How Not To Be A Developer

Subdividing The Family Home, Business Premises or Farm

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Warning:
Parts of this booklet have had to be re written even before it was finished due to changes in the law or ATO rulings. This booklet contains too many hot topics to remain up to date for any length of time. Section numbers and rulings are always quoted so it is not hard to check whether there has been any changes. Please make sure you ask a professional to do this for you before you act. We take no responsibility for any action you take as a result of reading this booklet as it is only a guide and professional advice on your particular circumstances is also required.

Introduction

This booklet is not for developers who regularly subdivide land. It is only intended for people who have purchased the land for some other purpose and have now decided to subdivide it. We address how to keep the whole transaction as the mere realisation of an asset and not change over to the business of developing land. If the transaction is the mere realisation of an asset the CGT provisions apply rather than normal income tax law. If you have held the property for more than 12 months being taxed under the CGT provisions will at the very least halve your tax bill. If you can retain the asset's status as an active asset in a business you will further be able to reduce your tax bill, possibly down to zero. So read up there is some real tax savings to be made with careful planing.

There are also GST considerations in developing land regardless of whether normal income tax or CGT apply. The GST ramifications can be reduced in some cases by the use of the margin scheme.

The primary consideration in determining how you are taxed on the profits on the subdivision is what your intentions were when you purchased the land. Of course it is up to you to prove what those thoughts were. What can you expect from a tax and welfare system that is based on who you have sex with and how regularly. So watch those thoughts.

In the following reference will be made to whether a profit is capital or revenue in nature. If it is revenue it will be taxed at normal tax rates. If it is capital in nature CGT applies, so if the property has been held for more than 12 months CGT concessions will apply.

The income tax issues

There are three possible outcomes:

1) Merely Realising an Asset – You did not buy with intention of resale at a profit and you are just doing enough to prepare the property for sale at the best price. CGT applies
2) An Isolated Business Transaction – You did not buy the property with the intention of resale at a profit but to use in a business (ie Farm) then later you subdivide and sell the land but it is not in the ordinary course of the business. CGT and Possible Active Asset Concessions.
3) Property Development – The land is held (TD92/124A) even if not initially purchased for the purpose of resale and a business activity which involves dealing in the land has commenced. The activity of subdividing has blown out to a business activity rather than merely realising an Asset. This is not covered is this booklet other than to explain what not to do. TD92/124 was amended to change the word acquired to held which signals the ATO's opinion that even if you did not purchase the land with the intention of reselling it at a profit you can at sometime change your mind and commit it to this purpose and so be taxed at normal tax rates on the profit. Fortunately the courts have taken a very narrow view of when land purchased without the intention of resale at a profit can become part of a business and thus subject to normal income tax rates.

Crossing the line between CGT and normal tax

If you buy a property with the intention of making a profit on its resale or you at sometime commit the property to a business of selling land for profit (rather than merely realise an asset) you are in the business of trading in property. Even if you purchase a property with the intention of developing it for resale at a profit and for some reason the project is abandoned, you are still liable for normal tax on the resale of the undeveloped land.

If you did not originally buy the property with the primary purpose of resale at a profit it is important that you don't cross the line to making the property part of a business venture. You can have bought a property for some purpose other than resale at a profit but be considered by the ATO to have changed that purpose and commenced the business of development. If you do cross the line and take a property you did not purchase with the intention of resale at a profit, yet put it into a business of property development, normal tax rates will apply to the business's profit. But you will be entitled to bring the property into the business at its market value when the business commenced. This way CGT will apply to the gain up to the market value of when the business commenced. So at least you will get the CGT concessions on some of the profit. If you are going to get caught here, consider making the most of it by transferring the property to a more tax advantaged entity or person.

To not cross the line and ensure that the profit on the sale of the property is taxed under the CGT provisions it is important that your activities in preparing it for sale amount to no more than the mere realisation of an asset in the most profitable way and not the start of a business.

Some examples

The following are reasons you may have purchased the property other than for resale at a profit and a discussion on some of the tax issues:

Purchased To Use As Your Home:

This section assumes that the property is 2 hectares or less, you have owned it for more than 12 months and you have only used the property as your home up until the subdivision. If the property is larger and/or has also produced income while you were living there, you need specific advice and should read the example for farms.

The property would normally be exempt from tax because it is your main residence. But this is only if you sell it as a home. So if you cut a block off and sell it there will be no main residence exemption at all because you are not selling your home. Your exemption would remain with the block your home is on. Here is another trap, if you demolish that home and sell vacant land you will completely lose the main residence exemption for the whole time you owned the property. To qualify for the main residence exemption there must be a dwelling on the property at time of sale, though this can be a caravan. If you sell vacant land after demolishing your home you will be up for CGT on half (assuming held for more than 12 months) the difference between the price you paid for it plus costs and improvements less the selling price. If you purchased the property after 20th August 1991 you can also reduce the gain by the cost of rates, insurance, repairs, maintenance and interest section 110-25.

