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CGT CHANGES- APPORTIONING THE PRE 2027 DISCOUNT AND POST 2027 INDEXED GAIN – PART 1

The capital gains tax (CGT) changes enacted by the Australian Government represent one of the most significant reforms to the taxation of investment assets since the introduction of the CGT regime in 1985. Although much of the public debate surrounding the reforms has focused on housing affordability and the accessibility of residential housing for owner-occupiers, the legislative changes extend well beyond the housing sector and have important implications for investors, developers, private groups and foreign residents.

Recognising that many taxpayers had acquired assets and made investment decisions on the basis of the existing capital gains tax framework, the legislation includes grandfathering rules designed to preserve the treatment of gains that accrued before the commencement of the new regime on 1 July 2027. Rather than applying the new indexation framework to the entire gain realised on a future disposal, the legislation separates gains that arise before and after the commencement date. This is achieved through the deemed disposal and reacquisition mechanism, which effectively treats an asset as having been disposed of immediately before 1 July 2027 and reacquired on that date for its market value or an amount determined under the statutory apportionment methodology.

There are two methods for calculating the capital gain pre and post 30 June 2027. The first is to simply adopt the market value where it is available on 30 June 2027.

The second is the apportionment methodology. The apportionment methodology is set out in the *Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026*. The Explanatory Statement states that the instrument prescribes an apportioning method for particular CGT assets, dividing an overall capital gain or capital loss

between the ownership period prior to 1 July 2027 and the ownership period from 1 July 2027 to the sale date.

The method is available for real property (real estate) and for CGT assets that do not have a readily ascertainable market value, provided the asset's cost base is not otherwise worked out by reference to market value under another provision outside the deemed sale and reacquisition rules. The Explanatory Statement notes that listed shares would generally have a readily ascertainable market value, whereas some private company shares may not, particularly where control premiums affect the value of different holdings. It would be expected that Goodwill would also not have a readily ascertainable market value, absent engaging a licensed business valuer.

The methodology is based on a compounding daily growth rate. It assumes that the asset grew, or declined, at a daily compounded rate over the entire ownership period. That rate is then used to estimate the capital proceeds of the deemed sale just before 1 July 2027. The resulting deemed capital proceeds are used to calculate the deferred pre-start date gain or loss and to set the cost base at the start date for the post-1 July 2027 calculation.

The Determination sets out a nine-step process. In reality, these nine steps can be achieved in seven steps, where the taxpayer must:

1. Work out the cost base and reduced cost base of the CGT asset at the end of 30 June 2027.
2. Divide the capital proceeds from the realisation event by the first element of the pre-start date cost base to determine the total growth rate.
3. Work out the number of days the asset has been held over the full ownership period and the number of days it was held until 30 June 2027.
4. Calculate the daily growth rate using the prescribed formula.
5. Calculate the pre-start date capital proceeds using the daily growth rate.
6. Determine the capital gain or capital loss from the deemed disposal.
7. Treat the pre-start date capital proceeds as the cost base at the start date.
8. Work out the post-start date cost base and reduced cost base at the time of the realisation event, including indexation where applicable.
9. Calculate the post-start date capital gain or capital loss by comparing the actual capital proceeds with the post-start date cost base or reduced cost base.

This methodology is significant because it gives taxpayers a statutory alternative to obtaining a formal market valuation as of 30 June 2027 for qualifying assets. It also introduces a more computational approach to allocating gains across the reform date, which will require careful record keeping and, in many cases, modelling support from advisers.

Example- applying methodology

Assume:

- Sarah purchases a commercial property on 1 July 2018 for \$500,000.
- Sarah sells the property on 30 June 2030 for \$900,000.
- The property qualifies for the statutory apportionment methodology.
- No acquisition or disposal costs are incurred.

- CPI increases by 4% per annum after 1 July 2027.
- Rather than obtaining a formal valuation on 30 June 2027, Sarah elects to apply the statutory apportionment method.

