

CGT and your property investments

Working through the Capital Gains Tax (CGT) issues on property can be a minefield! This month we look at making sense of the key CGT issues that affect investors and property owners.

The ATO have capital gains tax on property in their sights with a new series of reviews and data matching projects. If you have sold a property over the last few years and in particular a holiday home, rental and investment property, or if you are a non-resident selling Australian property, you may be contacted.

The ATO are cross checking tax returns against State Government real estate sales data, and will follow-up on any discrepancies.

Generally, property owners pay CGT when they sell a property for more than they paid for it. The gain you make on the property (discounted by 50% where you owned the property more than 12 months) is treated as income and is taxed at your marginal tax rate. Exemptions from the tax exist for your home (main residence) and for properties acquired before CGT was introduced on 20 September 1985.

Understanding main residence

When does main residence begin?

The main residence exemption generally applies to a house that you occupy as your home from the time you actually move in. Normally this would be from the time you purchased the property assuming you moved in as soon as practicable after that time. If you delay moving in due to an existing lease having to run its course, then the exemption will not apply until you move in.

Establishing a property as main residence

An intention to occupy is not sufficient to qualify as main residence; the property must be lived in to establish it as a main residence. Factors indicative of a property being 'lived in' include:

- The length of time you have lived in the property;
- The place of residence of your family;
- Whether you have moved your personal belongings into the property;
- The address to which your mail is delivered;
- Your address on the Electoral Roll;
- The connection of services such as telephone, gas and electricity; and
- Your intention in occupying the property.

Changing main residences

Generally you (and your spouse) can only have one main residence at a time. However, if you acquired a new home before you disposed of the previous one, both properties will qualify for main residence exemption if:

- The old property was your main residence for a continuous period of at least 3 months in the 12 months before it was sold;
- The house was not used to produce assessable income in any part of that 12 months when it was not the main residence; and

The new property becomes the main residence. You are allowed a maximum of 6 months between the time you acquire the new property and when you sell the existing one in order to claim the main residence exemption on both properties.

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Don't let timing tick away the value of your business

The old adage that 'timing is everything' is especially true when preparing your business for sale - that is if you're after the greatest capital return.

Timing your business succession is crucial to creating the best environment for the best capital realisation. So how much time do you need to get your business ready for sale? When should you start the preparation process and what are the implementation steps?

Preparing your business for sale is a process, not an event. Business owners who deal with their succession as an event, that is something that they decide on at the spur of the moment, almost always dilute the value that may have otherwise been available to them. Based on the theory that sooner or later every business will be sold or die, it makes sense then that businesses should be developed with a view to its eventual sale from day one. In most cases this does not happen, so what is the next best alternative?

Where possible, business succession should be mapped and planned, three to five years before the business sale. When assessing the value of a business the majority of purchasers look for established trends. This means that most buyers and their advisers will want to review the financial performance of the business for at least the past three years.

So if you work on a three to five year time frame what are the critical steps?

Undertake a business diagnostic - this is a thorough review of your business - warts and all. It is designed to assess where the business is currently at, a level of risk analysis, and identify the areas where the business could improve.

Complete a valuation - you need to put a stake in the ground and know what the business is worth.

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Constructing or renovating a main residence

Generally, land does not qualify for a main residence exemption, however, you can choose to treat land as your main residence for up to four years where you are building, renovating or finishing a partly constructed property. This is provided you:

- Move into the property as soon as practicable after it is finished; and
- Continue to use the property as your main residence for at least three months.

The exemption applies if the residence is occupied within 4 years. If the period exceeds 4 years, then the exemption applies 4 years prior to moving in. This rule can also apply where an existing property is demolished and a new property is built.

If you are living in an existing home that you own while constructing a new one, you must choose whether to:

- Maintain the exemption for the old home; or
- Apply the exemption to the land while constructing your new home.

Absences from your home

You can choose to treat a property as your main residence even when you are not living in it. It is important, however, that the property has already been established as a main residence for this to apply. This means that you had to have lived in the property previously and met the main residence exemption rules.

You can continue to treat the property as your main residence indefinitely if it is not being rented or otherwise used to earn income.

If you are renting the property out, the maximum period you can continue the main residence exemption is 6 years without moving back in. However, if you want to claim the exemption during a period of absence, no other house you are living in will qualify for the main residence exemption.

Using residence to produce income

If you are using part of your home for income producing activities and it has the character of a "place of business", such as a home business, you may end up paying CGT on the portion of your home used by the business. That is, the main residence exemption does not apply to the portion of the home used by the business.

While the main residence exemption doesn't apply to your home business, you have the advantage of being able to claim a deduction for a portion of expenses such as interest, repairs, house and contents insurance, rates and property taxes as a business expense. Choosing not to claim deductions for a principal place of business will not protect the CGT exemption.

Certain rules and tests used for income producing activities apply to the main residence exemption. It's best not to make a guess about your situation and seek professional advice if you are in this situation.

If you have investment properties or a home business and would like us to review your situation, please call us today.

Don't let timing tick away the value of your business *continued*

Start on the housekeeping - often we see businesses where some of the history needs to be cleaned up. This is often reflected in the balance sheet and may take some time to sort through.

Business enhancement – based on your diagnostic, start making changes in the business that will cause permanent and measurable improvement.

Create a reporting and results trail – one that tracks the changes and the improvements achieved. At the same time build your forward budgets and estimates around the leverage that will come out of the change.

When you have worked through this and established your trends over a three year plus time period, then you are ready to go to market.

This brings us back to the timing issue. When selling your business you should work on 'window periods'. These are the times within a succession plan when a sale will bring about the most ideal outcome. For most small businesses, the window is any time plus or minus eighteen months from the ideal sale date. Being open to a window period means that if the right buyer comes along before the time you want to sell, then you should still take the opportunity. Alternatively, if you need to wait an extra year for the right sale environment, then this should also be manageable.

Getting your succession timing right will ensure you have the right conditions in place to bring about the best value for your business.

If you need assistance with any of the issues raised in this article, please call us today.