The Tax Institute

21 August 2026

The Treasury
Langton Crescent
PARKES ACT 2600

By email: TaxChanges@treasury.gov.au

Dear Treasurer,

Capital Gains Tax and Negative Gearing – Tranche 2 Legislation

The Tax Institute welcomes the opportunity to make a submission to the Treasury in relation to the consultation on:

- the exposure draft Treasury Laws Amendment (Tax Reform No. 3) Bill 2026: CGT adjustments (tranche 2) and accompanying explanatory material;
- the exposure draft Income Tax Assessment (Method for Apportioning Capital Gains and Capital Losses) Determination 2026 (**apportionment Determination**) and accompanying explanatory statement;
- the exposure draft Treasury Laws Amendment (Tax Reform No. 3) Bill 2026: Negative gearing (tranche 2) amendments and accompanying explanatory material; and
- the exposure draft instrument and explanatory material defining a 'new residential dwelling' and negative gearing activity exemptions.

We acknowledge the need for the apportionment Determination and new residential definition definitions, and some of the complexities involved in transitioning to these new CGT and negative gearing rules.

We have set out below some suggestions for improvement.

Amendments to tranche 1 legislation

The Government's announcement that it will address the so-called 'widow tax' and 'divorce tax' will no doubt be welcome news to many taxpayers and their advisers. The changes in this tranche that preserve existing tax treatment for certain property transfers arising from death and relationship breakdown respond to these concerns, and should provide greater certainty for families dealing with inheritance and relationship breakdown.

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However, the need for these amendments so soon after the first tranche of legislation passed Parliament highlights a broader concern about the process used to develop changes of this scale. Many of the measures in the two Tranche 2 exposure draft Bills are not new policy initiatives, but corrections to unintended outcomes, technical deficiencies and design issues that stakeholders and the Government identified only after the legislation had already been enacted. These are significant, economy-wide tax changes affecting millions of Australians, and a more comprehensive consultation process before the first tranche was passed would have likely identified many of these issues earlier, and avoided the need for successive rounds of legislative correction.

It is welcome that the Government is willing to listen to community concerns and improve the legislation. However, these amendments also raise an important question: if a number of significant problems have already emerged and required correction, what other unintended consequences remain undiscovered? That question is particularly pressing, given that Treasury has already flagged that further tranches of legislation will be required to address unresolved issues. This is not how good tax policy should be developed, and it adds to the uncertainty and cost that taxpayers and advisers already face in adapting to changes of this scale.

Consultation timeframe

We made a similar point in our submission to the Senate Economics Legislation Committee on 9 June 2026 (**June 2026 submission**) regarding the Treasury Laws Amendment (Tax Reform No. 1) Bill 2026 (**Tranche 1**). In that submission, we expressed concern that the CGT discount and negative gearing measures were introduced into Parliament without any public consultation. We also noted a broader pattern of limited or rushed consultation on significant tax reforms.

We welcome the release of this second tranche for public consultation, unlike Tranche 1. However, we remain concerned that the timing and sequencing of the consultation process continue to reflect the same underlying issues.

Consultation on the minimum tax on discretionary trusts closed on 31 July 2026. Treasury then released draft regulations and a determination relating to Tax Practitioners Board sanctions reforms on 3 August 2026, with submissions due by 14 August 2026. The following day, on 4 August 2026, Treasury opened consultation on the CGT and negative gearing Tranche 2 legislation, with submissions due by 21 August 2026. During the same period, Treasury also conducted targeted consultation on the Innovative Business CGT Concession and on other aspects of the Tranche 2 package.

Each of these measures is significant on its own and involves many of the same stakeholders, advisers and representative bodies. Running multiple major consultations simultaneously limits stakeholders' ability to thoroughly analyse the proposals, engage with their own stakeholders, including members, and provide considered feedback on each proposal.

Against this background, our submission focuses on the aspects of the exposure drafts that we consider raise the most significant policy, technical, and administrative issues. In particular, we comment on the prescribed apportionment method, the scope of the minimum tax exemption for testamentary trusts and deceased estates, and the definition of a new residential dwelling. We also identify a number of interactions with existing provisions of the tax law that we consider require further clarification.