If you are a builder or developer by trade and you start to cut up the family property you are more likely than other professions to be considered applying the property to a business. Other professions subdividing their own home into a small amount of lots would be very unlikely to be considered to applying the property to a business rather than merely realising an asset. Though to play it safe don't sell the blocks yourself, organise this through a Real Estate Agent.

If you are subdividing your home block and you do not normally develop land or build houses you need to limit your activities to the extent that you will not be considered in the business of developing the land. If you simply apply to council for approval of the subdivision, and sell your home together with the land up to 2 hectares, to a developer you will not pay a cent in tax because of your main residence exemption. If you cut the land up yourself, you are starting to get involved in development activities and you start to cross over to business operations. You will be subject to tax on each block you sell other than the one with your home on it, but the tax will be at least half if you can stay within the CGT provisions because you are merely realising an asset rather than starting a business operation. More detail on this is in the section Are You Merely Realising an Asset? You should be safe if you simply do nothing more than what the council requires under the conditions of the subdivision (ie water, roads) and then engage a real estate agent to market the lots for you.

To Run a Business On:

This is the best outcome as with careful planning the gain can be completely tax free if it qualifies for the capital gains tax small business concessions. On this basis it would be a major tax blunder to take the development too far or be found to have purchased the land for resale at a profit or have transferred the property into a business of developing land and end up being taxed on a revenue basis. Farms are discussed later, this section is devoted to business premises that are later subdivided.

To qualify for the small business concessions you need to be in the simplified tax system or your's and your associates' assets to be less than $6 million and in some cases satisfy a controlling individual test. The following only addresses the ramifications for the land and buildings not the plant and equipment on it.

The property also needs to pass the active asset test and this is littered with traps. The property must be used in the business up to the day of sale and for at least half of the time it was owned. If the business ceases before the sale the asset must have been used in the business up to the time it ceased (note the ATO is taking a very strict view here it means right up to the last day) and then must be sold within one year of the business ceasing. Make no mistake here take one day more than a year from the date you ceased business to the date you sold the land (either subdivided or only with Council approval) and you will go from possibly paying no

tax on the whole project to paying tax on half the profits on the blocks. Note it is the government's intention to make this test easier to pass so check up on this before you start. A property would not be an active asset if it was used to derive rental income unless the rent was received from an associated (common ownership) business. For more details on how the active asset rules work refer to the section titled Active Assets Concessions.

To Rent Out Domestic Accommodation on the Land:

If you buy land with the intention of building a home on it to rent, when you eventually sell, the profits on the sale are a capital gain and subject to the 50% CGT discount if it is more than 12 months between the time you agreed to purchase the land and the time you agreed to sell the house and land.

Steele's case created the precedent that interest can be claimed as a tax deduction while you hold land with the intention of building a rental property on it.

Be careful here if you sell the home within 5 years of it being built GST will apply to the sale if you are already registered for GST in the enterprise that owns the home. . If you are not registered for GST the sale of a new rental property in less than 5 years will not force you to be registered providing of course you can prove that you built the property to rent not to profit from its resale, refer section 188-25.

To Farm:

Just being a farmer does not automatically mean developing the land is capital rather than revenue in nature In Crow v FC of T 88 ATC 4620 the profit a farmer received on selling 51 portions of land was assessable as revenue because his intention when buying the property was to make a profit.

Out of all possible reasons for purchasing a property you are subdividing, using it as a farm or business is the most tax advantageous. If you can convince the ATO that you purchased the property to farm, not to subdivide you may be able to eliminate all tax from the transaction by using the active asset concessions. These are discussed in more detail in the section on active assets. The best concession is the 15 year exemption. If you purchased the property over 15 years ago, farmed it for at least half the period of ownership and used it as a farm right up until the date of sale or within the last 12 months if the business is sold separately, and the development is not so elaborate that you are considered to be in the business of developing land, you don't need to pay any CGT.

Another advantage of this method is you do not have to offset the gain against your capital losses first so they are still there for your future benefit. The owner or owners must also retire (a state of mind) then the profits are completely tax free.

If you miss out of the 15 years do not despair, a careful combination of the remaining small business exemptions will give you almost as good a result. For example combine the retirement exemption with the 50% CGT discount and the 50% active asset discount and you will pay no tax but 25% of the profit may need to be contributed to super if you are under 55 years of age. This will not be taxed in the hands of the superannuation fund.

Most farmers would already be registered for GST for the farming enterprise so they will have to charge GST when they sell the lots. Read the section on the margin scheme to minimise the impact of GST. If you were not registered for GST when farming, you need to make sure you do not fit the definition of enterprise when developing the blocks. In other words don't be too business like.

An idea may be to reduce the farming business down to where it has a turnover of less than $50,000 so the farmer can de register for GST, but still be in business so be entitled to the active asset concessions outlined above. You could also consider ceasing the business in order to deregister but you must be careful to sell all the blocks within 12 months in order to keep the active asset concessions. This last catch may soon change.

