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National Accountants Group

Granny Flats

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Granny Flat Tax Issues

Important points to discuss with your Accountant before you build a Granny Flat in your back yard.

1) If you are building the Granny Flat to rent out and it is in the back yard of your home then this is very similar to renting out rooms in your house which is covered by ATO ruling IT 2167 https://www.ato.gov.au/law/view/document?DocID=ITR/IT2167/NAT/ATO/00001 . If up until that point in time it has only been used as your home then section 118-192 ITAA 1997 will reset your cost base to market value at the date it first earns income. From that point onwards only the portion of the property that you use as your home will be protected from CGT by your main residence exemption.

2) If you are building the Granny Flat to house a family member then as long as both households interact frequently and it is not earning income both units could be considered one dwelling for capital gains tax purposes and both buildings will be covered by the main residence exemption. Reference TD 1999/69 https://www.ato.gov.au/law/view/document?locid=txd/td199969/nat/ato

3) Centrelink permits pensioners to sell their home and pay money to their child for a right to occupy part of the child's home, without triggering the gifting provisions. But this is not a good outcome for the child. If they simply receive the money in return for granting their parent a right to occupy the property then the child is selling a legal right, not part of their home. The right is a separate asset from the home and will trigger CGT event D1 with only any legal costs to form the cost base and no 50% CGT discount because the right comes into existence at the time it is sold so 12 months cannot lapse. For this reason it maybe more practical for the parent to actually buy part of the property so the transaction can be covered by the main residence exemption.

4) If you build a Granny Flat on a property that you purchased before 20th September, 1985 then you have created an asset that is separate from the land and your house. The land and original building are still considered a pre CGT asset but the Granny Flat will be a post CGT asset and subject to CGT unless covered by your main residence exemption as discussed above.

5) If you think you will be caught with some CGT, when you eventually sell the property, then make the most of section 110-25(4) ITAA 1997. This section allows you to increase your cost base by the costs of holding the whole property, such as rates, insurance, interest, cleaning materials, lawn mower fuel, light globes, just keep lots of records. These expenses cannot have otherwise been claimed as a tax deduction (ie against the rent received) and cannot be used to create a capital loss.
   Now the way the CGT formula works is you work out the capital gain on the whole property first, then apportion it on the ratio of the percentage of the area covered by your main residence exemption and the percentage of the area not covered. This flat pro rata apportionment based only on a percentage does not take into account, when calculating the capital gain, whether the expenses relate to the side covered by your main residence exemption or not. Effectively allowing a portion of the costs associated with the exempt side to reduce the capital gain on the side that is exposed to CGT. Meanwhile the expenses relating to the side exposed to CGT have already been claimed as a tax deduction. The best tax tip is to keep good receipts.

How To Get Your Questions Answered:

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