UNDERSTANDING CAPITAL GAINS ON INVESTMENT PROPERTY

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Capital gains on investment property or a capital loss on an asset is the difference between what it cost you and what you receive when you sell it.

You pay tax on your capital gains on investment property and it forms part of your income tax, commonly referred to as capital gains tax (CGT).

When does capital gains tax on investment property apply?

Most personal assets are exempt from capital gains tax including your home (your primary place of residence), your car and most of your personal belongings and it doesn't apply to depreciating assets used soley for taxable purposes, such as business equipment. However, capital gains tax does apply to investments which is why it is important to understand capital gains on investment property.

If your home or primary place of residence later becomes an investment property, the capital gain or loss will only be calculated on the length of time the property was not the primary place of residence.

Capital gains tax also applies to your property investments anywhere in the world but your assets may be exempt if they were acquired before the 20 September 1985 which is when capital gains tax was introduced. It is important to remember that even if your property is exempt, major improvements to your property after this date may be subject to the capital gains tax.

Capital gains tax and record keeping

As soon as you acquire an investment property, it is important to start keeping accurate records of every transaction or circumstance relevant to that property as it may affect whether you make a capital gain or a capital loss.

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Length of ownership and capital gains tax

When calculating capital gains tax on investment property (or a capital loss) you need to establish exactly when you acquired the property as how long you have owned it might affect the outcome. Generally, the acquisition date is when you become the owner (ie. purchase the property), when you receive the property as a gift or when ownership of the property was transferred to you.

There are two situations which will affect the date of ownership. The first is when you buy a property under contract and don't take immediate possession. This is relevant for properties with a long settlement date or if you purchase property off-the-plan. In this instance the acquisiton date is the date you enter into the contract, not the date of settlement.

Secondly, if you inherit a property, the acquisiton date is the date of the death of the person who bequeathed it to you, not the date you took posession of the property. If you inherited a pre-CGT property, it is important to know the market value of the property at the date they died. A qualified property valuer will be able to provide this information for you. The date of ownership is very important and can have a large impact when calculating the capital gains on investment property or the capital loss.

A number of considerations also apply when the ownership of an investment property changes as a result of marriage, legal separation or divorce. You should consult with the Australian Taxation Office (ATO) or your accountant in this instance.

Capital gains tax discount

Individuals and small businesses can generally discount a capital gain by 50% if they hold the investment property for more than one year. If you have owned the investment property for less than twelve months, capital gains tax on the investment property will apply to 100% of the profit.

Capital gains tax and SMSFs

Capital gains tax on investment property is calculated differently if you purchase the investment property through a Self Managed Super Fund (SMSF). If you sell the property once you've retired you'll pay no capital gains and if you sell the property while you are still accumulating super, this will be taxed at a rate of only 15%. This rate will drop to 10% if the property has been held for longer than a year. However, buying investment property via a SMSF comes with a range of careful considerations and all investors are urged to seek professional advice to ensure all capital gains on investment property purchased via a SMSF is clearly understood.

Joint ownership and capital gains tax

Capital gains tax on investment property still applies when a property is jointly held. If investors own a property as tenants in common, the capital gain or loss is split according to their legal ownership of the property (eg. 80/20). For joint tenants, the owners will share the capital gain or loss equally when they sell the property.

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Capital gains tax and selling a property

When you sell or dispose of your property, this is the point at which you will make a capital gain on the investment property, or a capital loss. It is important to clearly establish the timing because the timing will affect which income year your gain or loss is reported in and it may affect how you calculate your tax liability.

Similar to when you acquire an investment property, the date of disposal is the date you enter into the contract, not the date of settlement. If the property is lost or destroyed, the date is deemed from the date you receive any compensation. If you don't receive compensation, it is the date when the destruction occurred or was discovered.

Calculating capital gains on investment property

A capital gains tax on investment property is when you receive more for the property than what it cost you and there are three different ways to calculate a capital gain – the CGT discount method; the Indexation Method; and the 'Other Method' which is used for properties held for less than twelve months. A qualified accountant will be able to outline the three methods in greater detail and advise which method best applies to your property.

Carrying forward capital losses

If you haven't made a capital gain on investment property, you have made a capital loss. This is when you sell a property for less than what it cost you.

If you make a capital loss from the disposal or sale of your investment property, you can't claim it against income but you can use it to reduce a capital gain in the same income year. If your capital losses exceed your capital gains in an income year, you can generally carry the loss forward and deduct it against capital gains in future years.

Hopefully this Guide has provided a useful introduction to understanding capital gains on investment property. Capital gains tax on investment property is fairly straightforward however there are always plenty of minor exceptions to the rules. This is why every property investor is urged to speak to an expert Property Investment Specialist from Investor Assist or seek professional advice before purchasing an investment property to ensure any financial or taxation implications of a capital gain or capital loss are clearly understood.

For further information, contact Investor Assist on (08) 9200 7200 or email info@investorassist.com.au