We encourage Treasury to continue engaging with stakeholders as these measures progress. We also intend to provide further comments should additional issues emerge.

Finally, we reiterate the recommendation made in our June 2026 submission that the Government should recommit to the principles of good tax policy development. This includes early and ongoing engagement with the tax community on complex legislative changes, and better sequencing of major consultations so that stakeholders can give each proposal the careful consideration it deserves.

A summary of our key issues and recommendations is contained in **Appendix A**. Our detailed comments and recommendations are contained in **Appendix B**.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

If you would like to discuss any of the above, please contact our Tax Counsel, John Storey, at (02) 9602 2003.

Yours faithfully,

Julie Abdalla	**Tim Sandow**
Head of Tax & Legal	President

APPENDIX A

Summary of key issues and recommendations

CGT adjustments (tranche 2) — exposure draft Bill

- **Targeting of the minimum tax on capital gains.**

  We are concerned that the 30% minimum tax on capital gains may have a greater impact on small-scale and first-time investors than on wealthier and more established investors. Treasury should consider introducing a small-value threshold based on a taxpayer's income or level of investment.

- **CGT event K7 and the residential/non-residential distinction.**

  We seek clarification on whether a capital gain under CGT event K7 for a depreciating asset used in a residential rental property is treated as a residential or non-residential capital gain for the purposes of section 102-6.

CGT apportioning method — the apportionment Determination

- **Assumption of steady growth**

  The apportionment method assumes that an asset grows at a constant rate over the entire ownership period. This may not reflect how assets actually increase in value. As taxpayers can choose between a market valuation and the apportionment method, they are likely to want to retain the option of using the valuation method, so many of the compliance savings of this alternative method will not be realised. Treasury should consider offering a broader array of alternative methods more likely to track real growth rates, for example publishing a growth index that applies to certain asset classes. In this way it is more likely that taxpayers will have confidence that an alternative methodology will fairly deal with any future capital gain.

- **Growth rate calculated only by reference to the first element of cost base.**

  Step 2 calculates the growth rate using only the first element of the cost base and ignores other cost base components, such as capital improvements. This can produce very different outcomes for similar assets. We recommend using the full pre-start date cost base instead.

- **Assets with a nil or nominal first element of cost base.**

  The formula does not work properly where the first element of cost base is nil, such as internally generated goodwill. It can also produce distorted outcomes where the first element is only nominal. Treasury should introduce specific rules for these assets.

- **Guidance on acceptable valuation evidence.**

  While the ATO is preparing guidance on the apportionment method, there is currently no guidance on what valuation evidence will be accepted if a taxpayer obtains a market valuation as at 30 June 2027. Treasury should ensure that this guidance is published well before that date, and that it reflects different asset types and levels of materiality.

- **Interaction with the capital works cost base reduction**

  We seek clarification on how the existing cost base reduction for capital works deductions under section 110-45 applies under the apportionment method, particularly in calculating the growth rate in Step 2.

Negative gearing (tranche 2) — exposure draft amendments

- We seek clarification on whether losses from balancing adjustment events for depreciating assets that are recognised on the revenue account are included in the net rental loss quarantining rules in section 26-155.

New residential dwelling and negative gearing activity exemptions — exposure draft instrument

- We seek clarification on when a building is considered sufficiently 'condemned or derelict' to be treated as though there is no residential dwelling on the land for the purposes of subsection 5(2). In particular, Treasury should clarify whether the demolition of the existing building is required and how this rule interacts with the separate provisions governing the conversion of a non-residential building into a residential dwelling.

APPENDIX B

We have set out below our detailed comments and observations for your consideration.

CGT adjustments (tranche 2) — exposure draft Bill and explanatory material

Better targeting of the minimum tax on capital gains: *de minimis* threshold

We recognise that the design of the 30 per cent minimum tax on capital gains is not itself the subject of this consultation. However, as this tranche introduces targeted exemptions for testamentary trusts, deceased estates and special disability trusts, it is also an opportunity to consider whether further targeting measures are warranted to ensure the minimum tax operates consistently with its stated distributional objectives.

