WELCOME

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CAPITAL GAINS TAX

21 February 2018

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Session Overview

- **What is Capital Gains Tax (CGT)?**
  - Basic Concepts
- **Sale of Holiday Home**
- **Main Residence Exemption (MRE)**
- **Effect of Death**
- **Other CGT Concessions**
- **CGT and your Superannuation Fund**
- **Superannuation Contributions on Downsizing the Family Home**
- **WGC Role and Questions**

What is Capital Gains Tax?

- The CGT regime commenced operation on 20 September 1985
- Assets acquired prior to 20 September 1985 are referred to as pre-CGT assets - gains are disregarded
- CGT is not a separate tax. Once calculated, the gain is included in the taxpayer's taxable income and taxed at marginal tax rates
- Capital losses can only reduce capital gains but can be carried forward indefinitely
- CGT taxes gains made on the disposal of assets held on capital account

What Is Capital?

The Tree & Fruit Analogy

- **The Tree is the underlying asset (the capital) used to generate income.**

- **The Apple is the "Fruit" - the income derived from the tree.**

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What Is Capital?

- Capital assets are taxed under the CGT regime including:
  - Shares
  - Real Estate etc

- Income derived from the capital assets are taxed under the income provisions including:
  - Dividends
  - Rent etc

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Assets subject to CGT include:

- Real Estate
- Shares in a Company or units in a Trust
- Leases
- Rights
- Goodwill or other intangible assets
- Collectables* (acquired for more than $500)
  - Including Artwork, Stamps, Antiques & Jewellery
- Personal Use Assets* (Acquired for more than $10,000)
  - Boats, Furniture, Electrical Goods & Household items
- Foreign Currency
- Cryptocurrency (Held for personal use, trading or capital investment)

What is Exempt from CGT

1. **Certain Assets - e.g.**
   - **Motor Vehicles**
   - **Trading Stock**
   - **Collectables* (Acquired for less than $500)**
   - **Personal Use Assets* (Acquired for less than $10,000)**
   - **Assets subject to the depreciating rules**
2. **Certain Transactions - e.g.**
   - **Compensation for personal injury**
3. **Gains that have been taxed under another taxing provision**
4. **Gains subject to small business relief**

Remember, not all gains are subject to CGT - some gains can be discounted and some gains are completely exempt

Basic Concepts

For most CGT Events

Gross Capital Gain = is the difference between your capital proceeds and the cost base of your CGT asset

Capital Loss = is when the cost of your CGT asset exceeds the capital proceeds

- CGT is only payable when there is a CGT event
- The most common CGT event is a change of ownership by way of:
  - Sale by contract
  - Transfer to a related or third party
- The timing of the CGT event is generally the contract signing date

What if I'm not a Tax Resident?

The CGT regime applies quite differently if you are not an Australian Resident

- Foreign & Temporary residents are only subject to CGT if the asset is Taxable Australian Real Property (TARP - e.g. real estate)
- If you then become an Australian Resident, you are taken to acquire your non-TARP assets for market value at that time (becoming subject CGT)
- If you cease to be an Australian Resident you can either choose to:
  - Pay CGT on a deemed disposal of your Non-TARP assets for market value at the time of the residency change

    OR
  - Pay CGT on the eventual sale of the asset considering the whole period of ownership

How to Calculate CGT

Capital Proceeds > Cost Base	Capital Proceeds < Cost Base
Capital Proceeds	Capital Proceeds
(Less): Cost Base	(Less): Reduced Cost Base
= Gross Capital Gain	= Gross Capital Loss
(Less): 50% General Discount* (Assets held by an individual and some trusts for more than 12 months only)	
(Less): Small Business Concessions	
= Net Capital Gain	

- **Net Capital Loss cannot reduce a taxpayer's taxable income**
- **Capital Losses are carried forward for future years and are available to offset against future Capital Gains**

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How to Calculate CGT

- **Capital Proceeds -** amount of money received or the market value of the CGT Asset (non-arms length transactions)
- **Cost Base -** is effectively what the asset cost, including the following elements:
  1. Purchase Price
  2. Any Incidental Costs in acquiring the Asset
  3. Ownership Costs **
  4. Costs associated with increasing or preserving its value
  5. Costs to establish, preserve or defend your ownership or rights to it

** **Applies to Assets acquired after 20 August 1991 and includes costs of holding assets (e.g. interest, rates etc) that have not been claimed as a tax deduction**

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Basic Concepts

What if you transfer assets to a relative for $nil consideration or for less than Market Value?

