

NSW Tax Forum

Property Development – Complex Issues

Presented at the NSW Tax Forum on 17 May 2023

Sam Ayoubi

PwC

Contents

1. Paper Overview	5
1.1 Abstract	5
1.2 Background	5
1.3 Relevance/significance of Property Development.....	5
1.4 The Scenarios	6
1.5 Using this Paper and the Scenarios	6
2. ‘Property development’ and ‘complexity’	8
2.1 What is “property development”?	8
2.1.1 Terminology	8
2.1.2 Classification.....	8
2.2 What is a ‘complex’ issue?	8
3. A ‘simple’ scenario.....	10
3.1 Complex issue 1 – capital or revenue?	10
3.2 Complex issue 2 – Land ‘ventured in’	11
3.3 Complex issues arising from our ‘simple’ scenario	11
4. Rental Property subdivision scenario.....	12
4.1 Scenario facts and circumstances.....	12
4.2 Analysis	12
4.2.1 Is there a profit-making undertaking or isolated transaction?	12
4.2.2 Revenue Asset <i>not</i> Trading Stock.....	13
4.2.3 Mere Realisation?	13
4.3 Complex issue 3 – Am I in business?	14
4.3.1 What is a “business”?	14
4.3.2 Implications of holding as Trading Stock.....	15
5. Other ‘simple’ scenarios	16
5.1 Speculation to Development	16
5.1.1 Small Business Entity	16

5.2	Development Land sold undeveloped	16
6.	Complex issues in SME property development	19
7.	JV Scenario.....	20
7.1	Facts and circumstances.....	20
7.2	Entering into the JV	21
7.2.1	What is in a JVA?	21
7.2.2	Land Registrations and Dealings	21
7.2.3	Complex issue 4 – Goods and Services Tax	22
7.3	Subdividing and Partitioning	23
7.4	Conducting the Development	23
7.4.1	Complex issue 5 – JV or Partnership?	23
7.4.2	GST (again!)	24
7.5	Selling.....	25
8.	PDA scenario	27
8.1	PDA terms	27
8.2	Why enter into this type of arrangement?	27
8.3	What is the arrangement?	28
8.4	Relevant Income Tax Principles.....	29
8.4.1	General Principles recap	29
8.4.2	Capital account.....	30
8.4.3	Revenue account.....	30
8.4.4	Capital and Revenue Account elements not mutually exclusive	32
8.5	Application of Income Tax principles to the Property	32
8.5.1	General Income Tax implications	32
8.5.2	Developer Fee	32
8.5.3	Profit from the Profit-making use of the Property as Assessable Income	33
8.5.4	Value of CGT Asset “committed to” Profit-making Venture.....	33
8.5.5	Dissection of profit on Sold Apartments	34
8.6	Goods and Services Tax (GST)	37

8.6.1	General GST principles and relevant authorities.....	37
8.6.2	Margin Scheme	37
8.6.3	GST withholding notice.....	37

1. Paper Overview

1.1 Abstract

The property development sector is both very easy and very difficult to understand. The commercial issues are relatively well understood – obtaining finance, costs of land and development, market prices for completed lots and the obvious challenges with bringing together all of the elements for a successful development.

But as a large and valuable sector that involves landholdings, financial instruments and legal complexities, there are multiple tax traps that would-be developers can fall into.

This paper will focus on the key traps (and provide some practical tips) to advisers and property developers in dealing with some of these complexities. Issues considered will include:

- *Co-ownership and co-development of property*
- *Partitions between co-owners*
- *Strata Titling; and*
- *The age-old ‘capital vs revenue’ issue*

1.2 Background

This paper accompanies a practical session that considers some scenarios where owners find themselves in a position to take advantage of property development opportunities, and the tax issues that arise. Case studies will include considerations around:

- ‘Simple’ development scenarios in the small-to-medium enterprise (**SME**) market;
- Joint venture arrangements; and
- Development agreement structures.

While focussed on the practical application and tax considerations, some legislative citations are necessarily made throughout this paper. Unless otherwise stated, all legislative references are to the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**). Any judicial authorities or guidance/opinions/rulings/determinations issued by a tax or revenue authority are cited with their full reference wherever possible.

1.3 Relevance/significance of Property Development

While it should probably go without saying, real property is a major asset class in Australia and the natural scarcity or limit of land available makes the asset class ripe for value accretion and attractive to investors for a wide variety of reasons (too long to list here).

Total wealth in Australia is approximately \$14,346 billion (see: <https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-financeand-wealth/latest-release>.)

Of this, residential dwellings in NSW alone amounts to approximately \$ 3,624 billion or 25.26% of total Australian private wealth (see <https://www.abs.gov.au/statistics/economy/price-indexes-and-inflation/total-value-dwellings/dec-quarter-2022/643201.xlsx>).

Also according to the Australian Bureau of Statistics (ABS) at <https://www.abs.gov.au/statistics/economy/finance/household-income-and-wealth-australia/latestrelease#household-income-and-wealth>:

In 2019–20 the largest household assets were from owner occupied dwellings, 40% of total household assets (a decrease from 42% in 2017–18). The second largest household assets were from superannuation, at 18% which was consistent with 2017–18.

This excludes other property investments which the ABS notes:

In 2019–20, 15% of household assets were from other residential and non-residential property e.g. for rent and holiday homes.

This means that for the average private individual or household, more than half of their wealth is in real property (and that is ignoring the value of real property in their other investments such as superannuation, property funds and even landholdings of business entities in which they may also invest.

With so much of their wealth invested in land, it is also a natural and expected occurrence that Australians will look to exploit that for profit, gain or further wealth accumulation. It is also very important to limit (as much as possible) any tax leakage from such profit or gain at a time of rising interest rates (as the graph at this link will show you: <https://www.rba.gov.au/statistics/interest-rates/>).

