The method for apportioning Capital Gains and Losses

The alternate valuation method for determining the deemed capital gains and losses on 30 June 2027 has been released. This mechanism has been provided as a fall-back option for taxpayers that do not want to have their various assets subject to a valuation or incur the costs.

The apportioning method is not available for all assets. Specifically, only the following classes of assets can use the method:

- Real property; and
- A CGT asset that, at the time of the deemed sale and reacquisition, does not have a readily ascertainable market value and its cost base is not worked out (in whole or in part) by reference to market value under another part of the tax law.

The term 'readily ascertainable' takes its ordinary meaning – *to be easily or quickly able to be determined*. As such, small shareholdings in listed shares could be easily valued using the closing price on any given day and would therefore not be covered.

This needs to be compared with shares in privately held companies or where control premiums affect the market value of different holdings. These would appear to be covered by the methodology.

Assets whose cost base is worked out under another provision could include an asset whose cost base is subject to an apportionment. For example, this could be where an original CGT asset splits into two separate CGT assets (eg shares). In these cases, the methodology is not available.

So what is the methodology?

The proposed methodology is a nine step calculation process that seeks to apportion value by assuming the asset grew at a compounding daily growth rate (or declined in value at a negative daily compounding rate) over the entire ownership period. Whilst this looks and feels like time based pro rata, the compounding nature of the formula appears to weight more growth to the period after 30 June 2027.

The growth rate is based on the realisation proceeds as a function of the original cost. This is then used to determine the capital proceeds on the deemed sale at the end of 30 June 2027. A simple example provided in the explanatory memorandum is as follows:

> *Zoe acquires a piece of artwork for $520,000 to display in her home on 1 July 2016. At the time, Zoe incurs auction and broker fees of $2,000 as part of the purchase. The artwork is not a depreciating asset.*
>
> *On 30 June 2034, Zoe sells the artwork for $1,500,000. At that time, and as part of the disposal, Zoe incurs auction and broker fees of $3,000.*

Assumptions: CPI index number for the quarter in which 1 July 2027 occurs is 105.54 (start date). CPI index number for the quarter in which Zoe sells the artwork is 125.45.

Apportion the capital gain using the determined method by applying the method statement:

Step 1: *The pre-start date cost base and pre-start date reduced cost base are $522,000 (520,000 + 2,000).*

Step 2: *Total growth rate is 2.88462… (1,500,000 ÷ 520,000).*

Step 3: *Total days held (ignoring deemed sale and reacquisition) is 6,574. Total number of days held until 30 June 2027 is 4,017.*

Step 4: *Daily growth rate is 0.00016… (2.88462… $(1 / 6574)^{-1}$).*

Step 5: *The pre-start date capital proceeds are $993,429.55 (520,000 × $(1 + 0.00016\ldots)^{4017}$).*

Step 6: *Capital gain from the deemed disposal is $471,429.55 (this is a discount capital gain).*

Step 7: *Cost base at the start date is $993,429.55.*

Step 8: *The post-start date cost base and post-start date reduced cost base are $1,183,838.90 ((993,429.55 × (125.45 ÷ 105.54)) + 3000).*

Step 9: *Capital gain from the realisation event is $316,161.10 (1,500,000 - 1,183,838.90).*

The worked example provided in the explanatory memorandum for the apportionment of a loss appears to be incorrect as it increases the loss by indexation. As such it has not been provided here.

If you have questions arising from these proposed changes please contact your ESV Engagement Partner.