There are further concessions that allow farmers to sell their farm as a going concern or to an associate or another farmer with no GST being applicable.

Building a Spec Home:

GSTR2003/3 states at paragraph 10 "The sale of new residential premises by a registered entity in the course or furtherance of an enterprise it carries on, is a taxable supply for GST purposes." Unlike the rental property situation discussed above if you build a spec home its sale is part of your normal business turnover so it will cause you to be registered for GST. Section 9-20(1) (b) includes as an enterprise an adventure or concern in the nature of trade. An adventure or concern may be a one-off transaction that is not a continuous business but it must have business like characteristics to be caught. So if you did not build the property to sell, but only to rent, then when you sell it, it is not part of a normal sale in your enterprise of rental properties and as such

does not force your taxable supplies over $50,000, if all you are involved in is domestic rentals, you are not required to be registered for GST. Even though the sale of the house would be the first sale of a new residence and therefore subject to GST you are not registered for GST so you are not caught.

If you buy land with the intention of building a home on it to sell then the proceeds of the sale are normal business income, the 50% CGT discount is not available to you and GST will apply. You are entitled to claim GST credits for the cost of building the home and purchasing the land if it was not purchased under the margin scheme. As your buyer is unlikely to be in the business of buying and selling houses they will not be able to claim the GST back.

Vacant Land:

TD 92/127 & TD 92/126 - if a property is acquired for development, subdivision and resale at a profit but the development is abandoned and the land is sold the sale is still in the business of property development so the proceeds taxable as normal income. This is the case if the land is as an isolated transaction or part of a property development business because it was purchased for development or subdivision.

On the other hand if land is purchased with the intention of building a house, farming it or constructing business premises CGT applies to the sale proceeds. The only problem being proving that your intention was not profit making by sale despite the fact you never carried out the activities you intended. This situation gets worse if you develop or improve the land in someway before selling.

If you purchased the land for use in a business and you actually used it even though it remained vacant land (ie parked trucks on it) you may be able to benefit from the Active Asset CGT concessions discussed later.

Active assets concession

This is only applicable if the land was not purchased with the intention of resale at a profit, it was owned by a business or an associate of a business and was actually used in the business,

If you farmed the land or used it in a business utilising the active asset rules, in section 152 can take your tax payable down to zero, so if the following could apply to you seek professional advice and get it right. You must have a tax plan before you move or sell the business, not just before you sell the premises.

Before any of the following apply you will need your assets to be less than $6 million or be in the simplified tax system and have held the property for more than 12 months. The property must also be an Active Asset – Section 152 that is used in the business up to just before sale and for at least half of the time it was owned. If the business ceases before the sale the asset must have been used in the business up to the time it ceased (note the ATO is taking a very strict view here it means right up to the last day) and then must be sold within one year of the business ceasing. The government is considering making this last requirement more lenient. The property would not be an active asset if it was used to derive rental income, unless the rent was received from an associate. The following only addresses the ramifications for the land not the plant and equipment on it. .

a) If you purchased the property over 15 years ago, farmed or used it in a business for at least 15 years**?????** and the development is not so elaborate that you are considered to be in the business of developing land, you are home and hosed you don't need to pay any CGT. Another advantage of the 15 year concession is you do not have to offset the gain against your capital losses first so they are still there for your future benefit. The owner or owners must retire (a state of mind). This would certainly be worth it for the profits to be completely tax free.
b) If you miss out on the 15 years do not despair a careful combination of the remaining small business exemptions will give you almost as good a result. For example combine the retirement exemption with the 50% CGT discount and the 50% active asset discount and you will pay no tax but 25% of the profit may need to be contributed to superannuation if you are under 55 years of age. Despite its name you do not need to retire to utilise the retirement exemption. Assume the gain on the property was $100,000 the 50% CGT discount would reduce this to $50,000 and the 50% active asset discount would further reduce this to $25,000. Placing the remaining $25,000 into superannuation would mean that the whole $100,000 is received tax free. The $25,000 is not taxed in the hands of the superannuation fund but you will have to be at least 55 before you can touch it. Companies are not entitled to the 50% CGT Discount and the use of the 50% Active Asset Discount creates problems when the asset is owned by a Company. In Discretionary Trusts the CGT flows through to the beneficiaries so is treated the same as an individual.

All the benefits in a) and b) above are only available if you stay within the CGT provisions rather than enter into the business of property developing. As these effectively mean that you will pay no tax on the profit it is worth dotting your i's and crossing your t's and seeking professional advice to ensure you don't miss a trick. Also read the section on *Merely Realising An Asset*.

Determining whether you purchased the property for resale at a profit or some other purpose

Good stuff, this keeps the lawyers in their BMWs. It is simply a question of fact what your intentions were but the circumstances surrounding the events must support your claims.

