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Accounting • Taxation • Business Services

About Tax

A FRIENDLY TAX NEWSLETTER FROM MANU GUPTA

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IN THIS EDITION

PLANNING POINT

ALL ABOUT CAPITAL GAINS TAX (CGT)

Simply stated, Capital Gains Tax or CGT is a tax on realisation of appreciation in value of an asset. Common examples of assets are real estate, shares and other investment products, boats etc. Certain assets like your principal home, private use motor vehicle, furniture and personal affects are expressly exempt. Believe it or not, Australian tax system started taxing capital gains only from 20th September 1985. Some countries, including our neighbour, New Zealand still do not tax capital gains. But wait, before you book the next available flight to NZ and buy a property, it is important for you to know that as an Australian Resident (for tax purposes) you are liable to pay tax on all capital gains you make anywhere in the world.

TIP! If you own an asset prior to 20th September 1985, in most circumstances, you wouldn't need to pay any CGT. This applies to overseas assets as well.

TIP! A non-resident or a temporary resident is exempt from CGT on certain 'non-Australian real property gains'. This includes students and NZ citizens settled in Australia who are on temporary residency visa.

The following are some common scenarios of Capital Gains Tax illustrated in a Q&A form to help explain the concept in a simpler and concise form;

Q: I have sold some CBA shares at a gain of $20 each. Does CGT apply?

A: Yes, your $20 capital gain would be subject to CGT. However if you have owned these shares for more than 12 months you may be eligible for 50% discount in capital gains earned. As such you may be required to pay CGT on $10 per share. Similar outcome may apply to an investment property, options, futures and other derivative products. CFDs however are usually treated as ordinary income.

Q: How much capital gains tax do I need to pay?

A: After applying various discounts and concessions, whatever capital gains you have earned is added to your other sources of income and taxed at marginal rate of tax. Thus if you have earned a net capital gain of $10,000 on top of your other sources of income of $65,000 your marginal rate that applies to capital gains is 31.5% (please refer to marginal tax rates for the year).

Q: I have had losses in my share investments. Can I claim these losses against my other income and get a refund?

A: Sadly No. Capital Losses can only be claimed against current or future capital gains. Till they are fully consumed, they stay in your return as a carried forward capital loss. Tax outcome might be different if you are a share trader, instead of a share investor. In this scenario your income and loss are treated on revenue account and you would be allowed to claim your share trading loss against other income. However you would not be eligible for CGT concessions. Whether you are an investor or a trader depends on your intention and actual trading behaviour.

Q: We have been claiming depreciation and capital works deduction on our investment property. Will that be added back into capital gains when we sell it?

A: Effectively your depreciation claim reduces the cost of your purchase value of your property. So if you had purchased a property for $400,000 and claimed $50,000 as depreciation on the property, your cost of purchase for tax purposes is treated as $350,000. If you then sell this property for $500,000 your taxable gain is $150,000 and not $100,000 (this is a very simplistic presentation of a fairly complicated treatment of this subject).

Q: My husband and I want to sell our main residence in which we have lived ever since purchase. We estimate to make capital gains of $100,000. Would this be taxed?

A: Principal place of residence are expressly exempt from CGT.

Q: If we instead convert our home into investment property for a few years, would the outcome change?

A: Yes, you would then have to ordinarily pay CGT on increase in value of your property from the day it converts into income producing till the day you sell it. It might be a good idea to get a market valuation on your property before you move out and convert it into investment.

TIP! You may be able to convert your main residence into investment and not pay any CGT for up to 6 years from the date of moving out. What's more, before the 6 years end, you could move back in and out and have another 6 years of CGT Free period.

Q: When we purchased our main residence, it was on a lease from vendor. As such we had to give them a few weeks' notice to vacate before we could move in. Can we claim main residence exemption on the property?

A: You need to move into your residence as soon as practical after purchase to claim full main residence exemption. Sadly courts have decided that the fact that there was a tenant prior to your purchase does not allow this concession. As such, your capital gain would be subject to CGT on proportionate basis for the period your residence was leased out prior to moving in. This outcome is the total opposite of putting the property on rent after you have made your house your main residence and then moved out.

Q: I use part of my home as my business office and claim its running and ownership cost, including mortgage, to that extent. How much capital gains will I have to pay?

A: You may be liable to pay CGT on capital gains earned, in proportion to the extent and portion of time to which the property was used for income producing. In simpler terms, if 20% of your property was used as your office for 50% of its ownership period, you would be required to pay tax on 20% x 50% = 10% of the gain made.

TIP! You may be eligible for further CGT discounts and concessions in the legislation including 50% CGT discount and Small Business CGT Concessions, possibly reducing capital gains tax to NIL! Not a bad outcome, is it?

TIP! CGT on your residence used as your office does not depend on whether you claim a portion of its mortgage interest in tax, rather on whether you were 'eligible' to claim. So even if you give away your tax benefits, you may still be subject to CGT at sale!

Q: I moved to Australia permanently in 2000. Prior to that I had purchased a property overseas. Now I want to sell it. Will I be subject to CGT? If I don't bring the money into Australia, would that save me from paying any CGT?

A: As a resident of Australia for tax purposes, you are liable to pay CGT on any capital gains made by you on any asset held anywhere in the world. However, you may be eligible for a credit for tax paid on such gain overseas against your Australian tax liability. Whether you bring the money into Australia or not, you are still liable to pay tax in Australia on any Capital Gains earned overseas. This however may be subject to some concessions based on the 'Double Tax Agreement' between Australia and your home country.

TIP! Your cost base of such overseas property is not the price you paid for it, but the market value of the property on the date you became a tax resident of Australia. Further you may be eligible for the 6 year principal place of residence exemption and other concessions, similar to what would apply to an Australian property.

Q: I have sold my franchise business at a gain of $200,000. How will CGT impact this sale?

A: Sale of business can be tricky. Portion of sale price applicable to stock and equipment does not fall under CGT and any difference is ordinary income or loss. CGT is compared on capital assets like Goodwill, Licenses and Real Estate. So your sale price and purchase price will need to be apportioned into various categories and then CGT will apply to only the gain made on capital assets.

TIP! For small businesses, there are quite extensive CGT concessions available under Small Business Capital Gains Concessions of Division 152 of ITAA 1997. Potentially they may apply to your sale to reduce the taxable gain to NIL.

Q: I have heard that we can now sell our property to our SMSF and even borrow in the fund to hold the asset. Are there any CGT advantages in doing so?

A: The in-house asset rules of SIS Act prohibit a SMSF from purchasing assets from its members or their associates. Two of the key exemptions to this rule are Listed Securities and 'Business Use' property. As such your commercial property or residential property used for business can potentially be sold to your SMSF and it can borrow money to pay you for it. The advantages of holding an asset in SMSF are; asset protection, concessional Income Tax of 15% & CGT of 10% prior to pension phase and NIL Tax in pension phase.

TIP! If you are concerned about paying a huge CGT on sale of your property to your SMSF, there is a possibility you may be eligible for Small Business CGT Concessions, possibly reducing CGT to NIL. Further there are recent changes to NSW Stamp Duty provisions which could potentially reduce the applicable stamp duty to only $50. Similar Stamp Duty provisions may apply in other states too.