This paper looks at some scenarios where this profit, gain or wealth objective using landholdings has been observed to occur.

1.4 The Scenarios

The following scenarios are considered in this paper and accompanying seminar:

1. Subdivision and Development of Land initially (allegedly) held as a capital asset;
2. Joint venture (JV) property development; and
3. Development agreement between landholder and developer, known colloquially as a “Project Delivery Agreement” (PDA)

1.5 Using this Paper and the Scenarios

All scenarios are purely hypothetical and any resemblance to any actual facts or circumstances of particular taxpayers is entirely coincidental.

The intention of the scenarios, and how this paper is intended to be read, is for illustrative purposes only. The tax issues and authorities considered are, in the opinion of the author, the key complex issues to be considered and the likely application of the relevant authorities in resolving those issues. There may be other tax issues and authorities relevant to each scenario, and there will definitely be other issues and authorities relevant to real-life situations that readers may encounter in practice.

Therefore, this paper can and does only serve as a starting point for tax considerations. It is not a substitute for specific professional tax advice (or any other relevant advice such as legal or other professional advice). Nothing in this paper is intended to, and nothing in this paper does, amount to advice or is intended to be relied upon by a taxpayer or adviser.

Readers are strongly encouraged to obtain their own tax, legal and other professional advice in relation to any matter considered by them in practice, and before commencing any transaction, plan, scheme, undertaking or venture.

2. ‘Property development’ and ‘complexity’

2.1 What is “property development”?

2.1.1 Terminology

Property “development” is a term, of art. While many people, tax practitioners among them, know intuitively or instinctively what “property development” is, defining that term with data or facts that are specific, measurable and certain is not something that has been done to universal acceptance.

Investing in or exploiting property as a general proposition falls often into one or more of the categories that are colloquially referred to as property “investment”, “speculation” or “development” and many practitioners would accept that each of these classifications would usually result in the relevant property being held, respectively, on capital account, on revenue account, and as trading stock.

2.1.2 Classification

While this approach would be a good place to commence analysis, there is a dangerous assumption upon which such a starting point is predicated: that these classifications are mutually exclusive. In reality, especially where the land may be held for an extensive period of time, the use of the property and intention of the owner will change or evolve such that a property (or parts of it) will be held for different reasons at different times (or different parts held for different reasons at the same time).

The prudent practitioner should keep in mind that the biggest mistake is often trying too hard to classify the use or intention, rather than simply going where the facts lead.

2.2 What is a ‘complex’ issue?

The Oxford Dictionary definition of “complex” is:

adjective: **complex**

1. *consisting of many different and connected parts.*
"a complex network of water channels"
2. *not easy to analyse or understand; complicated or intricate.*
"a complex personality"

noun: **complex**; plural noun: **complexes**

1. *a group or system of different things that are linked in a close or complicated way; a network.*
"a complex of mountain roads"

2. *a group of similar buildings or facilities on the same site.*

"a leisure complex"

antonym: **simple**

So let's consider something simple in property development.

3. A ‘simple’ scenario

One of the most common methods applied by landowners for adding value to landholdings in the private or SME market is the ‘plain vanilla’ single landholder who improves or subdivides land.

While this basic premise seems simple enough, it raises several issues that are universal to the determination of tax implications of many property development activities, which include:

- The capital or revenue classification of the land for tax purposes;
- If capital, whether and to what extent any capital gains tax (**CGT**) concessions apply;
- If revenue, whether the land is:
 - Being used as part of a profit-making undertaking (**PMU**) or other isolated transaction for a primarily profit-making purpose; or
 - Held as trading stock – which itself requires analysis as to whether a “business” exists and whether the land in question was/is “anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a * business”: [section 70-10\(1\)\(a\)](#).

Consider the following scenario as the “basic” case observed regularly:

- b. An owner (**Owner**) of land (**Land**) wishes to add value to their Land by small-scale development
- c. The Owner subdivides the Land into two (2) separate land titles (each a **Lot**).
- d. The Owner either sells one Lot and keeps the other Lot or sells both Lots.

The following scenarios and issues (and probably many more) all flow from these simple facts.

3.1 Complex issue 1 – capital or revenue?

Knowing nothing else, would the Lots in our ‘simple’ subdivision scenario be fairly and reasonably considered to be held only for profit-making? Arguably yes, from a point. The Commissioner provides his views in *Taxation Ruling TR 92/3* – ‘Income tax: whether profits on isolated transactions are income’.

At what point did the Land begin to be held for profit-making? The technical answer will depend on the “intention” of the Owner. How is this evidenced? Practically, this is a difficult fact to prove. For simplicity, one could look at the time when the Owner first commenced the process of seeking approval for the subdivision (e.g. Council application or engaging a consultant, etc).

Does this mean the purpose was for profit-making at that time? What if there were other facts, such as the Owner actually had intended to develop the Land? Again the facts will be crucial.

Assuming that the profit-making purpose did arise after acquisition, and can be identified at a particular point in time, then the Land was “committed to” the profit-making purpose.

3.2 Complex issue 2 – Land ‘ventured in’

Where such an asset is “ventured in” to a profit-making undertaking, the “profit” from the undertaking or scheme is assessed as ordinary income, and such “profit” is calculated with reference to all proceeds less an “allowance” or reduction for the value of the asset committed to the profit-making adventure at the time such adventure commenced: see *NF Williams* [1972] HCA 31; 72 ATC 4188 at 4193 per Menzies J in the majority; and *FCT v McClelland* [1969] HCA 72; (1969) 118 CLR 353 (1969) 43 ALJR 72 (1969) 1 ATR 31 (1969) 15 ATD 204; 69 ATC 4001.

