The fine line between property development and "merely realising an asset"

There can often be a fine line between whether a person is carrying on property development activities or is "merely realising an asset".

For example, it may not be clear whether the extent of a person's development activity in respect of, say, subdividing his or her backyard and building one or more units of accommodation and selling them either amounts to property development or merely realizing an asset – and one that has been used mainly for domestic purposes.

And a person may be considered to be carrying on property development activities if they are not in the business of property development and it is a one-off activity.

Suffice to say, the tax consequences between property development and "merely realising an asset" are entirely different.

In the case of carrying out property development activity, the gains are assessable as ordinary income (or as business income) – and, importantly, without the benefit of the capital gains tax (CGT) 50% discount which would otherwise reduce the assessable amount.

However, relevant expenditure incurred is generally deductible as it is incurred, ie, in the income year that it is incurred. And this may be of great benefit to the developer.

On the other hand, if a person is "merely realising an asset" then any gain is only accounted for under the concessionally taxed CGT regime (and with the benefit of the 50% CGT discount, if generally the land has been owned for more than 12 months).

Furthermore, in this case, if the property in question was acquired before 20 September 1985 then there will be no consequences (either CGT or ordinary income). And there are still quite a few pre-CGT properties around that are ripe for realisation.

continued on page 5

The CGT main residence exemption concessions *continued...*

And in the case of the absence concession, for example, it even allows you to negatively gear the property during the six-year period of absence that you rent it!

On the other hand, there are also some CGT rules that can expose your home to a partial CGT exemption in a number of circumstances.

For example, there is a rule that spouses (including de-facto spouses and same sex spouses) cannot each have a CGT exempt main residence on different residences for the same period that they are spouses. And this may apply in a variety of situations. However, it seems to be a rule that the ATO does not actively pursue – nevertheless it is there in the tax law.

Another rule that may limit your ability to claim a CGT exemption on your home is where you may subdivide some of it off and sell it or transfer it to another party (eg, typically on the subdivision and sale of part of a large backyard). And this rule may be highly relevant in the current housing market – especially given more flexible council regulations.

If you are considering buying or selling a home – or find yourself thinking that you may need to use any of these concessions – we can advise you on their applicability to your case and how you can use them most effectively.

The fine line between property development and "merely realising an asset" *continued...*

So, how does the Tax Office tell the difference between the two when it is not abundantly clear from the nature of the activity itself?

Well, several factors are particularly important (among the many that can be taken into account).

These include the intention with which the person originally acquired the land. To develop it and on-sell it for a profit? Or merely for some other non-profit purpose? For example, to live in it as their home (although this distinction is getting harder to tell in the current property market!).

Another key factor is the extent to which the person gets involved in the activity. As a broad principle, where a person is less involved in the activity and merely acts passively it is generally considered to be "merely realising an asset". But this is not a hard and fast rule.

There are also important GST consequences depending on the nature of the activity and the property involved.

Finally, it should be stressed that just because the nature of the activity is a one-off transaction it does not mean that the person is immune from being taxed on the profits as ordinary or business income.

If you are contemplating carrying out any such activity, come and have a chat to us first so we can help you do things with the best possible tax outcomes.