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INCOME TAX AND GST ISSUES CONCERNING BUYING AND SELLING ASSETS

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ACQUIRING AND DISPOSING OF ASSETS

INTRODUCTION

This seminar discusses various taxation issues that arise when buying and selling assets. One scenario where it is important to be aware of these issues is when selling or buying a business. For CGT and depreciation purposes, it will be necessary to allocate consideration to each of the assets of the business.

Due to the differing taxation implications for both, the purchaser and vendor may have conflicting interests when it comes to doing this allocation.

For example:

Depreciable assets

The vendor would prefer to sell these assets for their written down value so as to avoid any balancing charges.

The purchaser would prefer to maximise the amount it can begin claiming as depreciation deductions in the future.

Pre-CGT assets

The vendor would wish to allocate as large an amount as possible to these assets as any gain will be tax free.

Any amount allocated to these assets will become their cost base for the purchaser.

Land and buildings

The vendor will want to allocate up to the cost base for the asset. Any more and there will be a capital gain upon disposal.

Any amount allocated to these assets will become their cost base for the purchaser.

Usually the Tax Office will accept the figures allocated in the contract between arms length parties. Where the contract does not allocate the sale price, the parties should ensure they can justify their figures.

GST CALCULATION AND TIMING ISSUES

GST calculation

Where a business is registered for GST, the sale of any assets by that business will result in a GST liability where there is a taxable supply.

This means that it must be determined for each type of asset disposed of, whether or not the supply is a taxable supply or GST-free or input taxed.

Tax invoices must be provided to the purchaser for the purchaser, registered for GST, to be able to claim back the GST as input tax credits.

Where there is a taxable supply, a value has to be allocated to each of the assets sold. The GST which must be remitted to the ATO is 1/11th of the consideration in respect of that asset.

There is generally no correlation between the income tax and GST treatment of assets.

For example (assuming the vendor and purchaser are registered for GST and the following are taxable supplies):

Depreciable assets

The GST for the vendor and input tax credit for the purchaser will be 1/11th of the consideration for the supply.

Pre-CGT assets

The GST for the vendor and input tax credit for the purchaser will be 1/11th of the consideration for the supply.

Special rules re disposal of buildings

There are special rules that may apply in relation to the disposal of buildings.

Residential premises

Subject to two exceptions, the sale of residential premises such as houses and units is input taxed (section 40- 65 of the GST Act). This treatment ensures comparable treatment with owner-occupiers and means that no GST is charged on the transaction but no input tax credits can be claimed in relation to GST charged on expenses relating to the sale.

"Residential premises" refers to land or a building that is occupied as a residence or is intended to be and capable of being occupied as a residence. This is determined objectively by reference to the physical characteristics of the property as at the date of disposal - **Sunchen Pty Ltd v FCT [2010] FCAFC 138.**

The Commissioner regards the residential premises as the land and the residential building on the land, ie the land and building are seen as a "package" - **GST Ruling GSTR 2012/5**.

The exceptions are the sale of:

- commercial residential premises such as hotels; and
- "'new residential premises".

Residential premises are "new residential premises" if they:

- have not previously been sold as residential premises and have not previously been the subject of a long-term lease
- have been created through "substantial renovations" of a building; or
- have been built, or contain a building that has been built, to replace demolished premises on the same land.

Therefore, the sale of new residential premises by a registered entity (such as a builder or developer) in the course or furtherance of an enterprise it carries on, will be a taxable supply.

Note however that where the residential premises are sold after five or more years of being rented continuously, they are not regarded as new residential premises and the sale is an input taxed supply.

Margin scheme

The margin scheme, in Division 75 of the GST Act, applies to supplies of real property and premises that are held at 1 July 2000 and subsequent supplies of real property.

Under the margin scheme, GST is calculated on the supply as 1/11 of the margin on the sale. Generally, the margin is the tax inclusive sale price less the original purchase price.

Example
Don, a property developer, is registered for GST. This year on 1 February, he bought land for $200 000. The supply of the land to him was not a taxable supply. He sold the land six months later for $288,000. He chose to apply the margin scheme to his sale of the land. Under the margin scheme, the margin for the supply of the land is $88,000 ($288,000 – $200,000). The GST payable on the margin is $8,000 (1/11 of $88,000).

If the property was held at 1 July 2000, the margin is the GST inclusive sale price less the value of the property at 1 July 2000 (a valuation of the property at that date is necessary).

NOTE:
Real property that was purchased as a taxable supply on which GST was calculated on the full value of the supply generally cannot be resold under the margin scheme.

