

Welcome to the third Abacus **YOUR KNOWLEDGE** Newsletter for 2006. In this edition we discuss *how to calculate the cost base of real estate*, and also *how to calculate capital gains tax on assets acquired from a deceased estate*. Both important considerations for many clients in a variety of situations.

CALCULATING THE COST BASE OF REAL ESTATE

To calculate a capital gain or capital loss, you need to know the cost base of your asset. The basic rules are the same for all assets, but some additional rules apply to calculating the cost base or reduced cost base of real estate.

There are a few rules that you may need to keep in mind when you calculate your capital gain or capital loss from real estate, in particular rules relating to:

- the non-capital costs of ownership, and
- cost base adjustments for capital works deductions.

Non-capital costs of ownership

Rates, insurance, land tax, maintenance and interest on money you borrowed to buy the property or finance improvements to it are not included in the **reduced cost base**. They are only included in the **cost base** if:

- the property was acquired under a contract entered into after 20 August 1991 (or if you didn't acquire it under a contract, you became the owner after that date), **and**
- you could not claim a deduction for the costs because the property was not used to produce assessable income – for example, it was vacant land, your main residence or a holiday home during the period.

Example:

On 1 July 2000, Kris purchased a block of land for \$40,000 (including legal fees, stamp duty and related expenses). On 30 June 2004, he sold it.

During the four years he owned the block, he paid \$5,000 for rates, land tax and interest. As he did not use the land to generate any income, he could not claim a deduction for any of these expenses.

The cost base of the block of land is \$45,000.

Cost base adjustments for capital works deductions

In working out a capital gain in respect of property that you used to produce assessable income – such as a rental property or business premises – capital works deductions you claimed, or were entitled to claim, may need to be excluded from the cost base or reduced cost base.

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Abacus Staff Profiles



KATRINA HALL *Client Relationship Manager*

"Service is the greatest benefit we can provide to a customer."

Katrina has an extensive background in many different industries including Corporate Services, Real Estate, Aviation, Transport & Logistics. Her specialist areas of expertise include Change Management, Process Re-engineering, Client Management and Human Resources.

On a more personal note, Katrina loves Indian food, although she can't cook, has a gorgeous two year old son and loves nothing better than a great meal with her husband and close friends at one of Melbourne's many great restaurants.

Katrina is enjoying the fast paced environment at Abacus and is looking forward to meeting and working with more Abacus clients.



ANTHONY BEEKMANS *Senior Accountant*

"I am passionate about achieving the best possible outcome for clients' tax & business affairs."

Anthony has over 10 years professional experience, and in his current role as Senior Accountant at Abacus he is predominantly involved with Companies, Trusts, Partnerships and Superannuation Funds.

Anthony lives in Melbourne's CBD and loves being close to the vibrancy of the city's heart. He has two children, loves Chinese food and the movie 'Goodfellas', and is an admirer of the charismatic Richard Branson.

If he could change one thing in the world it would be to come up with an alternative to timesheets!

Calculating the cost base of real estate... Continued from page 1

Exclusions from the cost base

You must exclude from the cost base the amount of capital works deductions you claimed or were entitled to claim for a building, other structure or improvement if you acquired the property (including vacant land):

before 20 September 1985 and:

- the capital works deductions were for a building or other structure constructed on the property after 13 May 1997
- the capital works deductions were for improvements (such as renovations) made to the property after 13 May 1997 and the cost base of the improvements is more than
 - the **improvement threshold** for the income year in which the property was disposed of, and
 - 5% of the proceeds received from the sale of the property

during the period 20 September 1985 to 13 May 1997 and:

- the capital works deductions were for a building, other structure or improvements constructed on the property after 30 June 1999

after 13 May 1997 and:

- the capital works deductions were for a building, other structure or improvements constructed on the property at any time.

Exclusions from the reduced cost base

The amount of the capital works deductions you claimed or were entitled to claim for a building, other structure or improvement is excluded from the **reduced cost base**.

Example: Capital works deduction

Zoran acquired a rental property on 1 July 1997 for \$200,000. Before disposing of the property on 30 June 2005, he had claimed \$10,000 in capital works deductions.

At the time of disposal, the cost base of the property was \$210,250. Zoran must reduce the cost base of the property by \$10,000 to \$205,250.

Example: Sale of a rental property

Brett purchased a residential rental property on 1 July 1997. The price he paid was \$150,000 of which \$6,000 was attributable to depreciating assets. He also paid \$20,000 in total for stamp duty and solicitor's fees.

