EXPLANATORY STATEMENT

Issued by authority of the Treasurer

Income Tax Assessment Act 1997

Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026

Section 112-185 of the *Income Tax Assessment Act 1997* (the Act) provides that the Minister may, by legislative instrument, determine a method for apportioning capital gains and capital losses between deferral realisation events happening on or after 1 July 2027 in relation to capital gains tax (CGT) assets, and earlier CGT events relating to those CGT assets that are taken to have happened under Subdivision 112-E of the Act.

The purpose of the *Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026* (the Instrument) is to prescribe such an apportioning method.

In the 2026-27 Budget, the Government announced reforms to help improve the fairness of the tax system, support home ownership and help fund new tax cuts for workers. The reforms reintroduce cost base indexation and apply a 30 per cent minimum tax on capital gains to achieve a more neutral and fair treatment of capital gains compared with the fixed 50 per cent CGT discount that applied to nominal capital gains. The new CGT regime applies to capital gains accruing from 1 July 2027, where they are made directly or indirectly (through an interposed entity) by individuals (including individual partners in a partnership) and trusts. Capital gains accruing before this time remain subject to the 50 per cent CGT discount regime. These reforms also mean pre-CGT assets will be subject to CGT on any gains that accrue from 1 July 2027.

Division 112 of the Act modifies the cost base and reduced cost base of a CGT asset in certain situations, ultimately for the purpose of a taxpayer calculating a capital gain or capital loss to include in their assessable income for an income year. Subdivision 112-E caters for situations where a CGT asset was acquired before 1 July 2027 and a realisation event (such as disposal or sale) happens on or after that date. The asset is deemed to be sold just before, and reacquired immediately on, 1 July 2027. This allows a taxpayer to calculate capital gains or losses that accrued between acquisition and the end of 30 June 2027 under the law as it applied before these reforms, and to calculate capital gains or losses that accrue from 1 July 2027 to the realisation event under the reformed law.

The capital proceeds from the deemed sale and reacquisition of the CGT asset are equal to its market value as at the end of 30 June 2027 or an amount calculated under an apportioning method determined by the Minister in a legislative instrument. Section 112-185 of the Act requires that a method for apportioning:

- must take into account the deemed reacquisition of the CGT asset on 1 July 2027 and any expenditure including indexation in an element of the cost base or the reduced cost base;

- must enable the capital proceeds of the deemed sale just before 1 July 2027, and the cost base and reduced cost base of the CGT asset when it is deemed to be reacquired on 1 July 2027, to be worked out; and
- may take into account other matters the Minister considers relevant and may enable other things to be worked out.

This Instrument prescribes an apportioning method, for particular CGT assets. This method divides an overall capital gain (or capital loss) between:

- the ownership period prior to 1 July 2027, which continues to benefit from the existing 50 per cent CGT discount if applicable; and
- the ownership period from 1 July 2027, where capital gains are taxed after allowing for inflation through CPI indexation.

The apportioning method estimates the CGT asset's value as at the end of 30 June 2027, by assuming the CGT asset grew at a compounding daily growth rate (or declined in value at a negative daily compounding rate) over the entire ownership period. The capital proceeds on the deemed sale at the end of 30 June 2027 are determined using this growth rate.

The method then calculates the capital gain (or capital loss) accrued up until the deemed sale on 30 June 2027. As the deemed sale constitutes CGT event A1, subsection 104-10(4) of the Act requires a comparison between the cost base (or reduced cost base) and capital proceeds to calculate the capital gain (or capital loss) made on the deemed sale. The capital proceeds, determined using the growth rate above, are used to calculate this capital gain (or capital loss). If applicable, the CGT discount may be applied to this capital gain, (when it is ultimately brought to account at the realisation event).

The amount of the capital proceeds on the deemed sale then sets the cost base (or reduced cost base) for the purposes of calculating the capital gain (or capital loss) for the ownership period from 1 July 2027. On the realisation event happening, the relevant CGT event sets the method for calculating the capital gain or capital loss, using the actual capital proceeds and the cost base (or reduced cost base) set at the time of the deemed sale and reacquisition. In calculating the capital gain at the realisation event, each element of the cost base of the CGT asset (except element 3) is inflated using CPI indexation, if applicable.

The resulting effect of applying the apportioning method is that the taxpayer has a deferred capital gain (or deferred capital loss) and a capital gain (or capital loss), both of which are included in the taxpayer's net capital gain (or net capital loss) for the income year in which the realisation event happens.