NOTE:
Purchasers of real property and premises where GST on the supply was calculated on the margin cannot claim input tax credits on the supply – section 75-20.

The going concern rules

Where certain conditions are satisfied, a sale of a business may be regarded as the GST-free supply of a going concern. This means it will not be necessary to determine in respect of each asset disposed of, whether there has been a taxable, input taxed or GST-free supply.

Section 38-325(1) of the GST Act provides a supply of a going concern is GST-free where all the following conditions are met:

- the supply is for consideration;
- the recipient of the supply is registered (or required to be registered); and
- both parties have agreed in writing **prior** to the sale that the supply is of a going concern.

This results in stamp duty savings. It also means that the purchaser does not have to obtain additional funds to cover the GST that would otherwise be included in the price of a going concern if the section did not apply.

However, the vendor needs to be very wary as if a sale is not accepted as the supply of a going concern by the ATO, then the vendor, not the purchaser, will have the liability for the GST. An indemnity clause should be inserted in the contract to enable the vendor to be indemnified by the purchaser should this happen.

The agreement in writing must be obtained prior to the sale otherwise the sale will not be regarded as a supply of a going concern and the vendor will be regarded as having charged GST on the supply.

A supply of a going concern is defined at section 38-325(2) as a supply under an arrangement under which:

- the supplier supplies to the recipient all of the things that are necessary for the continued operation of an enterprise; and
- the supplier carries on the enterprise until the day of the supply.

The ATO has issued **GST Ruling GSTR 2002/5** on its interpretation of section 38-325.

All things necessary

The ruling states that the ability of the recipient to provide some of the things necessary for the continued operation of the enterprise is not a relevant consideration.

A ‘thing’ is necessary for the continued operation of an ‘identified enterprise’ if the enterprise could not be operated by the recipient in the absence of the thing. For example, a boat may be essential to the conduct of the businesses of a professional fisherman or a water-ski instructor, because, in most instances, the relevant business could not be conducted at all without a boat. The supplier must supply the boat for the continued operation of the enterprise.

The ATO will regard the surrender of a relevant licence, permit, quota or franchise as the supply of that thing which is necessary for the continued operation of the enterprise in circumstances where the purchaser is able to obtain the necessary licence etc.

Supplier needs to carry on the enterprise until the day of the supply

A supply under an arrangement will only be the ‘supply of a going concern’ where the enterprise is carried on by the supplier until the day of the supply. All of the activities of the enterprise must be active and operating on the day of the supply. The activities must be capable of continuing after the transfer to new ownership. The vendor does not need to make sure the business actually continues after the sale.

A supply will not be a ‘supply of a going concern’ where, on the day of the supply, the activity carried on by the enterprise has ceased.

Example

An operating motel is sold but under the contractual agreement, the sale is subject to vacant possession and the land, building and chattels only are transferred to the purchaser. At settlement, the motel is closed down and there are no future bookings. The premises start operating as a motel again several weeks after settlement.

The supply will not be a supply of a going concern because, at the time of the supply, the motel business was not operating.

However, **GSTR 2002/5** states that a supplier, who temporarily ceases some activities of an enterprise for a short period, for example, for cleaning and maintenance purposes, to facilitate the supply under the arrangement, has not ceased to carry on the enterprise.

Be wary of a 'supply of a going concern' which would otherwise be input taxed

Input tax credits relating to a supply on sale of property which would have otherwise been input taxed (eg. residential rental property) but is GST-free because there is a supply of a going concern, are available to the extent that they relate to the supply under the arrangement.

However, Division 135 requires purchasers to make an increasing adjustment where they have acquired a GST-free going concern but then use the enterprise for input taxed or private purposes.

Section 135-5 provides that the adjustment is 1/10 x supply price x proportion of non-creditable use.

Proportion of non-creditable use is the proportion of all the supplies made through the enterprise intended to be supplies that are neither taxable supplies nor GST-fee supplies, expressed as a percentage worked out on the basis of the prices of those supplies. Supply price means the price of the supply in relation to which the increasing adjustment arises.

Example – GST payable
A going concern is sold for $500,000. The purchaser intends to have 100% non-creditable use. The increasing adjustment will be 1/10 x $500,000 = $50,000.

ATO ID 2007/72 states the increasing adjustment arising under section 135-5 is attributable to the tax period in which the entity acquired the GST-free supply of the going concern.

