement of property as maintenance for a party to the marriage (s 80(ba)) and the power to appoint or remove trustees (s 80(e)).
- 4 Section 81, which imposes a duty on the court to make such orders as will finally end the financial relationship between the parties to the marriage.
- 5 Section 84, which allows the court to appoint an officer of the court or other person to execute any deed or instrument necessary to give effect to its determination.<sup>4</sup>
- 6 Section 85, which confers upon the court the power to set aside or restrain the making of an instrument or disposition designed to defeat an existing or anticipated order. This instrument or disposition can be made by either of the spouses or a third party as long as it is 'made in the interests of the party.'<sup>5</sup> Nor is the court's power dependent upon the parties having as their prime motive the defeating of the order.<sup>6</sup>

---

2 See also s 77A.

3 This power does not extend to the alteration of the children's interests in such property: above n 1 at 4.

4 See also s 84(1A) in relation to this power in the context of ss 86 and 87 maintenance orders.

5 Cf *O'Loughlin*, above n 1 at 6.

6 See *Cameron v Cameron* (1968) 12 FLR 22.

- 7 Section 86, which allows for the registration of a maintenance agreement, slightly different in effect from a s 87 maintenance agreement.
- 8 Section 87, which provides for the formal approval of maintenance agreements by the court. These are given the status of orders of the court and are in substitution of any rights relating to financial matters under the Family Law Act 1975.
- 9 Section 88, which provides for the enforcement of such maintenance agreements.
- 10 This broad range of powers allows the court to affect even the rights and property of third parties.<sup>7</sup> A garnishment order requires or restrains individuals, such as trustees, from making payments to the parties of the marriage or their children.<sup>8</sup>

As O'Loughlin notes,<sup>9</sup> given these extensive powers and broad discretions, there is little scope for avoiding or affecting the distribution of matrimonial property through 'asset planning'.

### Tax implications of Part IIIA

The Income Tax Assessment Amendment (Capital Gains) Act 1986 introduced Part IIIA, comprising ss 160A-160ZZU, into the Australian taxation system, establishing the first general capital gains tax in Australia. While previously some provision was made for the taxation of capital receipts generally, the Income Tax Assessment Act 1936 was confined to the assessment of 'income'. Nevertheless, the classification of receipts as either 'capital' or 'income' remains important. While the new legislation renders previously non-taxable capital receipts taxable, in certain cases there may still be tax advantages in classifying a payment as 'capital'.

Many capital items are, for example, still exempt from taxation. These include:

- 1 Principal residence and curtilage (s 160ZZQ).
- 2 Part of the gains attributable to goodwill in certain cases (s 160ZZR).
- 3 Proceeds from superannuation and life assurance (s 160ZZI, s 160ZZJ).
- 4 Gains on certain motor vehicles (s 82AF(2)(a) and s 160A).
- 5 Personal use assets (other than 'listed' assets) where the disposal value is \$5,000 or less.
- 6 Certain transfers between spouses pursuant to court orders under the Family Law Act 1975 (s 160ZZM and s 160ZZMA).

The principal residence exemption given by s 160ZZQ and the s 160ZZM and s 160ZZMA exemptions are probably the most important exemptions in the context of family law and practice.

7 Above n 1 at 6.

8 Ibid 7.

9 Ibid.

Another difference between capital and income receipts is that only 'real' capital gains are taxed. Inflation is taken into account when calculating a capital gain and only profits made in excess of inflationary increases are included in the taxpayer's assessable income. In these ways capital and income are treated differently and advantages may at times still be found in a capital classification. This possibility should be borne in mind when advising clients how to structure a property settlement.

## Outline of provisions

The forms property settlements take are infinitely various. For this reason a general picture of Part IIIA is given here.

Part IIIA generally takes effect only where there is:

- 1 a 'taxable Australian asset';
- 2 that is an 'asset' within the definition in s 160A;
- 3 which is not exempt from the scope of Part IIIA;
- 4 that was acquired on or after 20 September 1985; and
- 5 'disposed' of on or after 20 September 1985;
- 6 and the consideration received is in excess of any inflationary rises.