Whether you purchased the property for resale at a profit is a question of your state of mind at the time. The trouble is proving that was your state of mind. In Case R25 84 ATC 224 a group of taxpayers bought land to resell at a profit, which they did 13 years later. One of the taxpayers argued that his intention was to build a factory on the land not re sell it. The court did not accept this. Be careful to have evidence of a well researched viable use for the land other than development. You will also need to have a reason for selling that doesn't contradict your original intention.

It is very difficult if you are a builder to claim that you purchased a property with an intention other than developing it and reselling, especially if you build a spec home. In case R51 84 ATC 392 a builder who built a block of flats and leased them to tenants for 6 years was still assessed as revenue on the profit on the sale. TD 92/135 states that even if a builder builds a home as a spec but then decides to live in it he or she is not entitled to the main residence exemption or the 50% CGT discount because it was built with a profit making motive so is taxed as normal business income.

If you inherited the property or received it as a gift you are in a good position to argue that you did not acquire it with the intention of resale. Careful, artificially organising this has lots of other problems not least of which in the case of inheriting is possible murder charges. Gifts between husband and wife are unlikely to have a purpose other than a tax benefit, due to the mutuality of marriage, so will be caught by Part IVA or will simply be considered that whatever purpose the original spouse purchased for applies to the spouse receiving the gift.

Are you merely realising an asset?

Even if you can pass the test that you did not buy the property with the intention of resale at a profit, you still need to be careful not to cross the line of later applying that property for a business making purpose. If you are considered to have changed the property from some non business purpose to the business of selling it for a profit you will be taxed as normal income on any profit made between the market value at the time of change of purpose and eventual selling price. You will also be up for capital gains tax on the capital gain made on the market value at the time the property became part of the business of property development. Accordingly, the property will be introduced to the business as a cost at the market value at the time. The actual calculation of the tax is far more complex than this if you do not change entities when committing the land to development. It is also date sensitive and is affected by whether the property is an isolated transaction or trading stock of a developer. Details are not included here as it is not within the scope of this booklet. This is just a warning not to crunch your numbers without having a professional calculate the tax considerations. The actual committing of the land to a business or the subdivision do not trigger a CGT event ie generate a tax liability. So the CGT is not payable until the land is actually sold. But if you transfer the land to another entity for development CGT will be payable in the year of transfer.

If you want to be completely sure the transaction will only be treated as a mere realisation of an asset and you can prove the purchase was not for profit making by resale, don't turn a grain of soil until you have received council approval for the sub division and then sell the land for its market value to another entity. Note if you take this line of action the new entity will have buckly's of arguing it was merely realising an asset and will pay full tax on all future profits because they are revenue in nature. Professional advice should be sought on the nature of this new entity to minimise the tax consequences, depending on your particular circumstances. If the council require you to undertake work before the subdivision will be approved you have a real problem getting the market value to a decent figure. In Case W59 89 ATC 538 it was decided that the property became part of the business when these works started so market value at this time could not include

the fact it was subdividable but there is hope in TD 97/1 which says the market value should include the highest and best use including the potential of consent being given for subdivision.

Factors that suggest you are merely realising an asset rather than operating a business include:

1) Whether there is another valid purpose such as rental or farming that was viable at the time and that this was actually carried out.
2) How quickly you resell the property. The longer you own the property the more likely it is that you held it as an investment rather than for use in the business of property development.
3) A valid reason for changing the use of the land ie being too ill to continue to farm it.
4) Attempts to sell the land undeveloped that had failed.
5) The owner of the property is not a developer, real estate agent or builder by occupation.
6) Don't go transferring the property to a new entity for the development.
7) Many factors inherent in the development itself such as:
    a) The significance of the development costs compared with the value of the undeveloped land. The more money borrowed to finance the development the more likely it is to be a business.
    b) The size of the development.
    c) The business like nature of the activities, avoid letterheads and employing staff.
    d) How involved the land owner is in the process. For example the difference between Cassimaty's case and Stevenson's case (refer below) could be summed up by the fact that Stevenson made the mistake of being actively involved in selling the lots where as Cassimaty left the job to a real estate agent.
    e) The more stages the development is done in the more it will appear to be a business. This can be countered by developing on the basis of need to repay debt or finance living expenses.
    f) The amount of works required for the land to be subdivided. To this end it may be more advantageous to pay a contribution to council to put in kerb and channelling rather than undertake the work yourself. Or paying a developer to take responsibility for all of the works.
    g) Don't quit your day job.
    h) Don't estoppel yourself by trying to claim a tax deduction for expenses such as interest and rates while the development is taking place.

