



Tax for Small Property Developers

Issues

- Mere realisation – tax and GST issues
- Property Joint ventures and the Loch Ness Monster
- Joint property developments - tax and GST issues
- Syndicated property investments - title held by nominee
- Use of superannuation

Isolated Transactions

- Will profits be capital or income
- Critical if pre-CGT land
- Still important for post-CGT land
 - 23% v 46%

Isolated Transactions

- If land acquired for re-sale/ development – profits are assessable (TR 92/3)
- Does not matter how long you own it – no 12 month rule
- Be careful what you tell
 - Your bank
 - Anyone else
 - *Reiger v FCT* 2002 ATC 2020

Isolated Transactions

- Is tax payable where land held for long time and then subdivided
For example farm land near urban areas
- Mere realisation v profit making undertaking

Consequences

- Original profit making purpose – all ordinary income
- Mere realisation – all capital
- Profit making undertaking – capital up to start of PMU and ordinary income from that point
- If development involves a business – capital asset converts to trading stock (CGT Event K4)

Isolated Transactions – Mere Realisation

- Do not assume profits taxable
- *Casimaty* (97 ATC 5135) – 80 lots/8 stages
- *Allied Pastoral Holdings* (83 ATC 4015) - \$648K profit in 1966
- *Statham* (89 ATC 4070) – 105 lots/4 stages

Isolated Transactions – Mere Realisation

- Mere Realisation Factors - TR 92/3
- Nature of entity
- Any prior history of development
- Scale of development
- Level of active involvement

Mere Realisation – MT 2006/1

- When is isolated transaction an enterprise

“The issue is whether activities are an enterprise in that they are of a revenue nature ... concern in the nature of trade (profit making undertaking or scheme) as opposed to the mere realisation of a capital asset”

Mere Realisation – MT 2006/1

- Change of purpose for which land is held.
- Additional land added to original parcel.
- Land is brought to account as a business asset.
- There is a coherent plan for the subdivision.
- There is a business organisation – e.g. a manager, office and letterhead.

Mere Realisation – MT 2006/1

- If clients borrow to finance the subdivision.
- Interest is claimed as a business expense.
- There is a level of development beyond that necessary to secure council approval (erection of buildings)

Mere Realisation

- Strong prospects if passive role and no prior history
- Consider private ruling - certainty

CGW Private Rulings – Mere Realisation

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- PBR 61376 – part of rural property subdivided into 50 lots.
- PBR 71222 – part of rural property subdivided into 19 lots in two stages.
- PBR 80502 – vacant land held for 10 years subdivided into 44 lots.
- 23 lots - clients had lodged development approval for second stage (40 hectares)
- PBR 89235 – rural property subdivided into 36 lots

Mere Realisation & GST

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- *MT 2006/1*

“The issue is whether activities are an enterprise in that they are of a revenue nature ... concern in the nature of trade (profit making undertaking or scheme) as opposed to the mere realisation of a capital asset”

- Does this mean no GST payable if mere realisation?

Mere Realisation & GST

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- GST payable if
 - Carrying on enterprise; and
 - Turnover > \$75,000
- *MT 2006/1* suggests that mere realisation does not amount to enterprise.
- Doubtful - multi lot subdivisions could easily amount to an “enterprise”

Mere Realisation - GST

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- *FCT v Swansea Services Pty Ltd - [2009] FCA 402*
 - Nothing in GST Act indicates that investment activities would not amount to carrying on an enterprise
 - One activity alone may be an enterprise

Mere Realisation - GST

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- Even if an enterprise - strong argument that
 - sale proceeds from mere realisation not included in turnover threshold; and
 - clients who are not otherwise registered do not need to register or pay GST on sales

Mere Realisation - GST

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- Entity will not exceed registration turnover threshold if:
 - “current GST turnover” is at or below the turnover threshold; or
 - “projected GST turnover” is at or below the turnover threshold (s.188-10)

Mere Realisation - GST

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- Sale proceeds from transfer of capital assets are disregarded when calculating projected GST turnover
- GSTR 2001/7
 - 'capital asset' is given its general meaning
 - no new meaning of 'capital asset' for GST purposes
- Therefore a 'capital asset' for income tax purposes is also a 'capital asset' for GST purposes
- See Example 3 - GSTR 2001/7

Joint Ownership/Projects

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- Joint development with related company to allow client to "lock in" capital gain - project profit derived by company.
- Where profit will be ordinary income - engage related company to accelerate deductions (Kurts Developments)
- Clients lack funds and/or expertise & engage third party to project manage and/or fund the development in return for a share of profit