The basic formula for the calculation of the capital gain or loss is provided for in s 160Z:

Subject to this Part, where an asset other than a personal-use asset has been disposed of during the year of income:

- a) If the consideration in respect of the disposal exceeds the indexed cost base to the taxpayer in respect of the asset—a capital gain equal to the excess shall be deemed for the purposes of this Part to have accrued to the taxpayer during the year of income; or
- b) If the reduced cost base to the taxpayer in respect of the asset exceeds the consideration in respect of the disposal—a capital loss equal to the excess shall be deemed for the purposes of this Part to have been incurred by the taxpayer during the year of income.

The overall capital gain or loss is calculated having regard to past 'expenditure' incurred in buying and maintaining the asset. These costs are indexed to reflect inflationary rises and then subtracted from the value given for the asset. The result is the taxable capital gain or loss. The taxpayer's overall taxable capital gains are then calculated having regard to the gains and losses of the current year and the previous year (s 160ZC(1)). This net capital gain in excess of the inflation rate is then included in the taxpayer's assessable income (s 160ZO(1)). Determination of the indexed cost base of an asset is central to calculating tax liability under Part IIIA.

## The indexed cost base

The calculation of the cost base is provided for by s 160ZH. This recognises expenditures incurred in relation to an asset may include much more than the basic purchase price. Costs are incurred to acquire,

preserve, upgrade, and finally sell an asset. These costs must be taken into consideration if only the taxpayer's real capital profits are to be taxable.

Section 160ZH(1) specifies five items to be included in the cost base of an asset:

- a) The amount of any consideration in respect of the acquisition of the asset.
- b) The amount of the incidental costs to the taxpayer of the acquisition of the asset.
- c) The amount of any expenditure of a capital nature incurred by the taxpayer to the extent to which it was incurred for the purpose of enhancing the value of the asset and is reflected in the state or nature of the asset at the time of the disposal of the asset.
- d) The amount of any expenditure of a capital nature incurred by the taxpayer to the extent to which it was incurred in establishing, preserving or defending the taxpayer's title to, or right over, the asset; and
- e) The amount of the incidental costs to the taxpayer of the disposal of the asset.

As such expenditure is incurred at various times throughout the period of ownership, the applicable consumer price index (CPI) used for indexing these amounts may vary considerably. For this reason it is crucial to index each item separately in accordance with the CPI for the relevant quarter (s 160ZH(2)).

(a) *Consideration for the acquisition*

The consideration for the acquisition of an asset is the full contract price paid pursuant to an arm's length agreement. It is not the amount the 'owner' personally pays either at the point of purchase or over many years pursuant to a repayment or mortgage scheme. It does not matter that only a small portion was actually paid by the taxpayer at the point of purchase, nor that over many years the taxpayer paid in dollar terms far more for the asset than the contract price under, for example, a mortgage.

If property, or a combination of money and property, is given for the asset, the consideration paid for the asset is the sum of those monetary payments and the market value of the property given at the time of the acquisition (s 160ZH(4)). It is a different matter when the taxpayer is given an asset as a gift when all or part of the consideration cannot be valued, or when the parties are not dealing at arm's length (s160ZD(2)). In such cases the taxpayer is deemed to have paid an amount equal to the market value<sup>10</sup> of the asset at the time of acquisition. Consequently,

10 In the absence of provision to the contrary, it can be assumed that the market value is to be determined on the basis of the price that a willing purchaser would pay to a vendor, not unwilling but not anxious to sell (see the High Court in *Spencer v The Commonwealth* (1907) 5 CLR 418; 14 ALR 253). As Griffith CJ said, the appropriate manner to value land was to ask 'What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?'

sometimes it will be necessary to obtain retrospective valuations of either the asset itself or the property given as consideration.<sup>11</sup>

(b) *Incidental costs of acquisition*

The costs that may be included in the incidental costs of acquisition are set out in s 160ZH(5):

- a) Fees, commission or remuneration for the professional services of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal adviser.
- b) Costs of transfer, including stamp duty or other similar duty.
- c) Costs of advertising to find a seller; or
- d) Costs in relation to the making of any valuation or apportionment under or for the purposes of this Part in respect of the acquisition

but excluding any expenditure by way of fees, commission or remuneration paid for professional advice concerning the operation of this Act or of any other law relating to taxation.

