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This session will cover

- What is CGT?
- CGT events
- Cost base rules
- How to calculate a capital gain
- Indexation and the CGT discount
- Special rules for small businesses
- Applying CGT to the family home
- CGT for investors
- CGT for partnerships, trusts and companies
- Record keeping

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What is Capital Gains Tax?

- When an asset is disposed of, capital gains tax (CGT) is normally payable on any profit made on the disposal. Amongst the assets which are potentially subject to CGT are:
  - Shares, units and similar investments but not cash
  - Property, including investment properties (but not the family home, which is generally exempt)
  - Business assets, such as an asset used in a business or the whole business
  - Personal use assets or collectables, such as jewellery and works of art
  - Foreign assets
- CGT operates by taxing any increase in value from the time the asset was acquired or created. The capital gain is taxed in the year the asset is sold.

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CGT events

- CGT is triggered by the happening of a CGT 'event'.
- Typically, this occurs when an asset is sold but can also happen if the asset is given away, if it's destroyed or lost, or the taxpayer stops being an Australian resident.
- Examples:
  - Event A1 – happens when an asset is disposed of
  - Event C1 - happens if a CGT asset owned by a taxpayer is lost or destroyed
  - Event C2 - happens if a taxpayer's ownership of an intangible CGT asset ends because it is redeemed, cancelled, released, discharged, satisfied, abandoned, surrendered, forfeited or expired (for example, shares held in a company where the company is wound up or when an option expires without being exercised)
  - Event E2 – happens when an asset is transferred to a trust
  - Event I1 – happens when an individual or company stops being an Australian resident

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CGT events

- Subdiv 104-A — Disposals
- Subdiv 104-B — Use and enjoyment before title passes
- Subdiv 104-C — End of a CGT asset
- Subdiv 104-D — Bringing into existence a CGT asset
- Subdiv 104-E — Trusts
- Subdiv 104-F — Leases
- Subdiv 104-G — Shares
- Subdiv 104-H — Special capital receipts
- Subdiv 104-I — Australian residency ends
- Subdiv 104-J — CGT events relating to roll-overs
- Subdiv 104-K — Other CGT events
- Subdiv 104-L — Consolidated groups and MEC groups.

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Working out a capital gain

- A capital gain is worked out like this:
  - Deduct the cost base from the sale proceeds. The cost base includes the price paid for the asset as well as any costs incurred in buying and selling the asset and certain incidental costs.
  - This amount is the gross capital gain
  - Next, take away any eligible capital losses.
  - Then apply any applicable discount factor. Individuals are entitled to a 50% discount and complying super funds a 33 1/3% discount. In both cases the asset must have been held for 12 months or more for the discount to be available. Companies are not entitled to a discount.
- The resulting figure is the net capital gain. This is added to assessable income in the tax return and taxed at the taxpayer's marginal rate.
- CGT only applies to the disposal of assets acquired after 19 September 1985, the date CGT was introduced. Assets acquired on or before that date are not subject to CGT.

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Working out a capital gain

- Sometimes the law requires that the proceeds and cost base of the asset are not what was actually paid and/or received, but rather, the market value of the asset at that time.
- This is typically to prevent people from minimising their tax by, say, selling the asset to a relative for a low price.
- If sale proceeds are less than cost base, a capital loss arises. These losses can be offset against capital gains arising in the same year and to the extent they are not used up, they can be carried forward indefinitely until capital gains arise to absorb them.
- Capital losses can only be offset against capital gains, they can't be offset against any other form of income.

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Cost base

- The cost base of a CGT asset to a taxpayer consists of five elements :
  - first element — the amount of any money or the market value of any property the taxpayer paid or gave, or was required to pay or give, in respect of the acquisition of the asset
  - second element — the incidental costs the taxpayer incurred to acquire the asset or that relate to a CGT event that happens in relation to the asset.
  - third element — the amount of costs of owning the asset provided the asset was acquired on or after 21 August 1991
  - fourth element — the capital expenditure incurred to increase or preserve the asset's value, or that relates to installing or removing the asset.
  - Fifth element — the capital expenditure incurred by the taxpayer to establish, preserve or defend the taxpayer's title to, or a right over, the asset.
- The reduced cost base of a CGT asset is the amount that is compared with the capital proceeds from the event to determine whether the taxpayer has made a capital loss from the CGT event happening and, if so, the amount of the capital loss.
- The elements of the reduced cost base are the same as the cost base except that costs of owning the asset (third element costs) are not included.