What this basically means is that the gain (if any) on the Lots will be ‘split’ into the capital portion (up to the time that a profit-making intention is formed) and the revenue portion (from formation of the profit-making intention), with a valuation at the time of forming the profit-making intention being used as the proceeds for CGT purposes and the cost base for profit-making purposes.

3.3 Complex issues arising from our ‘simple’ scenario

From the above ‘simple’ facts, the following issues have arisen for consideration:

- a. Is the Land held on capital or revenue account?
- b. What happens if it is concluded that the Owner has commenced to hold the Land on revenue account as trading stock? Consider [CGT event K4](#). This will rest on whether there is actually a “business” being carried on (which will be considered later in this paper).
- c. On the question of whether a “business” exists, is the property ownership/development history of the Owner relevant? Could historical property development activities taint the perception of the Owner’s intention with respect to the Land?

TIP: Document your intention

TRAP: Don’t behave contrary to your documented intention

4. Rental Property subdivision scenario

4.1 Scenario facts and circumstances

- a. A land Owner (**Landlord**) owns farmland (the Land) which has always been used for the purpose of deriving rental income.
- b. Due to rezoning, the Land is now “mixed use” and can be used for high-density residential and commercial.
- c. The Landlord submits a development application (**DA**) which is granted.
- d. The Landlord then places the Land on the market for sale, targeting property developers.

4.2 Analysis

At this point, the sub-heading is perhaps misleading. Whatever “development” means, one could reasonably argue that some physical development of the land would be expected to have taken place to answer to the description “property development”. Perhaps all that has occurred to date on the above facts is property ‘use enhancement’.

The Landlord is not a developer and has not developed the Land.

The Landlord could reasonably argue that they have sought to “merely realise” the maximum value of the Land in its current state and allowed use. This would mean that the Land continues to be held on capital account and if sold for an overall gain the gain would be subject to taxation under the CGT regime.

4.2.1 Is there a profit-making undertaking or isolated transaction?

Is there a PMU or some isolated transaction with a principal purpose or intention of profit-making by way of resale? This is very unlikely and the Commissioner does not appear anywhere in *TR 92/3* to assert that such a scenario would amount to a PMU deeming the Land to be held on revenue account.

The factors in *TR 92/3* paragraph 49 as to whether a property is held on revenue account as part of a business or commercial operation are directly quoted below:

(a) the nature of the entity undertaking the operation or transaction (Ruhamah Property Co. Ltd. V F C of T (1928) 41 CLR 148 at 154; Hobart Bridge Co. Ltd. v. FC of T (1951) 82 CLR 372 at 383; FC of T v. Radnor Pty Ltd 91 ATC 4689; 22 ATR 344). For example, if the taxpayer is a corporation with substantial assets rather than an individual, that may be an indication that the operation or transaction was commercial in nature. However, if the taxpayer acts in the capacity of trustee of a family trust, the inference that the transaction was commercial or business in nature may not be drawn so readily;

(b) the nature and scale of other activities undertaken by the taxpayer (Western Gold Mines N.L. v C. of T. (W.A.) (1938) 59 CLR 729 at 740);

- (c) *the amount of money involved in the operation or transaction and the magnitude of the profit sought or obtained;*
- (d) *the nature, scale and complexity of the operation or transaction;*
- (e) *the manner in which the operation or transaction was entered into or carried out. This factor would include whether professional agents and advisers were used and whether the operation or transaction took place in a public market;*
- (f) *the nature of any connection between the relevant taxpayer and any other party to the operation or transaction. For example, the relationship between the parties may suggest that the operation or transaction was essentially a family dealing and not business or commercial in nature;*
- (g) *if the transaction involves the acquisition and disposal of property, the nature of that property (Edwards v. Bairstow [1956] AC 14; Hobart Bridge 82 CLR at 383). For example, if the property has no use other than as the subject of trade, the conclusion that the property was acquired for the purpose of trade and, therefore, that the transaction was commercial in nature, would be readily drawn; and*
- (h) *the timing of the transaction or the various steps in the transaction (Ruhamah Property 41 CLR at 154). For example, if the relevant transaction consists of the acquisition and disposal of property, the holding of the property for many years may indicate that the transaction was not business or commercial in nature.*

Query whether anything in the scenario facts suggests that the paragraph 49 factors require further consideration.

4.2.2 Revenue Asset *not* Trading Stock

Where a profit-making undertaking or plan is commenced using the asset, but the profitmaking activity falls short of amounting to a business being carried on, the asset could still be “ventured in” to an activity in such an enterprising way as to result in assessable ordinary income from an “adventure or concern in the nature of trade”: Case W59 [\[1989\] AATA 433](#); (1989) 20 ATR 3728; 89 ATC 538 at paragraph 44. The decision in this case also cites *FCT v NF Williams* [\[1972\] HCA 31](#); (1972) 127 CLR 226 at 249; 72 ATC 4188 at 4194 per Gibbs J, referred to earlier in this paper. Interestingly, Case W59 was appealed to the Federal Court as *Stevenson v FCT* [\[1991\] FCA 224](#); (1991) 22 ATR 56; (1991) 29 FCR 282; 91 ATC 4476.

Based on the facts provided, this is the most likely outcome assuming the Owner had no intention originally to develop the Land and had no history of property development that could ‘infect’ their tax profile such that a reasonable assertion could be made that this was part of a broader property development enterprise.

Of course, the actions of the owner could be so significant as to amount to a “business”.

4.2.3 Mere Realisation?

Should the Landlord do more than what amounts to a “mere realisation” of the Land, then the Land will begin to be held on revenue account. Whether such revenue purpose then amounts to a business activity (whereby the Land will be held as trading stock) will be a matter of fact and degree.

