

# Rental Properties & Capital Gains Tax

When calculating the Capital Gains Tax (CGT) implications on the sale of a rental property many aspects in relation to this property need to be considered and evaluated. This fact sheet details a number of factors to consider when determining the CGT implications due to the sale of a rental property.

The first thing that needs to be considered is if a CGT event has occurred in the financial year, by way of the owner signing a sales contract prior to 30 June. The timing of a capital gain event is based on contract and **not** settlement date. The gross capital gain is worked out by finding the difference between the cost base of the rental property and the sales consideration on the disposal of the rental property.

## Calculating the Cost Base

The cost base of a property is calculated by starting with the purchase price for the property and then adding other expenses to the cost base of the property which the taxpayer has never claimed a tax deduction for in the past. Examples of these expenses are as follows:

- Legal Fees;
- Conveyancing costs;
- Advertising costs;
- Stamp duty to sell the property;
- Real Estate Commissions;
- Discharge of mortgage fee;

Please be aware the cost base of a rental property must be reduced by any capital works deductions that have been claimed on the property as tax deductions in the past.

## Example

An example of how to calculate the capital gains can be demonstrated with Debbie. Debbie purchased a property and signed a contract on 1 July 2007 and the house settled on 1 August 2007. The consideration was \$400,000, and on top of this Debbie paid a total of \$25,000 for legal fees, stamp duty, commission and pest/building inspection.

After one year Debbie was looking at selling the property and the real estate suggested that by adding a carport to the property it would increase the value to \$500,000 so Debbie installed a car port at a cost of \$15,000 on 1 August 2008. The property was rented out for the entire time Debbie owned it, and Debbie sold the property on 1 October 2008 for \$500,000. Real estate agent fees and solicitor's fees in relation to the Sale were equal to \$10,000.

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Debbie calculates her capital gains as follows:

Purchase price of the property	\$400,000.00
Plus:	
Stamp duty, commission, pest and building inspections.	\$ 25,000.00
Capital expenditure (car port)	\$ 15,000.00
Real estate agents fees and solicitor's fees on sale of property.	\$ 10,000.00
Less:	
Capital Works Deductions at 2.5%	
$0.025 \times \$15,000 \times (61/366)$	\$ 62.50
<b>Total Cost Base</b>	<b>\$449,937.50</b>
Proceeds from sale of property	\$500,000.00
Less: Total Cost Base	\$449,937.50
<b>Gross capital gain</b>	<b>\$ 50,062.50</b>
Less 50% discount	\$ 25,031.25

As Debbie held her asset for more than 12 months she is entitled to the 50% discount on capital gains, meaning her assessable capital gain is \$25,031. This amount is recorded in Debbie's tax return and assessed with her ordinary income to find out the total tax payable by Debbie.

### Main Residence Exemptions

In general terms, a taxpayer is able to disregard a capital gain or loss made from the sale of the property if the owner of the property is an individual taxpayer, and they resided in the property as their principal place of residence. If you reside in the property during the ownership period you may be entitled to a full or partial capital gains 'main residence exemption'.

To get the full exemption from CGT:

- The dwelling must have been your home or main residence for the whole period you owned it;
- You must not have used the dwelling to produce assessable income; and
- Any land on which the dwelling is situated must be 2 hectares or less.

If you inherited a dwelling or a share of a dwelling and it was not the deceased's main residence, you may not get a full exemption.

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## Partial Exemption

If you are not fully exempt, you may be partially exempt if:

- The dwelling was your main residence during only part of the period you owned it
- You used part of the dwelling to produce assessable income, or
- The land on which the dwelling is situated is more than 2 hectares.

Please note, leaving your home for example, annual holidays does not affect you from applying the main residence exemption.

## Extension of the main residence exemption

If a dwelling was not your main residence for the whole time you owned it, some special rules may entitle you to a full exemption or partial exemption from capital gains tax from the sale of your rental property. These special rules are discussed below.

## Moving into a main residence

If the owner of a property can claim the dwelling as main residence by the time it was first practicable for the owner to move into it after it was acquired, then the dwelling is treated as the owners main residence from the point that they first purchased the property to the point where they moved into the dwelling.

## Dwelling stops being main Residence

If the owner of a property has a dwelling on the property as their main residence and that dwelling stops being their main residence, the owner may choose to continue treating that dwelling as their main residence. The maximum period of time that the dwelling can be claimed as main residence is six years if the dwelling is used for income producing activities. If the owner re-establishes as a main residence in the dwelling and then leaves again, the six year period starts again. If the dwelling is not used for income producing activities, then the main residence can be maintained indefinitely. A partial exemption can be applied if only part of the property was used as income producing.

## Main Residence for part of ownership period

If the owner of a rental property claims main residence for some of the ownership period and then moves to a separate dwelling that they claim as main residence, and uses the first dwelling as income producing, then they are able to claim a partial exemption from capital gains, proportional to the time spent as the main residence, to time spent not as main residence.

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When calculating the partial exemption of the capital gain, the amount of capital gain that is assessable income is calculated by working out the capital gains and then calculating the percentage of the property used as income producing, and percentage of time not claimed as main residence, or alternatively, the area of land outside the 2 hectare range.

*If you have any questions or require any further information please feel free to contact your Client Manager and they will be happy to assist you.*

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