

27th of January 2009

Peter's Question:

We have a home we currently live in which is valued at approximately \$1m.

We only owe \$70k on the mortgage.

We think we would like a sea change.

We plan to trial this for 1 year or so and the plan is to rent a home in the area we like, whilst we retain our principal residence; however we plan to rent this property out.

We may then either then return to our Principal Place of Residence or stay up the coast if we like it and sell that property to enable a purchase at the coast.

What are the Capital Gains Tax Implications?

Do we have to declare the rental income received?

Are there any other outcomes to be aware of?

When providing advice on these issues we need to consider all of the circumstances of the individual, especially things such as age or stage of life. The answers will be different for different people.

For older age groups – they must consider Centrelink and age care rules. There are important issues to consider regarding the asset and income tests. Homeowners are treated differently to non homeowners and Centrelink rules are different to the ATO rulings. If you leave your family home for longer than 12 months you would be considered a non home owner for Centrelink purposes.

Provided the above points are not issues that affect the individual then the following applies:

You can move out and rent property whilst maintaining a Principal Place of Residence Capital Gains Tax exemption for up to 6 years, so long as you do not own another property as a Principal Place of Residence.

You are not required to move back in to the property prior to sale to maintain the exemption. Within the six year period you could move back in to the property for a period and if you then moved out again, you would gain another 6 year exemption.

The strategy that has been outlined can be a smart way of determining whether a sea change is what you really want.

A few points to note:

1. Renting is generally cheaper than buying.
2. You retain your principal residence for a period of time to ensure the change is truly what you desire and if not you can reverse it all relatively easily.

3. You retain a capital gains tax exemption for up to six years if you do not purchase a new principal residence.
4. You avoid the transaction costs associated with disposing of a property and indeed if you had to repurchase a new property if it did not all work out how you would have liked.

Rent will need to be declared and is assessed as income. This highlights the need to consider your tax planning so you don't get a nasty tax bill at the end of the year when you lodge your return.

Interest costs and maintenance expenses will be deductible but the debt is only \$70,000 so there may not be much interest to claim.

You should be aware of differences between capital expenses vs maintenance and repair expenses. Maintenance and repair expenses will be deductible in the year in which they are incurred. Any expenditure that is considered capital in nature or a capital improvement will have to be depreciated over many years.

Depending on the property you may be eligible to claim some depreciation. It is a good idea to get a quantity surveyor to provide a report for you. On what is depreciable.

Many questions are raised when someone is in this position:

How do you manage your tax position?

Should you increase your salary sacrifice to super to reduce tax? This can certainly be a good way to reduce tax but there are limits and we need to be conscious of the preservation rules.

Should you have an additional investment strategy to try and generate some deductions and reduce your tax liability? This may be a possibility but it all depends on your circumstances.

It would more than likely be a combination of all of the above and possibly other strategies also.

Of course this information is meant to be general information only. Everyone's circumstances are different so you should always seek individual advice that takes your personal circumstances into account fully.

If you have a question you would like discussed on air please email us at admin@rodneygibson.com.au or for more answers call us on 3252 9990 or visit rodneygibson.com.au.