Step 1 – Calculate the Total Growth Rate

The Determination first requires the taxpayer to determine the overall growth in value of the asset across the entire ownership period.

Item	Amount
Sale proceeds	\$900,000
Original cost base	\$500,000
Total growth rate	1.8

The total growth rate is:

$$\frac{\$900,000}{\$500,000} = 1.8$$

This means the property increased in value by 80% over the ownership period.

Step 2 – Calculate the Daily Compounded Growth Rate

The property was owned as follows:

Period	Days
Total ownership period (1 July 2018 to 30 June 2030)	4,383
Pre-1 July 2027 ownership period	3,287

The Determination assumes the property grew at a compounded daily rate throughout the ownership period. The daily growth factor can therefore be estimated as:

$$1.8^{\frac{1}{4383}} = 1.000134$$

This suggests the property increased in value by approximately 0.0134% per day on a compounded basis.

Step 3 – Estimate the Value on 30 June 2027

The next step is to estimate what the property would have been worth immediately before 1 July 2027. The Determination effectively applies the daily growth factor to the original cost base for the period ending 30 June 2027:

$$\$500,000 \times (1.000134)^{3287} = \$776,500$$

Accordingly, the statutory methodology produces a deemed value of \$776,500 as of 30 June 2027.

This is essentially the figure you would compare against the independent market value obtained from a licensed valuer as of 30 June 2027 to determine whether using this method or an independent valuation gave your client a better CGT outcome.

In part 2 of the article to be issued in our Summer QTB released in December, we will then work through the remaining steps to determine the overall tax outcome when the asset is finally disposed of.

If you have any questions in relation to applying these methodologies and which method may yield the best outcome, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

ATO DATA MATCHING: INCREASED SCRUTINY OF TAX RESIDENCY POSITIONS

Residency status can materially affect an individual's Australian tax position, including how income, capital gains, the tax-free threshold and Medicare levy obligations are treated.

On 24 August 2026 the ATO announced that it is increasing its focus on tax residency through its passenger movements data-matching program. Under the program, the ATO will obtain selected travel and immigration information from the Department of Home Affairs for the 2026-27 to 2028-29 financial years.

The ATO may use this data to compare a taxpayer's reported residency position with their actual travel history, visa status and immigration records. This means unsupported or inconsistent residency positions are more likely to be identified and queried.

The data may include names, dates of birth, arrival and departure dates, passport details, visa status, residency status, lawful presence and citizenship information. The ATO estimates that records for approximately 115,000 individuals will be obtained each financial year.

The data matching program is particularly relevant for individuals with cross-border arrangements, including those who spend extended periods overseas, return to Australia after living abroad, work remotely across borders, or maintain homes, family or business connections in more than one country. These arrangements increase review risk where travel records, visa status or Australian connections are inconsistent with the residency position disclosed in tax returns.

For Australian tax residents, the program may also highlight whether foreign income has been included in Australian tax returns, as residents are generally taxable on worldwide income. For non-residents, frequent or extended visits to Australia may expose unreported Australian-sourced income, taxable Australian property gains, or PAYG withholding obligations, particularly where travel records indicate work, business activity or asset dealings in Australia.

The program may also have implications for companies, trusts and other non-individual entities. The residency of directors and key decision-makers can be relevant to whether central management and control is exercised in Australia, and therefore whether an entity is treated as an Australian tax resident. Passenger movement records may make it easier for the ATO to identify where directors were physically located when important decisions were made,

particularly where board meetings, approvals or strategic decisions are said to occur offshore, but travel records show a continuing Australian presence. This may increase review risk for entities that rely on offshore management arrangements, overseas boards or non-resident status.

Clients with cross-border business or investment arrangements should review their residency position before lodging tax returns or making significant tax decisions. This includes checking travel history, visa status, living arrangements, family and employment connections, overseas ties, and how residency has been disclosed in Australian tax documents.