Examples of the points made above can be found in:

Stevenson v Com. of Taxation 1991 29 FCR 282 – Profit on Subdivision of Farm Taxed as Normal Income
446 acre farm owned by family since 1904. 26 acre single block sold 1965. 360 acre block sold 1971. Another 35 acres sold when taxpayer reached 70. The balance was later subdivided and attempts made to sell it with development potential. Council required water and Sewerage. 180 blocks subdivided finance by considerable borrowings. Development done in 8 stages. The taxpayer was very involved in the development right down to selling the land himself rather than appointing an agent. The taxpayer had no previous development experience.

George Casimaty v Com. of Taxation 1997 1388 FCA 10-12-97 – Profit on Subdivision of Farm Capital
Purchased 988 acre farm from father in 1955 and father forgave obligation to pay for the land. 1956 purchased 40 adjoining acres to build a house. 1963 could not sell the property for enough to cover debts. In 1965 diary farming became uneconomical. 1967 to 1969 drought effected. 1972 tried to sell the whole property to state housing department. Rural market depressed so continued farming. Ill-health and high interest payments forced taxpayer to sell off 3 lots in 1975. More financial problems lead to second subdivision of 10 lots in 1977 for which Council required roads, water and fencing. More financial problems in 1983 so 9 lots subdivided included water, roads and fencing. 1988 13 lots roads plus gift of 2 hectares to son. Council required roads, water, fencing and draining a creek. 1992 16 lots water, fencing and roads. 1993 19 lots. Ill-health suffered from early 1970s but continued to live on the property and farm it a third remained un-subdivided. Properties were sold by a real estate agent.

ID 2002/483 – Is an interesting example of when the ATO wanted to argue the other way because the property was sold at a loss. The taxpayer's spouse completed a Real Estate course and they claimed that the property was purchased for development. Meetings were held with real estate agents and project builders but the local council was not consulted regarding any restrictions effecting the viability of the project nor was a costing analysis done before purchase. When the costing was done afterwards it indicated the project was not going to be profitable so the taxpayer sold the land unimproved. The ATO concluded a profit motive could

not be readily drawn from the facts and that the project was approached in a haphazard way with little activity from the taxpayer.

What if your activities amount to carrying on a business?

If you didn't initially purchase the property with the intention of resale at a profit but now feel that your activities go beyond the mere realisation of an asset, you need to get professional advice. It is important that you get this advice as soon as you feel there may be a chance you will go beyond merely realising an asset. There are strategies that can reduce the tax consequences. Usually this involves selling the property to a new entity before you go beyond merely realising and asset. But the advantages of changing structure need to be weight up against the stamp duty expense.

The cheapest and most straight forward method is to transfer the property to low income family members. Note transferring to just one member may mean they are pushed into a maximum tax bracket by just a few sales in one year. There is also concern regarding retaining control of the property, the possibility of this person being sued and their level of debt. Both of these problems can be solved by the use of a discretionary trust that can choose who receives the profits each year.

Do not transfer the property into an established entity that may have problems. For example putting the property in to a company that is already trading will leave the property vulnerable if someone sues the company regarding the already existing business.

A company may be the answer due to its tax rate of 30% but when you take the money out of the company you will have to top it up to your marginal rate. Do not use a company if there is a chance that any of the activities will qualify for CGT rather than normal income tax as companies do not get the 50% CGT discount.

Superannuation funds only pay 15% tax on income and 10% on capital gains. But a superannuation fund cannot borrow to purchase the property and is very limited in purchasing property from an associate. Vendor finance is borrowing. Superannuation funds are not allowed to run a business so if you are doing this because the activity is becoming business like, odds are the superannuation fund won't be allowed to do it any way. Though a joint venture structure may overcome these problems.

Subdividing pre CGT land

Assuming the profit on the sale is capital in nature, no tax should be payable on the sale of the land because it was purchased before 20th September, 1985. Section 108-70 states that improvements to pre CGT land will be considered a separate asset from the land if they exceed the threshold and exceed 5% of the capital proceeds. In 2004 the threshold was $104,377, it is indexed each financial year. Improvements can include most development costs including removal of items from the land. In TD5 the ATO states that improvements that do not actually touch the land such as council fees for re zoning are included. In ID 2002/387 the ATO state that the threshold and 5% test apply to each individual block sold so it is unlikely that development costs will trigger a separate asset from the land that is post CGT so subject the CGT. If you put building or structure on pre CGT land it is automatically considered a separate asset from the land regardless of its cost, section 108-55(2).

GST and subdivisions

GST should also be taken very seriously when doing your costing as GST is not a tax on the profit but 1/11th of the selling price which may well be all your profit though you will be allowed input credits.

MT 2006/1 is the ATO ruling on this topic and the short answer is, GST is unlikely to apply if the subdivision is not considered to be a business of developing property and the entity that owns the property is not already registered for GST.

Section 38 (1) of the GST Legislation states that; **an activity, or series of activities** done in the form of a business or in the form of an adventure or concern in the nature of trade, would be a taxable supply, unless specifically exempt. So, a one off subdivision of land, if done in a business like manner, can be subject to GST. This means that the sale of the blocks is part of the business's turnover and as that is more than $50,000 pa you are required to be registered for GST and charge GST on each block.

