The CGT exemption for land adjacent to a home

The rules surrounding the circumstances in which a home will be fully exempt from capital gains tax (CGT) are quite extensive – and complex.

One crucial one is that the exemption is only available for a home and *"adjacent land to the extent that the land was used primarily for private or domestic purposes in association with the dwelling."*

There are some key things to know about this adjacent land requirement.

Firstly, it only applies where the adjacent land is no greater than two hectares – but excluding the land immediately under the home. And two hectares is roughly the old five acre block – and it is pretty big, being 20,000 square metres ie, 200 metres by 100 metres. (Step it out around your neighbourhood and you will see how big.)

Of course, there would be few homes in major metropolitan cities that would approach this block size – albeit it may be an issue for homes on the rural outskirts of such cities.

In the case where adjacent land exceeds two hectares, a full CGT exemption on the sale of the home is not available and some sort of partial capital gain arises on a pro-rata or valuation method. And the ATO is quite generous on how this can be calculated.

Secondly, the adjacent land must be *"used primarily for private or domestic purposes in association with the dwelling"*. This would include where a granny flat is erected on the adjacent land and a child, a relative or other person lives in it rent-free (or only pays outgoings – and not arm's length or commercial rent).

Likewise, it would include where adjacent land has other structures on the land such as a large shed, a pool and cabana, a tennis court – provided again that the land and these structures on it are *"used primarily for private or domestic purposes in association with the dwelling"*.

But what constitutes *"primarily for private or domestic purposes..."*?

The ATO has a ruling on this issue which broadly provides that "primarily" requires a judgment as to time (and/or area) of land that the land was so used.

So, if for example a home that was owned for 30 years originally had a shed on a small part of it in which the owner carried on a small "shed" activity for a year, it should be possible to conclude that the land was used "primarily" for private or domestic purposes.

But otherwise, only a partial CGT main residence exemption is available to the extent that the adjacent land was not so *"used primarily for private or domestic purposes in association with the dwelling"*.

Thirdly, the adjacent land need not be immediately surrounding the home. It could for example, include vacant land on a separate title across the road or next door (or such land that has a dwelling or other building on it) – as long as it is *"used primarily for private or domestic purposes in association with the dwelling."*

However, the further the distance between the relevant land and the land on which your home is situated the less likely it is that the relevant land is "adjacent" land.

Finally, and importantly, if you sell (or gift or transfer) any part of adjacent land separately from the whole of your home and adjacent land (eg, on its subdivision) then no CGT main residence exemption is available for any capital gain or loss you make on this transaction. And this is because the exemption applies to the home in totality – which includes all of the adjacent land.

This issue also arises in relation to dual occupancy arrangement where the new dual occupancy dwelling may be sold separately from the original home. However, the ATO has detailed guidelines on how the CGT rules apply in these circumstances.

If any of these scenarios apply to you come and get some advice from us – if only for peace of mind's sake.