The High Court found for the Commissioner on this point is the case of **FCT v MBI Properties Pty Ltd [2014] HCA 49.** The taxpayer and also Mum and Dad investors bought residential apartments which were subject to leases to a company that used all the apartments together as part of a serviced apartment business. The apartments were sold as going concerns which meant the purchasers registered for GST.

The Commissioner issued GST assessments which included increasing adjustments under Division 135 as the apartments were now being used for input taxed supplies.

The High Court unanimously held there was a Div 135 adjustment for the purchaser.

Investors need to be very wary of agreeing that the sale of a leased residential property to them is the sale of a going concern.

GST timing issues

Entities accounting for GST on a cash basis

These entities do not have to remit GST until it is received from the customers ie. the GST is attributed to the tax period in which the payment is received – section 29-5.

No input credit entitlements arise until the purchases are paid and the entity holds a **tax invoice** for the creditable acquisition – section 29-10. A tax invoice is not necessary if the value of the supply is less than $75.

Entities accounting for GST on an accruals basis

These entities have to remit the whole of the GST payable on the earlier of:

- the issue of an invoice; or
- the receipt of any consideration in connection with the supply.

Section 29-10 provides that input credit entitlements on creditable acquisitions arise on the earlier of:

- any consideration being provided by the entity; or
- the entity becoming liable to provide any consideration,

and the entity holds a **tax invoice** for the creditable acquisition. A tax invoice is not necessary if the value of the supply is less than $75.

The Commissioner can change the attribution rules where he is satisfied that otherwise their application would be inappropriate – section 29-25. Many changes were announced in **GSTR 2000/29.**

Sale under a standard land contract

In **GSTR 2000/28**, the Commissioner stated that where there is a taxable supply of land under a completed standard land contract, the GST is attributed to the tax period in which settlement occurs whether the taxpayer accounts on a cash or accruals basis.

Example

Bill is selling land, a business asset, to James. Bill and James return on an accruals basis.

Scenario One

The agreed sale price for the land is $330,000. The contract for the sale is signed on 5 April. Settlement and payment of the purchase price occurs on 15 August.

The GST is attributed to the tax period containing 15 August – **GST 2000/28.** James can claim his input tax credits in that period.

Scenario Two

As in scenario 1 except that the purchase price is payable in four equal instalments over the next four years.

The GST relating to the four instalments is attributed to the tax period containing 15 August – **ID 2004/181** states that an agreement, which requires a purchaser to provide the purchase price to a vendor in the form of a number of instalments, as opposed to a deposit and a final payment upon settlement, is not a standard land contract for the purposes of GSTR 2000/28.

Under the terms of the contract with the entity, the purchaser agrees to make payments, by monthly instalments, over an extended period of time. The purchaser does not pay a deposit that is to be forfeited for failure to perform the obligations under the contract. The certificate of title to the land will not pass, from the entity to the purchaser, until the final instalment has been paid. As such, the entity is not supplying the land under a contract that is regarded as a standard land contract for the purposes GSTR 2000/28.

Therefore, the entity is required to apply the attribution rules in accordance with section 29-5 of the GST Act and attribute all the GST payable on its taxable supply of land to the tax period in which it receives the first instalment payment from the purchaser.

James can claim all the input tax credits in that period.

CALCULATION AND TIMING OF CAPITAL GAINS AND LOSSES

Calculation of capital gains

Generally, a capital gain will arise where the capital proceeds are greater than the cost base of the asset.

There will be a capital loss where the capital proceeds are less than the cost base.

A capital gain will only have to be calculated where there is a CGT event. There is a list of all applicable CGT events at section 104-5 ITAA 1997.

Capital proceeds

Section 116-20 provides that the capital proceeds from a CGT event are the total of:

- the money you have received, or are entitled to receive, in respect of the event happening; and

- the market value of any other property you have received, or are entitled to receive, in respect of the event happening (worked out as at the time of the event).

Cost base

Section 110-25 provides that the cost base consists of 5 elements:

1. The price paid, or the market value of property given, to acquire the asset.

2. The incidental non-deductible costs of acquiring the asset **or** of the CGT event:

    - remuneration for specified professional services
    - transfer costs
    - stamp duty or similar duty
    - advertising costs
    - valuation costs
    - marketing expenses
    - search fees
    - the cost of a conveyancing kit

3. Capital and non-capital costs of ownership such as interest and rates which are not deductible (for assets acquired after 20 August 1991)

4. Expenditure of a capital nature incurred for the purpose of increasing or preserving the value of the asset (example – legal and other expenses incurred to preserve the value of a rental property by opposing a nearby development that would adversely affect the rental property's value) ; or that relates to installing or moving the asset

5. Expenditure of a capital nature incurred to the extent to which it was incurred in establishing, preserving or defending the taxpayer's title to, or a right over the asset

As with capital proceeds, if no money is paid or no property given to acquire the asset; or the asset is not acquired through an arm's length dealing, the market value of the CGT asset may be taken into account in calculating the cost base – section 112-20.

