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Renting The Family Home - Capital Gains Tax

In our global economy it is becoming more common for people to move once, twice or more during their lifetime. Many of these people have purchased a home for them or their family and are concerned about the taxation implications if they move and then later on decide they want to sell.

There are quite a few scenarios to consider when trying to answer this question and we will endeavour to look at each of them and the taxation implications.

1. Do you need to pay capital gains tax when you sell your family home and it has been rented out ?

Scenario One Troy and Mary purchased a home in 2005. They move in straight away and lived in it for 2 years. They then kept the property, moved overseas, rented a house overseas and rented their house in Australia. They now want to sell their house in Australia. Will they pay tax on the sale ? Troy and Mary will be able to elect for their house to continue to be their main residence for a period of up to six years and therefore if they sold their house from the time they moved overseas up to six years later. This concession is sometimes referred to as the 'absence' provision and does not just apply to moving overseas. It applies whenever you move from your main residence. Even if it's 'down the road'. The term election makes people think that there are some forms to fill in or they need to somehow tell the Australian Taxation Office that this property is their main residence. Nothing like that has to happen. You just need to know in your own mind that this is what you want and that is considered to be adequate. Make sure your accountant also knows so they don't make mistakes when preparing your tax returns.

Scenario Two As above except Troy and Mary have now been overseas for 5 years. They move back to Australia and move back into their house for another 2 years and then move overseas again, rented a house overseas and rented their house in Australia. Do they have only one year left for it to be tax free on sale ? Thankfully the time period started again when Troy and Mary moved back into the house. Therefore when they move overseas they have another period of six years for the house to be their main residence and for it to be tax free. The important point for both Scenario One and Scenario Two is that the Troy and Mary do not have another main residence. If they purchased a property overseas instead of renting then the scenarios are very different.

Scenario Three Troy and Mary purchased a property in 2005. They did not move in and rented it out and claimed it as an investment property in their tax return for 2005 and 2006. They then moved into it in 2007 and want to sell the property. Will they pay tax when they sell ?

Troy and Mary would have had to have moved into their investment property 'as soon as practicable' for it to have been considered to be their main residence. This means that even though it became their main residence when they moved into in 2007 it was not their main residence from the time they purchased it. Unfortunately for Troy and Mary the 'absence' provisions talked about earlier do not apply and they will have to pay tax when they sell. But how do they calculate the amount of the capital gain (or sometimes it's not worth thinking about but a capital loss) ? Troy and Mary are eligible for some relief. They are entitled to a partial exemption because they lived in the house. The capital gain or capital loss that Troy and Mary will make is calculated on the number of days the house was not lived in by them compared to the number of days they owned the house. Let's work through a simple example. The house was purchased on 1 July 2005 for \$300,000 inclusive of all associated costs such as stamp duty, etc. They rented it out from the day they purchased it (they had some great estate agents) and moved into the house on 1 July 2007. They sold the house on 1 July 2008 (it's strange how Troy and Mary manage to align everything to the tax year) for \$500,000 inclusive of all associated costs. Troy and Mary will have a capital gain of \$200,000. The amount that Troy and Mary will need to consider for tax purposes is calculated as

Amount of capital gain x Number of days rented out / Number of days owned This equals $200,000 \times \frac{730}{1,095} = 133,333$

This amount will be eligible for a discount called the general capital gains tax discount which is currently 50%. This would reduce the capital gain to \$ 66,666. This is the amount they would be taxed on.

Scenario Four What if Troy and Mary lived in the house when they bought it in 2005, moved out in 2007, rented out the house in 2007 and purchased another house at the same time they rented out the old one ? You might

think this is the same as Scenario Three but it is slightly different. Instead of calculating the capital gain or loss based on the number of days, Troy and Mary can calculate the capital gain or loss based on the difference between what they sell the house for and the market value on the day they moved out. If the market value on the day they moved out was \$400,000 and they then sell the house for \$500,000 the capital gain for tax purposes will be \$100,000.

As in Scenario Three Troy and Mary will be eligible for the general capital gains tax discount of 50% which will reduce the capital gain to \$50,000. This is the amount they would be taxed on.

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