Calculating capital gains in a segregated fund with carried forward losses

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Calculating the net capital gain or loss for an income year is usually straightforward; however, there can be some uncertainty where a fund has carried forward capital losses and moves into full pension phase.

The facts

Very simplistically your net capital gain or loss for an income year is:

total capital gains for the current income year

minus

total capital losses from the current income year

minus

capital losses carried forward from previous years (applied in the order in which they were incurred)

minus

any discounts the fund is entitled to.

The ATO suggests in its article on working out capital gains and losses' that capital losses must be applied against capital gains in the order in which they were made. This may cause confusion as it is important that current year capital losses are applied against current year capital gains prior to applying carried forward capital losses.

This distinction is particularly relevant when it comes to calculating net capital gains or losses, and losses to be carried forward, for funds that are entirely in pension phase.

Carrying forward capital losses

We know that capital losses incurred on segregated current pension assets cannot be carried forward – this is one of the sources of capital losses that must be disregarded. The ATO have confirmed that a fund fully in pension phase for a financial year is considered to be fully segregated for that year. This means than any net capital losses incurred in that year must be disregarded and cannot be carried forward.

However, if a fund incurs capital losses in a year where it is not entirely in pension phase these losses can continue to be carried forward even after the fund segregates its assets to pension. These unsegregated losses can be carried forward to future years until they are fully offset by capital gains.

Remember, it is possible to choose which capital gains to deduct a fund's losses from. Any capital losses, including carried forward losses, must be offset against each year's capital gains. The ATO won't allow a fund not to apply capital losses against capital gains if it has them.

Applying carried forward capital losses in a year the fund is segregated

Example 1

Consider a fund with $50,000 in carried forward capital losses from previous unsegregated income years.

The fund moves entirely into pension phase on 1 July 2013 and in the 2013/14 financial year makes a capital gain of $20,000. The fund has no capital losses in 2013/14.

The capital gain for 2013/14 is $20,000. However, as this gain is incurred on segregated pension assets we disregard this gain.

Our net capital gain is $0 so we have no capital gains against which to offset our carried forward losses. The full $50,000 in carried forward capital losses can be carried forward to future income years. This is because those capital losses relate to losses carried forward from a previous unsegregated income year.

Example 2

Consider instead however that in 2013/14 that only one member in the fund moved into pension phase and the fund's remains unsegregated. The fund made a capital gain of $60,000 was on one asset and a capital loss of $20,000 on another.

As all the gains and losses are on unsegregated assets, the fund's net capital gain for 2013/14 is $60,000 – $20,000 = $40,000.

The carried forward losses are then applied in the order in which they were made. So the $40,000 net gain is offset against the $50,000 capital loss carried forward, leaving a $10,000 loss to be carried forward to future income years. The loss relates to carried forward losses from when the fund was unsegregated so can be carried forward.

Example 3

Finally, consider that in 2013/14 one member of the fund moves into pension phase and some of the assets supporting that income stream (e.g. a property) are segregated. Not all the assets supporting the income stream are segregated meaning the fund also has a pool of unsegregated assets which support both pension and accumulation liabilities.

The fund makes a capital gain of $60,000 on the segregated pool of pension assets, a $25,000 capital gain on unsegregated assets and a capital loss of $50,000 on unsegregated assets during the year.

The $60,000 capital gain made on the segregated pension assets is disregarded and the fund makes a net capital loss of $25,000 (i.e. $25,000 – $50,000).

The carried forward capital losses are then applied against the fund's net capital gain/loss for the year in the order in which they were made. As the fund has a net capital loss of $25,000, this is added to the capital loss carried forward from previous unsegregated years and the fund can carry forward $75,000 (i.e. $50,000 + $25,000) in capital losses. When applying these losses against capital gains in future years the $50,000 loss will need to be applied prior to the $25,000 loss made this year, as capital losses must be applied in the order in which they were made.

Conclusion

Capital gain and losses incurred on segregated current pension assets should be disregarded and cannot be carried forward. However, capital losses can be carried forward from years where the SMSF was unsegregated (not incurred solely on segregated current pension assets).

To calculate a fund's net capital gain or loss remember to offset the current unsegregated losses from the unsegregated gains during that current year before applying any carried forward losses. This order is important in ensuring you correctly calculate the funds capital gain or loss in an income year.

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