How to pay ZERO Capital Gains Tax on an investment property

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How to pay ZERO Capital Gains Tax on an investment property: If you're the trustee of a self-managed super fund (SMSF), it's important to understand how your fund's returns may be affected by capital gains tax.

SMSF trustees can generate returns for their funds by buying and selling investment assets with the money in them. However, there are a number of key risks and responsibilities, including the need to comply with a wide range of super and tax laws.

The trustee for the SMSF should be aware of the timing of the sale in order to reduce tax. When it comes to capital gains tax (CGT) obligations specifically, the Australian Taxation Office (ATO) explains that any "net capital gains" an SMSF makes from selling certain assets may attract CGT.

The ATO points out that the actual tax liability of an SMSF will depend on several factors, however, so let's go over some of the situations in which an SMSF will be liable to pay CGT, and how much tax it may need to pay.

What is CGT (capital gains tax) and How to pay ZERO Capital Gains?

When you sell capital assets, like real estate, cryptocurrency or shares, you can either make a capital gain or loss. This refers to the amount you receive by selling it, minus the amount you paid to acquire and maintain the asset. You're only obliged to pay CGT when you receive capital gains from the sale of assets that you acquired after September 20, 1985 (when CGT became effective). Your home (principal place of residence), car and belongings are exempt from CGT.

Capital gains or losses need to be declared on your annual income tax return. Gains are added to your assessable income and may increase the tax you need to pay. Losses can be used to reduce capital gain.

How much capital gains tax do SMSFs have to pay?

The general rule

According to the ATO, the income of an SMSF – including income from capital gains – is generally taxed at a concessional rate of 15% while the SMSF is in the accumulation phase. Any capital gains and losses an SMSF makes during a financial year will be included in the fund's assessable income, so if its gains are more than its losses, it will normally have to pay CGT of 15% on the excess.

There are some cases, however, where an SMSF may pay a higher or lower CGT rate than this.

Non-complying funds

The ATO warns that 'non-complying' SMSFs – those that fail to meet their legal obligations – are not eligible for concessional tax treatment, so they will have to pay a much higher tax rate on all their assessable income, including capital gains. The ATO says this higher rate will be the highest marginal tax rate, which at the time of writing is 45%.

Selling a rental property isn't as simple as taking the money and leaving. Depending on how much you earn and how long you've owned the property, you can incur significant capital gains tax (CGT) charges. That means you're losing a revenue-generating asset and even paying a lot to get rid of it.

There are several ways to avoid capital gains tax when selling an investment property. These are all legal means to reduce the amount of tax you pay, so it's within your rights to take advantage of them. Let's look at five ways to lower your capital gains tax, plus some examples.

The one-third discount rule

If an SMSF sells an asset it has owned for at least 12 months, the ATO indicates the fund may be entitled to ‘discount’ the capital gain by one-third, so only two-thirds of the gain would be subject to tax. This means an SMSF would pay an effective tax rate of 10% (15% minus the one-third discount) on capital gains where the discounting rule applies.

CGT exemptions for SMSFs

In addition to the one-third discount rule, an SMSF may qualify for further tax concessions or exemptions, depending on its members’ circumstances. If any members of an SMSF have entered the retirement phase (i.e. the SMSF has started paying them a retirement income stream), then the SMSF may pay even less CGT according to the ATO. This is because SMSFs in this phase can claim an exemption for income generated by assets used to pay a superannuation income stream. The ATO calls such income ‘exempt current pension income’ or ECPI.

The ATO says that if an eligible SMSF trustee takes the necessary steps to claim this exemption, it can take the tax rate on those assets – including CGT – to nil.

If all the members of an SMSF are in the retirement phase (i.e. none remain in the accumulation phase) this could mean the fund is eligible to pay no CGT, regardless of how long it has owned any of the assets it sells.

Keep in mind, though, that if some of the SMSF members are still in the accumulation phase, or if a member holds both an accumulation account and a pension account, the ATO suggests the tax treatment of capital gains can be a little more complicated and the fund may need to pay some CGT

Capital Gains Tax Liability – SMSF Properties | Accumulation Phase

There are two main reasons why people use an SMSF to purchase investment properties:

- Properties that are earning rent. Once the SMSF is converted into Pension Phase, all rent received into the SMSF is tax-free. The SMSF then pays out a tax-free income to the member of the SMSF (assuming the member is over 60).
- Selling a property and not having to pay capital gains tax. This is a great trick to avoid CGT. Let’s say you purchased a property in your SMSF for $500,000 when you were 50 and you sold it 15 years later after you had retired at 65. Your SMSF sold the property for $1 million, realising a gain of $500,000

Capital gains are also taxed at 15% **unless the asset has been held for more than 12 months**, where the rate of tax drops to 10%. For example, if your SMSF purchased a property for $500,000 and sold it 13 months later for $600,000, the profit of $100,000 would be taxed at 10%, i.e. $10,000 tax payable (assuming no other capital expenses were available to lower the profit).

Capital Gains Tax Liability – SMSF Properties | Pension Phase

Once you convert your SMSF to the Pension Phase, all income and capital gains is taxed at 0%. This is a huge advantage that SMSFs have over all other types of holding vehicles.

> If you convert your SMSF to a pension phase prior to selling this asset, you will pay ZERO Capital Gains Tax.

If you had of held this property in your own personal capacity, you would have to pay tax on $250,000 profit (after applying the CGT discount of 50%) at your marginal rate of tax. For most people, this would be a tax saving of around $90,000- $117,500 by holding the property in your SMSF.

If you are contemplating using an SMSF to purchase a property, it is advisable that you seek advice from your accountant, solicitor and financial planner to determine if this investment vehicle is appropriate for you.

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Table of Contents

- How much capital gains tax do SMSFs have to pay?
- Non-complying funds
- The one-third discount rule

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