The reduced cost base is what is used when calculating a capital loss. It is basically the same as the cost base except that element 3 costs are excluded.

Timing of capital gains

When the capital gain arises

Capital gains made on the sale of assets will be assessable income in the year the contract is entered into – s 104-10 ITAA.

A contract is entered into where there is a contract at common law, ie. there is offer and acceptance, certainty of terms and consideration. This will usually be on exchange of the contract, not the date of settlement.

What if the contract is subject to a condition

If a contract is subject to a condition eg. a subject to finance clause, it does not affect the time of the making of the contract, unless it is a condition precedent to the formation of the contract – **Case 24/94 94 ATC 239.**

If there is no contract, the timing of the capital gain is when the change of ownership occurs.

Example

Bill is selling land to James. Advise the CGT consequences for Bill and James in the scenarios below.

Scenario One

The agreed sale price for the land is $330,000. The contract for the sale is signed on 5 April and is subject to finance. Finance is approved on 1 July and settlement and payment of the purchase price occurs on 15 August.

The capital gain or loss is deemed to arise on 5 April. The subject to finance clause does not alter the time the contract is entered into – **TD 94/89**.

Scenario Two

As in scenario 1 except that the purchase price is payable in four equal instalments over the next four years.

The capital gain or loss is deemed to arise on 5 April. It is based on the full $300,000 as capital proceeds includes amounts received and receivable.

12 month holding period

There is a 50% discount where an asset has been held for 12 months prior to disposal. Companies do not qualify for the 50% discount.

If the taxpayer chooses the CGT discount, capital losses will be applied against capital gains before applying the CGT discount.

Example
Assume an asset is disposed of for \$5,000. Its cost base is \$3,000. There are capital losses of \$200. Discount method = ½ x (\$5,000 - \$3,000 - \$200) = \$900.

THE SMALL BUSINESS CGT CONCESSIONS

The four available small business concessions are
15 year exemption - a full exemption from CGT on the disposal of an active asset which has been held continuously for 15 years
50% active asset exemption – 50% exemption on disposal of active assets
Small business retirement exemption – exemption of up to \$500,000 on disposal of active assets
Small business rollover – deferral of making of capital gains**.**

How to qualify for the small business concessions
To qualify for any of the small business concessions, 3 basic conditions must first be satisfied: - a taxable capital gain must be made - from the disposal of an active asset; and - either the net value of CGT assets that the business and entities connected with it and its affiliates and entities connected with them must not exceed \$6m; or the taxpayer is a small business entity with aggregated turnover of less than \$2m.

Further conditions then may need to be satisfied in relation to each of the concessions.

What is an active asset

Section 152-40(1) defines an **active asset** as one that is owned by the taxpayer (whether the asset is tangible or intangible) and:

- is used or held ready for use in the course of carrying on a business; or
- is used or held ready for use in the course of carrying on a business by the taxpayer's affiliate; or another entity connected with the taxpayer
- if the asset is an intangible asset – it is owned by the taxpayer and it is inherently connected with a business that the taxpayer, its affiliate, or another entity connected with the taxpayer, carries on (for example, goodwill).

What is not an active asset?

Assets that are specifically excluded from being an active asset are listed at s 152-40(4). They include:

- interests in entities connected with the taxpayer other than certain shares and interests in trusts
- financial instruments eg loans, debentures, bonds, rights or options in respect of shares, securities, loans or contracts
- assets whose main use is to derive interest, annuities, rent, royalties or foreign exchange gains unless:
  - the asset is an intangible asset and has been substantially developed, altered or improved by the taxpayer so that its market value has been substantially enhanced; or
  - its main use for deriving rent is temporary.

Assets used mainly to derive rent will be excluded from being an active asset even if they are used in the course of carrying on a business (eg commercial premises rented to tenants) - **TD 2006/78**.

Example from TD 2006/78

Commercial Property Co owns 5 commercial rental properties. The properties have been leased for several years under formal lease agreements to various commercial tenants which have used them for office and warehouse purposes. The terms of the leases have ranged from 1 year to 3 years with a 3 year option and provide for exclusive possession. The company has not engaged a real estate agent to act on its behalf and manages the leasing of the properties itself.

