MORSE | GROUP
ACCOUNTANTS & ADVISORS

PROPERTY DEVELOPMENT – THE TAX ISSUES

(A Paper authored by

Paul Dowd FCA CTA M Tax

Tax Counsel, Morse Group)

This Paper has been specifically written for the purposes of explaining the tax implications that arise in the circumstances of a taxpayer who undertakes a property development. It is general in nature, not tax advice and should not be relied upon in the absence of proper professional advice on how these implications and rules would apply in particular circumstances.

In regional areas, it is not uncommon that the Local Council will rezone certain lands from rural to residential. In some cases, such rezoning will be done on the Council's own volition and, in others, it will be as a result of the relevant owner making an application to the Council. An owner of such rural land then has the opportunity to turn some or perhaps all of that land to such residential use and derive a substantial gain or profit on the said land. The significant tax issue that will arise in such a case is the tax outcome of such activity.

1. Is the activity on revenue account or capital account? – general observations

The issue that will arise, almost invariably, is whether the activity carried out by the taxpayer is on revenue account such that any profits are assessable as ordinary income and taxed at marginal rates of tax or whether the Capital Gains Tax (CGT) provisions apply and where certain concessions may be available.

As with a lot of tax questions that arise – the answer is not always apparent nor easily answered – the answer will depend on taking into account all of the surrounding and relevant facts and circumstances. Simply put, it means that although there may be similarities between two (2) cases such similarity may not be decisive and the question will be determined on a case by case basis.

Income Tax Ruling TR 92/3 – "whether profits on isolated transactions are income" remains the leading ruling issued by the ATO on the revenue/capital distinction. Notwithstanding the age of the Ruling, most of its reasoning emanates from cases that could be considered good law today. A more contemporary insight into ATO thinking on the issue can be found in Miscellaneous Taxation Ruling MT 2006/1 titled "the meaning of 'entity carrying on an enterprise' for the purposes of entitlement to an Australian Business Number" even though it is concerned with definitions under the Goods and Services Tax (GST) Act. In particular, it canvasses the concept of "an adventure or concern in the nature of trade" (see the very old but still relevant UK case – *California Copper Syndicate v Harris* (1904) 5 T.C. 159).

Both of the above Rulings are lengthy and contain observations about many cases that have come before the Courts over the years and are too long to produce extracts in this Paper. However, it can be said with some degree of certainty that the distinction to be drawn falls into whether the activity of the taxpayer is one of:

- a profit making undertaking or scheme; or
- the mere realisation of a capital asset.

The determination as to whether the activity in question falls into one or the other of these categories is necessarily one of fact and degree with no one fact being decisive and, as one Judge observed, it is necessary to "look at the whole picture and ask the question – was this (activity) an adventure in the nature of trade" or a profit making undertaking or scheme?

Such a profit making scheme can include an isolated business venture and requires an answer to the (two part) question – what is the venture and what gives it its commercial or business character. The indicia or factors that will be relevant to concluding that an activity involving a subdivision falls into the first category will be considered under the next heading.

However, it can be said with a high degree of certainty that a "simple" sale of a part of land (not acquired for resale at a profit or gain) that has been used for farming or agricultural activities for some time will constitute a mere realisation of a capital asset. Such a sale or disposal will thus fall for consideration as to its tax consequences under the CGT provisions of the Act and will be considered later herein.

There have been many cases concerning whether an activity of a taxpayer amounts to a profit making undertaking or scheme but in at least two (2) – *Statham* and *Casimaty* – farm land was subdivided and sold and, on the particular facts, the Courts held the sales were a mere realisation of a capital asset.