CGT Aspects of owning and selling Real Property

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November 2018
CGT Overview

A capital gain generally arise on happening of CGT event if taxpayer receives amounts from the CGT event which exceed taxpayer's costs associated with that event.

CGT Events:
- A1 – disposal / E1 and E2 if property transferred to trust
- C1; C2 – loss, destruction, expiry, surrender
- D2; granting option
- F1; granting lease - lease premium
- H1; forfeited deposit
- H2; Catch-all CGT event

Conversely, capital loss arises if taxpayer's costs associated with CGT event exceed amounts received from it.

CGT Overview

- Capital gains made on or after 21 September 1999 may be discounted by 50%
- Discount generally only applies if the asset has been held for at least 12 months.
- No discount is allowed for companies (whether resident or non-resident)
- Net capital gains are included in assessable income
- Net capital loss can only reduce capital gains
**CGT Assets**

**Buildings and structures**
- Post-CGT building or structure is treated as separate CGT asset from land if a balancing adjustment can apply to building or structure.
- Buildings and structures subject only to capital works deduction are not separate assets from land.
- Building or structure constructed on Pre-CGT land is treated as separate CGT asset from the land if construction contract was entered into post-CGT.

**Adjacent land**
- Post-CGT land adjacent to pre-CGT land is treated as a separate CGT asset from pre-CGT land if both are amalgamated into one title.
- If pre-CGT land owned by two tenants in common, a buy-out by one of the parties will result in that party owning two assets:
  (i) a pre-CGT interest in the land; and
  (ii) a post-CGT interest.
CGT Assets

Capital improvements

- Capital improvements to land treated as separate CGT asset if a balancing adjustment applies
- Capital improvement to pre-CGT asset is also separate CGT asset if its cost base is:
  (i) more than improvement threshold for the income year in which event happened; and
  (ii) more than 5% of capital proceeds from event

CGT Assets

Capital improvements

- If a person makes a post-CGT improvement to a pre-CGT asset and it is transferred to a spouse on marriage breakdown, CGT roll-over applies
- However, if improvement exceed threshold and 5% of capital proceeds, then, for any subsequent disposal by the spouse, original pre-CGT asset and the post-CGT improvement retain their status as such in the spouse's hands
CGT Assets

**Capital improvements**

- Improvement not separate CGT asset if from a pre-CGT contract or had pre-CGT start date

- Improvements of pre-CGT asset are not separate CGT assets if there is CGT roll-over due to asset compulsorily acquired, lost or destroyed.

- If taxpayer makes a post-CGT improvement to a pre-CGT asset which is inherited by beneficiary, improvement and asset are treated as one asset

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**Cost base of assets**

The *first element* is the total of:

- the money paid, or required to be paid, in respect of acquiring the CGT asset, and

- the market value of any other property given, or required to be given, in respect of acquiring the CGT asset (s 110-25(2)).
Cost base of assets

The *second element* consists of various specified incidental costs incurred by the taxpayer (s 110-25(3)).

Cost base of assets

The *third element* is the costs of owning an asset (but only if the asset was acquired after 20 August 1991) (s 110-25(4)).
The *fourth element* is capital expenditure incurred to increase or preserve the value of the CGT asset (s 110-25(5)). The fourth element includes capital expenditure that relates to installing or moving the asset.

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The *fifth element* is capital expenditure incurred to establish, preserve or defend the taxpayer's title to the asset (s 110-25(6)).

