TAX TALKS

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20 | 50% CGT Discount

The 50% CGT discount in Div 115 has saved millions of taxpayers billions of dollars since it was first introduced on 20 September 1985.

50% CGT Discount

The 50% CGT discount is relatively straight forward. You take your capital gain, deduct any capital losses, check whether the 15-year exemption in Subdiv 152-B applies and if not, divide the amount by 2. That’s all. The other small business CGT concessions come after that.

Legislation

The 50% CGT discount is legislated in Division 115.

Subdivision 115-A covers the general rules. Subdivision 115-B discusses who gets what percentage. Subdiv 115-C is just about net capital gains in trusts so highly relevant if you are working on a trust. And Subdiv 115-D is for shareholders in listed investment companies.

Basic Rule

Individuals and trusts receive a 50% and superannuation funds receive a 33 1/3% discount on their net capital gain.

> *s115-100: The discount percentage for …a discount capital gain is 50% if …by an individual …or…by a trust ..or…33 1 / 3 % if ..by a complying superannuation entity; …*

Companies get nothing, since not mentioned in s115-10.

> *s115-10: To be a discount capital gain, the capital gain must be made by (a) an individual or (b) a complying superannuation entity or (c) a trust or (d) a life insurance company in relation to….a complying superannuation asset.*

That’s the basic rule. But…

Conditions

There are quite a few conditions attached to all this. The first three are highly relevant. After that it gets either very specific or outdated.

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For all this, let's assume that it is you selling the asset. 'You' feels more personal and less boring than 'the entity' or 'the taxpayer'.

1 At least 12 months

The first condition is that you must have owned the CGT asset for at least 12 months.

> *s115-25 (1): To be a discount capital gain, the capital gain must result from a CGT event happening to a CGT asset …acquired … at least 12 months before the CGT event.*

2 Australian resident for tax purposes

The second condition is that you must be an Australian residents for tax purposes (irrelevant what your visa or passport says). So foreign residents don't qualify.

> *s115-105 (1) and s115-110 (1) : …to deny you a discount..while a foreign resident or temporary resident.*

3 Certain CGT events

And the third condition is that the CGT event must not be a CGT event excluded from the discount. Capital gains from certain CGT events are specifically excluded.

> *s115-25 (3): A capital gain from one of these CGT events is not a discount capital gain**…**CGT event D1… D2… D3… E9… F1… F2… F5… H2… J2… J5… J6… K10.*

The most relevant of these are D2 – creation of a right – and J2, J5 and J6 regarding the CGT rollover in s152-E.

Why these exclusions? Let's use an earn-out right as an example. Its only comes into existence through D2, so would never pass the 12-months test.

> *Note to s115-25 (3):[These]…are not discount capital gains because the CGT asset …comes into existence at the time of the event, so it is impossible … that the asset have been acquired at least 12 months before the event.*

But certain CGT events are specifically included.: D4 (conservation covenant), E 8 (trust capital) and K6 (interest acquired before 20 September 1985, the day CGT started).

4 After 21 September 1999

One less relevant condition is that you must make the capital gain after 11.45am on 21 September 1999 to claim the 50% CGT discount – s115-15. So this was highly relevant in 1999 but pretty irrelevant now, unless you are working on a tax return for the 1999/2000 financial year.

5 No indexation

Another less relevant condition is that you can't use an indexed cost base **and** claim the 50% CGT discount. But this is a) fairly obvious – anything else would be double-dipping – and b) less relevant as each year passes, since indexation stopped in 1999.

And then it gets really specific from s115-30 onwards. If you are dealing with replacement assets, estates, transfers between trusts or anything else around trusts or listed investment companies, make sure you go back to the fine print in Division 115.

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How It Works

So once you meet these conditions and have deducted any capital losses (and no 15-year exemption in Subdiv 152-B applies), this is a straight forward calculation of capital gain / 2.

But how does this exactly work in actual tax returns?

Let's use this scenario: An Australian tax resident entity owned a CGT asset for 2 years, sells for $1.1m with a cost base of $0.1m and hence makes a capital gain of $1m. To keep it simple no exemption or rollover applies.

Individual

If this is you as an individual, you show a capital gain of $1m and a net capital gain of $500,000 in your individual tax return. And then you tax on the $500,000 at your marginal tax rate.

So in your 2018 tax return: 18 G: Y – 18M: N – 18H: $1,000,000 – 18A: $500,000

Partnership

If this is you as a partner – let's say 50% – you show a capital gain of $500,000 and then a net capital gain of $250,000 on which you pay tax at your marginal tax rate. You don't show the gain as partnership income in the partners' tax returns. But instead as a direct capital gain. So everything is the same as if you had sold the asset as an individual, except that you now only show your 50% share.