There is an argument available to the Owner that improving the Land by conducting physical works is only done as part of a “mere realisation”. This would be difficult to sustain if the activities go beyond what is required to merely realise the maximum value of the Land in its current state.

It is arguable, although tenuously, that the Owner is deriving capital proceeds from the “mere realisation” of the Land in the most advantageous manner. The Commissioner has issued a favourable private binding ruling (PBR) (Authorisation Number [1051417438986](#)) relatively recently (24 August 2018). Note that the involvement of the land owner in that PBR engaged external participants for much of the development activities, and the profit from the land to be enjoyed by the owner does not appear to depend on the success of the development activities.

There is of course some classic case law that works against the Owner in similar circumstances: for example see *Federal Commissioner of Taxation v Whitfords Beach Pty. Ltd.* [\[1982\] HCA 8](#); 82 ATC 4031; (1982) 150 CLR 355; (1982) 12 ATR 692; (1982) 39 ALR 521; (1982) 56 ALJR 240.

More recently, there is the cautionary tale of *August v Commissioner of Taxation* [\[2012\] FCA 682](#) on the capital revenue distinction (although mere realisation was not strictly argued as it was in, say, *George Casimaty v Commissioner of Taxation* [\[1997\] FCA 1388](#)).

4.3 Complex issue 3 – Am I in business?

4.3.1 What is a “business”?

In *Taxation Determination TD 92/124* – ‘Income tax: property development: in what circumstances is land treated as “trading stock”?', the Commissioner considers (at paragraph 2) that:

The business activity is taken to have commenced when a taxpayer embarks on a definite and continuous cycle of operations designed to lead to the sale of the land.

However, *TD 92/124* contemplates the acquisition of the land for such a profit-making purpose and therefore a “business” would not necessarily be deemed to have commenced merely because a capital asset is applied for a profit-making purpose by way of development and sale. Further, for completeness, the development activity contemplated in *TD 92/124* (and the series of contemporaneously issued determinations at *TD 92/125* to *TD 92/128*) is undertaken by the land owner itself. Later we will consider whether this risk of holding a CGT asset as trading stock can apply to more ‘passive’ ventures of the Owner’s Land, for example under an arrangement such as a project delivery agreement (PDA).

It could reasonably be argued that nothing in the ‘farmland subdivision scenario’ or the ‘simple subdivision scenario’ suggests that a “business” is being carried on under the application of the ‘business indicia’ provided by the Commissioner.

Consider the indicia provided by the Commissioner in *Taxation Ruling TR 97/11* – ‘Income tax: am I carrying on a business of primary production?’ at paragraph 13 extracted below (note that each indicator is numbered for later reference but is not numbered in the original ruling text, and paragraph references in the extract below are to other paragraphs in *TR 97/11*):

The courts have held that the following indicators are relevant:

1. *whether the activity has a significant commercial purpose or character; this indicator comprises many aspects of the other indicators (see paragraphs 28 to 38);*

2. *whether the taxpayer has more than just an intention to engage in business (see paragraphs 39 to 46);*
3. *whether the taxpayer has a purpose of profit as well as a prospect of profit from the activity (see paragraphs 47 to 54);*
4. *whether there is repetition and regularity of the activity (see paragraphs 55 to 62);*
5. *whether the activity is of the same kind and carried on in a similar manner to that of the ordinary trade in that line of business (see paragraphs 63 to 67);*
6. *whether the activity is planned, organised and carried on in a businesslike manner such that it is directed at making a profit (see paragraphs 68 to 76);*
7. *the size, scale and permanency of the activity (see paragraphs 77 to 85); and*
8. *whether the activity is better described as a hobby, a form of recreation or a sporting activity (see paragraphs 86 to 93).*

4.3.2 Implications of holding as Trading Stock

If a CGT asset was to become trading stock of a property development business, for example, the consequences would be that a deemed CGT event K4 would arise pursuant to [section 104-220](#). The time of this event would be the time of the change of intention (to holding the asset as trading stock), and the deemed proceeds would be either:

- (i) market value of the asset at the event time – section 104-220(3); or
- (ii) cost of the asset – section 104-220(1): Note 2, and [section 118-25\(2\)\(b\)](#).

The deemed proceeds elected to be used for CGT event K4 purposes will also be adopted as the cost of the trading stock asset from that point: [section 70-30\(1\)\(a\)](#).

Recall for a moment that the definition of “trading stock” in section 70-10(1) provides (with bold emphasis added) that:

Trading stock includes:

- (a) *anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange **in the ordinary course of a *business**; and*
- (b) ** live stock.*

5. Other ‘simple’ scenarios

5.1 Speculation to Development

What if land is originally acquired by the Owner as part of a speculative property venture?

Assume for a moment that the Owner was knowledgeable about the property market and took a calculated risk to invest in the Land with the potential for a rezoning. Perhaps the Land is on the ‘urban fringe’ or in an industrial area where surrounding suburbs had been rezoned and gentrified.

Does this impact the outcome? Most certainly this would be a serious consideration. Suddenly, the factors from *TR 97/11* paragraph 13 are more relevant, especially indicators 1 and 6.

However, even if the speculative investment is successful, this could simply be a one-off PMU and on revenue account but not amount to a business (so the Land is *not* trading stock).

Query what would be the tax implications of this distinction? The tax rate and revenue nature would not be any different (surely ‘mere realisation’ on capital account is not likely to be argued).

Interestingly, there actually is a possible tax outcome that relies on the distinction between whether the proceeds or profits are deemed to be from an isolated (non-business) commercial transaction or PMU as opposed to trading stock sold in the ordinary course of a business.

5.1.1 Small Business Entity

Consider the meaning of a “small business entity” (**SBE**) in [section 328-110](#) as requiring a certain “aggregated turnover”.

