From: Sounding Board <noreply@ideascale.com>
Sent: Friday, 22 November 2019 9:45 AM
To: Ian Raspin
Subject: Thanks for submitting an idea to Sounding Board community

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Idea #88: **Cost base of deceased main residence.**

Author: **Ian Raspin**

There is a deficiency in the CGT main residence exemption relating to deceased estates which has a considerable impact on tax compliance costs.

The deficiency is that the market value cost base rule in item 3 in the table in subsection 128-15(4) of the ITAA 1997 does not literally apply where a deceased's dwelling was used to produce assessable income just prior to death, but this would not have affected an exemption for the deceased because, for example, of an absence choice (section 118-145 of the ITAA 1997).

Literally, the income producing use can be disregarded under subsection 118-190(3) but only for the purposes of the main residence exemption, not the cost base rule in subsection 128-15(4).

This is at odds with the way the ITAA 1936 operated – see paragraph 160X(5)(a) and note.

Example
Frank owns his own home in Sydney. He moved into a nursing home in 2017 and made a choice to continue to treat the dwelling as his main residence. He rented the home to help cover costs. Frank died in April 2019.

Because the house was rented for less than 6 years, Frank's LPR is able to qualify for a full main residence exemption if the dwelling is sold within two years of Frank's death. The income-producing use is able to be disregarded for the purposes of section 118-195.

However the income-producing use is not disregarded for the purposes of item 3 in the table in subsection 128-15(4). So if the LPR is not able to sell the property within 2 years they will have to go through the arduous process of establishing what Frank's cost base would have been, rather than rely on the market value rule which was introduced to overcome this very problem.

The defect was included as a minor technical amendment measure in the 2011-12 Budget, and was consulted on between May and July 2011.

However, the measure did not proceed following the government's decision on the backlog of announced but unenacted measures in December 2013.

In the case of the deficiency, the CGT rewrite in 1998 did not clearly reflect the effect of the ITAA 1936, but it is difficult for the ATO to take the same view in light of the view taken in Sherlinc Enterprises Pty Ltd v Federal Commissioner of Taxation [2004] AATA 113 regarding the scope of section 1-3 of the ITAA1997 and the long passage of time since the rewrite.

Further there are limits to what a court would choose to do to overlook deficiencies in drafting (see Cooper Brookes (Woollongong) P/L v FCT and the more recent case of Paule v Commisioner Taxation [2019] FCA 394).

At the same time the ATO has not issued any binding public advice (such as a Tax Determination or Practical Compliance Guideline) to confirm its approach to the interpretive question underlying the measure.

As a result, people administering deceased estates face a high degree of uncertainty as to the way the current law operates. This translates into further compliance costs for example, if a private ruling is requested, it would involve at the least several thousands of dollars. It can also mean that those who are better advised may end up in a worse tax position than those whose advisors are not aware of the issue. [For example, the NTAA, takes the view that a cost base uplift is not available – see Deceased Estate Seminar 2019 Notes – page 74.]

Solution
Clarify that in item 3 in subsection 128-15(4) income producing use does not include use that can be disregarded under section 118-190..

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