The minimum tax may, in some circumstances, have a greater relative impact on taxpayers with modest levels of ordinary income than on those realising much larger capital gains. This is because the minimum tax operates by imposing a top-up amount where the tax otherwise payable on a capital gain is less than 30 per cent of that gain.

For example, a single parent earning $35,000 who sells a modest investment property and realises a capital gain of $45,000 (after taking into account quarantined rental losses) may be required to pay an additional $1,600 of minimum tax because the ordinary tax payable on the gain is less than the 30 per cent minimum rate. By contrast, a retiree with no other income who realises a capital gain of $400,000 may not be required to pay any additional minimum tax because the ordinary tax payable on that gain already exceeds the 30 per cent threshold.

This outcome arises because the minimum tax is driven not only by the size of the capital gain, but also by the interaction between that gain and the taxpayer's broader income position. As a result, taxpayers with relatively modest levels of non-capital-gain income may be more likely to be affected by the top-up tax than taxpayers realising significantly larger gains.

The effect may be particularly acute for small-scale investors. An investor with a single established residential property generally has no ability to offset a quarantined rental loss against profits or gains from other properties, unlike an investor with a diversified property portfolio. When combined with the reduced CGT discount and the operation of the minimum tax, small-scale and first-time investors may bear a disproportionate share of the impact of these changes relative to their capacity to pay. This is difficult to reconcile with the stated objective of improving equity within the tax system.

Consideration could therefore be given to a *de minimis* threshold, based on a taxpayer's income or the scale of their investment holdings, below which the minimum tax would not apply. Such an approach could preserve the intended operation of the measure for larger or more sophisticated investment portfolios, while reducing the impact on small-scale and first-time investors.

Recommendations

- Treasury should consider whether a *de minimis* threshold, based on a taxpayer's income or the scale of their investment holding, would better target the minimum tax on capital gains toward the wealthier and more sophisticated investors as the measure is intended.
- If such a threshold is not adopted as part of this tranche, Treasury should consider the distributional impact of the minimum tax on small-scale investors in further Tranches or in any post-implementation review of the CGT reforms.

CGT event K7 and the residential/non-residential capital gain distinction

Existing section 40-27 of the ITAA 1997 denies deductions for the decline in value of second-hand depreciating assets used in residential premises. Where such an asset is later disposed of, a capital gain or loss may arise under CGT event K7 (which applies to depreciating assets that have been used for a non-taxable purpose). We seek clarification of whether a capital gain arising under CGT event K7 in relation to a depreciating asset used in a residential rental property is treated as a 'residential capital gain' or a 'non-residential capital gain' for the purposes of section 102-6 of the ITAA 1997. This classification determines the taxpayer's eligibility for the CGT discount, cost base indexation, and the interaction with the 30 per cent minimum tax under the new residential dwelling provisions.

Recommendation

Treasury should clarify whether a capital gain arising under CGT event K7 in relation to a depreciating asset used in a residential rental property is a residential or non-residential capital gain for the purposes of section 102-6, and how this interacts with the new residential dwelling CGT discount and indexation rules.

CGT apportioning method — the apportionment Determination and explanatory statement

Our comments on the apportionment method are set out below. Several of the identified issues stem from the same underlying feature of the method. The method estimates the market value of a CGT asset at 30 June 2027 by taking the first element of its cost base and applying a constant daily growth rate over the ownership period.

This approach may produce reasonable outcomes where an asset was acquired at market value, no significant capital expenditure has been incurred since acquisition, and the asset's value has grown steadily over time. However, those conditions will not apply in many real-world situations. Assets may have increased in value unevenly, been subjected to substantial capital improvements, or experienced periods of rapid growth or decline. In these circumstances, the resulting allocation may bear little relationship to the asset's actual value at the transition date.