So in your 2018 tax return: 18 G: Y – 18M: N – 18H: $500,000 – 18A: $250,000

Why is that? A partnership is a contractual relationship between individuals, trusts or companies. It is not a separate legal entity. As such the partnership prepares a partnership tax return, but does not pay tax on the capital gain. In fact the partnership doesn't even show the capital gain in its tax return. You as a partner do.

And you do because you own the asset. The partnership doesn't. The partnership is not a legal entity and hence can't. You own the asset in the proportion to which you and the other partners have agreed.

Trust

If it is the trust selling the asset – let's assume you are a beneficiary – then we need to first look at the trust.

There are many similarities between a partnership and a trust. Both are contractual relationships and not separate legal entities in their own right. Both don't actually own the asset. Both prepare a tax return but don't pay tax. And both pass the capital gain to the parties involved and then have these parties assessed afresh regarding any discounts or exemptions.

But different to a partnership, the trust actually shows the capital gain in its tax return.

So 21G: Y – 21M: N – 21A: $500,000

But now there are five things that happen upon distribution to you as a beneficiary. You are now in Subdivision 115-C territory.

1 Capital gain stays capital gain

You as beneficiary receive a capital gain – not ordinary income or something else. But a capital gain. The capital gain retains its nature as it is passed on from trust to beneficiaries.

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2 Gross up

Subdiv 115-C ITAA97 requires you to gross-up the amount of the net capital gain back to the original gross capital gain. So each beneficiary starts with their portion of the $1m capital gain.

3 New assessment

The gross capital gain is now assessed anew on your level. Check the 15-year retirement exemption in Subdivision 152-B first and then go through method statement in s102-5 as if it had been you who had sold the asset.

> *Note to s125-215: This ensures that your share of the trust estate's net capital gain is taxed as if it were a capital gain you made.*

You check current year capital losses (Step 1), past year capital losses (Step 2), the 50% CGT discount (Step 3), the other small business CGT concessions (Step 4) and then determine the net capital gain (Step 5). So you don't just look at the 50% CGT discount, but go through the full method statement again.

If the beneficiary is a bucket company – bad luck – no CGT discount. So don't distribute capital gains to a bucket company.

4 Distribution in the same year

The trust needs to distribute the capital gain in the year of the CGT event for you to have any chance of claiming the 50% CGT discount. If they don't – no discount. Instead the trustee is taxed on the full capital gain of $1m at the highest marginal tax rate under s99A ITAA36.

5 No E4

For a unit trust you need to always consider CGT event E4. However, the payment of a 50% CGT discount to unit holders does not result in an E4 cost base adjustment. This is important. No E4 for the portion of the payment that relates to the 50% CGT discount.

This is different to the distribution of an active asset reduction per s152-C. That one does trigger CGT event E4 and a cost base adjustment.

SMSF

The SMSF is a special form of trust. By definition an SMSF only receives a CGT discount of 33.33% and not 50% like other trusts. Like a trust an SMSF prepares a tax return and lists any capital gain they make.

There are two important differences though. Different to a trust, the SMSF pays any tax on the capital gain. And different to a trust, the capital gain is not pushed down into the beneficiary's tax return. The members of the SMSF do not include the distributed capital gain in their individual tax returns. The taxation point is at the SMSF level.

When fully in accumulation, the SMSF pays 15% tax on the discounted capital gain. This results in an effective tax rate of 10% on the capital gain. 66.66% x 15% = 10%.

When fully in pension mode, the SMSF pays 0% tax on the discounted capital gain. And when in dual mode, the actuarial certificate will determine what proportion of the capital gain is subject to tax.

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So in the example the SMSF reduces the capital gain by the 33.33% discount and then pays 0% to 10% on the net amount of $666,666. The members don't show any distribution in their tax returns, unless the distribution happened without meeting a condition of release.

Company

Companies don't qualify for the 50% CGT discount in Div 115. So when a company sells a CGT asset and makes a capital gain, it doesn't receive a 50% CGT discount. Instead the capital gain is taxed at the company tax rate and then distributed to shareholders as dividends. This is important. The shareholders receive a dividend, not a capital gain.

So in the example the company recognises a capital gain of $1m, pays tax at the corporate tax rate and distributes $700,000 to the shareholders (assuming a 30% tax rate). The shareholder grosses the dividend back up to 100%, taxes it at marginal tax rates and recognises a refundable tax offset of $300,000 for franking credits.

Conclusion

So you got the 50% CGT discount sorted now. But don't stop here. There might be more CGT concessions to claim. It's time to look into the basic conditions of the small business CGT concessions.

MORE

Net Capital Gain

CGT Rollover

Small Business CGT Concessions

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