There are, therefore, a number of types of expenditure which may be included in the indexed cost base of an asset to reduce the taxpayer's liability to tax. The costs of surveys, valuations, stamp duty and disbursements, ordinarily irrelevant to family law proceedings, are now crucial to maximising the cost base.<sup>12</sup> Whether this particular transfer falls outside or is included in the exemptions provided by Part IIIA, these costs may be needed in the future to calculate the transferee's liability to tax upon a transfer within the scope of Part IIIA. Consequently, it is important that details of such costs be collected and retained.

(c) *Capital expenditure enhancing the asset*

A number of elements must be satisfied before an expenditure can be included in the cost base of the asset. Section 160ZH(1)(c) provides it must be:

- (i) capital in nature;
- (ii) incurred by the taxpayer;
- (iii) incurred for the purpose of enhancing the value of the asset; and
- (iv) reflected in the state or nature of the asset when it is ultimately disposed.

There is a plethora of case law relating to what expenditure is 'capital' in nature. The distinctions are often difficult to draw and ultimately the character of an expenditure will depend on the facts of each case.<sup>13</sup> In one case, for example, the courts held the rebuilding of a wall to be a

11 Note that s 160ZH(10) provides that this will not be so if the transaction is caught by those sections of the Act, such as s 160M(7), which deem no consideration to have been paid.

12 *Family Law and Practice* (CCH loose-leaf publication) paras 42-020 and 42-026.

13 *Lindsay v Commissioner of Taxation (Cth)* (1960) 106 CLR 377; see especially Kitto J's judgment.

repair,<sup>14</sup> while in another, because of the consequent change in character, the building of two retaining walls was held to be a capital improvement.<sup>15</sup> What factors are relevant to this determination?

Some of the factors to be considered in determining the purpose of expenditure are:

- (i) Was the expenditure incurred to increase or preserve an asset/capital/the profit yielding structure?<sup>16</sup>
- (ii) Was the expenditure incurred to promote or preserve the 'tree' rather than to produce 'fruit'?<sup>17</sup>
- (iii) Was the expenditure incurred a mere repair or a capital improvement?<sup>18</sup>
- (iv) Is there a reconstruction of the entirety as distinct from part of the asset?<sup>19</sup>
- (v) Has it been replaced by newer and better materials?<sup>20</sup>
- (vi) Has an improvement been made?<sup>21</sup> Is it better and of a different character?<sup>22</sup>

The section requires a consideration of each repair or improvement separately to determine which, if any, are capital in nature. Only those items which are capital expenditures can be included in the cost base.

The expenditure must also be 'incurred by the taxpayer'. Implicitly this appears to exclude work undertaken, or money expended, by friends or relatives. Only money actually paid by the taxpayer can be included in this limb.

The expenditure must be for the 'purpose of enhancing the value of the asset'. This seems to require the taxpayer to have acted pursuant to a definite purpose or intent. Spontaneous or unplanned expenditure, only incidentally enhancing the value of the asset, may not, therefore, be included in the cost base.

It does not appear to be necessary for this be the sole purpose, for the words 'to the extent' contained in s 160ZH(1)(c) provide for apportionment and exclude the percentage of the monies expended for other purposes.

Perhaps the harshest requirement under s 160ZH(1)(c) is the need for the expenditure to be 'reflected in the state or nature of the asset at the time of the disposal of the asset'. Additions and alterations, which are in turn replaced with further additions and alterations

14 See *Lurcott v Wakeley and Wheeler* [1911] 1 KB 905, 924. Note that this is not a revenue case, but rather was dealing with principles of landlord/tenant law. It is nevertheless a useful authority in this context.

15 See *Case S 13* (1985) ATC 171.

16 See Lord Blackburn in *United Collieries Ltd v IRC* (1929) 12 TC 1248.

17 The High Court referred to this metaphor in *FCT v D P Smith* (1981) 81 ATC 4114.

18 See *Morcom v Campbell-Johnson* [1955] 3 All ER 264; and *Case S 13*, above n 15.

19 See *O'Grady v Bullcroft Main Collieries Ltd* (1932) 17 TC 93, 102; and *Lindsay v Commissioner of Taxation (Cth)*, above n 13.

20 See *Commissioner of Taxation (Cth) v Western Suburbs Cinemas Ltd* (1952) 86 CLR 102 per Kitto J.

21 *Morcom v Campbell-Johnson*, above n 18.