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Working out a capital gain

- In some cases, there is a delay between signing the contract and finally relinquishing ownership of the asset. With property disposals for instance, the contract date can occur several months before the settlement date.
- The date of the CGT event is the **contract date**. This can be an important factor where the contract date and settlement date occur in different tax years. It's important to ensure that the disposal is recorded in the tax return in the correct (earlier) year.
- Where settlement occurs in a later year to the date of contract, even though the gain arises in the earlier year, the gain doesn't need to be reported in that year's tax return until settlement actually happens. If the gap is long – several years, say – that may mean going back and amending the tax return for the year the contract was signed.

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Poll

- How many CGT events are there?
- A) 37
- B) 54
- C) 66
- D) 74
- E) 122

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The CGT discount

- The general 50% discount is available against most capital gains arising on the sale of assets, including shares, property and business assets.
- Applies to CGT events arising after 21 September 1999
- For assets acquired before that date but CGT events arising after that date, client can choose indexation or discount (TIP: discount will usually be more beneficial)
- The main features of the discount are as follows:
  - The discount is available to individuals, trusts, partnerships and complying superannuation funds but not to companies
  - The rate of the discount is 50% for individuals, trusts and partnerships and 33 1/3rd% for superannuation funds
  - To qualify, the asset must have been owned for 12 months.
- Alternatively, if an asset was bought before 21 September 1999, it is possible to increase the cost base by an 'indexation' factor, which adjusts the cost base to eliminate the inflation portion of the gain. If indexation is applied, you can't also claim the discount; it's one or the other.

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Special rules

- **Personal use assets**
- Personal use assets are those assets which are used in everyday life for personal enjoyment. Provided the cost of the asset is less than $10,000, any capital gain made on such an asset is ignored.
- Examples of personal use assets are items like the family car, household furniture and electrical goods like televisions and fridges. In reality, most of these items lose value over time so even if they were included in the CGT rules, it's highly unlikely that a capital gain would arise on their disposal. For that reason, capital losses arising on the disposal of personal use assets are also disregarded.

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Special rules

- **Collectables**
- In some circumstances, collectables are exempt from CGT.
- A collectable is something which is owned for personal enjoyment and includes such items as:
  - Works of art (paintings, sculptures, etc)
  - Jewellery
  - Rare books
  - Antiques
  - Stamps and coins
- For the exemption to apply, the collectable must have been acquired for $500 or less. If an individual collectable items is sold which would normally be part of a set (such as one stamp out of a stamp collection), the entire set must have cost $500 or less.
- If the collectable (or set of collectables) was acquired for more than $500, the normal CGT rules apply.
- If a capital loss arises on disposal of a collectable, the loss is quarantined and can only be offset against capital gains from other collectables.

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Special rules

- **Depreciating assets**
- If the taxpayer runs a business or owns an investment property, it's likely that they will have purchased capital items for use in the business or in the rental property.
- These are usually depreciated over time, and a deduction for the loss in value claimed in each tax return over the asset's effective life.
- Where the asset is disposed of, a profit or loss is claimed as assessable income.
- As such, these assets are excluded from the CGT rules and no capital gain or loss arises on their disposal, except where the asset was partly used for private purposes, in which case a capital gain (CGT event K7) might arise on the proportion of the asset which related to private use

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CGT and the family home

- A capital gain or loss from a CGT event that happens to a dwelling is disregarded if (s118-110):
  - The taxpayer is an individual;
  - The dwelling was the taxpayer's main residence throughout the ownership period;
  - The dwelling was not used to produce assessable income;
  - The dwelling did not pass to the taxpayer as a beneficiary in a deceased estate and the taxpayer did not acquire it as a trustee of an estate of a deceased person; and
  - Any land on which the dwelling is situated is two hectares or less
- The taxpayer cannot choose whether or not to apply the MRE
- Short absences from the dwelling (eg holidays) do not affect entitlement to the MRE