This is significant because the two portions of the gain are subject to different tax treatment. The portion attributed to the period before 1 July 2027 continues to benefit from the 50 per cent CGT discount and is not subject to the minimum tax in Division 119. By contrast, the portion attributed to the period after 30 June 2027 does not receive the 50 per cent discount and may be subject to the minimum tax. Where the apportionment method incorrectly allocates gains between these periods, it effectively results in an incorrect allocation of the relevant tax concessions and liabilities.

As a result, any systematic inaccuracies in the apportionment method may lead to taxpayers being taxed on amounts that do not appropriately reflect when the economic gain was actually accrued.

Assumption of a steady (constant) growth rate as the only alternative method to a valuation

Step 2 of the method statement in subsection 5(3) calculates a 'total growth rate' by comparing the capital proceeds from the disposal with the first element of the asset's pre-start date cost base. Step 4 converts that figure into a daily growth rate, and Step 5 applies that daily rate across the pre-transition ownership period to determine the amount of the gain attributed to the period before 1 July 2027. In effect, the method assumes that the asset increased in value at a constant rate throughout the entire period of ownership.

In practice, assets rarely increase in value in this way. Commercial property values tend to move in cycles. Private businesses often experience growth in stages, driven by events such as winning significant contracts, expanding into new markets, making acquisitions, or hiring key personnel, followed by periods of slower growth. Similarly, many other assets experience periods of rapid appreciation, stagnation or decline.

As a result, the assumption of a constant growth rate may produce outcomes that do not reflect the economic reality of how value accrued over the ownership period. Rather than being a simple approximation of actual growth, the method may attribute gains to the period before or after 1 July 2027 in a manner that bears little relationship to when those gains were actually realised economically.

Example — commercial property with uneven growth

A commercial property acquired on 1 July 2007 for $1,000,000 and sold on 30 June 2037 for $8,000,000 illustrates the issue. Assuming no further cost base expenditure, the pre-transition period represents 7,304 of the total 10,957 ownership days. Under the proposed method, the asset is assumed to have grown at a constant rate over the entire ownership period, resulting in pre-transition capital proceeds of approximately $3,999,000.

However, if the property's value increased substantially between 2015 and 2022 and then remained largely unchanged, its actual market value at 30 June 2027 may have been closer to $6,500,000. In that case, the formula would significantly understate the amount of gain that accrued before 1 July 2027. Approximately $2,500,000 of gain would instead be attributed to the period after that date, causing that amount to lose access to the 50 per cent CGT discount and potentially become subject to the minimum tax. Conversely, where an asset experiences most of its growth after 30 June 2027, the formula can overstate the amount of gain attributable to the pre-transition period.

Importantly, these outcomes are unlikely to balance out across taxpayers. The apportionment method is not mandatory. Under subsection 112-155(3) of the ITAA 1997, taxpayers can instead obtain a market valuation and use the valuation method. As a result, taxpayers whose assets experienced strong growth before 1 July 2027 will generally have an incentive to obtain a valuation, while taxpayers whose assets experienced most of their growth after that date are more likely to choose the formula method.

Because taxpayers are likely to be aware of the possibility that a market valuation approach could produce a substantially better outcome, many will choose to retain the option of using a market valuation method upon a future sale. This could involve seeking such a valuation as at 1 July 2027 as a contingency, or at a minimum seeking advice and retaining records sufficient to obtain one in the future. At the time of a future realisation event, they will need further advice as to whether such information is sufficient and whether a market valuation can be substantiated and relied on.

In other words, the full compliance costs of the market valuation method are still likely to be borne by taxpayers, irrespective of the alternative, simplified method. The only way to prevent this is to ensure that the alternative method is more likely to accurately reflect market value, or that there are multiple alternative apportionment methods, so a taxpayer can be confident that at least one of them is likely to produce a fair outcome, so there will be no need to go through the potentially expensive market valuation process.

This may involve offering different valuation methods for different asset classes. For example, real property could be apportioned using relevant published indices, such as Australian Bureau of Statistics property price indices or State Valuer-General data. For other assets, taxpayers could be permitted to rely on abbreviated market valuation processes, such as prescribed business valuation multiples audited financial statements.