The “aggregated turnover” definition in [section 328-115](#) refers to “annual turnover” in [section 328-120](#), which reads (bold italics added for emphasis):

Meaning of annual turnover

General rule

(1) *An entity's annual turnover for an income year is the total * ordinary income that the entity * derives in the income year **in the ordinary course of carrying on a * business.***

Would profit made from realisation of a revenue asset fall within the definition of “annual turnover”?

5.2 Development Land sold undeveloped

Of course, not all development properties follow such a linear path from capital asset to some form of revenue intention.

What if the Owner originally acquired the Land with an intention to develop, but the facts evolved differently from their original intention or plan? At some stage after undertaking some initial processes, the Owner has determined that their plan will not come to profitable fruition as designed.

Let's say that the height limit could not be increased as they had hoped, or the feasibility report and costings had determined that the development would not be as profitable for the Owner based on their own unique cost and operating structure.

The Owner does manage to sell the Land for a profit, to an unrelated developer who probably has a more efficient and cost-effective supply chain and structure. Someone will probably end up making a profit from development of the Land, but it won't be the Owner.

The profit of the Owner is entirely referable to the movement of the undeveloped Land value.

This is where determining the outcomes is far more problematic.

On a simplistic approach and reading of *TR 92/3*, the Land was acquired with a profit-making intention and ultimately sold. There has been a profit from a PMU and that is on revenue account.

If the Commissioner were so inclined, perhaps he would even seek to assess the Owner as having acquired the Land in the ordinary course of its business (even if the Land was the first asset acquired as part of that business and the Owner's business consisted solely of the Land and the potential development thereof).

This is where arguably the judicial authorities and the Commissioner may partly diverge. *TR 92/3* was issued on 30 July 1992. The judgment in the case of *Westfield Limited v FC of T*. [91 ATC 4243](#); 21 ATR 1408; (1991) 21 ATR 1398 (1991) 99 ALR 510 (1991) 28 FCR 333 was delivered on 20 March 1991 (prior to the issuance of *TR 92/3*). The Commissioner has decided to cite *Westfield* in *TR 92/3* but distinguish the case on its facts (see *TR 92/3* at paragraphs 51-58).

What the judgment of Hill J in *Westfield* provides (which the other justices, Lockhart and Gummow JJ, agreed with), and the Commissioner does not actually dispute, is that it would be expected that a profit on revenue account would only arise if the means of making the profit had been planned or contemplated by the taxpayer.

The relevant parts of the Hill J judgment extracted in *TR 92/3* at paragraphs 52-53 read:

'...where a transaction falls outside the ordinary scope of the business, so as not to be a part of that business, there must exist, in my opinion, a purpose of profit-making by the very means by which the profit was in fact made. So much is implicit in the decision of the High Court in Myer.'

53. His Honour limited this broad statement when he pointed out:

'There may be a case, the present is not one, where the evidence establishes that the taxpayer has the purpose or intention of making a profit by turning an asset to account, although the means to be adopted to generate that profit have not been determined: cf Steinberg v Federal Commissioner of Taxation (1972-75) 134 CLR 640; 75 ATC 4221; 5 ATR 594 ... While a profit-making scheme may lack specificity of detail, the mode of achieving that profit must be one contemplated by the taxpayer as at least one of the alternatives by which the profit could be realised. Such was the case in Steinberg.'

Is there any evidence that a sale to a developer had been "contemplated by the taxpayer as at least one of the alternatives by which the profit could be realised"? It would not appear so.

What if the excavation and earthworks in the development disturbed some bedrock and the Owner accidentally or unwittingly struck oil or other paydirt? Suddenly the development property is now a

mineral-rich rigging, mining or quarrying prospect. If this is sold to a larger mining, resources or energy entity, would that sale be on revenue account? *Westfield* would suggest not. The Commissioner may take a different view.

6. Complex issues in SME property development

In the experience of this author, and to keep the scope of this paper and the accompanying presentation narrow enough to consider some common scenarios in sufficient depth and detail, there are two common categories of land development that could be undertaken by landowners:

- The loosely-termed “joint venture” (**JV**) – where the landowner(s) actively participate in the property development activity; and
- The PDA – where the landowner(s) do not actively participate in property development activities (but may nonetheless participate or acquiesce to the necessary extent to enable their land to be developed and sold.

The following scenarios have been drawn from the author’s observations in practice as embodying the key recurring tax issues and possible approaches in each category (JV and PDA).

Warning: do not advise based on simple scenario facts or basic tax implications. The issues are complex and should not be dealt with in a simplistic manner. While the scenarios, facts and analysis is presented in a simplistic manner for education purposes, the actual application in practice of tax issues to property development is one of the most complex areas of any tax practice.

7. JV Scenario

At this point, it is important to note that the term “JV” is being used for convenience. The actual arrangement between participants may:

- amount to a partnership (association of persons in business with a view to profit or in receipt of income jointly); or
- be an actual JV (no common business with view to profit, no joint receipt of income).

In this part of the paper, the term JV simply means that multiple participants are each separately acting in their own best interests, but may act somewhat co-operatively with other participants in a larger activity or pursuit where the separate self-interests of each participant align sufficiently to justify some level of co-operation.

7.1 Facts and circumstances

Xavier and Yolanda (each an **Owner**) own adjoining properties (each a **Property**).

Each Property is of equal size and value (assume they are identical with no special features in either absent from the other).

Yolanda has owned her Property for many years (but post-CGT!) and used its Property for personal or private purposes.

Xavier is a property developer.

Yolanda has no history of property development or speculation.

After discovering a change to the zoning and consent limits in their street, from discussions up at the Canterbury Hotel during the NBA Playoffs, the Owners each decide to develop their own Property. Further conversations ensue after the conclusion of the epic game 6 between the visiting Warriors from San Francisco and the hosts, the mighty LA Lakers. Discussions lead to a tentative direction where the Owners will explore the prospect of developing their Properties as part of a single project.