Joint Ownership/Projects

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- Land owner retains title
- Other party contributes funds/development expertise
- Profits shared
- Sale contracts in name of land owner

Joint Ownership/Projects

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- Critical to clarify the entity/entities involved as significant tax/GST issues if incorrect
 - For example, who:
 - is taxable and when?
 - accounts for GST?
 - claims input tax credits?
- Get private ruling if in doubt – eliminate risk

Joint Ownership/Projects

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- Possible Entities
 - Joint venture
 - General law partnership
 - Tax law partnership (TLP)
 - Individual entities
- Rare to have a "joint venture"

Joint Ownership/Projects

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- Joint venture
 - Requires intention to share product (United Dominions v Brian 157 CLR 1)
 - "non-entity joint venture"
 - S 995-1 ITAA 1997
 - Parties must share output
 - Rarely applicable to joint property ownership or developments

Joint Ownership/Projects

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- General law partnership - must carry on business
- Usually – joint projects are either TLP or individual enterprise

Joint Ownership/Projects

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- Relevance ?
 - Correct GST registration – penalties
 - Income tax treatment – passive land owners
 - Small business CGT concessions (connected entities and partnerships)

Joint Ownership/Projects

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- TLP – persons in receipt of income jointly
- GSTR 2004/6 - indicators of TLP
 - Written agreement to share income
 - Joint bank account
 - Purchase price borrowed jointly

Joint Ownership/Projects

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- GSTR 2004/6 - indicators of separate enterprises
 - Parties separately registered
 - Agreement excludes partnership
 - Parties borrow separately and contribute funds
 - Revenues distributed to parties' separate accounts

Joint Ownership/Projects

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- If TLP
 - Parties liable for tax on share of profit
 - No GST on dealings between parties
 - Land owner will issue tax invoices on sales (GSTR 2004/6 – para 212)

Joint Ownership/Projects

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- If separate enterprises
 - Both parties register for GST
 - Dealings between parties subject to GST
 - Landowner issues tax invoices in own right

Joint Ownership/Projects

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- Margin scheme may not be available if TLP
 - Margin is excess of sale price over price paid by “entity” making supply
 - If the entity is TLP – it will not have paid for the land

Joint Ownership/Projects

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- Avoid “profit share” agreement
- City Link
 - 2005 ATC 4945
 - 2006 ATC 4404
- Pay a fee not a share of profit

Joint Ownership/Projects

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- Property often held by nominee where land acquired/developed by syndicate of investors
- Mandatory for managed investments
- Partnership or trust?

Joint Ownership/Projects

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- Losses
 - Partnership – partners can claim deduction
 - Trust – losses quarantined
- Tax free distributions (e.g. capital write offs)
 - Flow through to partners
 - Event E4 for trust

Joint Ownership/Projects

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- Appointment of nominee does not preclude partnership
 - ARM Constructions 87 ATC 4790
 - Ryvitch 2001 ATC 4403
 - Howland Rose 2002 ATC 4200
 - Hance v. FCT – [2008] FCAFC 196

Joint Ownership/Projects

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- TD 2005/28
 - Managed investments
 - Separate trust estate
- TR 2004/D25 - cannot have absolute entitlement if more than one beneficiary
Contrary to authorities

Joint Ownership/Projects

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- ATO adopts different view in GSTR 2008/3 (on bare trusts)
Paragraphs 13 and 84

Joint Ownership/Projects

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- What can you do to avoid trust
 - Nominee must act in accordance with syndicate's instructions
 - Decisions made by committee of syndicate members – not directors
 - Syndicate separately registered for GST
 - Appoint nominee as agent of syndicate to issue tax invoices/claim input credits
 - All funds banked to/paid from syndicate account

Related Entity & Superannuation Fund

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- “Joint venture” where land owned by another entity
- ATO TA 2009/16
- Loan or financial accommodation
- SMSFR 2009/4 – “investment in”
- Sole purpose

Related Entity & Superannuation Fund

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- Super fund buys interest in land
- Land held as trading stock is business real property – SMSFR 2009/1
- Super fund – buys/develops stages
- No debt

Related Entity & Superannuation Fund

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- Super fund owns property
- Development agreement with related party
- Sole purpose
- No debt

Related Entity & Superannuation Fund

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- Super and borrowing
- S67(4A) – instalment warrant rules
- Borrow to “acquire an asset” – develop?
 - Section unclear
 - View is not covered
- Banks won't lend for development
- Turn key agreement – buy end product



Thank You

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