Recommendations

Consideration should be given to permitting alternative, and potentially multiple, methods to be applied to certain identified asset classes.

Growth rate limited to the first element of cost base

Step 2 of the method statement in subsection 5(3) calculates the 'total growth rate' by dividing the capital proceeds from the realisation event by only the first element of the pre-start date cost base of the CGT asset. The first element is then used again in subsection 5(5) to calculate the pre-start-date capital proceeds.

This approach sits uncomfortably with the structure of the method as a whole. Step 1 requires the taxpayer to work out the full pre-start date cost base, including all cost base elements, while Step 6 compares the pre-start date capital proceeds against that full pre-start date cost base in determining the capital gain or loss on the deemed disposal. As a result, the calculation of growth is based on a different measure of cost from the calculation of the gain itself.

Where an asset has incurred significant capital expenditure after acquisition, the consequences can be material. Expenditure that forms part of the cost base under Step 1 is ignored when determining the asset's assumed growth rate under Steps 2 to 5. This can distort the allocation of growth between the period before and after 1 July 2027, even though that expenditure may have contributed significantly to the asset's value.

While the methodology preserves the aggregate outcome, in the sense that the deemed gain and the gain on ultimate disposal will together equal the total economic gain realised over the ownership period, it does not necessarily preserve the allocation of that gain between the pre-transition and post-transition periods. That allocation is the central purpose of the instrument.

This distinction is important because gains attributed to the period before 1 July 2027 retain access to the 50 per cent CGT discount and fall outside the minimum tax in Division 119, whereas gains attributed to the period after that date do not receive those benefits. A methodology that uses different cost-base measures for growth and gain calculations may therefore produce allocations that do not accurately reflect when the economic gain was accrued, particularly where substantial capital expenditure has been incurred after acquisition.

Example — capital expenditure before the transition

The distortion created by using only the first element of the cost base can be illustrated by a simple example.

Property A is acquired on 1 July 2007 for $1,000,000. In 2015, the owner undertakes capital improvements costing $2,000,000. As a result, the property's pre-start date cost base at 30 June 2027 is $3,000,000. The property is ultimately sold on 30 June 2037 for $8,000,000.

Property B is also acquired on 1 July 2007 but for $3,000,000. No capital improvements are undertaken. It is sold on 30 June 2037, equally for $8,000,000.

By the transition date, both properties have the same cost base of $3,000,000, the same sale proceeds of $8,000,000, and the same acquisition and disposal dates. Despite this, the method produces materially different outcomes.

	Property A	Property B
Total growth rate (Step 2)	8.000	2.667
Pre-start date capital proceeds (Step 5)	$3,999,000	$5,769,000
Deemed gain to 30 June 2027 (Step 6)	$999,000	$2,769,000
Gain at realisation (Step 9)	$4,001,000	$2,231,000

The amount allocated to the period before 1 July 2027 differs by approximately $1,770,000.

It is difficult to identify a policy basis for this result. The capital improvements made to Property A were made 12 years before the transition date and plainly contributed to the property's value as of 30 June 2027. However, those costs are excluded from the growth calculation in Steps 2 to 5 because only the first element of the cost base is used. At the same time, the improvements are taken into account in Step 6 when calculating the deemed capital gain.

As a result, the methodology can allocate significantly less gain to the period before 1 July 2027 for Property A than for Property B, even though both properties have the same economic value at the transition date and generate the same overall economic gain. The difference arises solely from the way the calculation treats capital expenditure, rather than from any meaningful difference in the underlying economics of the two investments.

Recommendation

The denominator in Step 2, and the multiplicand in subsection 5(5), should be the full pre-start date cost base rather than only its first element, so that the growth calculation and the gain calculation run on the same measure of cost.

Assets with a nil or nominal first element of cost base

A further issue arises for assets with a nil or nominal first element of cost base. Paragraph 5(2)(b) brings within the method any CGT asset that does not have a readily ascertainable market value at the deemed disposal time and whose cost base is not determined by reference to market value. In practice, this category is likely to include many shares in private companies, units in private trusts and business intangibles. For these assets, the first element of cost base is often nominal and bears little or no relationship to the asset's value.

