

Property Development and tax



The ATO seems to be always looking over the shoulder of property developers to make sure they are complying with their tax obligations.

The considerations facing the ATO can include whether an agreement to develop and sell land is a “mere realisation” or a disposal either in the course of a business or as part of a profit making undertaking or plan.

A “mere realisation” is a sale on capital account to which the capital gains tax (CGT) rules will generally apply. Landholders will usually seek this treatment if they can access CGT concessions (for example, applying the appropriate CGT discount or the small business CGT concessions) or the property is a pre-CGT asset.

A sale that is more than a mere realisation will be on revenue account and the proceeds will generally be assessable as ordinary income. The two most common scenarios where the proceeds are income are:

1. where the land is sold in the course of a business or as an incident of business operations, or
2. where the land has been acquired and sold as part of a profit making undertaking or scheme.

Whether a sale is a mere realisation or something more is determined by examining and weighing the facts and circumstances taken as a whole.

Outside of the capital/revenue discussion (more below), the ATO must also consider timing issues relating to the recognition of income and deductions, property development agreements, and land banking activity.

A relevant discussion can be found in the Taxpayer Alert Trusts mischaracterising property development receipts as capital gains. This alert focuses on the recognition of profits from property developer activities as a mere realisation of capital rather than an allocation of ordinary income to trust beneficiaries.

About this newsletter

Welcome to our monthly tax and superannuation update. We hope you find the content informative. Should you require further information on how any of the content could affect you, please do not hesitate to contact Ray or Neal on (03) 9428 1033 or

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Also note for completeness that Taxation Ruling Income tax: whether profits on isolated transactions are income and Miscellaneous Taxation Ruling The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number provide public advice relevant to this issue.

Ask us for links to the above documents should you want to read more.

CAPITAL VS REVENUE CHARACTERISATION

The ATO has stated that it is important to weigh all the facts and indicia together, and not make any decisions or take any actions in isolation. The test the ATO applies is whether, on the balance of probabilities, it is more likely than not that the relevant tax provisions apply to the facts of the particular case.

The ATO says it is not simply a matter of tallying how many indicia point in each direction (for example, that a taxpayer acquired land with the requisite profitmaking intention or purpose). Some factors will be more influential than others, and some will, because of the particular circumstances, point more strongly to a particular conclusion.

The ATO has provided the following list of indicia, but says this is not exhaustive and may change over time:

- Whether the landowner has held the land for a considerable period prior to the development and sale
- Whether the landowner has conducted farming, or other non-development business activities, on the land prior to beginning the process of developing and selling the land
- Whether the landowner originally acquired the property as a private residence or for recreational purposes
- Whether the landowner originally acquired the property as an investment, such as for long term capital appreciation or to derive rental income
- Whether the land has been acquired near the urban fringe of a major city or town
- Where the property has recently been rezoned, whether the landowner actively sought rezoning
- A potential buyer of the property made an offer to the landowner before the landowner entered into a development arrangement
- The landowner was unable to find a buyer for the land without subdivision
- The landowner applies for rezoning and planning approvals around the time or sometime after

acquisition of the property, but before undertaking further steps that might lead to a profitable sale or entering into development arrangements

- The landowner has registered for GST on the basis that they are carrying on an enterprise in relation to developing the land
- The landowner has registered a related entity for GST that will participate in (or undertake) the development of the land
- The landowner has a history of buying and profitably selling developed land or land for development
- The operations are planned, organised and carried on in a businesslike manner
- The landowner has changed its use of the land from one activity to another (such as from farming to property development)
- The scope, scale, duration and degree of complexity of any development
- Who initiated the proposal to develop the land for resale
- The sophistication of any development or other presale arrangements
- The level of active involvement of the landowner in any development activities
- The level of legal and financial control maintained by the landowner in a development arrangement
- The level of financial risk borne by the landowner in acquiring, holding and/or developing the land
- The value of the development or other preparatory costs relative to the value of the land.

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