While a one off transaction in the nature of a business can be caught by GST, the mere realisation of an investment asset is not subject to GST.

The first sale of a house and land is subject to GST if it happens within its first 5 years and the owner is registered for GST. But if the owner is not in the business of building or developing, the property is not part of the normal turnover so it will not push their taxable turnover over $50,000 so will not force them to be registered. If your turnover is bound to exceed $50,000 you must register for GST and charge it on each block but the sale of the blocks is only included as part of your turnover if you are considered to be in the business of developing or building houses. If your turnover for the year is only domestic rental income which is not a taxable supply the sale of the rental property is not in the normal course of your business so your taxable turnover is under $50,000 and you do not have to register for GST or charge GST on the sale, even if the house is less than 5 years old.

When You are Caught for GST:

If you are already registered for GST because the taxable turnover of the business entity that owns the land exceeds $50,000 you cannot avoid the GST. If you develop the property to such an extent that you place buildings on the land you will be subject to GST on the blocks. If you purchased the property with the intention of subdividing right at the start you will also be subject to GST.

Factors that suggest you did not buy the property with the intention of developing it.

1) Whether there is another valid purpose such as rental or farming that was viable at the time and that this was actually carried out.
2) The length of time you own the property.
3) A valid reason for changing the use of the land ie being too ill to continue to farm it.
4) Attempts to sell the land undeveloped that had failed.
5) The owner of the property is not a developer, real estate agent or builder by occupation.

GST will always apply if you build on the land to sell. MT 2006/1 at paragraphs 273 to 276 gives an example where a taxpayer buys a waterfront property to build a duplex and live in one side and sell the other. GST applied. In paragraph 284 to 287 a couple who demolish their home split the land in half and build two new homes to sell are subject to GST. In paragraph 294 to 296 a subdivision of 9 lots, without buildings and utilising an existing road was not subject to GST.

The area of uncertainty is when you subdivide land into vacant lots, that has been used as part of your farm, home or rental property. The subdivision of such properties can be considered the mere realisation of an asset (not subject to GST) by presenting it for sale under the best possible circumstances rather than be in a business that is subject to GST. If you are personally registered for GST in a completely different business and you are subdividing land unconnected with the business you may still not have to charge GST if you can fit within the following

It is all about how business like the subdivision is. For example GST would not apply to a cutting in half of a 2.5 hectare block because the owners, who live there, are having trouble maintaining it. They continue to live in the house and just sold off the vacant land. The only thing they needed to do was apply to council, no physical changes needed to happen to the land. On the other end of the scale GST would apply to the subdivision of a 500 hectare property, on which the owner was not living, into over 30 lots where roads and services are a major work done in a business like fashion.

MT 2006/1 relies on established case law to determine when a development would be caught as a business for income tax purposes. So the points made back under the heading of Are You Merely Realising An Asset apply. The following factors are relevant in considering if you have crossed the line to being a business. Though several of these elements are usually necessary to be considered a business

As per MT 2006/1 paragraph 265 –

1) There is a change of purpose for which the land is held (ie you move off the land to subdivide rather than just subdivide part of it)
2) Additional land is acquired to be added to the original parcel of land
3) The land is bought into account as a business asset
4) There is a coherent plan for the subdivision of the land
5) There is a business organisation – for example a manager, office and letterhead
6) Funds are borrowed to finance the acquisition or subdivision
7) Interest on loans claimed as a business expense

8) The land is developed beyond what was necessary to secure Council approval for the subdivision, and
9) Buildings are erected on the land (fatal)

Other Factors from Income tax law that point to the business of property development
1) The significance of the development costs compared with the value of the undeveloped land and the more money borrowed to finance the development the more likely it is to be a business.
2) The size of the development.
3) How involved the land owner is in the process, so don't give up your day job.
4) The more stages to the development the more it will appear to be a business. This can be countered by developing on the basis of need to repay debt or finance living expenses.
5) The amount of works required for the land to be subdivided. To this end it may be more advantageous to pay a contribution to council to put in kerb and channelling rather than undertake the work yourself. Or pay a developer to take responsibility for all of the works.

In paragraphs 297 to 302 of MT 2006/1 a 13 lot subdivision the first time and then a further 2 subdivisions were still not subject to GST because of the unprofessional process, the fact the owners continued to live on 70% of the land and the minimal works.

GST and new or substantially renovated houses

The first sale of a new house is always subject to GST if the seller is registered for GST. If the house was built with the intention of resale at a profit then the seller must be registered for GST as the sale is part of the business turnover and that would be more than $50,000. If it was built to live in or rent out the seller would not be required to be registered for GST so when it is sold GST does not apply simply because the seller is not registered.

