Everything You Need to Know About CGT on Inherited Property



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Generally, when ownership of a property is transferred to another person or entity, the transfer will trigger a capital gain or loss regardless of whether there was a monetary exchange.

This can result in significant tax implications.

So what does this mean for inherited property?

Thankfully, you won't need to pay capital gains tax (CGT) at the time you inherit the property from a deceased estate. But, there's a strong possibility that you'll trigger CGT liability on the sale of that inherited property.

So, here's what you need to know about CGT on inherited property.

But First, What Is Capital Gains Tax (CGT)?

Suppose you make a profit on the sale of your investment property. If that's the case, that profit is considered a capital gain and must be declared on your income tax return.

According to the Australian Tax Office (ATO), CGT is not considered a separate tax and is added to your annual assessable income – taxed at your marginal tax rate.

However, there are particular rules on how to calculate it.

Once the profit on the sale of your property is calculated, you'll add it to your income return. The additional tax you have to pay resulting from capital gain on your tax return is known as capital gains tax or CGT.

Do Beneficiaries Pay Capital Gains Tax on Inherited Property?

Suppose you inherit property from a deceased estate. In that case, the transfer of ownership of the asset from the deceased estate to you (i.e. the inheritance transaction) isn't considered a capital gains tax event.

If the transfer isn't considered a CGT event, there is no capital gains tax liability.

However, if you decide to sell the property, CGT on inherited property may apply.

Paying CGT When Selling Inherited Property From Deceased Estate

According to the ATO, there are certain rules and exemptions that apply depending on whether you're selling property that was used as a main residence (such as the main residence exemption) or property that was used as an investment to generate income.

However, if you're selling an inherited property from a deceased estate, certain special CGT rules are relevant.

Whether CGT is applicable depends on the following factors:

- when the deceased acquired the property,
- how the deceased used the property while they owned it (i.e. was it the deceased's main residence or was it used to produce income?),
- the deceased's date of death,
- whether the deceased was an Australian citizen at the time of their death and
- whether you were an Australian resident when you sold the inherited property.

CGT Exemptions When Inheriting Property

Based on the factors listed above, certain circumstances will either fully or partially exempt you from paying CGT on inherited property.

You Inherited the Property Before 20 September 1985

If the deceased died before 20 September 1985 and the property transfer also occurred before that date (i.e. the property is a pre CGT asset), you'll be completely exempt from capital gains tax.

However, suppose the property underwent major capital improvements on or after that date for the purpose of using the property to generate income. In that case, part of any capital gain that's accredited to ~~those improvements~~ will be taxable.

You Inherited the Property On or After 20 September 1985

If the deceased purchased the property **before** 20 September 1985, but you inherited it after that date, certain conditions need to be met to exempt you from CGT on inherited property:

- **You sold the property within a two year period:** a two-year window allows you to be exempt from CGT if you sell the property that was the main residence of the deceased, regardless of whether you used the property as your family home (main residence) or to generate income.

(If you sell the inherited property after the two-year window, the full CGT exemption may still apply if the Commissioner of Taxation ~~grants an extension~~.)

Example:

Noah bought a property in January 2008. He treated the home as his main residence (or dwelling), and it was never used as an investment to generate income.

Unfortunately, Noah passed away suddenly in June 2019 and left the flat to his brother William.

After about 11 months of owning the property, William decided that it made financial sense to sell the property, so he put it on the market, and it sold within two months.

So after owning the property for 13 months, William disposed of the inherited property and is entitled to a full CGT exemption. This is because Noah had lived in it when he died, and William disposed of it within two years of his brother's death.

- **The inherited property becomes the main residence:** if the deceased's spouse or a nominated beneficiary in the will (including yourself) occupies the property as their main residence, you'll be exempt from paying CGT on your inherited property.

Example:

Olivia purchased a property on 3 July 1984. She passed away in January 2003, and her niece, Amelia, inherited the property.

According to Olivia's will, her husband, Jack, had the right of occupation of the property until Amelia decided to sell it. Jack moved into the property and treated it as his main residence for the entire period that he survived Olivia.

Amelia only sold the property in January 2012, after Jack had passed away.

As Jack moved into the property as soon as the administration of Olivia's estate was granted, it was his main residence until Amelia sold it.

So, Amelia is entitled to a full main residence exemption.

The Australian Taxation Office has put together a ~~useful questionnaire~~ that could help you establish whether or not you qualify for the full CGT exemption for the sale of inherited property.

Partial Capital Gain Exemption

If you don't qualify for the two full CGT exemptions, you may be able to claim a partial exemption – but it's dependent on how the deceased used the property before their passing.

For example, if they purchased the property after 20 September 1985 and wasn't considered the deceased person's main residence **just before** they passed away, a partial exemption may apply.

Or, if the property was an investment and used to generate income before the deceased's death, or once you inherited it, a partial exemption may also apply.

Example:

Sophia purchased an investment property for $520,000 in September 2002. She used it as an investment to generate rental income and never lived in it as her main residence.

Sophia passed away in May 2009 and left the property to her cousin, Henry, who decided to use the inherited property as his main residence.

The property has experienced substantial growth since Sophia initially purchased it. So, Henry decided to sell the property in April 2019 for $816,000.

As the property wasn't Sophia's main residence just before she died, Henry can't claim a full CGT exemption for the period that Sophia used it to generate rental income. However, Henry is entitled to a partial CGT exemption for the period that he used the house as his main residence.

To calculate the capital gain, Henry would have to work out:

- *how many days Sophia used the property for rental income purposes, and*
- *the total number of ownership days (i.e. Henry's and Sophia's ownership days in total).*

The formula would be as follows:

Capital gain x (non-residence days ÷ today days owned) = taxable amount.

~~Calculating a partial exemption~~ is pretty complex and there are special rules for calculating the inherited property's cost base for tax purposes, so you'll need to engage the services of an expert Tax Agent to get financial advice and see if you qualify for the partial exemption and how much the cost base and exemption amounts to.

Key Takeaways

While you won't be required to pay capital gains tax on inherited property when ownership is transferred to you, you may end up paying CGT on the eventual sale of the inherited property.

Specific CGT rules apply to your potential liability depending on various factors, including when the property was purchased, when it was inherited, and how it was used before and after inheritance.

Those factors will also establish whether you're eligible to claim a full or partial capital gains tax exemption.

Identifying your eligibility for a full exemption can be complex, and calculating your partial exemption can be pretty tricky.

So, to make sure you're meeting your CGT obligations or making the most of the available exemptions, you should seek professional advice from a tax agent who can help you navigate tax on your inheritance.

At Property Tax Specialists, we know the tax rules inside and out, so you don't have to. We make sure your investment property portfolio complies with regulations and meets the necessary reporting obligations.

So, if you have any questions about CGT on inherited property or capital gains tax in general, get in touch today.

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