Market Value Substitution Rule

- Where parties to the transaction are not dealing at arm's length
  - For the Vendor - the proceeds are deemed to equal the asset's Market Value
  - For the Purchaser - the cost base is deemed to equal the asset's Market Value

Market Value - conceptually an amount that a willing buyer and a willing seller would exchange on a given day in an arms length transaction

Sale of the Holiday Home

Facts

1. Acquired Lorne Property - 30 June 2010 — $ 600,000
2. Property only used for private holiday use
   - Rates, Land Tax and Insurance are $3,000 p.a. x 7 years
3. Property auctioned 30 June 2017 (Settled 1 Oct 2017) — $ 950,000
4. Selling Costs — $ 15,000

Taxable Gain

Proceeds on sale property		$ 950,000	
Less: Cost Base			
Purchase Price	$ 600,000		
Ownership Costs **	$ 21,000		
Selling Costs	$ 15,000	$ 636,000	
Gross Capital Gain		$ 314,000	
Less: 50% General Discount		$(157,000)	*Asset held for >12 months
Taxable Capital Gain		$ 157,000	

(included in owner's Taxable Income in the 2017 tax year - disposal is 30 June 2017)

** Record keeping for ownership costs is vital

Sale of Main Residence - Full Exemption

- **A Capital Gain or Loss you derive from the disposal of your Main Residence (dwelling) is disregarded for CGT purposes on the following conditions:-**
  - You are an individual taxpayer; and
  - It was your Main Residence throughout your ownership period; and
  - The ownership interest did not pass to you as a beneficiary or you did not acquire it from a deceased estate (special rules apply)

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Concept of Main Residence

- **Factors to consider whether your dwelling is considered to be your Main Residence:**
  - You reside at this address
  - You have personal belongings at this address
  - Utilities are connected in your name
  - Your mail is delivered to this address
  - It is listed as your address on the Electoral Roll

In the case of building, repairing or renovating, the Act requires you to move in as soon as practicable and maintain residency for at least 3 months – which is an occupancy period the ATO uses as a rule of thumb to establish main residency in most cases.

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Sale of Main Residence

- **Full main residence exemption (MRE) may not apply if:**
  - It was only your main residence during part of your ownership period; or used for income purposes (e.g. rent)
  - If you rent out your main residence - you can retain MRE status for up to 6 years if you have no other main residence (no time limit for this absent rule if not rented)
  - MRE can still apply if you are overseas but a foreign resident can no longer avail themselves of this exemption for a residence situated in Australia

A dwelling must be present to claim MRE - extends to 2 hectares of private adjacent land. MRE doesn't apply to a vacant block, although can apply to land if you build your Main Residence within 4 years of acquisition

Sale of Main Residence - Partial Exemption

- You buy a new Main Residence and rent out the old property - you get an uplift in the cost base to market value at the time the property is first rented
- Property maintained as your Main Residence for only part of the ownership period - claim a partial exemption on the gain based on the number of days it was held as your Main Residence
- Multiple homes - you can choose the number of days you wish to treat a particular property as your Main Residence
- A couple can only maintain one Main Residence - you have a 6 months overlap for full MRE when buying & selling homes or becoming a couple (then you must make a choice)

- MRE can be affected if you use your home for business purposes (other than home office use)

Effect of Death

CGT Basics on Death

- A capital gain or loss from a CGT event for a CGT Asset you owned just before dying is disregarded
- CGT assets you owned prior to death will:
  - First passes to your Legal Personal Representative (LPR) (the Executor) during administration; then
  - Passes to a beneficiary of your Estate; and/or
  - Passes to a Testamentary Trust as named in the Will
  - May further pass from the Testamentary Trust to a Beneficiary
- The LPR is taken to acquire the asset on the date of death, which is the same acquisition date for the beneficiary when it passes to them, even if via a Testamentary Trust
- The cost base of the asset acquired by the LPR is either:
  - The asset's Market Value if the deceased acquired it prior to 20 Sept 1985; or
  - The deceased cost base for the asset if acquired post 19 Sept 1985

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1. Sale of Assets by Executor

Sale of asset by LPR of Deceased

Asset owned by Deceased but sold by Executor = subject to CGT on the difference between the Proceeds and the Cost Base as per the Table below

Date Asset acquired by the Deceased	Date of Acquisition	CGT Cost Base to LPR/Beneficiary
Pre - CGT (Pre 20 Sept 1985)	**Date of Death**	**Market Value at Date of Death** (Starts the CGT clock)
Post - CGT (Post 19 Sept 1985)	**Date of Death**	**The Deceased's Cost Base or Reduced Cost Base** (Effectively stand in the shoes of the deceased)

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2. Passing Assets to Beneficiaries