Tax residency should not be assumed based only on citizenship, visa status, time spent in Australia or where income is earned. It requires a broader assessment of the person's living arrangements, family and economic connections, intention, travel pattern, and ties to Australia and overseas.

If you are unsure whether your tax residency position is properly supportable, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

ARE THESE WORK FROM HOME EXPENSES ACTUALLY WORK-RELATED DEDUCTIONS?

There are numerous items that can be deducted as a work-related expense. And though the relevant legislation has not materially changed in recent memory, there continues to be many cases dealing with claims for work related expenses, particularly regarding home offices.

Courts and the ATO look at whether a loss or outgoing are "incidental and relevant" to the taxpayer's income-producing purpose and whether it has the "essential character" of an income-producing expense.

Employees who conduct some or all of their income-producing activities from home are generally entitled to deduct a portion of the household running costs. Expenditure in the nature of occupancy costs (e.g. mortgage interest or rent) is not deductible unless the taxpayer can establish that a specific part of the home is set aside as a business area and that it is accepted as such by the public generally. Accordingly, employees generally cannot claim occupancy expenses such as rent, mortgage interest and council rates.

In the 1972 case *Thomas v FCT*, the High Court found that a barrister was not entitled to deduct a portion of the mortgage interest paid on a loan to finance the addition of three rooms to his residence, one of which was used as a home office. It was considered that the barrister's home could not be regarded as business premises because he had city chambers. The home did not lose its domestic character merely because, like many professionals, he did some work at home.

The exponential advancements in digital technology now allow many employees to conduct larger portions, if not all, of their work effectively from home and may provide employees another way to link their home office activities to their employment activities. There have been 2 recent cases that have dealt with these matters.

The first related to *Hall*, an ABC employee whose role comprised of two parts. One was a digital role to produce the ABC Sports Digital Radio station, while the live role was produce ABC live sports broadcasts. As a result of Covid-era and employee restrictions, Hall conducted his digital role; which comprised approximately 75% of his total work time, from his rented apartment, and conducted his live role from the ABC's studio.

Hall had moved to Melbourne for the role and knew he would have to work from home for the digital role. For that reason, he rented a two-bedroom apartment, the second of which he used for the digital role. Hall claimed deductions of \$5,900 for occupancy expenses and \$1,150 for car expenses in his 2021 tax return, which the ATO disallowed.

At both the Administrative Review Tribunal and the Federal Court, Hall's claim for deductions were allowed in full. This was prima facie on the arguments that the rent could be considered as two expenses, where one was additional expenditure for the use of the second bedroom, and that he was "at work" while travelling from his home to the ABC studio.

However, the Full Federal Court considered this approach was incorrect. It found that while Hall was using the second bedroom for income producing purposes and not just out of convenience, the character of the expense was rent paid to secure Hall's private accommodation. Therefore, the rent was private or domestic in nature and not deductible, regardless of whether Hall was required to work from home by the ABC.

With regards to Hall's car expenses, the Court found them to be non-deductible due to his two distinct roles, which meant he was actually travelling to perform work at his live role, not travelling while performing work.

The second case related to *Hartley*, who worked at Ericsson. He argued that his role required him to be a "thought leader" and "innovator". He set up an "IT lab" in his home that he claimed allowed him to conduct research, develop projects, conduct blogging for the betterment of Ericsson and his professional profile, and undertake self-education. The total deductions he claimed in relation to the IT assets, related repairs and maintenance and subscriptions were in excess of \$31k.

The Administrative Review Tribunal found that even though Ericsson had used, or at least acknowledged, projects that Hartley had developed in his IT lab, and that his blogging was at least in some part as an Ericsson employee, Ericsson did not require Hartley to perform these activities as part of his job nor use his personal equipment for same. There was an insufficient nexus with his employment duties; instead, they were undertaken in respect of his interest in his professional skillset. For that reason, the deductions were denied in full.