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CGT and the family home

- A partial exemption may apply where:
  - The dwelling was the taxpayer's main residence for only part of the period they owned it;
  - The dwelling was used to produce assessable income; or
  - The land on which the dwelling is situated is more than two hectares
- Other rules apply where:
  - The taxpayer used the dwelling to produce assessable income
  - The taxpayer was a beneficiary or trustee of a deceased estate
  - Land adjacent to the dwelling (but not the dwelling) was compulsorily acquired

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Special rules for small businesses

- Exemption from CGT for capital gains events arising to eligible small businesses or their owners in relation to eligible assets
- Basic conditions:
  - A CGT event happens to an asset owned by the taxpayer which would otherwise result in a capital gain.
  - At least one of the following applies:
    - the taxpayer is a "CGT small business entity", broadly meaning that it has a turnover of less than $2m
    - the "net value" of assets owned by the business and related entities is $6m or less
    - the entity is a partner in a partnership that is a CGT small business entity for the income year and the CGT asset is an interest in an asset of the partnership, or
    - the CGT asset is a passively held asset used in the business of an affiliate, connected entity or partnership in which the taxpayer is a partner that is a CGT small business entity.
  - The CGT asset which is the subject of the CGT event is an "active asset", meaning an asset used, or held ready for use, in carrying on the business.

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Special rules for small business

- An active asset is one owned by the taxpayer and used, or held ready for use, in the carrying on of the business by the taxpayer, an affiliate of the taxpayer or an entity connected to the taxpayer. This includes shares in a business and goodwill but does not extend to "passive" assets such as an investment portfolio of shares or investment properties.

  The asset must have been an active asset for at least half the ownership period (or at least 7 ½ years if the asset has been owned for more than 15 years).
- *Example:*
- *You own a commercial building which is let to a number of office tenants, none of them connected in any way to you. The building **is not** an active asset.*
- *You own a shop which is rented by your spouse who runs a hairdressing salon from the shop. The shop **is** an active asset.*

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Special rules for small businesses

- **15 Year exemption**: This allows a taxpayer to disregard entirely a capital gain arising from a CGT event happening to a CGT asset if it has owned the asset continuously for at least 15 years prior to the CGT event. If the taxpayer is an individual, the individual must also retire or become permanently incapacitated for the exemption to apply
- **50% reduction**: The amount of a capital gain is reduced by 50% (in addition to the 50% general discount, where available)
- **Retirement exemption**: This allows a taxpayer to choose to disregard all or part of a capital gain in relation to a CGT asset of the taxpayer's small business if the capital proceeds from the CGT event are used in connection with retirement. There is a $500,000 limit which applies in the individual's lifetime.
- **Rollover**: defers the making of a capital gain from a CGT event that happens in relation to an asset where a replacement asset is acquired within two years

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Poll

- During the current income tax year a taxpayer, Rachel made a capital gain of $100,000 from the sale of land and a capital loss of $10,000 from the sale of shares. She also has prior year carry forward capital losses from the sale of shares that total $30,000. Adele elects to use the capital gains tax (CGT) discount method to determine her net capital gain. What is Adele's assessable net capital gain for the current income tax year?
- A) $30,000
- B) $60,000
- C) $15,000
- D) $45,000

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CGT and relationship breakdown

- Compulsory rollover relief if CGT event happens involving an individual and his or her spouse or former spouse because of a court order, binding financial agreement or an award made under arbitration
- Relief is automatic unless conditions are not met
- CGT consequences for the transferor:
  - Capital gain or loss is disregarded
- CGT consequences for the transferee:
  - If transferor acquired asset pre-CGT
    - Asset remains pre-CGT
  - If transferor acquired asset post-CGT
    - Asset acquired at transferors cost base at date of original acquisition
    - For CGT discount purposes, transferors holding period is preserved
    - Collectables and personal use assets maintain status

