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Via email: cgt_natural_disasters@treasury.gov.au

The General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Mr Paul McMahon

7 November 2011

Dear Paul

CAPITAL GAINS TAX RELIEF FOR TAXPAYERS AFFECTED BY NATURAL DISASTERS

Thank you for the opportunity to provide feedback on the consultation paper relating to capital gains tax (CGT) relief for taxpayers affected by natural disasters.

About BDO and our involvement in natural disaster relief work

BDO is the fifth largest international accounting network in Australia and the world, and an adviser to a significant number of Australian taxpayers.

In Queensland, BDO was an adviser to the Queensland Reconstruction Authority and the Lockyer Valley Regional Council in the aftermath of the January 2011 floods. In that capacity we were involved in negotiations with the Australian Taxation Office in relation to the application of the existing CGT rollovers to the Lockyer Valley Regional Council Grantham land swap program.

As a result of that involvement we are ideally positioned to comment on the proposals outlined in the consultation paper.

Our feedback

We agree with and fully support the broad thrust of the proposals outlined in the consultation paper. The proposals when enacted will significantly simplify the application of the CGT provisions to those adversely affected by natural disasters generally, and particularly those who are eligible to participate in asset swap programs. This will have the further effect of not putting unnecessary emotional stress on those who are already stressed because of the natural disaster itself.

Other than as noted below in relation to the cost base considerations, we consider that the proposals outlined are appropriate and effective to achieve their goals.

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Specific cost base matters

We consider that the rollover proposed in section 2.1 is appropriate. However, in relation to the cost base of the replacement asset we consider that it would be more appropriate, and more in keeping with the general replacement asset rollover provisions, to allow taxpayers to choose that the cost based (and reduced cost base) of the replacement asset was either:

- The cost base (and reduced cost base) of their original asset (and therefore the taxpayer should not disregard CGT Event C1 under the proposal in section 2.3); or
- The market value of the replacement asset.

This will therefore allow taxpayers to make a decision for emotional reasons to abandon a property that they (or their tenants) do not wish to return to, without being penalised in circumstances where the market value of the replacement asset is less than the cost base of their original property. Taxpayers who cannot or do not want to access their cost base records can still choose to utilise the market value cost base provision if this is simpler or less emotionally draining in the circumstances.

Further improvement to the law

Although not directly relevant to the question addressed by the proposals paper, we note that the application of the cost base apportionment rules in section 112-30 can lead to some incongruities where a composite asset is partly destroyed (eg the buildings on post-CGT land).

The effect of the provisions where there are no capital proceeds for the destruction of part of the asset (eg because the buildings are uninsured) is that unless section 112-30(5) can be accessed by the taxpayer no part of the cost base of the whole asset will be apportioned to the destroyed buildings. This seems to be an anomalous outcome in so far as the partial disposal is by way of involuntary loss or destruction. In our view, an appropriate amendment should be considered.

The following hypothetical example illustrates the potential impact of the proposals as currently drafted, and our proposed changes.

Laurence acquired an investment property in 2008 for \$500,000. The property consisted of the land and a house built on the land. Due to flooding, the house was destroyed. Laurence had not insured the property against the type of flooding experienced, and his insurance company refused to make an ex-gratia payment. His land is considered to be worth \$50,000 after the flooding event. He participates in a Government land swap and receives land valued at \$200,000.

Under the proposals, were he to participate in a land swap deal and choose the rollover, the cost base of his new property would be the market value of the land received (\$200,000). The cost base of the old house and land will never be recognised either as a capital loss or as cost base of the new property.

Under the existing law, if he does not choose the rollover he has a capital loss of \$300,000 on the old property (being the difference between the value of land received and the cost base of the old property) and a cost base of \$50,000 in his new land (being the value of the old property given up to receive the new land). Were he not to participate in the land swap, he would not realise a capital loss under CGT Event C1 for the destruction of the old house due to the lack of capital proceeds and the cost base apportionment rules in section 112-30. Any capital loss would be deferred until he was able to dispose of the old property.

Under our amended proposals, if he chooses to retain his cost base (and the cost base apportionment rules are changed) then Laurence will have a capital loss for that part of the \$500,000 apportioned to the original house and will retain the balance as the cost base of the new property.

Contact

Should you have any queries in relation to the above, please do not hesitate to contact me on (07) 3237 5848 or mark.molesworth@bdo.com.au

Yours faithfully

BDO (QLD) Pty Ltd

A handwritten signature in black ink that reads 'Mark Molesworth'.

Mark Molesworth
Director