All Properties are in the same zoning area (mixed use) with the same height limit (14 metres) and floor space ratio (**FSR**) of 2:1.

The suddenly friendly Owners come together and obtain some architectural designs (**Designs**).

Based on the maximum density of development on the Properties, and the Designs, it is determined that the combined area of the Properties (collectively, the **Site**) is capable of being developed into separate strata lots (each a **Lot**) comprising residential apartment lots (each an **Apartment**) and commercial lots (each a **Shop**), with sufficient basement to provide one (1) car space per Lot (each a **Space**).

Despite all their planning and negotiating, none of the configurations would allow for Lots and Spaces to rest evenly across the Site with each Lot wholly within a Property.

The Owners agree to develop the entire Site collectively in accordance with the Designs and upon completion each owner will be entitled to take half of the completed Lots. Neither of the Owners desire to co-own with any other Owner.

Xavier intends to sell all of his Lots.

Yolanda intends to retain as many Lots as possible, and sell only what she needs to she can fund any taxes and development costs. Where possible, she will sell only Apartments and not sell any Shops.

The following are the likely basic phases and tax implications/considerations.

7.2 Entering into the JV

Each Owner will need to enter into some kind of legal arrangement. This could typically be referred to as a JV Agreement (**JVA**).

7.2.1 What is in a JVA?

Each Owner will commit their own Property into the development of the Site (the **Development**).

The JVA will often provide for how the Development will be funded and how the Site will be used, as well as engaging of a development manager or other professional advisers, etc.

TIP: Document your JVA

7.2.2 Land Registrations and Dealings

The development and strata subdivision plans (**Plans**) need to be lodged with the relevant statutory authorities such as Council and New South Wales (**NSW**) Land Registry Services (**LRS**).

Note that LRS has a process where separate lots are 'consolidated' into new lots for development pending registration of the final subdivided lots: see https://rgguidelines.nswlrs.com.au/land_dealings/dealings_involving_folios

Consider the following example from those Folios Dealings Guidelines (with underlining added for emphasis):

Example

X and Y lodge a plan of subdivision over part of their respective lots 6/712345 and 5/765432 to create a new lot 1/789012. Three new titles are issued:

- *Folio 2/789012, registered proprietor 'X' (for the residue land)*
- *Folio 3/789012, registered proprietor 'Y' (for the residue land)*
- *Folio 1/789012, registered proprietor 'X As Regards The Part Formerly Comprised In 6/712345 And Y As Regards The Part Formerly Comprised In 5/765432'. Note The line dividing the 'parts formerly comprised in ...' is not a legal parcel boundary, see Sections 23F and 23G Conveyancing Act 1919.*

An interest relating to one of the parts only is recorded in the Second Schedule, e.g. 'T123 Mortgage To Z As Regards the Part Formerly Comprised In 6/712345'.

Note Multiple ownership exists only in terms of parts of the land formerly owned, not in terms of a joint tenancy or tenancy in common.

Based on the above, there has been no CGT event of any original lot.

But the new lot parts referable to each “former lot” cannot be conveyed, mortgaged, leased or partitioned: see [section 23F](#) of the *Conveyancing Act 1919* (NSW).

This means that a new consolidated title must be created for the consolidated lot, with a single lot and registered owner(s) over the entire lot. This is then subdivided into the strata lots.

LRS explains that as follows, with respect to a mortgage dealing (underlining added):

Thus a transfer, mortgage or lease of part of the land owned by X in 1/789012 in the above example may contravene the Act because it describes the land in terms of a former plan, i.e. lot 6 in DP712345, and not the current plan, i.e. DP789012. The dealing may be registered if it attempts to resolve the multiple ownership, i.e. the dealing must move towards bringing all parts of the folio into single ownership, e.g. a transfer from X to Y.

The outcome of this will be that each Owner is actually disposing of their Property and receiving as consideration an interest in the Site. This may be preferable at the outset with the Property and Site value at its lowest rather than once the Development is completed and the Site value increased.

Note that a later attempt to “partition” without a joint ownership may lead to adverse duty consequences: see for example the case of *Aoun Investments Pty Ltd v Chief Commissioner of State Revenue* [\[2006\] NSWSC 1394](#).

Therefore, to align the interests in such a manner as to achieve the end result (20 Apartments and 1 Shop each, with the fourth Shop sold), the Owners will need to ensure the consolidated lot for the Site is owned in those portions of one-third each. This will trigger CGT events and dutiable transactions, but will likely be much less costly at the outset than the ‘back-end’.

7.2.3 Complex issue 4 – Goods and Services Tax

There is also the Goods and Services Tax (**GST**) impact to consider. Each Owner is making:

- a “supply” of part of their Property to each other Owner; and
- an “acquisition” of part of each Property of each other Owner from that other Owner.

GST is often the least flexible or manageable tax (among income, duty and GST) in property developments, but this impact is often mitigated by its input tax credit (**ITC**) attributes. Even though supplies are being made, acquisitions are also being made, and those acquisitions could be “creditable acquisitions” that entitle the Owner to ITCs for GST imposed.

The problem in the present case is that ITCs may not be available to a large extent because the acquisition of each interest is not made for a “creditable purpose” (taxable supply or GST-free supply), as each Owner may hold their Apartments to provide residential accommodation and receive residential rent, which is an input taxed supply (**ITS**): [section 40-35](#), *A New Tax System (Goods And Services Tax) Act 1999* (Cth) (**GST Act**).

This would be different if the purpose was to sell the Apartments within 5 years of completion as “new residential premises”, which is a taxable supply: [section 40-65](#), *GST Act*.