Example — nominal first element and self-generated goodwill

Assume ordinary shares are subscribed for $2 on incorporation of a company on 1 July 1998, and the company is sold on 30 June 2035 for $10,000,000. Under the proposed methodology, the total growth rate is 5,000,000. Applying that growth rate to 10,591 of the 13,513 total ownership days produces pre-start-date capital proceeds of approximately $356,000.

If the company was, in fact, worth $7,000,000 at 30 June 2027, the method would attribute only about 5 per cent of the actual pre-transition gain to the pre-transition period. In effect, almost the entire gain generated by a business built over nearly three decades would be attributed to the post-30 June 2027 period, causing it to fall outside the 50 per cent CGT discount and potentially become subject to the minimum tax.

The position is even more problematic for self-generated goodwill. As self-generated goodwill generally has no cost base, Step 2 requires division by nil and the method cannot be applied. However, self-generated goodwill appears to fall squarely within paragraph 5(2)(b), as it is typically an asset that lacks a readily ascertainable market value and whose cost base is not determined by reference to market value. The instrument does not appear to contain any provision excluding such assets from the operation of the method, or addressing how the calculation is intended to work when the first element of the cost base is nil.

If this issue is not addressed, the simplified apportionment method is unlikely to be a practical alternative to a formal valuation for many private business owners. While the method may technically be available, its outcomes may be so disconnected from the asset's economic reality that taxpayers and advisers would be reluctant to rely on it. This would undermine the apparent objective of providing a lower-cost alternative to obtaining a formal market valuation and delivering a meaningful compliance saving.

Recommendation

The Determination should deal expressly with a nil or nominal first element of cost base, either by excluding those assets from the method, by permitting a substituted starting amount derived from an audited or lodged balance sheet, or by adopting a proportional method that does not depend on a cost base denominator at all.

Guidance on acceptable valuation evidence

The explanatory statement says the ATO plans to provide guidance and tools to help taxpayers use the apportionment method. However, neither the draft Determination nor the explanatory statement explains what evidence the Commissioner will accept if a taxpayer chooses the alternative approach and obtains a market valuation as at 30 June 2027.

Without this guidance, taxpayers and their advisers cannot properly assess the cost, effort, and risk involved in obtaining a valuation, and compare it with the prescribed apportionment method. As a result, the choice provided under subsection 112-155(3) is not yet fully informed.

Recommendation

The ATO should publish guidance, well before 30 June 2027, on the types of valuation evidence it will accept for the deemed disposal. The guidance should reflect differences between asset classes, and recognise that the level of evidence required may vary depending on the size and significance of the holding.

Interaction with the capital works cost base reduction

Step 1 of the apportionment method requires a taxpayer to calculate the cost base and reduced cost base of a CGT asset as at 30 June 2027, taking into account any relevant cost base adjustment rules. This appears to include the existing rule in section 110-45, which reduces a cost base to reflect Division 43 capital works deductions that have been claimed.

We seek confirmation that any Division 43 cost base reduction is intended to be reflected in the pre-start date cost base calculated under Step 1. We also seek clarification on how this reduction is treated in the Step 2 growth rate calculation, as it appears to be based solely on the first element of the cost base. The interaction between these two steps is currently unclear.

Recommendations

Treasury should clarify how the existing cost base adjustment rules apply when using the apportionment method. This should include confirming whether the capital works cost base reduction in section 110-45 is taken into account in Step 1 and explaining how any such reduction affects the growth rate calculation in Step 2. Clear guidance is needed to ensure taxpayers can apply the method consistently and accurately.

