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Monthly Information Newsletter – Tax & Super

October 2021

Inheriting rental properties jointly A dilemma?

Imagine you're lucky enough to inherit, say, four post-CGT rental properties from a deceased parent – but what happens when your sibling also inherits a half-share of these?

While you both acquire a very valuable 50% interest across four properties, it's safe to say that in most scenarios, you'd both rather have a 100% interest in two of them.

CGT triggered

Assuming both siblings desire a 100% interest in two properties each (rather than a 50% interest in four properties), they're going to have to do a bit of "horse trading" between them.

This means that each sibling has to give up their 50% interest in two of the four properties, in exchange for acquiring a 50% interest in the other two properties.

It's important to note that such an exchange of interests will trigger CGT consequences. This is because the interest exchanged (or disposed of) is a CGT asset with a particular cost base (under the inherited asset rules in s 128-15), and the capital proceeds for this CGT event will be the market value of the interest acquired in another property. However, the benefit of the CGT discount should be available.

Moreover, because none of the properties are a main residence or a pre-CGT dwelling, the full CGT exemption rules in s 118-195 cannot be brought into play.

Even so, there may be a couple of solutions to this problem that allow both siblings to get their desired 100% interest each in two properties – without triggering any CGT consequences.

Solution 1: A broadly written will

If the will's been written in broad enough terms, the executor could use their power/discretion to treat the properties as a pool of assets that can be divided equally between the siblings (i.e., so they can get two each).

While this presents one solution, adjustments may still be required if some of the properties have a greater contingent CGT liability attached to them than others (at least at the time of distribution) – and this would have to be accounted for in some way to keep both siblings happy.

At any rate, this becomes a matter of the interpretation of the will – a complex topic that's beyond the scope of this article – and other issues relating to trustee powers may need to be factored in.

Solution 2: Section 128-20(1)(d)

Perhaps a better solution (assuming there are no Pt IVA issues) comes from the rule in s 128-20 of the ITAA 1997, which relates to assets in an estate passing to a beneficiary without any CGT consequences.

In particular, the rule in s 128-2091) (d) allows for this to occur on the settlement of a claim by one or more beneficiaries (or other persons) by way of entering a deed for consideration in which they relinquish rights under the will.

Specifically, the rule provides that an asset can pass to a beneficiary under a will:

> *(d) under a deed of arrangement if: (i) the beneficiary entered into the deed to settle a claim to participate in the distribution of your estate; and (ii) any consideration given by the beneficiary for the asset consisted only of the variation or waiver of a claim to one or more other CGT assets that formed part of your estate.*

If this is carried out during the period of administration of the estate, then each sibling could take their 100% interest in two properties without any CGT consequences arising from this sanctioned estate settlement.

Ruling TR 2006/14 (see paragraphs 33-37) also indicates that this is a legitimate way for beneficiaries who are dissatisfied with a will to dispute it and then enter into a deed of arrangement to affect a redistribution of estate assets – without jeopardising the CGT rollover that becomes available upon death.

It's important to note, however, that recourse to this section first requires that the deed is entered into to settle a claim to participate in the distribution of your estate.

Crucially, in this regard, paragraph 37 of TR 2006/14 states (*emphasis added*):

> *"A taxpayer is not required to commence legal proceedings in order to establish, for the purposes of paragraph 128-20(1)(d), that they have a claim to participate in the distribution of the assets of the estate. A claim may be established by a potential beneficiary communicating to the trustee their dissatisfaction with the will".*

The solution to the problem!

And so, we have a workable potential solution to this problem, subject to any Pt IVA considerations – if you call inheriting multiple rental properties a "problem"!

⇒ There are a range of factors at play when determining CGT on property. Speaking to an accountant or registered tax agent will help you to understand the options available to you.