22 See *Windeyer J in W Thomas & Co Pty Ltd v Commissioner of Taxation (Cth)* (1965) 15 ATD 78.

with the passing of time, will no longer be reflected in the asset and will not, therefore, be included in s 160ZH(1)(c). The cost of a new galvanised roof, for example, which is later replaced by a tiled roof, while arguably capital in nature, is no longer reflected in the quality or state of the house. It could not, therefore, be included in the cost base of the asset.

This seems draconian, given that in the normal calculation of assessable income expenditures can be deducted even though no longer reflected in the productivity of the business. Capital gains, arise over time and involve a degree of 'bunching' of gains—the gains only coming to fruition after a comparatively long period of expenditure. It would be more equitable to allow for the reflection of all expenditures incurred throughout the period of ownership, even if their benefit has expired.

(d) *Capital expenditure incurred in establishing, preserving or defending title*

Section 160ZH(1)(d) also contains a number of elements. Again the expenditure must be capital in nature. What sort of capital costs could be incurred in the process of establishing or defending the title or right to an asset? In the context of family settlements the most likely capital expenditure is the costs of family law litigation.

Such costs are capital in nature<sup>23</sup> and often incurred in the process of 'establishing, preserving or defending' the taxpayer's right or title to matrimonial property. Costs are incurred in preserving the taxpayer's interest in matrimonial property, or the right to use or occupy such. These costs appear to be incurred within the terms of the section whether they be formal court costs or payments incurred for advice relating to the negotiation of a s 86 or s 87 order.<sup>24</sup>

The workability of s 160ZH(1)(d) where title to a number of assets passes to, or is retained by, the taxpayer pursuant to a property settlement is questionable. The appropriate method of dealing with the complexities involved in identifying which costs relate to which assets, would seem to be to apportion the costs of litigation and legal advice amongst the assets. Further, where appropriate, the costs could be apportioned in accordance with the multitude of purposes underlying the litigation, and perhaps even amongst the applicable parties, to accurately reflect the true relationship between the expenditure and the asset.

For example, if after such litigation the taxpayer husband retains the 'family business' and the wife the 'family home' and through apportionment half of the litigation cost is allocated to the division of those assets, it could be argued half of the litigation costs were incurred in establishing, preserving or defending title to those assets.

While it could be suggested that only a quarter of the husband's costs, for example, were incurred in 'preserving' his title to the business, a quarter being incurred in 'defending' his title in the

23 See eg *Broken Hill Theatres Pty Ltd v FCT* (1959) 33 ALJR 337 and *John Fairfax and Sons v FCT* (1959) 101 CLR 30.

24 The CCH editors appear to agree; above n 12 at para 42-032.

matrimonial home,<sup>25</sup> it is submitted it is more appropriate to see the half as being expended to preserve the husband's interest in the business. In a broader sense it was all expended to preserve his title in whatever assets the court thought he should retain.

Even if we adopt the more strict interpretation in the allocation of costs in line with the purpose underlying the expenditure, the wife's ultimate retention of full title to the home is not a denial of the husband's interest in that asset.

By vesting full ownership of the business in the husband, the court is implicitly recognising his half interest in the matrimonial home. The defence of the husband's interest in the home, and the costs so incurred, are embodied in the costs incurred in obtaining full title in the business. It is not unlike a 'rollover'. The costs incurred in defending one asset rollover, and are included in, the costs incurred in preserving title to another asset.<sup>26</sup> In the family settlement context, where equity may call for a division of assets *in specie*, rather than an imposed sale and division of the profits, this is a concession Part IIIA should make.

It will now be necessary, not only to keep detailed accounts of your own client's legal expenditures, but also to take steps towards, or at least advise clients of the need to obtain information about the costs incurred by their ex-spouse.<sup>27</sup> While the incorporation of legal expenses into the cost base is far from certain, given the impact the inclusion of such expenditure will have on the indexed cost base of an asset, arguably it would be negligent for a practitioner to fail to advise a client of the need for, and importance of, keeping full and complete details of all legal costs associated with the settlement.