Unless you're using the fixed rate method, claiming deductions for work related expenses while working from home is rarely clear cut. The nature of the expense needs to be assessed against all the conditions required to meet deductibility, including whether the expense is private or domestic in nature, and whether there is a true nexus to your employment duties.

If you would like to discuss this matter further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

HOLIDAY HOME OR TAX TRAP? THE ATO'S NEW RENTAL PROPERTY RULES

For many Australians, a coastal apartment, ski chalet or beach house serves two purposes: a family retreat and a source of rental income.

Historically, mixed-use holiday homes have largely been treated as an apportionment exercise. Rental income is declared, private-use days are identified, and expenses such as interest, rates and maintenance are apportioned between deductible and private use.

Under the ATO's new guidance, that approach may no longer be sufficient. From 1 July 2026, owners of holiday homes must first determine whether the property is being used **mainly** to produce rental income. If not, section 26-50 of the *Income Tax Assessment Act 1997* may deny significant ownership-related deductions altogether.

When does a rental property become a holiday home?

According to the ATO, a property may be a holiday home where it is used, or held ready for use, for the holidays or recreation of the owner, family members or friends.

This is important because a holiday home may be classified as a leisure facility for tax purposes. If so, deductions relating to ownership and maintenance of the property can be denied unless an exception applies.

Potentially affected expenses include:

- Interest on borrowings
- Council rates and land tax
- Insurance
- Repairs and maintenance
- Other ownership-related costs

This represents a significant shift from the approach many owners have historically taken. In some circumstances, the issue is no longer merely whether deductions should be reduced, but whether they are available at all.

The key question: Is the property mainly used to produce income?

The exception most owners will rely on is where the property is used or held mainly to derive rental income.

Importantly, the ATO has made it clear that this is not simply a calculation based on the number of days rented. Instead, the ATO will consider the overall pattern of use, including:

- Actual rental occupancy
- Availability for rent on commercial terms
- Personal use by owners, family and friends

- Whether personal use occurs during peak demand periods
- Commerciality of rental arrangements
- Responsiveness to booking enquiries
- Efforts made to maximise occupancy and rental income

The timing of private use is particularly important. A property may be advertised throughout the year, but if Christmas, Easter and school holiday periods are routinely reserved for family use, the ATO may conclude that private enjoyment, rather than income production, is the property's primary purpose.

Green, amber or red?

The ATO has introduced a traffic-light style compliance framework.

Green Zone

Low-risk arrangements typically involve:

- High rental occupancy
- Strong availability during peak periods
- Commercial rental terms
- Minimal personal use
- Active efforts to maximise rental income

Amber Zone

The ATO may take a closer look where:

- Personal use increases
- Peak periods are reserved for owners
- Rental opportunities are regularly forgone
- Efforts to maximise bookings are limited

Red Zone

High-risk arrangements include properties that:

- Are rarely rented
- Are blocked out during high-demand periods
- Have unreasonable guest restrictions
- Are advertised at unrealistic rates
- Demonstrate limited genuine commercial activity

The ATO has made it clear that a listing on Airbnb alone will not be enough if the property is not genuinely being operated as an income-producing asset.

Evidence will matter more than ever

The new guidance places significant emphasis on contemporaneous evidence.

Owners should retain records such as:

- Booking calendars and occupancy reports
- Blocked-out dates and reasons
- Property manager agreements
- Rental advertisements and pricing history
- Correspondence with prospective guests
- Evidence supporting efforts to maximise occupancy

The stronger the evidence, the easier it will be to demonstrate that the property's primary purpose is income production rather than private recreation.

The takeaway

The ATO's new guidance changes the conversation around holiday homes. The question is no longer simply: "How many days was the property rented?"

It is now: "Was the property genuinely operated to produce rental income, or was it primarily a holiday home that happened to earn some rent?"

For many taxpayers, that distinction may determine whether deductions are merely apportioned or denied altogether.

If you have any queries in regards your clients' rental properties, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.