In this situation, the company has derived rental income from the leasing of a number of properties. Accordingly, the main (only) use of the properties is to derive rent and they are therefore excluded from being active assets under paragraph 152-40(4)(e) of the ITAA 1997 regardless of whether the activities constitute the carrying on of a business.

Active asset timing requirement

The active asset test will be passed if the asset is an active asset for the lesser of half the period of ownership or 7 1/2 years.

It is important to satisfy this timing requirement. In the case of **AAT Case [2011] AATA 758, Re Vaughan and FCT,** the AAT looked at whether the sale of a child care premises qualified for the small business concessions. The husband and wife taxpayers ran a child care business for 6 years on premises they owned. They then sold the business and leased the premises to a young couple for 6 years and then to ABC Learning for 5 years before selling the premises.

The AAT held the taxpayers did not qualify for the CGT small business concessions in relation to the capital gain made on the sale. This was because the premises did not qualify as an "active asset" for at least 7 1/2 years of the 17 year period that it was owned by the taxpayers.

DIVISION 43 CLAWBACK

Introduction

Division 43 provides a 2.5% or 4% capital works deduction for the cost of capital works on income-producing buildings and structural improvements.

Where ownership of the building changes, the right to claim any undeducted construction expenditure passes to the new owner.

The vendor is required to pass on sufficient information to the purchaser so that the purchaser can ascertain the manner in which Division 43 will apply to the purchaser’s holding. This information must be provided within 6 months of the end of the year in which the disposal occurs.

If the vendor does not or is unable to provide the information necessary to calculate the deduction, a building cost estimate by a quantity surveyor may be used to determine the amount that may be claimed.

There are no assessable balancing adjustments arising to the vendor on the sale of property where a capital works deduction has been claimed.

The clawback

However if the asset was acquired after 13 May 1997, the deductions allowed under Division 43 are removed from the cost base on disposal. It is referred to as the Division 43 clawback – section 110-45 ITAA.

Example from ID 2004/404
The taxpayer acquired a commercial property (land and buildings) for $1 million. The taxpayer then spent $250,000 on altering and improving the building. The taxpayer sold the property 3 years later for $3 million. In respect of their ownership period, the taxpayer was entitled to deduct, under Division 43 of the ITAA 1997, a portion of the capital works expenditure incurred by them in altering and improving the building and a portion of the expenditure incurred by the previous owner in constructing the building. The total amount the taxpayer deducted was $20,000, which was the total amount they were allowed to deduct under Division 43. The taxpayer did not have a profit making intention and was not in the business of buying and selling properties. The cost base for the taxpayer will be the $1m + $250,000 less the $20,000 = $1,230,000.

Practice Statement 2006/1 states that the Commissioner will accept that a taxpayer cannot deduct an amount under Div 43 for a CGT asset for construction expenditure in respect of that asset, and is therefore not required to reduce the asset's cost base, if the taxpayer:

(i) does not (as a question of fact) have sufficient information to determine the amount and nature of the expenditure; and

(ii) does not seek to deduct an amount in relation to the expenditure under Div 43 (or any other provision).

This means that in working out a capital gain or capital loss arising from a CGT event happening in relation to the asset, the taxpayer is not required to reduce the asset's cost base by the amount not deducted under Div 43 in relation to the asset.

SALE OF BUILDINGS - CGT and GST ISSUES

GST issues

For GST purposes:

- it needs to be determined whether the sale is a taxable or input taxed supply
- if it is a taxable supply, the margin scheme may be available to reduce the tax liability
- if the building is leased, it can be sold as a GST-free going concern. However this should only be done where it is a commercial building because otherwise the purchaser will end up paying GST due to the Div 135 adjustment.

Capital gains tax issues

If the sale will result in a capital gain:

- determine in what financial year the contract was entered into
- ensure the cost base is maximised by determining all relevant expenses
- adjust the figures where the taxpayer is registered for GST and required to pay GST and able to claim input tax credits
- determine the availability of the 50% CGT discount and the small business concessions to reduce the capital gain
- ensure Division 43 details are passed on /collected. Determine whether there is a Div 43 clawback.

Example 1

The ABC Trust acquired a CBD building to be rented out on 1st July 1995 for $1.2 m. It had been constructed in 1986 for $900,000. The Trust entered into a contract to sell the building for $2.2m with settlement date on 1st July 2015.

Associated costs of sale were real estate agent's commission of $55,000 and legal fees of $3,300.