An amount of damages paid by a taxpayer to a potential purchaser upon the acceptance of the termination of contract to sell the asset following repudiation of the contract by the taxpayer may be included in the fifth element of the cost base of that asset (ID 2008/147).
Cost base of assets

Expenditure does not form part of cost base if:

- it relates to illegal activities
- it is a bribe to public official or foreign official
- it is in respect of entertainment
- it is a penalty that is excluded from deduction
- It is for political contributions and gifts

CGT exemptions for real property

- **Main residence exemption**
  - Establishment of main residence required – period of occupancy
  - Capital gain disregarded relevant to main residence period of ownership
  - Six-year absence rule if no other main residence is required
  - **Main residence exemption available for non-resident if Australian dwelling established as main residence.**
CGT roll-overs applicable to real property

- Compulsory acquisition – application to land / structures adjacent to main residence – exemption available – also applicable to foreign residents

- Marriage breakdown – same asset roll-over - also applicable to foreign residents

Specific CGT treatment for foreign residents - Overview

Non-residents only incur CGT on TAP:

- Interest in real estate located in Australia

- interest in an entity of 10% or more which is principally (> 50%) attributable to Australian real estate

- asset used in carrying on business through a PE

- option or right to acquire one of the above

- Note – no CGT discount for non-residents from 8 May 2012
Specific CGT treatment for foreign residents

- From 8 May 2012, foreign or temporary resident individuals must meet certain eligibility conditions to apply the CGT discount.
- For CGT events occurring after 8 May 2012, the application of a CGT discount percentage will depend on:
  - whether CGT asset was held before or after 8 May 2012, and
  - the residency status of the individual who has the capital gain.

Specific CGT treatment for foreign residents

- Restricted access to 50% CGT discount will specifically affect individuals (including a beneficiary of a trust and a partner in a partnership), who are:
  - a foreign or temporary resident
  - an Australian resident with a period of foreign residency after that date
  - had a discount capital gain from a CGT event that occurred after 8 May 2012.
Specific CGT treatment for foreign residents

- You must calculate CGT discount to apply to capital gain if foreign resident individual and, after 8 May 2012, you have a discount capital gain from a CGT event.
- If foreign resident on 8 May 2012, you may get market value for the CGT asset as at 8 May 2012 and use a market value calculation.
- The market valuation will be the basis to apportion the CGT discount to take into account the capital gain you have that was accrued before 8 May 2012.
- ATO has CGT discount calculator tool that can be used to determine your eligibility and calculate the CGT discount you can apply.

Specific CGT treatment for foreign residents

- If Australian resident, you must calculate CGT discount to apply to capital gain if after 8 May 2012, you have:
  - a capital gain from a CGT event, and
  - a period of foreign or temporary residency
- The period of foreign or temporary residency after 8 May 2012 is taken into account when calculating CGT discount to apply to your capital gain.
- ATO has CGT discount calculator tool to use to determine eligibility and calculate CGT discount percentage you can apply.
CGT on death

- Impact for deceased – CGT roll-over if K3 not apply

- CGT event K3, relevant to assets bequeathed to:
  - Tax exempt entities – exception for DGRs
  - Superannuation funds
  - Non-residents – exception for real property in Australia

- Impact for estate / beneficiaries
  - Main residence
  - Pre-CGT assets
  - Post CGT assets

CGT Protocol

Step 1 – Calculate total current year capital gains.
Step 2 - Work out net capital gain or loss – this is amount remaining after applying to current year capital gains the following items in the order listed:

- capital losses from the current year
- unapplied net capital losses from earlier years
- any general CGT discount
- small business 50% active asset reduction
- small business retirement exemption or rollover.
CGT Small Business Concessions

- CGT events relevant to disposal of TAP - see list in earlier slides
- Eligibility for SBE CGT concessions
  - **Note:** foreign residents can be eligible for SBE CGT concessions
- CGT small business concessions available
  - the 15-year asset exemption
  - the 50% reduction for active assets
  - the retirement exemption, and
  - the small business asset roll-over

CGT Small Business Concessions (continued)

Basic conditions for eligibility to small business concessions:

- a CGT event happens to an asset that the taxpayer owns
- the event would otherwise have resulted in a capital gain
- the taxpayer must either:
  1. be a "small business entity" ($2m annual turnover test); or
  2. satisfy the maximum net asset value test ($6M), and
- the asset satisfies the active asset test
- If the asset is a share in a company or an interest in a trust, the company / trust must have a CGT concession stakeholder.
CGT Small Business Concessions (continued)

