Tax Talk Article –Sale of an Investment Property

There have been some enquiries on the sale of an investment property and whether it will be subject to Capital Gains Tax (CGT) or Income Tax. In this week's article we will identify the respective taxes applicable and its application. Prior 2016, any gain on sale (excluding exemptions) of property or capital asset whether it was an investment property, business or personal asset, would have been subject to CGT of 10%. A Capital Gain is the consideration received by a person on the disposal of a capital asset reduced by the cost of the asset at the time of disposal
Under the new Income Tax Act 2015 (ITA 2015), there is a distinction on the gains from a Capital Asset to a Depreciable Asset where the gain on disposal of a Capital Asset is subject CGT whilst the gain on disposal of a Depreciable Asset is subject to Income Tax.

Depreciable Asset

Investment property includes commercial properties and residential properties on lease or rent. Owners of such property would declare income earned from such properties and would also claim depreciation on such property. These assets are known or regarded as depreciable assets.
In broad terms, a depreciable asset is an asset that loses value over its useful life as it is used to derive amounts included in gross income. The cost of a depreciable asset is deducted over the useful life of the asset rather than deducted in the tax year in which the cost was incurred. This allocates the cost of the asset to the tax years in which the asset is "consumed" (i.e. used up) in deriving amounts included in gross income.

A depreciable asset is tangible personal property (such as plant or equipment) or a structural improvement to real property (such as a building) that satisfies the following conditions -

(1) The property or structural improvement must have a useful life of more than one year.

(2) It loses value as a result of wear and tear, or obsolescence. The property or structural improvement is "consumed" or "used up" in the taxpayer's business operations.

(3) The property or structural improvement must be wholly or partly used to derive income included in gross income or gains that are taxable

The concept of a depreciable asset is confined to tangible personal property and structural improvements to real property.

Non Depreciable Asset

Property or a structural improvement used solely to produce exempt income or for private purposes is not a depreciable asset so as Land as it does not have a limited useful life.

Taxes and Applicability

When selling an investment property, any gain on a Depreciable asset, which is building, will be subject to 20% Income Tax whilst the gain on land will be subject to 10% CGT. For a sole trader or partner, where the gain on sale of a depreciable asset exceeds $270,000, the excess will be subject to Social Responsibility Tax starting at 23%.

Example: Grace, a sole trader sold an investment property for $700,000 (Land $200,000 plus Building $500,000). The total cost for the land and building was $300,000 (Land $50,000 plus Building $250,000). The depreciation Grace had already claimed against the investment property was $50,000 which meant that the written down value of the building was $200,000.

CGT 10% Calculation

CGT will only be applicable to Land as it is depreciable asset in this case.

Capital Gain on Land = $150,000 = ($200,000 less $50,000)

Therefore, CGT payable = $15,000 = ($150,000 x 10%)

Income Tax 20% Calculation

Capital Gain on Building = Recoupment of Depreciation plus Capital Gain on Building

$300,000 = $50,000 + $250,000

Therefore, Income Tax (using the PAYE Calculator) = $55,460.00

Social Responsibility Tax = $6,900

Capital Asset

A Capital Asset defined under the ITA 2015 must be located and registered here in Fiji. Capital gains tax is imposed on a person who has made a capital gain on disposal of a capital asset. Any Capital Asset not listed in the definition under the ITA 2015 is not a capital asset and, therefore, the disposal of such asset is not subject to capital gains tax. Capital Asset under the ITA 2015 does not include; (i) trading stock; (ii) a depreciable asset; and (iii) a business intangible asset. These exemptions are dealt with solely under the ITA 2015.

Capital Gains Tax Certificate

Irrespective whether the gain on the disposal of an asset is a capital gain or a revenue gain, the settlement cannot take place without a CGT certificate issued from FRCA. The Registrar of Titles will not register an instrument relating to the transfer of a asset, unless the transferor or transferee has furnished the Registrar of Titles with a CGT certificate from FRCA. FRCA will not issue the CGT Certificate unless the proper tax due on the transfer has been paid or satisfactory arrangements for payment of the tax have been made. For migration cases, FRCA will need the CGT to be cleared before the CGT certificate is issued. In order to obtain the CGT certificate the following are required:

a) CGT return (IRS 230)

b) CGT declaration form (IRS 228);

c) Stamped transfer document;

d) Previous transfer document;

e) Undertaking from the solicitors for payable cases;

f) Evidence of improvements and incidental expenditures.

g) Loan offer letter

The turnaround time for processing the application is 3 working days.