Death Tax will make Widow Homeless unless Husband Dies before 1st July, 2027

A lovely couple, I hadn't seen them in a few years, since they retired. Very sad news he has been diagnosed with pancreatic cancer but that wasn't his major worry. He always felt that his wife would be fine, they own their house so she should be able to get by on the pension. That was until he realised the new budget measures mean that capital gains tax will be payable on the house when he dies regardless of whether it is sold or not. The government have moved the goal posts to tax unrealised capital gains.

This elderly gentleman bought the house back in 1990 as an investment property. When his first marriage broke down in 2020 his first wife took the family home and he took the rental property. This means there was no main residence exemption on the property between 1990 and 2020. The property cost $80,000 in 1990 and is now worth around $1mil.

His life expectancy is a couple of years with palliative care support. They wanted me to calculate how much capital gains tax will be payable when he dies.

It is a simple enough calculation because the property was purchased before 20th August, 1991 so holding costs cannot be used to increase the cost base. In other words all the costs of maintaining property such as insurance, interest, rates and repairs are not taken into account when determining how much the capital gain is. So not only will the government be taxing unrealised capital gains they will be ignoring the cost of expenses associated with achieving the capital gain. It is a simple calculation but eye watering.

Assuming the property is still worth $1mil on 30th June, 2027 that is a $920,000 capital gain, less the 50% CGT discount $460,000. Only seven of the 37 years it has been owned are covered by the main residence exemption. Eighty one percent of the gain is taxable, $372,600 is included in his date death tax return plus whatever pension he received that year.

The tax bill payable on his death will be $142,270 plus Medicare of $7,800 and Medicare Levy Surcharge of $5,850 a total payable of $155,920. She is in tears, when he dies she will have to sell the home to pay the tax and sell quickly. He is left thinking the best thing he can do to provide for his wife is not accept palliative care because if he dies before 1st July, 2027 no tax will be payable, at all. In fact, the whole capital gains tax liability disappears as his wife will inherit the house with a cost base of the market value at the date of his death simply because it will be his home when he dies.

Why is this so? Newly passed legislation calculates capital gains made up to 1st July, 2027 on assets acquired between 20th September, 1985 and 30th June, 2027 and deems you to have sold the asset and re acquired it. You just don't have to pay the tax on the gain until a realisation event. As the law currently stands death is a realisation event. The capital gain up to 1st July, 2027 becomes a deferred capital gain, waiting for the realisation event. The amount is locked in as per your circumstances at 1st July, 2027. The rollover normally available on death cannot apply because you are not dead at 1st July, 2027. These pre 1st July, 2027 gains have been redirected away from the provisions intended to ensure capital gains tax did not result in a death tax. Now the deferred capital gain ie the gain up to 1st July, 2027 will be included in your date of death tax return.

The government is well aware of this problem in fact there is a cryptic mention of it in in their draft explanatory memorandum (EM) for tranche 2 (code for corrections to their thought bubble legislation). But all the EM does is mention there is a problem with rollovers that they will look into in the future. Do we trust them? Why have they not fixed this fundamental flaw? Big rush to introduce the tax not much interest in making it fair. Are they waiting for the heat to die down, hoping the outrage will pass? Before we know it it will be 1st July, 2027 and the death, disaster and divorce tax already introduced into law, in such a rush, will take full affect. We need to keep up the pressure. Even if they do attempt to fix this, what other problems will they cause in the process? Their track record is not good on looking at the legislation as a whole, just thought bubbles. Remember they also said they would not even introduce these taxes back at the election but now we are supposed settle down and believe they will remove this problem, one day!