The apportioning method provides an alternative to obtaining a formal market valuation. Its use is limited to real property and assets that do not have a readily ascertainable market value. This is likely to include assets for which there is no transparent or liquid market from which information on an asset's value at a point in time can be obtained.

The Act does not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

The Instrument is a legislative instrument for the purposes of the *Legislation Act 2003*. It is subject to sunsetting and disallowance under that Act.

The Instrument commenced on the day after registration.

Details of the Instrument are set out in Attachment A.

ATTACHMENT A

Details of the Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026

Part 1 – Preliminary matters

Section 1 – Name

This section provides that the name of the instrument is the *Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026* (the Instrument).

Section 2 – Commencement

The Instrument commences on the day after it is registered on the Federal Register of Legislation.

Section 3 – Authority

The Instrument is made under the *Income Tax Assessment Act 1997* (the Act).

Section 4 – Definitions

This section provides definitions of key terms used throughout the Instrument. Most terms are defined by reference to the particular subsection that establishes the term and relate to the cost base or reduced cost base at a point in time that is before, at or after the start date of the reforms (1 July 2027).

Notably, this section provides that in the Instrument, 'the Act' means the *Income Tax Assessment Act 1997*. A note explains that paragraph 13(1)(b) of the *Legislation Act 2003* ensures that expressions have the same meaning in the Instrument as in the *Income Tax Assessment Act 1997* as in force from time to time. An example is the term 'realisation event', which is used in this Instrument and has the same meaning as in the Act.

Part 2 – Method for apportioning capital gains and losses between realisation events and earlier deemed CGT events

Application

Subdivision 112-E of the Act sets out how to modify the cost base and reduced cost base of CGT assets held by individuals and trusts, and pre-CGT assets. To support the transition to the CGT reforms, such CGT assets are deemed to be sold just before, and reacquired on, 1 July 2027 for the purpose of resetting the cost base and reduced cost base. Any initial notional gain or loss from the deemed sale is deferred until the income year of a realisation event that occurs in relation to the asset on or after 1 July 2027.

Section 5 of the Instrument sets out a method of apportioning capital gains and capital losses between the deemed sale and reacquisition of certain CGT assets on 1 July 2027 (under subsections 112-115(2), 112-165(2) and 112-175(2) of the Act), and a realisation event for the asset that happens on or after that date (subsection 5(1)).

This apportioning method is determined for the following classes of CGT assets, in accordance with subsection 5(2):

- 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 Act (disregarding sections 112-155, 112-165 and 112-175).

'Readily ascertainable' takes its ordinary meaning, namely to be easily or quickly able to be determined. Different methods of determining value could be used depending on industry standards and the type of asset. For example, information on the price of listed shares at the close of trading can be readily ascertained on any given day; such shares would not be covered by the Instrument. However, shares may not always have a readily ascertainable market value. For example, there may be control premiums that affect the market value of different holdings of private or closely held companies.

The Instrument would also not cover a CGT asset whose cost base is worked out by reference to market value under another provision of the Act (that is – outside of the deemed sale and reacquisition in sections 112-115, 112-165 and 112-175). For example, the cost base modification rules may apportion the cost base of an original CGT asset that splits into two separate CGT assets over these two new CGT assets based on market value. Another example is where the demerger rules apply to set the cost base of shares in the demerged entity and as the original share no longer exists, it is therefore not capable of being valued as at the end of 30 June 2027. In these cases, the other provisions, such as the cost base modification rules and the demerger rules apply, to set the cost base, and the Instrument is not available in these cases.

Method

Subsection 5(3) sets out the method to apportion capital gains and losses between realisation events and earlier deemed CGT events for CGT assets covered by the Instrument. The apportioning method is a nine-step process.

The first step is to work out the cost base and the reduced cost base of the CGT asset at the end of 30 June 2027. These are called pre-start date cost base and the pre-start date reduced cost base, respectively. To work these out, apply the general rules in subdivisions 110-A and 110-B of the Act, and any relevant cost base modification rules, to calculate the cost base and the reduced cost base.

The second step is to divide the capital proceeds from the realisation event by the first element of the pre-start date cost base of the CGT asset. The result of this calculation is the 'total growth rate', which is then used in calculating the daily growth rate of the asset (the next step of this method). Note that subsection 110-25(2) of the Act sets out the first element of the cost base, and other provisions may be relevant. The third step is to work out the number of days the asset has been held, from the day it was first acquired up to and including the day of the realisation event (needed for step 4), and from the day it was first acquired up to and including 30 June 2027 (needed for step 5). Where the asset was purchased in instalments, the clock starts from the first instalment.