What are the tax consequences for the Trust?

GST issues

There will be GST on the disposal of the building as it is the disposal of commercial premises which is a taxable supply. The GST will be 1/11th x $2.2m.

However, the GST does not have to be paid in the year ended 30 June 2015 as the ATO has advised that it is not payable until settlement where a standard land contract is used even where you are an accruals taxpayer – **GSTR 2000/28**.

As the building is rented out, it could be sold as a GST-free going concern as an enterprise of leasing is being carried on.

The Trust will be able to claim back as input tax credits, GST charged in relation to the transaction by the real estate agent and lawyers.

Calculating the capital gain

The remainder of these fees ie. the GST exclusive amounts - real estate agent $50,000 and legal fees $3,000 will be included in the cost base in determining the capital gain. It is only the amount net of GST that is included in the cost base where input tax credits can be claimed for the GST component.

The Trust will realise a gain on the sale of the building of $2m - $1.2m - $53,000 = $747,000. This will be brought into the year ended 30 June 2015 as a capital gain is recognised on the disposal of an asset on the date the contract is entered into, not when the monies are received – section 104-10(3).

The Trust can choose to reduce the capital gain by the 50% CGT discount as the building has been held for more than 12 months.

The gain will be 50% x $747,000 = $373,500.

Division 43

Division 43 provides a 4% write-off for eligible costs of construction of a non-residential income producing building in 1986. Where ownership of the building changes, the right to claim any undeducted construction expenditure passes to the new owner.

Since 1995, the Trust has claimed 4% x $900,000 = $36,000 each year as a deduction under Division 43.

There is a Division 43 clawback where properties are sold. However, it only affects assets acquired after 13 May 1997 and will not impact on the sale of the CBD building.

Small business CGT concessions

The small business concessions will not be available as the building does not qualify as an active asset. Section 152-40(4) specifically excludes assets used to derive rent from the definition of active asset.

Treatment of capital gains

Any net capital gain made by the trust will be included in its assessable income. If provided for in the trust deed and the minutes, the capital gain may be streamed to beneficiaries and retain its character as a capital gain. This is especially useful for beneficiaries with capital losses which can be offset against the capital gain.

Example 2

The XYZ Trust bought a residential rental property on 1st January 2014 for $360,000 which it sold on 30th June 2015 for $400,000. The property was constructed in December 2011 for $300,000. Associated costs of sale were real estate agent's commission of $5,500 and legal fees of $1,100.

What are the tax consequences for the trust?

GST issues

There is no GST as the disposal of the residential property is an input taxed supply. This also means that the trust cannot claim as input tax credits, the GST component of the agent's commission and the legal fees.

Division 43

The trust is entitled to claim 2.5% x $300,000 = $7,500 each year under Division 43. In the first year, its claim would have been 2.5% x $300,000 x 183/365 = $3,750.

When the trust sells the property, there is a Division 43 clawback. This means that the deductions that have been allowed under Div 43 ie. $3750 + $7,500 = $11,250, will be removed from the cost base on disposal.

Calculating the capital gain

The cost base of $360,000 will be reduced by the Division 43 clawback by $11,250 to $348,750.

However, the real estate agent's fees of $5,500 and legal fees of $1,100 will be included in the cost base.

Therefore the cost base will be $348,750 + $5,500 + $1,100 = $355,350.

The capital gain will be 50% x ($400,000 – $355,350) = $22,325.

This will be brought into the year ended 30 June 2015.

Small business CGT concessions

The small business concessions will not be available as the building does not qualify as an active asset. Section 152-40(4) specifically excludes assets used to derive rent from the definition of active asset.

DEPRECIATION BALANCING CHARGES

Plant subject to UCA regime

- can be written off in the year if cost is $100 or less (GST inclusive) – PS 2003/8
- can be written off in the year if cost is $300 or less and used by taxpayers predominantly in deriving non-business assessable income and do not exceed $300 as part of a set or with substantially identical items
- plant costing less than $1,000 may be allocated to a low-value pool
- all other plant written down to below $1,000 using the diminishing value method can be allocated to the pool
- plant not allocated to a low value pool is depreciated according to its effective life determined using the ATO's rates or by self-assessment
- the effective life can be later varied up or down having regard to changing market or technological developments
- there may be a CGT gain or loss where there is private use of the asset
- in determining the cost of a depreciating asset, the following amounts can be included: freight charges, import duties, sales taxes , installation charges, and transport costs where a depreciating asset is moved from one site to another
- the cost of the depreciating asset is reduced by any GST input tax credits relating to the acquisition of the asset.