He rented out the property after spending \$2,500 on initial repairs. In the next few years, Brett incurred the following expenses on the property:

Interest on money borrowed	\$10,000
Rates and land tax	\$8,000
Deductible (non-capital) repairs	\$15,000
Total	\$33,000

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CALCULATING CAPITAL GAINS TAX ON ASSETS ACQUIRED FROM A DECEASED ESTATE

If you become the beneficiary (or legal personal representative) of a deceased estate before 11.45am (by legal time in the ACT) on 21 September 1999 and dispose of a capital gains tax (CGT) asset that you inherited after that time and date, there are two ways of calculating your capital gain. You can use either the indexation method or the discount method, whichever gives you the better result. The discount method is only available if you are an individual, a trust or a complying superannuation entity.

As a general rule, elements of the cost base of an asset can be indexed if you own the asset for at least 12 months before disposing of it. However, if you receive an asset from a deceased estate, the 12-month period is calculated from the time the deceased acquired the asset, not from the date of their death.

For the CGT discount to apply, you must have acquired the asset at least 12 months before disposing of it. For the purposes of this 12-month ownership test, you are taken to have acquired the asset at one of the following times for:

- pre-CGT assets, the date the deceased died, and
- post-CGT assets, the date the deceased acquired it.

Example:

Transfer of an asset from the executor to a beneficiary

Maria died on 13 October 2000 leaving two assets: a parcel of 2,000 shares in ABC Ltd and a vacant block of land. Giovanni was appointed executor of the estate (the legal personal representative).

When the assets are transferred to Giovanni, any capital gain or capital loss is disregarded. Giovanni disposes of (sells) the shares to pay Maria's outstanding debts. As the shares are not transferred to a beneficiary, any capital gain or capital loss on this disposal must be included on the tax return for Maria's deceased estate.

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When Brett decided to sell the property, a real estate agent advised him that if he spent around \$30,000 on major structural repairs, the property would be valued at around \$500,000. He had the repairs done and put the property on the market.

On 1 April 2003, he sold the property for \$500,000 (of which \$4,000 was attributable to depreciating assets).

Brett's real estate agent's fees and solicitor's fees for the sale of the property totalled \$12,500.

Brett could not claim any capital works (special building write-off) deductions as construction of the property began before 22 August 1979 and, as a result, the repairs he made did not qualify. (For information about capital works that qualify for a deduction, see *Rental properties*; for information about how capital works deductions affect the CGT cost base, read *Cost base adjustments for capital works deductions*.)

This is Brett's only capital gain for the year – and he has no capital losses to offset from this year or previous years. Brett works out his cost base as follows:

Purchase price of property (not including depreciating assets)	\$144,000
<i>Plus</i>	
Stamp duty and solicitors fees on purchase of the property	\$20,000
Capital expenditure (initial repairs)	\$2,500
Capital expenditure (major structural repairs)	\$30,000
Real estate agents fees and solicitors fees on sale of the property	\$12,500
Cost base unindexed	\$209,000
Brett deducts his cost base from his capital proceeds (sale price): Proceeds from selling the house (not including depreciating assets)	\$496,000
<i>Less</i> Cost base unindexed	\$209,000
	\$287,000

He decides the discount method will give him the best result, so he uses this method to calculate his capital gain:

$$\$287,000 \times 50\% = \$143,500$$

Brett shows \$143,500 at **Net capital gain** on his tax return.

Brett shows \$287,000 at **Total current year capital gains** on his tax return. Brett must also make balancing adjustment calculations in relation to his depreciating assets. Because he used the property 100% for taxable purposes he will not make a capital gain or capital loss from the depreciating assets.

Calculating capital gains tax on assets acquired from a deceased estate...Continued from page 2

When all debts and tax have been paid, Giovanni transfers the land to Maria's beneficiary, Antonio, and pays the conveyancing fee of \$5,000. As the land is transferred to a beneficiary, any capital gain or capital loss is disregarded. The first element of Antonio's cost base is taken as Maria's cost base on the date of her death. Antonio is also entitled to include in his cost base the \$5,000 Giovanni spent on the conveyancing.

**Example:
Indexation and CGT discount**

Leonard acquired a property on 14 November 1998 for \$126,000. He died on 6 August 1999 and left the property to Gladys. She sold the property on 6 July 2004 for \$240,000. The property was not the main residence of either Leonard or Gladys.

Although Gladys acquired the property on 6 August 1999, for the purpose of determining whether she had owned the property for at least 12 months, she was taken to have acquired it on 14 November 1998 (the day Leonard acquired it).

At the time of disposal, Gladys is taken to have owned the property for more than 12 months. As she acquired it before 11.45am (by legal time in the ACT) on 21 September 1999 and disposed of it after that date, Gladys could choose to index the cost base. However, if the discount method gave her a better result, she could choose to claim the CGT discount.

If Gladys chose the discount method, she would have to exclude from the first element of her cost base the amount that represented indexation that had accrued to Leonard up until the time he died.

Wishing you all a smooth end of Financial Year as we rapidly approach June 30.

Speak to your Abacus consultant for more information on anything contained in this newsletter.

Call (03) 9655 3900