(e) *Incidental costs of disposal*

The expenditures qualifying as incidental costs of disposal are set out in s 160ZH(7):

- a) fees, commission or remuneration for the professional services of a surveyor, valuer, auctioneer, accountant, broker, agent, consultant or legal adviser;
- b) costs of transfer, including stamp duty or other similar duty;
- c) costs of advertising to find a buyer; or
- d) costs in relation to the making of any valuation or apportionment under or for the purposes of this Part in respect of the disposal, but excluding any expenditure by way of fees, commission or remuneration paid for professional advice concerning the operation of this Act or of any other law relating to taxation.

The incidental costs of disposal essentially echo those which may be taken into account as costs of acquisition. The transfer of property between spouses normally involves a 'disposal' of an asset by one party and a corresponding 'acquisition' of that asset by the other

25 This percentage of the costs being of no taxable value as he no longer holds title to that asset.

26 This was also suggested, but perhaps for another reason, by the CCH editors, above n 12 at para 42-032.

27 See also *ibid*.

party. Consequently, the costs involved in the acquisition and disposal of the asset will include all those expenses customarily incurred in the transfer of an asset.

These expenses include the real estate agent's commission, stamp duty, advertising costs and legal costs; particularly those legal costs referable to ascertaining, but not minimising or avoiding liability under Part IIIA. As with acquisition costs, the incidental costs of disposal may also include the costs of family law litigation pursuant to which assets are transferred to the other spouse. Until this point is clarified by the courts or the legislature, detailed records of all such expenditures should be maintained by the taxpayer, and the legal practitioner should generate appropriate bills of costs.

The allowable incidental costs of disposal listed in s 160ZH(7) are qualified by s 160ZH(8) which provides such costs do not include those which have been or are deductible as expenditures incurred in the course of the production of income. Further, as the expenditure must be capital in nature,<sup>28</sup> the most common forms of expenditure, such as rates and repairs, will be excluded from the cost base.

(f) *Method of indexing*

As previously noted, except when the asset is disposed of within twelve months of its acquisition, Part IIIA only taxes 'real' gains. Inflationary rises are not taxable. This is done through the indexation of the cost base, as determined by the processes described above.

The method of indexing as set out in s 160ZJ is very similar to the way variations in maintenance are calculated.<sup>29</sup> Part IIIA differs insofar as it uses a weighted average of the consumer price index for the eight capital cities (published quarterly), instead of the figure for the particular capital city where the individual resides. As the CPI may differ considerably from city to city, this may produce a significant variation in the calculation of tax liability.

Each of the components included in the cost base are indexed separately. The indexation factor is determined according to the formula set out in s 160ZJ(5):

index number with respect to the quarter in which the asset was disposed  
index number for the quarter in which the liability to pay the consideration  
or expenditure was incurred

This is calculated to three decimal places; the third decimal place being increased by one if the fourth decimal place is five or greater. If the indexation factor is less than one, the expenditure will not be indexed. This will only occur where there has been a deflation in the period between the expenditure and disposal of the asset.

Again the importance of indexing each item of expenditure in accordance with its own relevant indexation factor should be stressed. The indexation factor for individual items of expenditure can vary considerably throughout a single year, much less over decades.

---

28 As with the costs of acquisition.

29 Above n 12 at para 42-050.

*Example*

An asset was purchased for \$110,000 on 20 June 1986 and disposed of for \$200,000 on 20 June 1988.

Assume the index number at the date of acquisition was 142.2, the index number for December 1986, when capital improvements of \$20,000 were incurred was 161.5 and the index number at the time of the disposal was 179.0.

The indexed cost base would be calculated as:

$$\begin{aligned}
 & \$110,000 \qquad \qquad \qquad \$10,000 \\
 & (\text{consideration payable} + \text{incidental costs of acquisition}) \times \frac{179.0}{142.2} \text{ plus} \\
 & \$20,000 \\
 & (\text{costs of capital improvement}) \times \frac{179.0}{161.5} \text{ plus} \\
 & \$15,000 \\
 & (\text{incidental costs of disposal}) \times \frac{179.0}{179.0} \\
 & = ((\$110,000 + \$10,000) \times \frac{179.0}{142.2}) + (\$20,000 \times \frac{179.0}{161.5}) + (\$15,000 \times \frac{179.0}{179.0}) \\
 & = (\$120,000 \times \frac{179.0}{142.2}) + (\$20,000 \times \frac{179.0}{161.5}) + (\$15,000 \times 1) \\
 & = \$151,054.85232 + \$22,167.182663 + \$15,000 \\
 & = \$188,222.03498
 \end{aligned}$$

If the taxpayer received \$200,000 as consideration for the asset, there would be a taxable gain of (\$200,000—\$188,222.03498) = \$11,777.96502 (or \$11,778).