Balancing adjustment event

When there is a disposal of a depreciating asset, it will usually be necessary to determine a depreciation balancing charge.

Section 40-295 provides that a balancing adjustment event occurs for a depreciating asset where a taxpayer

- ceases to hold the asset (eg. the asset is sold, scrapped, destroyed, lost, disposed of , death of holder, or starts being held as trading stock); or
- stops using it and expects never to use it again; or
- has not used the asset and expects never to use it; or
- there is a change in the holding or, or in the interest of entities in the asset and one of the entities that has an interest after the change held the asset before the change.

Balancing adjustment

Where there is a balancing adjustment event, an amount is to be included in assessable income where the termination value of a depreciating asset is more than its adjustable value (the written down value).

An amount is to be deducted where the termination value is less than the adjustable value.

The general rule is that the termination value of a depreciating asset consists of amounts received, or taken to be received at the time when the balancing adjustment occurs.

Any GST payable and any expenses incurred in relation to the disposal are deducted from these amounts.

Section 40-300 specifies the termination value for different balancing adjustment events.

Example

Smith Co sells a depreciating asset for $220, including GST of $20, and the adjustable value of the asset before the sale was $250.

The deductible balancing adjustment amount will be $250 – ($220 - $20) = $50

Special rules

Note there are special rules which include the following:

Splitting or merging of assets

The splitting or merging of assets does not result in a balancing adjustment event.

Where the asset is split, the taxpayer is deemed to have stopped holding the original asset and started holding the assets into which they are split.

The cost of each separate asset is a reasonable apportionment of the cost of the original asset.

Where assets are merged, the taxpayer is deemed to have stopped holding the original assets and started holding the merged asset.

Part non-taxable purpose

If a depreciating asset has been used partly for a non-taxable purpose, the balancing adjustment amount is reduced to reflect only the taxable use. In addition there may be some CGT consequences, these are discussed later.

For example, a computer is sold for $600 when its adjustable value is $700. There was 60% business use. The balancing adjustment will be 60% x ($700 - $600) = $60.

Balancing charge offsets

There are no balancing charge offsets against the adjustable value of other depreciating assets except for involuntary disposals eg. where the asset is lost, destroyed or compulsorily acquired by the Commonwealth or a State or Territory government or government agency.

Elections for rollover relief

There are a number of situations where an election can be made for rollover relief – s 40-340. These include:

- the disposal of an asset to a wholly-owned company,
- the disposal of an asset by a partnership to a wholly-owned company, and
- a disposal because of marriage breakdown
- variation in a partnership

Rollover relief defers balancing adjustments on the transfer of property between related entities until the next balancing adjustment event occurs.

Special rules for disposal of cars where car expense methods used

There are special balancing adjustment rules for cars where one of the four methods to calculate car expense deductions has been used.

If the 12% method or cents per kilometer methods are used for calculating car expenses, there is no balancing adjustment when the car is disposed of.

If the 1/3 or log book methods, the balancing adjustment must be reduced by the amount that is attributable to the use of the car for non-taxable purposes.

For example, a car is acquired for $30,000 on 1 July and the 1/3 method is used to calculate car expenses. The car is sold for $24,500 on 30 June and the adjustable value then is $18,200. The balancing adjustment + 1/3 ($24,500 - $18,200) = $2,100.

Note that from 1 July 2015, the 12% and 1/3 methods are no longer available.

Interaction with CGT

Where there is a capital gain or loss made from a depreciating asset used 100% for income producing purposes, the gain or loss is completely disregarded for CGT purposes.

However, where the asset was not wholly used for income producing purposes, a capital gain or loss may arise under CGT event K7. It applies where a balancing adjustment event has happened on or after 1 July 2001 to a depreciating asset that has been used either wholly or partly for non-taxable (generally for private) purposes.

A capital gain from CGT event K7 happening may qualify for the CGT discount.

A capital gain or loss from CGT event K7 happening to a depreciating asset arises in the same income year as any balancing adjustment calculated under Subdivision 40-D.

Example
Fiona buys a depreciating asset for $1,000. Its effective life is 5 years and the decline in value is worked out using the prime cost method. Two years later Fiona sells the asset for $700. Its adjustable value at this time is $600. Fiona has used the asset 30% for non-taxable purposes. The balancing adjustment amount is reduced by the amount calculated using the formula: Sum of reductions/total decline x balancing adjustment amount Sum of reductions is the reductions in deductions due to private use ie. 30% x $400 = $120 The balancing adjustment amount will therefore be = $100 – (120/400 x 100) = $70 The capital loss is worked out using the following formula: (cost - termination value) x sum of reductions/total decline = ($1,000 - $700) x (30% x $400)/ $400 = ($1,000 - $700) x $120/$400 = $300 x 0.3 = $90 capital loss.