Minor drafting observations

The following minor drafting issues do not affect the policy outcome but should be corrected to improve the clarity and readability of the Determination:

- In subsection 5(3), Step 2, the result of dividing the capital proceeds by the cost base is a growth multiple, not a growth rate. Referring to it as the ‘total growth rate’ may cause confusion with the daily rate calculated under subsection 5(4).
- In subsection 5(4), the phrase ‘which maybe a negative amount’ should be corrected to ‘which may be a negative amount’. More importantly, the quotient itself cannot be negative. Where a capital loss is being apportioned, the quotient will be a positive number less than 1.
- In subsection 5(3), Step 4, the note states that the rate ‘will be negative if apportioning a capital loss’. Under the formula as drafted, the daily figure would instead be a positive factor that is less than one, not a negative number.
- In subsection 5(3), Step 6, both ‘pre-start date capital proceeds’ and ‘pre-start-date capital proceeds’ are used. The hyphenation should be made consistent and aligned with the defined term in section 4.

- In subsection 5(3), Step 6, Note 1, the sentence ‘Step 6 is included for the benefit of the reader, it does not seek to affect the ordinary operation of section 104-10’ contains a punctuation error. The comma should be replaced with a full stop or semicolon.
- In subsection 5(3), Step 9, ‘If the result negative’ should be corrected to ‘If the result is negative’.
- In the note to subsection 5(2), the phrase ‘seeks to exclude from the scope of this apportioning method, CGT assets where’ contains an unnecessary comma that should be removed.
- In section 4, the definition of ‘daily growth rate’ is missing a full stop, and the definitions of ‘post-start date reduced cost base’ and ‘pre-start date reduced cost base’ contain an extra space after the dash that is not used elsewhere. Consistent formatting would improve readability.

Negative gearing (tranche 2) — exposure draft amendments and explanatory material

Losses from balancing adjustment events for depreciating assets on revenue account

We seek clarification on how losses arising from a balancing adjustment event for a depreciating asset are intended to interact with the net rental loss quarantining rules in section 26-155 where those losses are recognised on the revenue account.

In particular, it is unclear whether these losses form part of a taxpayer's ‘net rental loss’ from a residential dwelling and are therefore subject to the quarantining rule, or whether they are outside the scope of that regime.

Recommendation

Treasury should clarify whether losses arising from balancing adjustment events for depreciating assets that are recognised on revenue account are included in a taxpayer's ‘net rental loss’ for the purposes of section 26-155, or whether they are excluded from the quarantining rules.

New residential dwelling and negative gearing activity exemptions — exposure draft instrument and explanatory material

Meaning of ‘condemned or derelict’ buildings

The explanatory material to the exposure draft instrument defining a ‘new residential dwelling’ state that the ‘basic case’ in subsection 5(2) can apply where land contains a building that is ‘condemned or derelict’, because such a building is not fit for habitation and therefore is not considered an existing residential dwelling. The example provided involves a derelict building being demolished and replaced with a new house.

However, it is unclear whether demolition of the existing building is required for the basic case to apply. In particular, the draft does not explain whether a severely dilapidated or condemned residential building that is renovated, rather than demolished, could also qualify under the basic case, on the basis that the existing structure did not meet the definition of a dwelling before the works were undertaken.

This distinction is important because subsection 5(8) contains a separate rule governing the conversion of a non-residential building into a residential dwelling. That rule operates differently and includes different requirements, including in relation to the timing of the occupancy certificate. It is therefore unclear which provision is intended to apply where a residential building is so deteriorated that it is no longer fit for habitation, but is retained and renovated rather than demolished.

There is also uncertainty around the meaning of ‘condemned or derelict’. These terms are not defined in the exposure draft, and no objective criteria are provided. As a result, taxpayers may reach different conclusions in similar circumstances.

For example, it is unclear whether a building will be regarded as condemned or derelict only where there is a formal order or notice from a council or other relevant authority declaring it unfit for occupation, or whether the assessment is intended to be based more broadly on the building's physical condition.

Recommendations

- Treasury should clarify whether the ‘basic case’ in subsection 5(2) applies only where a condemned or derelict structure is demolished, or whether it can also apply where such a structure is renovated without demolition.
- Treasury should also provide clear, objective guidance on the meaning of ‘condemned or derelict’, including whether a formal regulatory determination is required or whether the condition of the building is to be assessed on a factual basis.