In certain cases, not all the consideration will be paid immediately upon the receipt of the asset; for example, when the vendor gives some financial assistance. In such cases, according to *Taxation Ruling IT 2362*, even though all the monies may not be paid for some time, the indexation factor for the whole of the consideration is calculated in accordance with the date of acquisition,<sup>30</sup> for the liability to pay the consideration arises at the date of acquisition. Similarly, the vendor must use the indexation factor for the date of sale when calculating the gain, even though not all the consideration is received on that date.

The calculation of capital losses will not be considered here. It should, however, be noted that unlike expenditure incurred in the making of a capital gain, costs incurred in relation to a capital loss are not indexed.

Those who fail to keep detailed records of their expenditure will prejudice their ability to minimise capital gains tax. It is crucial to explain to clients the importance of maintaining accurate records to boost their indexed cost base and thus lower their liability to tax.

<sup>30</sup> *Ibid.*

## What is an 'asset'?

Only asset disposals are affected by Part IIIA. An 'asset'<sup>31</sup> is widely defined in s 160A:

In this Part, unless the contrary intention appears, 'asset' means any form of property and includes:

- a) an option, a debt, a chose in action, any other right, goodwill and any other form of incorporeal property;
- b) currency of a foreign country; and
- c) any form of property created or constructed or otherwise coming to be owned without being acquired, but does not include a motor vehicle of a kind mentioned in paragraph 82AF(2)(a).

The terms of s 160A are wide, echoing but also extending the scope of its English equivalent (s 19) through the inclusion of the phrase 'any other right'. Even if this phrase is confined to 'proprietary rights',<sup>32</sup> the ambit of the section is considerable. The definition includes legal and equitable interests in, and rights and powers over, tangible and intangible objects.

While generally Part IIIA only applies to assets acquired and disposed of on or after 20 September 1985, its scope is extended in a number of cases by deeming certain transactions to create a new 'notional asset' acquired and disposed of after the operative date.<sup>33</sup> While these deeming provisions, scattered throughout Part IIIA, are exceptions to the basic rule requiring both the acquisition and disposal of an asset be on or after 20 September 1985, practitioners should be careful to check that the pre-20 September assets they are dealing with are not caught by these deeming provisions.

Apart from the numerous exemptions set out earlier, certain assets are subject to special rules and are dealt with separately under Part IIIA. These include, ordinary motor vehicles (dealt with in s 82AF(2)(a)), some personal use assets and the taxpayer's principal residence.

## What is a 'disposal'?

The meaning of 'disposal' is very wide. Instead of specifically defining 'disposal', Part IIIA deems certain actions to give rise to a 'disposal'. Section 160M(1) contains the broadest of these deeming provisions, specifying a change of ownership of an 'asset' to be a 'disposal' of that asset by the person who previously owned the asset. The general language of s 160M(1) is reinforced by s 160M(2). This section provides this change in ownership may occur 'in any way', including as a result of:

- a) the execution of an instrument
- b) the entering into a transaction
- c) the transmission of the asset by operation of law

31 Or part of an asset: see s 160R.

32 See, for example, the High Court determination in *Commissioner of Stamp Duties (NSW) v Yeend* (1929) 43 CLR 235.

33 See, for example, s 160ZS deeming a lease to create a new asset.

- d) the delivery of the asset
- e) the doing of any other act or thing
- f) the occurrence of any event

As the words 'in any way' and 'including' indicate, any type of change in ownership will give rise to a 'disposal' and an 'acquisition' within the terms of Part IIIA.

This is further extended by other provisions of Part IIIA. Many of these are set out in s 160M. Section 160M(3) deems a declaration of trust to be a change in ownership where the beneficiary is 'absolutely entitled to the asset' as against the trustee.