LPR of the Deceased passes to either

Beneficiaries Direct

OR

to a TESTAMENTARY TRUST

Then

To Beneficiaries

All gains and losses on passing the deceased's Assets to the Beneficiaries are disregarded

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Deceased's Main Residence

- **A full MRE may be available where the Executor or Beneficiary disposes of the deceased's Main Residence within 2 years of the deceased's death**

Deceased Asset	Timing of Sale	Exemption	CGT Exposure
Pre - CGT	Sold within 2 years	Full Exemption	Disregarded
Post - CGT	Sold within 2 years	Full Exemption (not used to produce income at time of death)	Disregarded
Post - CGT	Sold after 2 years *	Partial Exemption	Pro-rated gain based on the number Main Residence days over the ownership period

* A full MRE may also apply to property that was the Main Residence of a deceased and also became the Main Residence of either the deceased's spouse, a person with a right to occupy or a beneficiary under the terms of the will from the date of death to the time of sale.

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Other CGT concessions

Small Business Concessions

- Provides Small Business owners some or full relief from CGT on business assets where certain conditions are met
- A Capital Gain on the sale of qualifying assets used in a business can be either reduced, deferred or fully disregarded.

- **Basic conditions for eligibility include:**

- A gain is made on the disposal of an asset that is actively used in your business or that of your affiliate or connected entity; and
- You're a small business (aggregated turnover of <$2M p.a)
  OR
- You and your connected entities have <$6M of CGT Assets (excluding personal use assets, super and main residence)

Small Business Concessions include:

- **15 Year Exemption -** Disregard an eligible capital gain arising from a CGT asset actively used in the business that is owned for at least 15 years and sold in connection to a CGT concession stakeholder's retirement
- **50% Reduction -** Reduce an eligible capital gain by a further 50% if the CGT asset was owned as an active business asset.
- **Retirement Exemption -** Choose to disregard all or part of an eligible capital gain up to a lifetime limit of $500,000 per person (if under 55, the amount to be disregarded must be paid to a superannuation fund)
- **Rollover -** Defer all or part of an eligible capital gain by reducing the cost base of a replacement business asset

Other rollover relief provisions can apply if assets are transferred or replaced as part of a restructuring of your financial affairs

CGT & your Superannuation Fund

- CGT is the primary taxing code for profits made from assets owned by an SMSF
- Capital Gains and Losses from assets supporting members accounts in pension mode are disregarded (or partially exempt if subject to an actuary exempt %)
- SMSF's enjoy a 1/3rd General Discount for assets held for more than 12 months (rather than 50% for individuals & some trusts)
- A member's account moving from accumulation mode to pension mode is not a CGT event

Self-Managed Superfunds

Effect of Member's Death

- CGT is not triggered on the death of an SMSF Member - although assets sold to fund the payout of a death benefit will be caught by the CGT rules (Subject to applicable pension exemption %)
- The pension exemption % applicable to a deceased Member's Account will continue after the death of the pensioner if the death benefit is paid out within a reasonable timeframe (Should apply to reduce CGT exposure on the sale of Assets)
- The use of reversionary pensions or payment of death benefits as an income stream to the spouse will effectively defer the requirement to withdraw benefits from the Fund at the time of death (Subject to the spouse's available transfer balance cap)
- Recent changes restricting member's pension balances to $1.6M at 30 June 2017 did provide a form of CGT relief - being unrealised gains at 30 June 2017 were effectively triggered at the existing pension exemption % before the necessary rollback to accumulation

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Superannuation Contributions on Downsizing the Family Home

- First Home Super Saver Scheme was enacted on 13 December 2017
- Applying to contracts signed after 1 July 2018, Australians aged 65 years or older will be able to make a non-concessional contribution of up to $300,000 into their Superannuation Fund from the proceeds of their family home if they owned the property for at least 10 years.
- The property sold must be the taxpayer's Main Residence or their spouse – no requirement to purchase another dwelling
- This contribution is in addition to the existing Contribution Caps and there is no work test requirement

- Need to consider the impact of downsizing on any social security entitlements
- Consider the reverse mortgage concept as an alternative?

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WGC Role

- Record Keeping is vital to ensure you have accurate details regarding the asset's cost and dates of acquisition & disposal
- Key information should be stored carefully and be available either in the event of the disposal of the asset or be passed to beneficiaries after a taxpayer's death
- Remember to take a holistic approach when reviewing your financial affairs. Income tax, including CGT, may only be one of the tax imposts. You should also consider other State and Federal Taxes, including GST, stamp duty, land tax and the like.

WGC is well placed to advise you on the CGT ramifications when acquiring and disposing of an asset, how to maximise discounts and exemptions available under the law and to assist you with maintaining accurate CGT Registers

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QUESTIONS?

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