7.3 Subdividing and Partitioning

Much of the implications here will depend on how the earlier components have been executed and managed.

Assuming that the Site consolidated title has been created with joint ownership interests and that a “Partitioning Deed” or something similar has been executed, this part should be achievable without any (further) adverse income tax or duty implications.

This is because there is:

- A rollover for strata subdivisions in certain circumstances: see [section 118-42](#) and [section 124-190](#); *Taxation Ruling TR 97/4* – ‘Income tax: capital gains: roll-over relief for buildings subdivided under strata title law into stratum units and common property’; and

TRAP: Strata titling on multiple strata plans

- A duty concession for partitions: see [section 30](#) of the *Duties Act*.

TRAP: Partitioning lots of differing values

As the Owners may each wish to take certain Lots, the Partitioning Deed should specify which Lots will be allocated to each Owner, to enable the CGT rollover to apply.

One interesting difference between the CGT rollover and the duty concession, in the case of strata partitions, is that the CGT rollover does not have a potential gap for differences in values whereas the duty concession does. This should be kept in mind when determining what the starting and ending interests of the Owners are or will be, and their respective actual/anticipated proportionate values.

7.4 Conducting the Development

The manner in which the Development is conducted may itself throw up some tax risks and complexities that should be managed carefully. The main risk that arises around the conduct of the Development is whether the Owners are acting in a manner consistent with a partnership, rather than a JV. That is, where the participants may share in profits, not taking output or product.

The tax implications of failing to heed this risk are that JVs could actually be partnerships for tax purposes. This could lead to an outcome whereby the transactions result in duplicate duty as a partnership interest is a separate item of dutiable property from the land interest.

7.4.1 Complex issue 5 – JV or Partnership?

The Commissioner sets out what a JV is for GST purposes in *Goods and Services Tax Ruling GSTR 2004/2* – ‘Goods and services tax: What is a joint venture for GST purposes?’

Additionally, it is important to clarify what a “partnership” is. There are several definitions of “partnership”.

The ‘classic’ or general definition of a “partnership” can be found in [section 1](#) of the *Partnership Act 1892* (NSW), which provides (with underlining added) that:

Partnership is the relation which exists between persons carrying on a business in common with a view of profit and includes an incorporated limited partnership.

A broader definition of a “partnership” is provided in [section 995-1](#)(1) of the *ITAA 1997* – referred to and adopted as the definition of a “partnership” for GST purposes in [section 195-1](#) of the *GST Act* – which states (with underlining added):

partnership means:

- (i) *an association of persons (other than a company or a limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly; or*
- (ii) *a limited partnership.”*

In addition to the definitions above, we also note that the *Duties Act 1997* (NSW) (***Duties Act***) does not define the term “partnership”. As such, for duties purposes the term “partnership” would take its ordinary meaning, classic or general law meaning.

The problem is that if there is a partnership, that will create GST and duty issues as these taxes recognise a partnership as being akin to a separate entity. If a partnership is formed, the entire Site could be seen to have been acquired by the partnership from the Owners. Similarly, the dutiable impact could be significant if each Owner is actually acquiring an interest in a partnership upon entering into the JV.

It is for these reasons that participants should be very cautious about how they structure their arrangements if there is actually no intention to conduct business together/jointly, but rather act cooperatively to develop land that will be divided between them for their own separate purposes.

While it is always true that the facts are critical and that ‘parties cannot agree something is red when it is actually blue’, the documentation will usually go a long way to determining the legal classification of the relationship(s) and the intention of the parties in entering into the venture.

TIP: Don’t call it a “partnership” if it is not a partnership

It would not be an oversimplification to say that the parties should not put the title “Partnership Agreement” on the collective agreement or deed if they do not intend to form a partnership.

7.4.2 GST (again!)

A critical issue arises as to how to fund the GST. There will be costs incurred and if the arrangement is a partnership then certain registrations will be required. We will leave these for now but suffice to say it’s yet another complex issue for consideration.

In terms of the input tax credit (**ITC**) claims of Yolanda, what is her ITC eligibility? She is retaining many lots. These lots will be a mix of commercial lots (making taxable supplies) and residential lots (deriving input taxed residential rent). The ITCs claimed will have to be calculated carefully, and then even allow for some prospect that ITCs claimed now could be repayable in future if intended sale Lots are ultimately retained: see *Goods and Services Tax Ruling GSTR 2009/4* – ‘Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose’.

TRAP: GST impact on unrealised Lots

It is important to also note that the partitioning may create taxable supplies between owners which require GST to be funded without any realisation of the Lots. This cash flow impact or 'leakage' could be critical – luckily Yolanda has considered this and will sell some of her Lots to fund the tax!

QUERY: Is there any GST if the sale of Lots is on capital account by a non-business taxpayer?

7.5 Selling

In this scenario, there are Lots being sold.

This will clearly be on revenue account and subject to GST as a taxable supply (of commercial premises or new residential premises).

Is there a partnership?

TRAP: creating an unintended partnership

A possible issue arises around the sale of the Lots if multiple Owners will receive income from the sale of a single Lot. Some Lots may be owned jointly, due to the manner in which Lot titles could be registered on registration of a strata plan. This could mean multiple Owners arguably receive income jointly (which could amount to a tax law partnership).

The Owners could probably still reasonably assert that there is no common law partnership, and that any tax law partnership is restricted to the Shop sold.

One interesting perspective to consider is that provided by the Commissioner in *Goods and Services Tax Ruling GSTR 2004/6* – 'Goods and services tax: tax law partnerships and co-owners of property'. Extracted below are some relevant comments from that ruling (the author has underlined some key indicia):

27. The expression 'in receipt of ordinary income...jointly' suggests that two or more persons have commenced an activity which gives rise to, or will give rise to, a right or entitlement to receive jointly an amount or payment of a revenue nature.