Aggregated turnover is the sum of:

- Your Turnover
- Your affiliates
- Any entity connected with you

CGT Small Business Concessions (continued)

Maximum net asset value Requirement:

- Test is met if the net value of the CGT assets of the taxpayer, its connected entities and affiliates does not exceed $6m
- The net value is based on the amount by which the market value of assets exceeds the liabilities

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CGT Small Business Concessions (continued)

Maximum net asset value requirement
• Disregarded assets
  • Assets used solely for personal use and enjoyment
  • Individuals main residence
  • Superannuation
  • Life insurance policies
• Assets of affiliates only included if used in a business carried on by you or an entity connect with you

CGT Small Business Concessions (continued)

Active asset requirement
• Used in the course of carrying on a business by taxpayer, connected entity or affiliate

The following are not active assets
• Assets whose main use is to derive rent, royalties or FX gains – recent case re holiday park
• Shares in widely held companies or trusts
• Shares in connected entities – unless they met 80% active test
• Financial instruments
CGT Small Business Concessions (continued)

Active asset requirement

If you have owned the asset for *less than 15 years*
• The asset was active for at least half the period you owned it

If you have owned the asset for *more than 15 years*
• the asset was an active asset for at least 7 ½ years in total
The asset need not be active at time

CGT Small Business Concessions (continued)

15-year exemption - capital gain disregarded where:
• Basic conditions in 152-A have been met
• You continuously owned the asset for 15 years ending
• just before the CGT event
• If the asset is a share or unit – the company or trust had a significant individual for a total of at least 15 years
• In the case of an individual you are over 55 and retire
• In the case of a company or trust – significant individual was 55 or over and retires
CGT Small Business Concessions (continued)

50% Active asset reduction
• Basic conditions in 152-A must have been met
• Gain is reduced by 50%
• If CGR discount already taken, the remaining gain is reduced by 50% (effectively 75% in total)
• Small business 50% reduction is optional
• Companies – may cause an unfranked dividend

CGT Small Business Concessions (continued)

Retirement exemption - Up to $500,000 exempt
• Basic conditions in 152-A have been met
• If under 55, the exempt amount must be paid into super

• Additional conditions for companies or trusts
  • Company or trust had a significant individual just before the CGT event
  • Company or trust makes a payment to one or more of the CGT concession stakeholders
  • No requirement to retire or terminate employment
CGT Small Business Concessions (continued)

- Capital gain can be deferred automatically for 2 years
- If a replacement asset is not acquired within this time, CGT event J5 or J6 will occur
- Replacement asset must be an active asset
- CGT event J2 occurs
  - if the replacement asset stops being active,
  - becomes trading stock
  - If a share in a company or interest in a trust – active assets fall below

Tax Update - Legislation

Tax and super LAM No 6 Bill

- New foreign resident capital gains tax withholding regime.
Tax Update - Legislation

Tax and super LAM No 6 Bill

Foreign resident capital gains tax withholding regime

• Purchaser who acquires taxable Australian real property assets from foreign resident must pay 10% (now 12.5%) of purchase price to the Commissioner.
• The purchaser may withhold this amount from the vendor.
• Withheld amount will be 10% (now 12.5%) of first element of cost base of the asset
• The obligation will apply to the acquisition of an asset that is:
  • a direct or indirect interest in taxable Australian real property (TARP)
  • an indirect Australian real property interest, or
  • an option or right to acquire such property or such an interest.

The following situations will be exempted from the withholding obligations:

• transactions involving TARP and certain indirect Australian real property interests valued less than $2m (now $750K)
• a transaction conducted through a stock exchange or a broker-operated crossing system
• an arrangement already subject to an existing withholding obligation
• a securities lending arrangement, or
• transactions involving vendors who are subject to formal insolvency or bankruptcy proceedings.

• Also, no obligation is imposed where vendor has clearance certificate from Commissioner.
• The amendments apply in relation to acquisitions on or after 1 July 2016.
Conclusion

Wrap up
Questions

Thank you