Tax Q&A

Your tax questions answered

Our tax experts are on hand to answer any tax queries you may have regarding your property investments and wealth creation strategies. Email your taxing questions to editor@yipmag.com.au

CGT ON SUBDIVIDED PROPERTY

Q In August 2012 I had two units on one title transferred out of my parents' name into mine (payments of tax, etc, sorted by accountants). I am using both properties as my PPOR with both units never let out or rental income collected as my son lives there with utilities, etc, in my name. I am in the process of subdividing the properties into two separate titles and selling both units separately, and I'm wondering if I will be subject to CGT on the sale of one unit.

A Ultimately, you are only entitled to nominate one property as your main residence at any given point in time. By nominating one property as your main residence, and providing this property has never been used for income-producing purposes, you will be entitled to the full capital gains tax (CGT) main residence exemption. When you subdivide your current properties into two separate titles, this will effectively create two separate assets for CGT purposes. When you sell both properties, you will trigger a CGT event for one of the properties (the property that is not your nominated principal place of residence), for which you may incur a CGT liability on the sale of this property.

– Angelo Panagopoulos

CGT WHEN TURNING IP INTO PPOR

Q I own two properties and I have been living in property one for seven years since I bought it. Now I want to move out of property one into property two, which I have rented out for three years since I bought it three years ago, and then live in property two for a long period. I still want to own these two properties for a long time from now. So which period of capital gain do I need to include in my income tax return for property two?

A A dwelling can be established as a main residence when the owner moves into it and resides there for at least three months, preferably more. For proof, the ATO also looks at whether or not the telephone, electricity account and mail redirection have been changed to the new address. Changing your address on the electoral roll is also a strong indicator of establishing a dwelling as a main residence.

A main residence is exempt from capital gains tax (CGT) when sold at a profit. Only one property can be nominated as your main residence at any one time. So the exemption from CGT is only available on one property at a time.

A dwelling purchased as a rental investment and immediately rented after purchase will accrue capital gains from that date.

CGT only applies when a capital gain is derived on sale. So there has to be a sale first before a liability arises.

When the use of a dwelling changes, so does the way capital gain is calculated should there be a sale.

For a property established as a main residence on purchase and occupied for seven years, any capital growth for that time will be exempt from CGT. To continue the exemption from CGT, this property would have to remain nominated as the main residence. This can be done for another six years.

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Where another property is nominated as the main residence, the market value of the property becomes the cost base used to calculate capital gain should it be sold. This means the capital gain up to that point will be exempt from tax. A valuer can provide the market value, or get an appraisal from a couple of agents.

Where the rental property is occupied as a main residence and nominated as the main residence after a period of being rented, capital gain is apportioned on a time basis – on sale of the property. The portion (number of days) relating to the period it was a rental will be taxable, while the portion relating to the period it was a main residence will be exempt.

A concession is available when the property has been held for longer than 12 months. A 50% discount on the gain is available. Only 50% will be assessable.

Consideration should be given as to whether or not to nominate the rental property as a main residence, and when to do it from. The decision can be made when a sale occurs and the tax return needs to completed afterwards. With the help of your property tax specialist, you can calculate which approach will result in the lowest tax position and apply that.

– Shukri Barbara

CGT ON IP REBUILT AS PPOR

Q I bought an investment property in 1997 and have rented it out since then. (The house is only under my name.) Next year I expect to demolish it and build a new house. Firstly, if I move into it to live there, and after 10 years I sell the property, do I still have to pay capital gains tax? If so, how is the capital gains tax calculated? Secondly, if I pass away, and my daughters as a result own it, and they sell the property, do they still have to pay capital gains tax?

A When you demolish your investment property and build a new house, you are effectively scrapping one asset (the existing dwelling) and creating a new asset (the new dwelling). The new dwelling will have a new cost base (cost of construction of the new dwelling plus additional costs which relate to the construction of the new dwelling).

If you intend to nominate the new dwelling as your principal place of residence and sell after 10 years, this will trigger a capital gains tax (CGT) event and you may be liable to pay CGT on a proportional basis. The basis of the calculation will be proportioned to the increase in the market value of the land between the time of acquisition to the time of sale, and then the 10 years that you would have been living in the new dwelling will be exempt from CGT. However, the preceding years (from 1997 to the time the property ceased to be an investment property) will be liable for CGT. While the land in itself will give rise to a proportion of the CGT liability, the new house will be CGT exempt because it was used as your main residence from the outset, post-construction.

The CGT and tax outcome will be the same in the event that you pass away and your daughters inherit the property (and subsequently sell it afterwards). Because it was an asset acquired after 21 September 1985, your daughters will inherit the same cost base and acquisition dates from when you acquired the property in 1997. (Please note, there is no CGT or stamp duty applicable when your daughters inherit the property from you. However, if your daughters subsequently sell the property afterwards, this will trigger a CGT event.)

Depending on the age of your current investment property (and also how it was used prior to you purchasing the property in 1997), it may be worthwhile engaging the services of a quantity surveyor to prepare a scrapping schedule for you prior to the house being demolished. Properly applied, scrapping may be available to you as an income tax deduction.

– Angelo Panagopoulos

The experts

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If you have a tax question for our experts, email it to editor@yipmag.com.au

QS Corner

TIP #52

In this month's *QS Corner*, we look at the most popular method of property depreciation

When you receive a depreciation schedule for your investment property, you have a choice to make.

You can choose between the diminishing value method (DVM) of depreciation or the prime cost method.

Once you've made your choice, you can't alternate between the two.

The DVM method depreciates items more quickly up front. This method recognises the fact that most plant and equipment items lose a higher portion of their value early on.

The decline in the value of the item gets progressively smaller over time on the way towards $0.

For example: If the carpet you bought has a value of $1,000 and a 10-year effective life, you would calculate the depreciation as follows:

- **Year 1:** $1,000 × 20% = $200
- **Year 2:** ($1,000–$200) = $800 × 20% = $160
- **Year 3:** ($1,000–$200–$160) = $640 × 20% = $128

And so on and so on.

Property investors tend to use the DVM when they want their deductions up front, but it's always best to check with your financial advisor as to which method suits your individual circumstances.

Next month we'll look at the benefits of the prime cost method.

FREE STUFF

For free property depreciation and construction cost calculators, visit: www.washingtonbrown.com.au

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