No GST on sale means no input credit for building costs. Even if the house hasn't been finished for 12 months at the time of sale you will still qualify for the 50% CGT discount on the profit on sale if you have held the land for more than 12 months. All this is only if you built the house for the purpose of rental not resale at a profit. Section 40-65 states even if new residential premises are rented for a period prior to the sale the first sale will still be a taxable supply. Section 40-75 states that premises are not new if they have been used as residential premises for at least 5 years.

Note if you are builder you will have two things working against you. Firstly, it will be hard to argue that you did not build it for resale refer Case R51 84 ATC 392 where a builder was found to have built a block of flats with the intention to profit on their resale. Even though the flats were not sold until 6 years after they were built. Secondly you own the property in your own name and are in business as a sole trader you are probably already registered for GST, the only way the sale could be excluded from the GST provisions is to argue that it was not purchased in the furtherance of your business. This would be impossible if you have been claiming input credits on the building costs.

Now if you did not build the house for resale at a profit and are not registered or required to be registered for GST you can sell the house without any GST concerns. If you build the house for resale at a profit you are required to be registered for GST. If you did not build for resale at a profit but you are registered for GST and the sale of the property is part of your enterprise even if it is not part of your enterprise's normal turnover, you will have to rent the property out for 5 continuous years or pay GST on 1/11th of the sale price (less if margin scheme applies). Continuity of the 5 years is not broken by short periods between tenants GSTR 2003/3.

Note if you substantially renovate a property it may be treated as a new property.

If you are caught for GST and have used the property partly for rental and partly for resale at a profit you will be entitled to claim back most of the input credits on the cost of the property but you are subject to GST on the proceeds of the sale. The margin scheme can help here refer below. In the Property and Construction Industry Partnership Issues Register item number 4 the ATO has agreed to pro rata the input credits on the basis of income received. The formula for apportioning input credits between the taxable supply of the home and the input taxed supply of rental accommodation is as follows:

Consideration for the taxable supply of the premises

Consideration for the taxable supply of the premises plus rental income

GST and sale of properties held for rental

Even holding domestic rental properties is considered an enterprise and qualifies for an ABN but normally landlords don't bother as they are not required to charge GST on rent on residential properties. So even if their turnover is more than $50,000 it is not for supplies to which GST applies to so they are not required to be registered. The eventual sale of the rental property will generate more than $50,000 but this is not included as part of the $50,000 normal turnover unless you are in the business of selling rental properties. So if you are just a normal investor in domestic rental properties your turnover of GST supplies in the course of your business is never likely to exceed $50,000. The mere realisation of an investment does not amount to an enterprise in its own right.

Even though the sale of the property is for more than $50,000 it is not part of your turnover so will not force you to be registered for GST. If you are not registered for GST, you will not have to remit GST on the sale of a rental property. If you are registered for GST the sale of a domestic rental property will still not be subject to GST providing it is not considered the sale of a new home. Refer above.

Landlords are required to charge GST on rent for commercial premises if they are registered for GST. They are required to be registered for GST if their commercial rents for the year exceed $50,000. Now the $50,000 is in turnover so it doesn't include the sale of capital assets but if you are registered for GST when you sell a commercial property you are required to remit 1/11th of the selling price in GST (subject to the margin scheme).

GST margin scheme

Basics:

- The margin scheme can only be used with a house and land or land. If the seller is registered for GST the margin scheme can only be used where the property was owned pre 30th June 2000 or purchased under the margin scheme. Or if the seller, who is registered for GST purchased the property from someone who was not registered for GST
- The margin is the amount of the selling price on which GST is calculated.
- The purchaser of a property under the margin scheme cannot claim any GST input credits back on the purchase price. But if they are registered for GST they can claim GST input credits for further expenditure on the property.
- On 17th March 2005 a bill was introduced to Parliament that will require a written agreement signed by both parties on or before settlement for the sale to be subject the margin scheme.

Property Purchased After 30th June 2000:

- If you are selling a property you purchased after 30th June 2000 and the price you paid was calculated under the margin scheme section 75-5 allows you to only charge GST on the difference between the selling price and the cost to you of the asset that was measured under the margin scheme. Note any improvements to the asset after purchase do not reduce the margin. For example a GST registered developer buys land for $66,000 from someone who is not registered for GST. The developer spends $100,000 (after claiming back input credits) putting a building on the land and sells the property for $200,000. If the GST on the sale is calculated under the margin scheme it will be 1/11th of $134,000 ($200,000 - $66,000). On 17th March 2005 a bill was introduced to Parliament to make it clear the margin must include the cost of improvements and to stop abuses of this area.
- Note there is one dubious exception to the above ID 2002/30 states that the price you paid for the property, as calculated under section 75-10 (i.e. the portion that is not subject to GST when you sell) includes any adjustments for land tax or council rates you may have paid at settlement. But ID 2002/31 states that this does not include legal fees.
- You cannot use the market value to set the cost under the margin scheme if you purchased the property after 30th June 2000. This is the case even if you did not register for GST until after the purchase

Property Purchased Before 30th June, 2000:

