



Australian Government
Australian Taxation Office

Disclaimer

You cannot rely on this record in your tax affairs. It is not binding and provides you with no protection (including from any underpaid tax, penalty or interest). In addition, this record is not an authority for the purposes of establishing a reasonably arguable position for you to apply to your own circumstances. For more information on the status of edited versions of private advice and reasons we publish them, see [PS LA 2008/4](#).

Edited version of your written advice

Authorisation Number: 1051483386284

Date of advice: 19 February 2019

Ruling

Subject: Capital gains tax – receipt of a surrender payment – lease – main residence

Question

Is the taxpayer entitled to disregard under subsection 118-110(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) any capital gain arising in respect of a surrender payment received by them under the proposed arrangement?

Answer

Yes

This ruling applies for the following period:

Year ending 30 June 2019

The scheme commences on:

1 July 2018

Relevant facts and circumstances

The taxpayer is in business.

They propose to acquire a residential property (a detached house) and occupy that property with their family as their main residence.

The taxpayer proposes to establish a family discretionary trust and acquire the main residence.

The taxpayer will have a lease of the main residence with a minimal rent per annum. No consideration is provided to the trustee of the trust in respect of the grant.

The taxpayer would:

- contribute money to the trustee on account of outgoings in respect of the main residence
- have a first and last right of refusal under the terms of the lease if the trustee of the trust desired to sell the main residence to a third party and
- be entitled to a payment from the trustee of the trust, a surrender payment if the rights were not exercised and the taxpayer agrees to surrender the lease (so that the trustee could sell the main residence with vacant possession to a third party). The surrender payment would be the market value of the lease at the time of the surrender.

The trust will not be used for any other purpose but to hold the main residence. The trust would not claim tax deductions for depreciation, capital allowances, interest or other outgoings in respect of the main residence or the lease.

Relevant legislative provisions

Income Tax Assessment Act 1997 section 102-20

Income Tax Assessment Act 1997 section 104-5

Income Tax Assessment Act 1997 section 104-10

Income Tax Assessment Act 1997 section 108-5

Income Tax Assessment Act 1997 section 118-110

Income Tax Assessment Act 1997 section 118-115

Income Tax Assessment Act 1997 section 118-130

Reasons for decision

A capital gain or capital loss is made when a CGT event happens to a CGT asset you own under section 102-20 of the ITAA 1997. CGT event A1 (section 104-5 of the ITAA 1997) occurs when a disposal contract is entered into, or if there is no contract, when an entity stops being an asset's owner.

Meaning of dwelling

Section 118-115 of the ITAA 1997 includes a dwelling to be a unit of accommodation that is a building that consists wholly or mainly of residential accommodation and any land immediately under the unit of accommodation.

Ownership interest

You will have an ownership interest in a dwelling (that is not a flat or home unit) if 'you have a legal or equitable interest in the land on which it is erected, or a licence or right to occupy it' (section 118-130 of the ITAA 1997).

Surrender payment

Pursuant to section 108-5 of the ITAA 1997, a CGT asset is any kind of property, or a legal or equitable right that is not property. A lease is a right and so is a CGT asset.

Section 104-10 of the ITAA 1997 provides that a CGT event A1 occurs when a CGT asset is disposed of. Generally an asset is disposed of if a change of ownership occurs.

Taxation Ruling TR 2005/6 *Income Tax: lease surrender receipts and payments* addresses a number of situations involving lease surrender receipts and payments, establishing the Commissioner's treatment of these payments. Paragraph 10 of Taxation Ruling TR 2005/6 introduces the Commissioner's position on the most relevant CGT event in the event of lease surrender. The market value substitution rule may be applied in determining the capital proceeds for the CGT event.

CGT event A1 will occur for the taxpayer if their leasehold interests under the lease are surrendered to the trust. Where CGT event A1 occurs:

- a capital gain will arise to the extent that the capital proceeds received by each taxpayer exceeds their CGT cost bases in the leasehold interest
- a capital loss will arise to the extent that the capital proceeds received by a taxpayer are less than the reduced CGT cost base.

In this case when the taxpayer receives a lease surrender payment, CGT event A1 will occur.