Section 160M(3)(b) deems a 'cancellation, release, discharge, satisfaction, surrender, forfeiture, expiry or abandonment, at law or in equity' of a debt, chose in action, or any other right or interest in property to be a change in ownership. This would appear to include an agreement under which one spouse agrees to give up, for example, the right to sue for maintenance. Unless those monies can be characterised as being in the nature of income, the right to sue (a chose in action) is a capital asset, the surrender of which is a 'disposal' within the terms of Part IIIA.

Section 160M(3)(c) provides the redemption in whole or part, or the cancellation of, a share or debenture shall be deemed to be a change in ownership.

Section 160M(3)(d) seems a transaction giving an individual the use and enjoyment of an asset for a period at the end of which title to the asset will or may pass to that person, to be a disposal. This could include an arrangement under which, for example, the wife and children retain the right to reside in the family home for a specified period.

Perhaps the most controversial provision deeming certain actions to be a disposal is s 160M(6). This provides 'a disposal of an asset that did not exist (either by itself or as part of another asset) before the disposal but is created by the disposal constitutes a disposal of an asset for the purposes of Part IIIA . . .'. In such cases the person is deemed not to have paid any consideration for the asset. The whole amount of the consideration will therefore be taxable.

The section has potentially a limitless scope, covering every contractual action under which a right to sue the other party passes to the contractor. The creation of a contractual right in favour of A, for example, will not involve a disposal by B of that same contractual right. B never had the right to sue himself or herself and it is the right to sue B which has passed to A under the agreement. We have, therefore, an asset (the right to sue B) which did not exist before the transaction or disposal, but rather was created by the arrangement.

Alternatively, s 160M(6) could be confined to cases where another section in Part IIIA has already deemed this 'transaction' to be a 'disposal'; for example s 160ZS. This would seem to be a necessary constraint to impose upon the otherwise unlimited reach of s 160M(6).

The potential scope of s 160M(7) is equally wide. This provides that where as a result of an act or transaction or event relating to an asset, including the forfeiture or surrender of a right or for the exploitation of the asset, a person has received or is entitled to receive money or other consideration, 'the act, transaction or event constitutes a disposal ... of an asset created by the disposal ...'. The taxpayer is deemed not to have paid any consideration for the asset, so again the full amount of the consideration will be taxable. The Commissioner has suggested the wide terms of s 160M(7) will fill many of the gaps said to exist in Part IIIA. Clearly it will extend to many acts and transactions otherwise outside its scope.

Other important deemed disposal provisions include s 160M(8), s 160M(9) (resident trust estates), s 160M(10) (resident unit trusts) and s 160M(11) (resident partnerships) which essentially deem a cessation of Australian residence to be a disposal of all the taxpayer's post-20 September 1985 assets.

To ameliorate the possible harshness of these sections, s 160M(11A) and (11C) provide a limited exemption for those persons who have been resident in Australia for a short period. These persons may elect to retain the 'Australian taxable asset' status, even though the assets are no longer in Australia. These assets will not be taxed on the taxpayer's change of residence.<sup>34</sup>

Section 160M is not, however, the sole section deeming actions or transactions to be a 'disposal' of an asset. Throughout Part IIIA there are deemed disposal provisions, but in this context these sections are generally of peripheral relevance and will not be considered here.<sup>35</sup>

34 Similar provision is made in relation to trust estates (s 160M(13)), unit trusts (s 160M(14) and partnerships (s 160M(15)) which have become resident in Australia.

35 They include:

- i) Section 160N deeming the loss or destruction of part or the whole of an asset to be a disposal.
- ii) Section 160V(1) which deems the disposal by the trustee of an asset to which the taxpayer is absolutely entitled to be a 'disposal'.
- iii) Section 160V(2) which deems the disposal of an asset by a person appointed to enforce a security in relation to an asset to be a disposal by the person who owns the asset.
- iv) Section 160W which provides that the disposal of an asset by a trustee in bankruptcy is a disposal by the owner of the asset.
- v) Section 160Y(3) deems a deceased individual to have disposed of an asset which immediately before his/her death was bequeathed to a tax exempt person.
- vi) Section 160ZL(1) and (3) which deem there to have been a disposal of shares where the shareholder receives an amount of money, other than a dividend, from the company.
- vii) Section 160ZM(2) and (3) which deem there to have been a disposal of units in a unit trust upon the receipt of a non-assessable distribution by the trustee.
- viii) Section 160ZS which deems the grant of a lease to be a disposal of an asset, the lease, by the lessor.
- ix) Section 160ZU which, when coupled with s 160ZS, deems a renewal or extension of a lease to be a disposal of an asset, the new lease.

