Death and taxes

In this world nothing is certain but death and taxes.

— Benjamin Franklin

Death and taxes have long been regarded as inevitable. However, payment of one tax — CGT — can be deferred for many years if you go about it the right way. This is because death does not trigger CGT — it merely transfers any CGT liability to the beneficiaries who receive the asset. If the asset is disposed of, they may be liable for CGT, but if the asset is kept for their lifetime any CGT applicable would be passed on, in turn, to their beneficiaries.

To help you understand how it works, let's imagine that you have been left an investment property by your aunt, who has recently died. Your first job is to thank her from the bottom of your heart, and the next is to find out when she acquired it.

If she bought the property before 20 September 1985, it would be free of CGT. Therefore, you will be deemed to have acquired it on the date of her death at its then market value. The position is the same as if you bought it via a normal sale. Suppose she paid $90,000 for the property in August 1985 and its value was $800,000 when she died on 1 September 2019. For tax purposes you are deemed to have acquired it for $800,000 on 1 September 2019; this will be your cost base when you dispose of it. You receive the property with no CGT liability, as the original owner had none.

If instead she bought the property after 20 September 1985, it is subject to CGT, and any capital gain is effectively transferred to you. For example, if ***she*** paid $300,000 on 1 July 2002 the ATO will assume that ***you*** acquired it on 1 July 2002 for $300,000.

The same principles would apply if she had left you her home. Usually it would be exempt from CGT and, in most cases, will be deemed to pass to the beneficiaries at its market value at the date of death. However, it must be disposed of within two years of her death for it to retain its tax-free status. If not sold within that time, your cost base would still be the value of the house at date of your aunt's death, but you could be liable for any capital gain from date of death until sale. Be aware that special rules apply if the deceased rented out the property at any time but, if it was her residence at date of death, all previous rental use is forgiven.

As you can see, it's simple, but the examples do highlight the importance of seeking advice before you sell any assets that you have received through a will, as you may find yourself facing an unexpected CGT bill. Also, when making a will, be aware that a pre-CGT asset is more valuable than a post-CGT asset, as the latter carries CGT liability with it.

If you are left a good property or quality shares, try to use that asset to borrow for more investment instead of selling it and paying CGT. This enables you to defer CGT, have more assets working for you, and also claim a tax deduction for the interest on the loan.

CASE STUDY:

An investor, who earns $110,000 a year, is left a property worth $400,000. It was bought in 1998 for $160,000 and now returns $16,000 a year after all expenses. He wants to diversify his assets by buying $400,000 worth of managed funds but discovers he will be liable for CGT of around $50,000 if he sells the property. His present position is:

Property income	$16,000
Less tax @ 39%	$6,240
Return after tax	**$9,760**

If he sells the property, he will pay almost $50,000 in CGT and so will have $350,000 left over for the managed funds.

However, if he keeps the property and borrows the whole purchase price of the managed funds, his position is:

Property income	$16,000
Managed funds income	$17,000
Investment income	**$33,000**
Interest *($400,000 @ 5%)*	$20,000
Taxable profit	$13,000
Less tax @ 39%	$5,070
Net profit	**$7,930**

This smart strategy has kept $7,930 in his pocket, avoided paying $50,000 of CGT, and has put another $400,000 of assets under his control, which should produce growth of 5% a year over the long term, plus dividends.

This is a graphic illustration of how a smart strategy and a basic knowledge of the tax laws can boost your wealth-creation program.

$ MONEY CLIPS

- *Death does not trigger CGT; it merely transfers any CGT liability to the beneficiaries who receive the asset.*
- *Seek advice before you sell any assets that you have received through a will.*