The surrender payment will constitute the capital proceeds for the disposal. To the extent that the surrender payment is not a market value payment for the surrender, the market value substitution rules will operate to deem the capital proceeds as being equal to the market value of the lease at the time of surrender.

Main residence exemption

Section 118-110 of the ITAA 1997 provides that you can disregard a capital gain or loss made from a CGT event that happens to a dwelling or your ownership interest in it. To qualify for full exemption:

- you must be an individual
- the dwelling must have been your main residence for the whole period you owned it
- you did not acquire the dwelling as a beneficiary of or a trustee of the estate of a deceased person
- the dwelling must not have been used to produce assessable income
- the land surrounding the dwelling (including the land on which the dwelling is situated) must not be more than two hectares.

This exemption is only applicable to CGT events A1, B1, C1, C2, E1, E2, F2, I1, I2, K3, K4 and K6.

Section 118-110 of the ITAA 1997 will apply to disregard any capital gain arising upon the receipt of the surrender payment provided that:

- any capital gain made by each of the taxpayers would be as a consequence of their surrender of their rights under the lease as the CGT event is regarded as happening in relation to their ownership interest in the main residence
- the taxpayers are individuals
- the main residence will meet the definition of dwelling
- each of the taxpayers would have an ownership interest in the main residence for the purpose of section 118-130 of the ITAA 1997 at all times during the period from the grant of the lease by the trust until the surrender of their leasehold rights under the lease
- the dwelling was used solely by the taxpayers as their main residence throughout the entirety of their respective ownership periods
- the taxpayers would not have acquired the main residence as a distribution from a deceased estate.

CGT event F1

The granting of a lease is a CGT event F1. CGT event F1 will happen if a lessor grants a lease under section 104-110 of the ITAA 1997.

The Commissioner will not rule on this CGT event as it does not have application to the taxpayers that are the rulees of this private ruling.

Matters we have not ruled on

We have not ruled on all of your questions. Here, we list each question that we have not been able to rule on, and explain why.

Question

Would Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) apply in respect of any part of the proposed arrangement?

Reasons for decision

In this case the Commissioner declines to rule on this question as to provide a correct answer unreasonable assumptions in relation to various matters would need to be made. Also to give a complete answer the position of a proposed trust must be considered.

The assumptions/matters that would prohibit us from ruling are listed below:

1. we have not been provided with the actual trust deed itself
2. we have not been provided with the actual lease agreement
3. the Commissioner is being asked to assume that the trustee will not exercise any of the wide powers that may be available in the proposed trust deed
4. the Commissioner is to assume that the trust will not claim tax deductions for the expenses in respect of the main residence or the lease
5. whether the beneficiaries will receive a distribution from the trust
6. who the beneficiaries will be when the main residence is sold
7. when the various steps of the scheme will tax place
8. how the pricing of the surrender fee will be determined
9. the security that the trust would advance to a lender to obtain the loan.

Review rights when we have declined to make a ruling

We have declined to make your private ruling, and have given you the reasons. This decision may be reviewable under the *Administrative Decisions (Judicial Review) Act 1977* (ADJR).

The ADJR provides you with two main rights.

1. You can send a written notice to the Commissioner requiring him to provide a written statement of:
 - the findings of material questions of fact
 - the evidence these findings were based upon, and
 - the reasons for his decision.
2. You can apply to the Federal Court of Australia or the Federal Circuit Court for a review of the decision.

If you decide to apply to the Federal Court or the Federal Circuit Court for a review of the decision, we suggest you seek professional advice on how to progress. In addition, the Court will be able to provide you with some direction and assistance about the process.

An application must be lodged within 28 days of the issue date on your *Notice of private ruling*.

You may lodge your application for review at the Federal Court or Federal Circuit Court in the State or Territory in which you ordinarily reside, or the State or Territory listed in the address for the ATO shown on your *Notice of private ruling*.

You can find more information on the Federal Court website **fedcourt.gov.au**, or the Federal Circuit Court **fedcircuitcourt.gov.au**

Copyright notice

© Australian Taxation Office for the Commonwealth of Australia

You are free to copy, adapt, modify, transmit and distribute material on this website as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).