- If you owned a property before 30th June, 2000 you need to set the amount that is not subject to the margin scheme. This is the value of it at 30th June, 2000 or when you first became registered for GST, whichever is the latter.
- GSTR 2000/21 details how to set the value as at 30th June, 2000 or when you first became registered but note this is only for property held before 30th June, 2000.
- If the property is fully complete the value can be set by a qualified valuer or the amount set by the government for land tax or council rates purposes.
- If the property is being developed at the time you require the valuation you can use a value set by a qualified valuer or use the cost of completion method.
- The cost of completion method determines what percentage of the total costs the costs that have been incorporated into the project at the date of valuation are. It is this percentage of the selling price that is not subject to GST. Note this method can only be used if the property is sold before 1st July, 2005 and owned by you before 1st July, 2000.

Don't do it again

If you have got through the above and feel you can satisfy the ATO that you are merely realising an asset rather than a business, don't do it again. The ATO has the benefit of hindsight and may say that because you did it a second time you always intended to develop property and that was really your intention in the first place. Or at least wait 4 years from the last tax return involving the first development so the ATO can't come back and amend it but don't expect to get away with it for the second property. At least if you wait the 4 years you have nothing to lose.

Summary

1) If you buy with the intention to resell at a profit normal income tax and GST apply
2) If you are merely realising an asset purchased for investment or private use CGT applies to the sale
3) Business premises or farms may be able to keep the whole transaction tax free by using the active asset concessions. This involves careful planning before you even start.

The following are articles from our Newsflash that are relevant to this Booklet:

Definition of Substantial Renovations

If you are registered for GST and sell a new house or substantially renovated house for the first time you must charge GST. If you did not acquire the house with the intention of reselling it at a profit (ie you acquired it as a rental or to live in) the sale of the house is not part of your normal business turnover so it will not force you to register for GST if you aren't already.

There is a concession, in that if you continuously rent out a property for more than 5 years and then sell it as the first sale of a new or substantially renovated property you do not have to charge GST even if you are registered. In the case of a renovated property the 5 years starts from the last substantial renovation.

People who buy a property with the intention of doing it up and selling it, are considered in business so, if their turnover of sales subject to GST is more than $75,000 they will be forced to register. This is where it is particularly important to know what a substantial renovation is. If it is a substantial renovation and you bought it with the intention of reselling it at a profit then the sale of the house is part of your normal turnover so you will have to register for GST and charge GST on that sale. But if the next property you renovate is not substantially renovated, even though you are already registered you will not have to charge GST because it is not considered the sale of a new or substantially renovated home, so it is input taxed. This means you cannot claim input credits on the costs associated with it and do not have to charge GST.

If you did not buy the property with the intention of resale at a profit and you are not registered for GST then you do not have to worry about this no matter how substantial your renovations to the house are.

If you renovate properties for profit it is important you understand exactly what a substantial renovation is. GSTR 2003/3 states that a substantial renovation does not have to be structural but it needs to substantially affect the house, so just about every area of the house must be affected. Of course this could simply be the case if you painted it inside and out. But painting is only cosmetic so cannot in itself be a substantial renovation. It is a question of whether a substantial part of the house has been removed or replaced. It gives as an example of a renovation that is not substantial, the removal and replacement of a kitchen and bathroom as well as repainting the whole house.

Replacing the floor boards, electrical wiring or plumbing in a property is dangerous because it usually affects every room in the house and is not merely cosmetic. Moving or replacing walls can have the same effect but only if enough walls are changed that most of the rooms in the house are affected. A combination of various forms of non cosmetic changes that combined, manage to affect every room in the house will be a substantial renovation. Cosmetic work such as painting, sanding floors, changing fittings, curtains and carpet do not in themselves amount to substantial renovations even if they affect every room. Further, cosmetic changes to every room and substantial changes to only a few of the rooms will not amount to substantial renovations because the cosmetic changes are disregarded in considering if all the rooms are affected.

Building a Duplex with a Friend

What are the CGT consequences of buying a piece of land as tenants in common with a friend on which you build two homes under separate titles so you can have one each? PBR 30342 looks at a rather more complex situation but answers this question quite well.

Two relatives buy a house together as tenants in common. Eventually they build two houses on the property and subdivide the title so that they can independently own a house each. The catch is the ATO sees this as each relative transferring their share of the other's house. So they are each up for CGT on the gain on half the other's house.

Note that if the properties are strata planned section 118-142 may allow rollover relief.

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Disclaimer: Please note in many cases the legislation referred to above has only just passed through parliament. The full effect is not clear yet but it is already necessary to make you aware of the ramifications despite the limited commentary available. On the other side of the coin by the time you read this information it may be out of date. The information is presented in summary form and intended only to draw your attention to issues you should further discuss with your accountant. Please do not act on this information without further consultation. We disclaim any responsibility for actions taken on the above without further advice as to your particular circumstances.