## Record keeping

As the above examples show, to determine a client's liability detailed information is required. Some of this information will need to be obtained from the other spouse. To determine the indexed cost base of an asset in the hands of the 'acquiring spouse', what expenditure has been incurred in the past in relation to that asset, possibly by the 'disposing spouse', must be determined. Given the impact such information will have on the cost base, '[t]he information about the history of the property will be almost as valuable as the title deeds . . .'.<sup>36</sup> While such details are only required when the asset is ultimately disposed of by the 'acquiring spouse', it is more convenient to obtain the relevant information at the property settlement.

The editors of *Family Law and Practice* set out a useful check list of information to be collected:<sup>37</sup>

- 1 The consideration for which the [spouse] originally acquired the property or the market value if it was acquired other than for valuable consideration.
- 2 The date of such acquisition so that the relevant CPI may be worked out.
- 3 The legal costs, stamp duty, disbursements, etc incurred about the time of the acquisition as incidental costs of the acquisition.
- 4 The dates upon which those amounts were actually paid in case they fall into a different quarter from the actual acquisition of the property. It is quite common that such costs may be incurred months before the actual transfer of the title.
- 5 Complete details with as much supporting documentation as possible concerning all monies spent on the capital improvement of the property and particularly including the dates upon which those monies were expended and the nature of the capital improvements so as to enable them to be identified as having altered the state of the property as at the date of final sale by the [acquiring spouse].
- 6 The amount of the [spouse's] costs of the family law litigation in relation to the property transferred by the court order or the s 87 agreement and when those costs were paid.
- 7 The proportion of those costs which might be fairly referred to the particular asset in the [spouse's] case.
- 8 The amount of the incidental expenses the [spouse] had in transferring the property to the [acquiring spouse] and the date of such costs.
- 9 The amount of the [acquiring spouse's] legal costs in relation to that family law litigation and when they were paid.
- 10 The proportion of the [acquiring spouse's] costs that related to that particular asset.
- 11 The amount of the [acquiring spouse's] incidental expenses in relation to the final transfer of the asset pursuant to the court order or the s 87 agreement.

---

x) Section 160ZX(1) which deems a trustee to have disposed of an asset when a beneficiary becomes absolutely entitled to the asset.

xi) Section 160ZX(4) which deems a beneficiary who has become entitled to an asset under a trust to have disposed of an interest in the corpus of the trust estate.

36 Above n 12 at para 42-150.

37 Ibid.

While the solicitor's client will be able to provide most of this information, ascertaining some of these may require the co-operation of the other spouse. Especially in the context of divorce and separation, this co-operation cannot be relied upon. Consequently, it may be necessary to make it a normal part of practice to include in both 'informal' settlements and court approved agreements, a clause requiring the 'disposing spouse' to furnish such information to the 'acquiring spouse'.<sup>38</sup>

## Conclusion

The existence of numerous exemptions, particularly s 160ZZQ, s 160ZZM and s 160ZZMA, does not mean family law practitioners do not need an understanding of the general mechanics of Part IIIA. Many property settlements will be subject to the general operation of Part IIIA. In other cases, liability will only be deferred and when the asset is ultimately disposed of outside the terms of these exemptions, the general provisions of Part IIIA will come into operation.

While it will only be at that point that the operation of Part IIIA will become a concern, the information required to calculate this subsequent tax liability can best be obtained at the initial date of settlement. It cannot be stressed enough how crucial the existence of such records is to establishing the indexed cost base and thus liability under the Act. Whether the taxpayer spouse will have the benefit of past expenditures to increase his or her cost base and thereby reduce his or her tax liability, will depend on the maintenance of these detailed records. It is, therefore, crucial for the practitioner to be aware of the implications of Part IIIA and the information required under the Act, and to be willing to assist clients in obtaining the necessary records. The general provisions of Part IIIA should always be borne in mind and the value of exemptions not over-valued.

---

38 Ibid.