BRIEFINGS

WATERHOUSE
CHARTERED ACCOUNTANTS

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Capital Gains and Property: Top Questions and Answers

The thought of the Australian Taxation Office (ATO) sharing up to 50% of any gain you make on an investment decision is enough to strike fear into the hearts of most people.

Given Australia's love affair with property, it is little wonder that we are often asked about the impact of capital gains tax (CGT) on property. This month, we explore the most frequently asked questions.

In general, CGT applies to any change of ownership of a CGT asset unless the asset was acquired before 20 September 1985 when the CGT rules first came into effect.

Most questions about CGT on property are based on the main residence exemption that exempts your home (your main residence) from any CGT exposure when you sell the property.

"I jointly own an investment rental property with my elderly mother. Neither of us has ever lived in the property. We've recently updated our wills. The lawyer says that if Mum's will gifts her half of the property to me then this 'gift' will not attract capital gains tax. Is this correct?"

If you inherit your mother's share of the property, there would generally be no tax liability until you sell the property. What is important here is how the CGT is calculated when you ultimately sell.

When the rental property transfers to you from your mother's estate, the tax rules determine how CGT is calculated when you eventually sell. Basically, if the property was bought on or after 20 September 1985 then when you sell the property your taxable profit will be based on the original purchase price. That is, you will end up being taxed on the increase in value of the property since it was acquired, including the portion that accrued while your mother was still alive.

In general, if you jointly own an investment property, your individual exposure to CGT will depend on how the property is owned. If the property is held as tenants in common then any CGT exposure is in line with your ownership interest. For example, in your case, it is 50% owned by your mother and 50% by you, but different people can own different ownership interests. If the property is owned as joint tenants then any CGT exposure is equally shared by the owners.

"I bought a house in 2000 and lived in it until 2003. I was posted overseas with my job between 2003 and 2011. During that time my brother lived in the house rent-free – he just paid for utilities. In 2011 to 2012, I rented the house out (to no-one I knew). I moved back into the property in 2012 and have just sold the house. Do I have to pay capital gains tax on the property?"

The CGT rules are more understanding about how people live their lives than other laws, and in some circumstances allow you to continue to treat your home as your main residence even if you are not actually living in it.

While you are away overseas, if you leave the property vacant or let a friend or relative live in the property rent-free, assuming you do not claim any other property as your main residence, then you can continue to treat the property as your main residence for CGT purposes indefinitely.

If you rent the property out while you are away, the tax laws allow you to still claim the property as your main residence as long as the period you rent it for is not more than a total of six years. This six year period can actually be reset by moving back into the property again.

Effectively, you can move out and move back in as many times as you like and still claim the property as your main residence as long as it is your only main residence during that time, and if you are renting it out and you do not rent it out for more than a total of six years across the period you are claiming the property as your main residence.

During the rental period you can also claim deductions against the rent, even though the property might still be exempt from CGT during this period.

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"I bought a property in 2008 and expected to move in straight away, but the tenants still had eight months to go on their lease. I waited for the lease to expire and then moved in. I have lived there ever since and plan to sell later this year. Can you just confirm that I would still qualify for a full CGT exemption on the sale as the property has significantly increased in value?"

This is a very common situation, but is probably overlooked much of the time. Unfortunately, you would not qualify for a full exemption in this case.

The main residence rules allow you to treat a property as if it has been your main residence since settlement date as long as you actually move into the property as soon as practicable after settlement. This is intended to cover situations where there is some delay in moving into the property due to illness or some other "reasonable cause". The ATO's view is that this rule cannot apply if you are waiting for existing tenants to vacate the property.

This means that you would only qualify for a partial exemption under the main residence rules. We will need to calculate your gross capital gain and then apportion it to reflect the period of time when it was actually your main residence (i.e. from when you actually moved in).

As long as you are a resident of Australia and have owned the property for more than 12 months we can also apply the 50% CGT discount to reduce the leftover capital gain.

It will be important in this case to gather as much evidence as possible of non-deductible costs that you have paid in relation to the property such as stamp duty, legal fees, commission paid to real estate agents, interest, rates, insurance, etc. This will help to reduce the gross capital gain that is subject to tax.

Bad Deeds: Is Your SMSF at Risk?

Your self-managed superannuation fund's (SMSF's) trust deed is its rule book. If the deed does not allow or recognise something then the trustees cannot do it.

Despite this, a lot of trustees are unaware of what their trust deed says – it was just something that was required when the fund was established. The problem with any document is that unless you amend it, it is only current for the circumstances that existed at that time. However, the law changes regularly and so do individual circumstances.

This month, we shortcut the review process and highlight the key SMSF trust deed problem areas.

Trust Deed does not Allow the Types of Payments being Made

A common audit issue is SMSF's paying pensions and other payments to members that are not allowed by the trust deed. The assumption is that because the superannuation laws allow that type of payment then it must be okay.

However, if your deed does not allow the types of payments your fund is making then you are breaching your deed. Check the deed detail well before you anticipate the fund needing to make payments. This is particularly important for deeds created before 1 July 2007 when the superannuation laws on pension payments changed significantly.

Trust Deed does not Recognise Life Changes and Estate Planning Needs

There are several aspects of an SMSF deed that have a direct impact if you die or your circumstances change:

- Does your deed allow you to nominate who will receive your super if you die? Some deeds do not allow for binding death nominations. In some cases the remaining trustees decide who gets your super.
- If you have death nominations in place, is the wording consistent with the requirements of the trust deed.
- Who has the power to add or remove trustees? There are a lot of court cases around this with children excluded from a parent's super by a new spouse or vice versa.
- When does someone become a member or stop being a member? Some deeds will automatically remove members with a nil balance.

Flexibility and Control

Does your deed allow the use of reserves or other strategies that your accountant may recommend at year end to minimise tax? Some deeds do not allow for effective tax planning strategies.

myGov – ATO Link

The Government is encouraging Australians to establish myGov accounts to allow online access to Government information such as Medicare, Centrelink and the ATO.

Please be aware that if you link your myGov account to the ATO, all future ATO assessments and correspondence will go to your myGov account and not to us as your tax agent meaning we can no longer be responsible for checking and advising you of assessments, instalment notices, etc. and we cannot be held responsible for any penalties or interest charges that may be incurred. Also, in some instances linking has meant clients have been removed (by the ATO) from our tax lodgement list.

We recommend you do not link your myGov account to the ATO. However, if you choose to do so, please advise us by email and ensure you check your account on a regular basis.

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