Indexation changes and other matters

The balance of this tranche's changes focuses on a number of areas, some of which are technical in nature and others that have wider application, addressing unintended impacts of the original changes which are not aligned with policy intent. When looking at the changes as a whole they can be broadly split into four categories as follows:

CGT outcomes for foreign and temporary residents

As widely reported, the first tranche of CGT reforms did not extend cost base indexation to foreign and temporary resident individuals. This results in some outcomes that are not aligned with policy intent (eg the availability of CGT discount for gains post 1 July 2027 in certain circumstances).

Foreign resident individuals continue to be able to benefit from CGT discount and indexation outcomes that are pro-rated to the number of days that they are Australian residents (and also not temporary residents) during the relevant testing period.

Indexation

The changes focus on taxpayers whose residency changes ("mixed residency cases") such that they:

- Extend the deemed sale and reacquisition provisions to mixed residency cases involving taxable Australian property assets - this ensures that assets acquired before 1 July 2027 have a cost base which is to be indexed in calculating the post-1 July 2027 portion of any capital gain.
- Remove residency restrictions when seeking to access indexation - there is no longer a residency requirement for taxpayers to apply indexation, with the calculation of indexation a function of the days an individual was a resident. Where an individual was a foreign or temporary resident throughout the testing period no indexation will arise; and
- Provide an apportioned indexation factor formula for mixed residency cases involving direct gains - in simple terms the standard indexation factor is apportioned for the number of days an individual is a resident of Australia.

CGT Discount

As a result of the amendments to indexation, foreign residents and temporary residents who would have had access to the pro-rata CGT discount prior to the reforms, will continue to have CGT discount outcomes, that are pro-rated to the number of days that they are Australian residents (and also not temporary residents) during the relevant testing period.

Extending the deemed sale and reacquisition provisions to mixed residency cases involving taxable Australian property assets ensures that for assets acquired before 1 July 2027 there is a deemed CGT event on 30 June 2027. This will result in any deferred notional capital gains that are discount capital gains having a discount testing period that ends on 30 June 2027.

So what does this mean?

- Individuals, who would have had access to the pro-rata CGT discount prior to the reforms, that cease being an Australian resident:
  - Before 1 July 2027 - will be able to access the CGT discount for any deferred notional capital gains that are discount capital gains - pro-rated to the number of days that they are Australian residents (and also not temporary residents) during the discount testing period which now ceases on 30 June 2027.
  - After 1 July 2027 - will be able to access the full 50 per cent CGT discount for any deferred notional capital gains that are discount capital gains (i.e. pre-1 July 2027 discount capital gains). Indexation will be available for the period of Australian residency post 1 July 2027.

Generally, there is no CGT discount for the post-1 July 2027 part of any capital gains, as a discount capital gain must not have an indexed cost base. These amendments extend cost base indexation to foreign residents and temporary residents with a period of Australian residency on or after 1 July 2027.

Importantly, these changes do not deal with indirect gains (ie trust gains) for the beneficiaries. The explanatory memorandum provides that further consideration is being given to determining appropriate outcomes for mixed residency taxpayers who make capital gains indirectly through a trust.

Trust changes and CGT minimum tax

The deemed disposal and reacquisition of assets

The rules for trusts have been updated in line with the changes for individuals in relation to the deemed disposal and reacquisition of assets again with the focus being on the residency of beneficiaries just before the realisation event.

As currently drafted, it would appear that a deemed disposal and reacquisition would arise at the trust level for all assets except assets that are not taxable Australian property. For assets that are not taxable Australian property at least one beneficiary must be a resident receiving the distribution to meet the deemed disposal requirements.

The impact of the above at the beneficiary level is yet to be confirmed where beneficiaries have a mixed residency status.

CGT Discount for new residential premises

Changes have ensured that trusts are able to apply the 50% discount at the trust level for gains in relation to new residential dwellings or affordable housing.

Testamentary/Special Disability Trusts and Deceased Estates

Amendments have been made to exclude these from the CGT minimum tax provision gains arising in Testamentary Trusts, Special Disability Trusts and Deceased Estates.

The gains of such trusts will be excluded from the minimum tax provisions where they meet certain integrity criteria.

The exclusion does not extend to subsequent gains made on the disposal of an asset transferred to a beneficiary from such a trust.

Deferred gains to certain CGT events and exemptions

The mechanism transitioning to indexation involves a deemed disposal and reacquisition of an asset resulting in a deferred gain or loss. This deferral crystallises when a realisation event occurs in relation to the asset.

The policy intent is that a deferred gain should only arise when there is a substantive realisation of the CGT asset in which a capital gain, based on the value of the asset is taxed. The outcomes of the original enacted law did not align with the policy intent across a range of situations.

Realisation event

The changes included in the exposure draft remove a number of potential CGT events (more than a dozen) from the definition of a realisation event and therefore from crystallising the deferred gains and losses. A simple and common example is as follows:

> *Roxi owns an investment unit which she rents out. She acquired the unit on 1 September 2025.*
>
> *In June 2027 Roxi decides that she wants to move into the unit. The tenants' lease on the unit does not end until 1 October 2027. After negotiating with her tenants, Roxi agrees to pay them $2,000 if they are prepared to end the lease on 31 July 2027. The tenants agree and the lease agreement is varied on 15 July 2027.*
>
> *CGT event F3 happens on 15 July 2027 when the lease is varied. Roxi will make a $2000 capital loss from CGT event F3 happening.*
>
> *Roxi does not need to recognise a deferred gain or loss as CGT event F3 is excluded from the definition of 'deferral realisation event' under subsection 112-152(1).*

Exemptions and deferrals

The changes included in the exposure draft ensure that certain exemptions or deferrals work as intended for deferred gains and losses aligning the treatment with the gain or loss on realisation. The definition of "deferral exemption" has been amended to include gains and losses deferred under:

- The general exemptions (eg motor vehicles, collectables, compensation and damages etc);
- The small business CGT concessions; and
- Capital gains of foreign residents.

The changes ensure that a deferred gain or loss receives the same treatment as the realisation event gain or loss.

An example would be where an individual (aged 54) makes a deemed gain or loss on 30 June 2027 and subsequently sells the asset when aged 56 and eligible to apply the small business CGT provisions. Without the changes, the deferred gain may not have been eligible to receive the exemption as the individual was 54 not 55 or over when the deferred gain was made. The changes seek to address such an erroneous outcome.

Attribution managed investment trust (“AMIT”) changes

The explanatory memorandum to this second round of CGT changes acknowledges that the CGT reforms are intended to apply to capital gains, including the capital gains of trusts. The original round of CGT reform legislation did not include trusts that are AMITs, which are subject to a specific tax regime.

The amendments made by this second round are to ensure that the new CGT regime applies appropriately to AMITs.

Compliance concession

In an attempt to provide some administrative concessions in what is quickly becoming a high compliance cost environment, the trustee of a trust can choose not to apply cost base indexation in determining its capital gain from a CGT event.

This concession is, however, only available if immediately prior to the CGT event, all of the trust’s beneficiaries satisfy one of two conditions being:

- If the beneficiary would not have been entitled to apply cost base indexation, had they made the gain in the same circumstances as the trust (eg a company or if the CGT assets are not taxable Australian property and distributed to non-residents); or
- If the beneficiary is the trustee of another trust which could in its own right, be eligible to choose, to not apply indexation.

If you have any questions please reach out to your ESV Engagement Partner.