Capital Gains Tax

Capital Gains Tax – Individual Taxpayers

Most investments (assets) generally provide you with income on a regular basis. But some investments, like shares and property, can also increase in value. This increase is called growth or capital gain.

If you sell your investment for more than you paid for it then you realise a capital gain and you may have to pay tax on this gain. Capital Gains Tax (CGT) is payable on the taxable portion of a capital gain if you acquired the investment

Sale Price − Purchase Price = Capital Gain/Loss

Pre-CGT Assets

If you bought or acquired an asset before 20 September 1985, the CGT rules do not apply. Any capital gain can be received by you tax-free.

Acquisition and Disposal

You are deemed to acquire an asset if you:

- Buy it
- Inherit it
- Build it, or
- Receive it as a gift

You are deemed to dispose of an asset if you:

- Sell it
- Give it away, or
- It is lost or destroyed

If the transaction is done at a price lower than the asset's market value, the market value will be deemed to be the acquisition or disposal price, even though this is not the amount of cash you received.

Example

Horace purchased a parcel of shares for $10,000 in May 2004. The shares increased in value and were worth $24,000 in November 2009 when he decided to gift the shares to his son.

Horace did not receive any payment for the shares, but for CGT purposes the shares are deemed to have been sold for $24,000. This means he has realised a capital gain of $14,000 and needs to calculate how much tax is payable on this gain.

Gains on the following assets acquired on or after 20 September 1985 are likely to be subject to CGT:

- Shares
- Managed funds
- Property investments

CGT Exemptions

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Not all assets which increase in value will be subject to CGT. Two main assets that are exempt from CGT are:

- Your principal home, and
- Assets purchased before 20 September 1985 (pre-CGT assets)

Your home can continue to be exempt from CGT for up to six years after you move out, provided you do not buy another home that you elect to claim the exemption on.

Taxation of a Capital Gain

The taxation of a capital gain depends on how long you have owned the asset.

If you have held the asset for <u>less</u> than 12 months the full amount of the gain less any capital losses (from current year or carried forward from previous years) is added to your assessable income in your tax return. This amount is taxed at your marginal tax rate.

If you have held the asset for 12 months or <u>more</u>, capital losses (from current year or carried forward from previous years) are deducted from the capital gain, then only 50% of the net gain is added to your assessable income and taxed at your marginal tax rate.

Note: if your asset was purchased before 21 September 1999 you could choose to calculate the taxable portion of the gain using an indexation method, but tax advice should be sought.

<u>Example</u>

Horace (in example above) had held the shares for more than 12 months. So his taxable capital gain is reduced by 50% to $7,000. This amount is added to his other assessable income and is taxed at his marginal tax rate.

If Horace had only owned the shares for less than 12 months, tax would be payable on the full $14,000.

If the asset is owned in the name of a company, the 50% exemption does not apply. Further tax concessions may apply if it is a business asset.

Capital Losses

If you sell an asset for less than you paid for it, you may realise a capital loss. A capital loss can reduce your taxable capital gains on other assets (as explained above) but cannot be used to reduce tax on other income sources. The reduction is done before you claim the 50% exemption.

Example

Last year Horace sold an asset which realised a capital loss of $2,000. This can be used to reduce his taxable capital gain as follows:

Taxable capital gain = ($14,000 - $2,000) x 50% = $6,000

Horace will only add $6,000 to his assessable income and pay tax at his marginal tax rate on this amount.

If you cannot use the loss in the year that it is realised, the loss can be carried forward to reduce taxable capital gains in future years. However, it is better to use losses as quickly as possible because the value of the loss diminishes over time with inflation.