3 tax tips for inheriting property

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13 August 2020



Inheriting property has the potential to significantly change your life – so make it count! In this article Catherine Chivers, Senior Manager of Strategic Advice at Perpetual Private addresses some of the biggest questions when it comes to inheriting property. She explores the complexity involved in receiving an inheritance and draws on her experience working with clients to highlight why it's important to seek advice first.

The tax treatment of a property inheritance is complicated.

Where you're an Australian resident for tax purposes and you inherit assets from the deceased estate of an individual who was also an Australian tax resident, the transfer of these assets from the deceased estate is not a capital gains tax (CGT) event, in and of itself. This means that only if you decide to sell the asset at a later point in time, then the normal CGT rules apply.

Whether capital gains tax is applicable will generally depend on four factors:

1. **When the deceased first acquired the property**: whether the property was bought before CGT was introduced in Australia (19 September 1985); or after this time. If acquired before 20 September 1985, it generally won't be subject to CGT as the property is considered a pre-CGT asset.

2. **How the deceased used the property in their lifetime:** whether the property was ever used as an investment and was used for income producing purposes. If it was always used as a family home, then the 'main residence' exemption (see below for more information) may apply in full; if it was ever used as a rental property, then the main residence exemption may not apply, or may only apply in part.
3. **The period between the death and any property sale (ownership period):** If the home was purchased post-CGT then no CGT will apply if, just prior to death, the property was the deceased's main residence and not used for income producing purposes at that time, and is sold within two years of the date of death. This CGT exemption will extend beyond this two-year window, if from the deceased's date of death until when the property is sold, it was the main residence of either:

    - the deceased's spouse,
    - an individual with a right to reside under the terms of the deceased's will, or
    - the beneficiary who will inherit the property.

    If the home was purchased pre-CGT the same criteria above applies, but the restriction on the property not being used for income producing purposes is removed.

    And, for a CGT exemption to apply to a spouse in the above circumstances, they must not have been living permanently and separately from the deceased at the time of their death.

    There is the discretion for the two-year period to be extended in certain cases too.

    A partial CGT exemption may apply where the property was used for income producing purposes at some stage during the ownership period.
4. **Location of the property and tax residency status:**issues to consider include where the deceased lived, where the property is located, as well as where you live. New rules from

1 July 2020 deny non-Australian tax residents the ability to claim the main residence exemption (unless it's in very limited circumstances).

For example, where an Australian residential property is inherited from a deceased person who had been a foreign tax resident for more than six years at the time of their death (and certain criteria is not met) then the main residence CGT exemption that the deceased person may have otherwise accrued is unavailable. This means that CGT may be payable when you dispose of the property.

A non-Australian tax resident may also need to pay tax on the inheritance when the property is transferred to them, subject to tax laws applicable within the country where they hold tax residency status. As the legislation surrounding the CGT exemptions applying to a main residence are amongst the most complicated in tax law, seeking tailored advice in this area is recommended.

The biggest myth is that this is an easy area to navigate and if a property was a main residence, then it’s automatically tax-free when it’s inherited. But as you can see, that's not always the case.

What is the main residence exemption?

Generally speaking, your ‘main residence’ is the home you live in. Typically, your main residence will be where you (and your family) live as well as where your personal belongings are. Other criteria are also important in determining if a property you own is your main residence, such as whether it’s: where your mail is delivered, noted on the electoral roll and key utilities like gas and power are connected and actually used. This list is not exhaustive.

You're likely to be eligible for a full main residence exemption where the property:

- has been your home (including that of your spouse/family as relevant) for the entire ownership period, and
- has not been used for income producing purposes, and
- is situated on a land size of two hectares or less.

If the full exemption applies, any capital gain or loss is disregarded. Alternatively, you may be entitled to a partial exemption.

There’s lots of misinformation about property out there

It's a complex topic and misinformation easily occurs. Understanding the nature of the property and who owns it, as well as considering the tax implications is important, especially in blended families.

It's relatively common that children from a previous marriage mistakenly assume that they'll inherit a property, on the basis they think it's solely owned by their parent. It's only when their parent passes away that they realise the property automatically passes to their step-parent because it was bought in both names as joint tenants. Or, it was never owned by their parent to start with.

Top tax tips for inheriting property

1. Know as much as possible about the property; how it was used, where it is and preferably have access to title deeds, important documents and details of any cash receipts that may have been used to acquire the property. In Australia, 'title' is a very fixed concept, but in some other jurisdictions it can be a little more uncertain or there may be difficulties in obtaining information due to bureaucracy or language constraints.
2. Avoid assuming ownership; ensure you understand how the property is owned rather than rely on assumptions.
3. Be aware of the rules applying from 1 July 2020 for non-Australian tax residents; as these may impact your property inheritance.

It's always a good idea to seek professional financial advice; a good financial adviser will help you navigate the emotions that come with receiving an inheritance as well as help you understand all your options as you decide what to do with it.

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