Capital gains tax explained

1 July 2018 (updated annually)

Capital gains tax (CGT) is the tax you pay on the profit you receive when you sell an asset or investment.

What is a capital gains tax event?

A CGT event occurs when:

- you sell an asset, such as property
- you sell an investment, such as shares
- you make an in-specie contribution to your super fund
- shares you own are redeemed, cancelled, surrendered or they are considered valueless by a liquidator
- you receive a payment from a company as a shareholder (not a dividend), or
- you give away, lose or destroy an asset resulting in a capital gain or a capital loss.

CGT will be included in your annual income tax return, however, assets acquired before 20 September 1985 are exempt from CGT considerations.

What is a capital loss or gain?

A capital loss is when you sell an asset for less than what you initially paid for it (known as the "cost base" of the asset). A capital gain is when you sell an asset for more than you initially paid for it. When your total capital losses for the year outweigh your total capital gains, you will finish up with a net capital loss for the year. This means you will not need to pay tax within your annual income tax return with respect to the capital gain you have realised upon the sale of the investment asset.

Managing your CGT

If, however, before the end of the financial year you have a CGT liability, there are a few strategies that you could consider to reduce the pain.

Use a capital loss to offset your tax: Selling poorly performing assets that no longer suit your circumstances before the end of that financial year is one option. By selling a poorly performing asset (ie an asset where the value has decreased) and thus incurring a capital loss, you may be able to offset a realised capital gain from another asset in the same financial year, allowing you to manage your capital gains tax liability. It may also free up money for more suitable investment opportunities.

Stay in it for the long haul: Another way to reduce CGT is to hold onto the investment for more than 12 months. For assets puchased after 21 September 1999, investors have been entitled to claim a 50 per cent discount on capital gains they make on assets held for longer than 12 months from the date of purchase.

Delay any income: If you are thinking of selling off a profitable asset, such as shares or property, it may be worth deferring this sale until after the end of the financial year. In doing so, you will delay incurring CGT for another financial year. So, while you will still need to pay the CGT eventually, freeing up short-term cash flow may be beneficial, depending on your circumstances.

Case study 1

Sarah purchased XYZ shares for $10,000 in 2003 and sold them in October 2018 for $12,000. She had no other capital gain or loss for the year and no unapplied realised capital losses from previous years. In Sarah's case her net capital gain for the 2018/19 tax year would have been: ($2,000) – ($0) – ($1,000 CGT discount*) = $1,000.

* The CGT discount of $1,000 represents 50 per cent of the gross $2,000 gain.

Case study 2

Joe purchased shares on 10 January 2018. He sold the shares on 16 December 2018 at a profit of $5,000. He had no other capital gain or loss for the year and no unapplied net capital loss from previous years.

As he held the shares for less than 12 months, Joe was not entitled to claim the CGT discount of 50 per cent. The total profit of $5,000 was taxable income within his annual tax return for 2018/19 tax year.

Discount method versus indexation method

If you acquired your assets between 20 September 1985 and 21 September 1999, you have the option of using the indexation method to calculate the CGT payable. This method takes into account inflation of the cost base for the asset, meaning you will pay tax only on the capital gain in excess of inflation.

You can usually decide on the option which will ensure the least amount of tax is paid. We recommend that you seek taxation advice on this matter.

Calculations

The formula for calculating a net capital gain or loss is:

Capital gains for current year **less**

Capital losses for current year **less**

Capital losses carried over from prior years **less**

Any applicable general CGT discounts after deducting losses

Equals net capital gain or loss

Ask your Bridges financial planner for more information.