

## FACTS SHEET – February 2005

# Capital Gains Tax: Running your business from home

Recently I had the pleasure of providing capital gains tax advice to an old friend. This person is a professional and about to embark on the course of running a professional business from home. This is becoming more of a common occurrence as modern corporate culture is demanding more 'outsourcing' and promoting contract work from home arrangements.

What are the capital gains tax implications should he decide to later sell his home?

Generally a home has a main residence exemption from capital gains tax. However, where a taxpayer actually runs a business out of the home then only a partial exemption will be available.

Please note that we are talking about running a business out of a home, using the home to produce an income, as opposed to using the home as a home office.

A home office is where you may take work home with you after hours. It is a place set up to assist you in earning your income which is derived from outside the home. Accordingly, tax deductions are available for some electricity and power, depreciation on any office equipment and furniture, and any business telecommunication costs. There is no capital gains tax implication so that the main residence exemption is available.

If you run a business out of a home you are entitled to the same income tax deductions above plus a portion of the mortgage interest expenses, insurance, council rates and so on. But that portion of the home out which the business is run is subject to capital gains tax.

It has been suggested that if you don't claim these expenses then you are not liable to the capital gains tax. This is wrong. The law is clear and states at Section 118-190 ITAA 1997 that capital gains tax is payable on that portion of the home used for running the business when:

- the home was acquired on or after 20 September 1985;
- part of it was used to produce income at some time when it was owned; and
- the taxpayer would be entitled to deduct interest had it been incurred on money borrowed to buy the home or an interest in it.

A full or partial capital gains tax exemption may be available if you move out of your home and then use it to produce income. A simple example would be where a person moves overseas for a few years into rental premises but continues to own the home and rents it out. If the property is sold the 'absence rule' may apply which effectively allows a capital gains exemption for up to six years. There are certain criteria to meet, for example that you own no other homes and that you still treat the home as your main residence. However, we do caution that an ATO Interpretative Decision ID 2005/19 has been recently released that limits the use to which the home is used in producing income when considering the application of these exemption rules.

In calculating the capital gains tax implications, and depending on circumstances, Section 118-192(2) ITAA 1997 allows the taxpayer who does run a business from home to have acquired the home for its market value on the day when the property was first used to produce assessable income. Accordingly, **we recommend that any persons running their business out of their home obtain a market valuation of their home at the time the home starts to produce income.**

***Important:** The information contained in this Facts Sheet is not advice. Many of the comments in this Facts Sheet are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances. Also please note that changes to legislation may occur quickly.*

**For more information**, or if you would like assistance, please contact Farmilo & Co.

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