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CGT and relationship breakdown

- Example:
- John transfers land to ex-spouse Ruth because of a court order under the *FLA*. Market value of the land is $400,000. The cost base of the land is $100,000. It was acquired in 2008.
- John would normally make a capital gain of $300,000. However, the capital gain that John makes is disregarded.
- The cost base for Ruth becomes $100,000, and she is treated as having acquired the land in 2008 for CGT discount purposes

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CGT and death

- Although death may give rise to a transfer of assets, there is generally no CGT due as a result. Instead, there is usually an automatic CGT roll-over relief (Div 128) on the disposal of CGT assets arising from death. This applies to transfers:
  - From the deceased to the executor or from the deceased direct to a beneficiary of the deceased estate
  - From the executor to a beneficiary
  - From the deceased directly to the beneficiary where an asset is held under a joint tenancy
- CGT arises when the executor or beneficiary subsequently disposes of the inherited asset. In other words, death defers a capital gain to the ultimate disposal of the asset by the estate or the beneficiary.

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CGT and death

Event/asset	Implications
Death	No direct CGT consequences for the deceased unless a post-CGT asset passes to an exempt entity, a complying superannuation fund or, in some circumstances, a non-resident.
Assets owned at death	Pre-CGT assets are acquired by the executor at the date of death for market value at the date of death. Post-CGT assets are acquired at the date of death for the deceased's cost base.
Assets pass from estate to beneficiary	No CGT implications for the executor. Beneficiaries inherit the same cost base and acquisition date as the executor.
Death of joint tenant	The surviving joint tenant generally acquires the deceased's interest on the same basis as it passed to them via the executor, even though they acquired it directly as the surviving joint tenant.
Assets acquired by the estate post-death	Where assets are acquired and disposed of by the estate post-death, the CGT roll-over does not apply and normal CGT rules apply unless the acquisition is done to satisfy a general legacy, in which case no CGT is due.
Main residence of the deceased	Full or partial main residence exemption available when disposed of by the estate or beneficiaries.

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CGT – other entities

- A **partnership** does not own assets for CGT purposes. A partnership asset is owned by the partners in the proportion to which they have agreed. If a CGT event happens to a partnership during the income year, or the partnership received a share of a capital gain from a trust, each partner must include their share of the capital gain or capital loss on their own tax return.
- Disposal of an asset held by a **trust** will generally produce a capital gain or loss for the trust. Capital gains and losses are taken into account in working out the trust's net capital gain or net capital loss for an income year. As part of the net income of a trust, the net capital gain for the year is then allocated proportionately to beneficiaries based on their entitlements to trust income, unless:
  - There is a beneficiary who has been made specifically entitled to the capital gain (in which case they're generally assessed on the gain), or
  - The trustee chooses to be taxed on a capital gain.
- When a **company** disposes of an asset, a capital gain arises to the company. The calculation is the same as for an individual except the CGT discount does not apply. The tax rate applied to the gain is the corporate tax rate.

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Record keeping

- Records must be kept for at least five years after the year when the CGT event happened
- Records for a net capital loss in a year, must be kept until two years (for individuals and small businesses; four years for other taxpayers) after the loss is offset against a capital gain. Note: There's no time limit on how long a net capital loss can be carried forward.
- Records must be in English and must show:
  - the nature of the transaction, event or circumstances
  - the date it happened
  - the parties to the transaction
  - how the transaction, event or circumstances are relevant to working out the capital gain or loss.

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Record keeping

- Examples of the kind of records a taxpayer must keep:
  - receipts of purchase or transfer
  - details of interest on money borrowed relating to the asset
  - records of agent, accountant, legal and advertising costs
  - receipts for insurance costs, rates and land taxes
  - any market valuations
  - receipts for the cost of maintenance, repairs and modifications
  - Accounts showing brokerage fees on shares.
- Also keep records to establish whether an income tax deduction has been claimed for an item of expenditure. If so, the amount can't be included in the cost base of the asset

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Questions?

- You can type them in the "Questions" box now
- Or contact me via:

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