

## PROPERTY DEVELOPMENT – THE TAX ISSUES

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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 & Anor.* (89 ATC 4070) and *Casimaty* (97 ATC 5135) – farm land was subdivided and sold and, on the particular facts, the Courts held the sales were a mere realisation of a capital asset.

MT 2006/1 (at para. 265) states that from *Statham* and *Casimaty* a list of factors can be ascertained that provide assistance in determining whether activities are a business or an adventure or concern in the nature of trade/a profit-making undertaking or scheme. If several of these factors are present it may be an indication that a business or a profit-making scheme is being carried on. These factors are as follows:

- there is a change of purpose for which the land is held;
- additional land is acquired to be added to the original parcel of land;
- the parcel of land is brought into account as a business asset;
- there is a coherent plan for the subdivision of the land;
- there is a business organisation e.g. a manager, an office and letterhead;
- borrowed funds financed the acquisition or subdivision;
- interest on money borrowed to defray subdivisional costs was claimed as a business expense;
- there is a level of development of the land beyond that necessary to secure council approval for the subdivision; and
- buildings have been erected on the land.

The said Ruling goes on to say (in para. 266) that in determining the “enterprise/capital asset question” “it is necessary to examine the facts and circumstances of each particular case. This may require a consideration of the factors outlined above however there may also be other relevant factors that need to be weighed up as part of the process of reaching an overall conclusion. No single factor will be determinative rather it will be a combination of factors that will lead to a conclusion as to the character of the activities”.

The Ruling also notes the observation of Foster J in *AB v FC of T* (97 ATC 4945) at p 4961:

“It is clear, in my view that before the label ‘adventure in the nature of trade’ can be applied it is necessary to isolate with clarity the particular matters which are the subject of its application. ... Accepting as I do, that the phrase means ‘an isolated business venture’ questions must be asked as to what was the venture and what gave it its commercial character”.

From the foregoing, it can be seen that there are no “hard and fast” rules where one might have a list where some boxes on the list would be “ticked”, others “crossed” and then a total taken of each that would then give the answer to the question based on some mathematical outcome.

MT 2006/1 contains a number of examples where there is a conclusion that an enterprise is being conducted and has others where no such an enterprise is being conducted. Examples in ATO Rulings generally are self-serving and often lack sufficient detail of surrounding facts and circumstances that might lead to a different conclusion and, particularly where the conclusion to be made is that of an independent Tribunal or a Court.

Whilst it may be accepted that *enterprise* is a lower threshold than *business*, in the eyes of the ATO, any such distinction is becoming blurred. Indeed some commentators feel that the ATO take the view that anything that makes a gain is on revenue account and anything that results in a loss would be on capital account – that is a very cynical view but for some ATO officers may be correct insofar as some views are concluded on the mathematics of the activities i.e. big profits/gains are clearly on revenue account.

Notwithstanding the above, the leading exposition of the ATO view on the revenue v capital distinction remains Taxation Ruling TR 92/3 – *Income Tax: whether profits on isolated transactions are income* that

was issued following the High Court decision in *FCT v The Myer Emporium Ltd* (87 ATC 4363). The said Ruling expresses the ATO view that profits from isolated transactions of taxpayers not carrying on a business will be income according to ordinary concepts where:

- the intention or purpose of the taxpayer in entering the transaction was to make a profit or gain; and
- the transaction was entered into and the profit was made in the carrying out of a business operation or commercial transaction.

The Ruling states that it is usually, but not always, necessary that the taxpayer has a profit making intention when the property is acquired.