If a balancing adjustment event happens to a depreciating asset that was used 100% for non-taxable purposes, there will not be any balancing adjustment.

SMALL BUSINESS ENTITY RULES RE ACQUISITION AND DISPOSAL OF ASSETS

Instant write-off

Small business entities can immediately write off any purchases of depreciable assets costing less than $1000 – s 328-180. The deduction is for the business use of the asset.

Assets acquired and installed ready for use between 7:30pm 12 May 2015 and 30 June 2017 can be written off where they cost less than $20,000.

The threshold applies on a per asset basis to new and secondhand assets.

Example from the 2015 Budget paper
A bakery is run as a company. In April 2015, the business purchased a new oven for $13,750 and a new proofing cabinet for $3,500 to replace its old, worn-out equipment. Because these assets each exceed the $1,000 threshold applicable to assets acquired prior to 12 May 2015, they will be included in the small business pool. Of their combined $17,250 cost, only 15%, or $2,588, will be depreciated in the year ending 30 June 2015. If the assets were purchased and installed in June 2015, because of the new $20,000 threshold, the company can claim an immediate deduction for both the new oven and the new proofing cabinet, giving an immediate deduction of $17,250 in the year ended 30 June 2015.

If the taxpayer is registered for GST, then the GST exclusive amount is the cost of the asset. Where the taxpayer is not registered for GST, then the GST inclusive amount is taken to be the cost of the asset.

When the asset is later sold

When an asset is written off because it cost less than $1,000/$20,000, an amount will be included in assessable income when the item is later sold. Section 328-215 provides that the taxable purpose proportion of the asset’s termination value is included in assessable income ie. if the asset was used 100% in the business, include 100% of the sales proceeds in assessable income.

Assets not eligible

A small number of assets are not eligible for these concessions. These assets include:

- horticultural plants - subject to their own uniform capital allowance (UCA) rules;

- buildings and capital works - subject to their own "capital works" depreciation rules;
- assets leased out or to be leased (not short term hire or hire-purchase)
- assets previously allocated to a low value pool or a software development pool prior to entering the STS – s 328-175(7). These continue to be deducted under Division 40
- horticultural plants
- assets deductible under the research and development provisions

Pooling

Depreciable assets valued at $1,000/$20,000 or more (which cannot be immediately deducted) are placed in the small business depreciation pool and depreciated at 15% in the first income year and 30% each income year thereafter. Note the pool can also be immediately deducted if the balance is less than $20,000 over this period (including existing pools).

The ATO states in a factsheet - where you can claim a GST credit for a depreciating asset, you must deduct the amount of the GST credit from the asset's adjustable value before working out the deduction for depreciation. The examples here use GST-exclusive figures – see https://www.ato.gov.au/printfriendly.aspx?url=/business/small-business-entity-concessions/in-detail/income-tax/simplified-depreciation-rules/

Example of operation of small business pool

Joan has a pool

Opening balance	$22,500
Additions	$20,000
	$42,500
Less	
Disposals	$2,500
Deductions	
$22,500 x 30%	$6,750
$20,000 x 15%	$3,000
Closing balance	$30,250

If the balance of the pool, prior to calculating the pool deduction for the year, falls below $20,000, that amount may be claimed as a deduction for the year – s328-210. The closing pool balance of the pool for that income year then becomes zero.

If a pooled asset is sold, its termination value is deducted from the pool balance. The termination value will be the sale proceeds, or a proportion of the sale proceeds based on the taxable purpose.

If including a termination value in a pool results in the pool having a negative value, the closing pool balance will become zero and the negative amount will be included in assessable income -s 328-215.

Private use of pooled asset

Only the business proportion of the depreciating asset is attributed to the pool.

When a depreciating asset is first used to produce assessable income, a percentage estimate of the business use of the depreciating asset must be made.

On sale, the business use percentage of proceeds is deducted from the pool.

If the estimate of the business use changes by more than 10%, an adjustment has to be made to the opening balance of the pool to reflect the changed usage – s 328-225. There is a formula for calculating the adjustment.

For each pooled asset, a record needs to be kept of the percentage that applied for each year.

No adjustment is required 3 income years after the income year is which the asset is allocated to the small business pool.