The fourth step is to work out the daily growth rate, using the formula set out in subsection 5(4). That formula is:

$$\text{daily growth rate} = \text{total growth rate}^{(1 / \text{days held})} - 1$$

This rate will be negative, if apportioning a capital loss.

The fifth step is to work out the pre-start date capital proceeds. Subsection 5(5) sets out the formula for working out the capital proceeds of the deemed sale that is taken to have happened just before 1 July 2027 in accordance with paragraphs 112-155(2)(a), 112-165(2)(a) or 112-175(2)(a) of the Act. That formula is:

$$\text{capital proceeds} = \text{first element of the pre-start date cost base of the CGT asset} \times (1 + \text{daily growth rate})^{\text{pre-start date days held}}$$

The sixth step determines whether there is a nominal capital gain or loss from the deemed disposal on 30 July 2027. Subtract the pre-start date cost base (calculated in step 1) from the pre-start date capital proceeds (calculated in step 5). If the resulting amount is positive, it is the capital gain from the deemed disposal. If the resulting amount is negative, subtract the pre-start date capital proceeds from the pre-start date reduced cost base; the result is the capital loss from the deemed disposal.

A capital gain or capital loss from the deemed disposal is deferred until the income year in which the realisation event happens to the CGT asset, as noted underneath subsections 112-155(2), 112-165(2) and 112-175(2) of the Act.

The approach in step 6 aligns with that taken for CGT event A1 (disposal of a CGT asset), in section 104-10(4) of the Act. A note clarifies that this step is included for the benefit of the reader but does not affect the operation of that section (as affected by sections 112-155 to 112-175), to understand how this Instrument relates to provisions of the Act.

It is also noted here that if the asset was a pre-CGT asset on 30 June 2027, a pre-start date capital gain or capital loss would be disregarded. This ensures that capital gains and losses from pre-CGT assets that have accrued prior to the CGT reforms commencing continue to benefit from the tax settings prior to the commencement of the reforms. Only capital gains or losses accruing after commencement will be subject to the new regime for relevant entities.

The seventh step is to work out the ‘cost base at start date’. This amount is equal to the amount of the pre-start date capital proceeds worked out in step 5. This step satisfies the requirement of paragraph 112-185(3)(b) to determine the cost base and reduced cost base at the time of the deemed reacquisition.

The eighth step is to work out the cost base and reduced cost base of the CGT asset as at the time of the realisation event. The ensures that subsequent expenditure incurred that falls within any of the cost base elements will be subject to any applicable indexation. Once calculated, these are the post-start date cost base and the post-start date reduced cost base, respectively. The note to step 8 reminds readers that, in working out the post-start date cost base, cost base elements are indexed in accordance with subsection 110-36(1A) of the Act.

The ninth step is to work out whether a capital gain or capital loss has accrued in relation to the CGT asset since the start date of the reforms, namely 1 July 2027. To do so, subtract the post-start date cost base (calculated from step 8) from the actual capital proceeds from the realisation event. If the result is a positive amount, the amount is the capital gain from the realisation event. If the result is negative, subtract the capital proceeds from the post-start date reduced cost base; the result is the capital loss from the realisation event.

The amounts (any capital gains and losses) from steps 6 and 9 are relevant in calculating a taxpayer's assessable income for the income year of the realisation event.

The ATO is preparing guidance materials and tools to support taxpayers in their calculations.

Example 1. Apportioning capital gains

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…) ^{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 is $1,183,838.90 ((993,429.55 × (125.45 ÷ 105.54)) + 3000).

The post-start date reduced cost base is $996,429.55 (993,429.55 + 3000).

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

Example 2. Apportioning capital loss

Assume the same facts from Example 1, except that Zoe sells the artwork for $440,000.

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.

Apportioning the capital loss 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: The total growth rate is 0.84615… (440,000 ÷ 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 -0.00003 ($0.84615\ldots^{(1/6574)} - 1$).

Step 5: The pre-start date capital proceeds are $469,539.06 ($520{,}000 \times (1 + -0.00003\ldots)^{4017}$).

Step 6: Capital loss from the deemed disposal is $52,460.94.

Step 7: Cost base at start date is $469,539.06.

Step 8: The post-start date cost base is $561,117.07 ((469,539.06 × (125.45 ÷ 105.54)) + 3,000).

The post-start date reduced cost base is $472,539.06 (469,539.06 + 3000).

Step 9: Capital loss from the realisation event is $32,539.06.

First, calculate: (440,000 – 561,117.07) = -$121,117.07. As this result is negative, then calculate: (472,539.06 - 440,000).