...

66. The following factors may point to an enterprise being carried on by each co-owner in their own right, and not by a tax law partnership:

...

- there is an agreement between the co-owners not to form a partnership nor to jointly carry on an enterprise;
- *each co-owner makes independent decisions with regard to the acquisition of an interest in income producing property;*
- *each co-owner's acquisition of their interest in property is made separately;*
- *any borrowings by a co-owner are to fund the acquisition of their interest in the income producing property only; the co-owners do not fund the acquisition of each of their interests out of joint funds or borrowings;*

- *the co-owners act independently of each other in making decisions about their respective investments;*
- *each co-owner acts independently with respect to the appointment of a manager or agent, even though the same manager or agent is usually appointed to act on behalf of all the co-owners;*
- *the gross rental income may be paid into a single trust account operated by a property manager or agent and operating expenses may be met from this trust account. The income is not paid into and the expenses are not paid out of a joint bank account in the name of the co-owners;*
- *the manager or agent accounts to each co-owner separately, both in respect of income and outgoings and will distribute net rental income from the trust account to the co-owners on a regular basis;*
- *each co-owner does not act for the mutual benefit or on behalf of the other co-owners and is primarily concerned with securing an enhanced value or return on their investment;*
- *property is held as tenants in common, rather than as joint tenants; and*
- *although contributing to a mutual fund to pay all liabilities in relation to the income producing property, each co-owner makes the payment in the course of carrying on their own enterprise.*

Overall, the Development could fairly described as a JV rather than a partnership. Provided the Owners are clear on their intentions and execute transactions and agreements at the outset to ensure they have aligned their interests accordingly, they can minimise the tax and duty impacts.

If they do not, the worst case scenario could be full duty on the entire value of the Site (which could be entirely conveyed at some point, inadvertently) and significant CGT and GST upon consolidating and partitioning land titles. The worst part about all of that is, based on the intentions of the Owners, there are no sale proceeds from which to meet these significant tax and duty costs. This would therefore cause either or both of the following problems:

- funding of significant tax and duty costs to come from other sources of each Owner; and/or
- sale of some or all of the Lots that they had planned to retain, to fund the unexpected significant tax and duty costs.

8. PDA scenario

What if Yolanda secretly obtains her own Designs for her Property and determines that there is, within the zoning, height and FSR limits, a way for the Property to be profitably developed?

Yolanda could reasonably decide that given all the tax and duty costs and further commercial and legal risks of co-operating with another owner, that it would be preferable to conduct a Development on her own land.

Yolanda is not a property developer and has owned her Property for many years.

Yolanda has a mate (not from the pub) who knows some property developers, and discussions between Yolanda and her mate lead to an introduction of Yolanda to a Developer (Zack).

The Developer provides some no-obligation friendly observations and suggestions to Yolanda about Developing the Property.

8.1 PDA terms

The interactions between Yolanda and the Developer lead to the Developer making the following unsolicited offer to Yolanda:

- a. The Developer will conduct the Development of the Property
- b. The Developer will take on all “development risk” including funding and regulatory risks and obligations
- c. Yolanda will retain some Apartments and the Shops
- d. The rest of the Lots will be sold
- e. Yolanda will keep \$2 million from the sales proceeds of the Lots sold (**Sold Apartments**) and pay the balance, after GST, to the Developer as a “Developer Fee”.

8.2 Why enter into this type of arrangement?

As can already be seen, there is some complexity or novelty in the arrangement.

It is therefore important to put the reasons at the forefront.

Aside from the general trend in the market and economy to move towards more individualised arrangements that will allow landowners to benefit from the value of their land in different ways, being for commercial and legal reasons, there are tax considerations.

The tax issues are considered below, and we note that the duty implications may differ outside NSW.

Commercially, the landowner may be able to extract more from their landholding than a simple sale of land. Therefore, if nothing else, there is often a compelling commercial and financial reason why the landowner will be open to and perhaps even prefer a PDA.

The developer is also attracted to this type of arrangement due to capital and funding considerations. Buying land as a starting point is a costly exercise (ignoring the tax and duty considerations). Significant amounts of capital are required, which in turn will put pressure on the balance sheet of a SME developer (or even a Tier 1 or Tier 2 developer in some cases). Additionally, if debt funded, land acquisitions will put added funding pressure on the acquirer who is then also a borrower. This will, if nothing else, squeeze margins.

It is therefore commercially attractive to both the landowner and developer to explore alternative arrangements that will allow the landowner to obtain the greatest benefit while the developer minimises their own financial commitment and exposure.

It is also important to put on the record that some arrangements, in order to achieve the necessary commercial and legal objectives, are necessarily complex. Complexity should not be confused with contrivance or artificiality. The Commissioner has noted this important distinction in recent publications. These concepts should not be conflated.

8.3 What is the arrangement?

A question arises as to whether the PDA amounts to a partnership.

The analysis above and comments/observations of the Commissioner would suggest that the PDA is not a partnership agreement. The parties are acting in completely different manners.

The Owner is allowing their Property to be developed by the Developer, and the Owner will receive two main benefits:

- Completed Lots for investment and private use; and
- A fixed cash sum.

There are no “at-risk” funds or proceeds referable to the success of the Development activity. The Owner is not an active participant in the Development, so could not be said to be a participant in the business conducted by the Developer.

The Developer is in a completely different set of circumstances. The Developer’s benefit is wholly dependent on successful execution of the Development. The Developer is active in the Development rather than merely committing land for a known, fixed and pre-agreed outcome.

The factors which indicate that a partnership is not present (with reference to key *TR 97/11* indicia above) are:

1. Owner does not intend to conduct any business, and Developer does not intend to conduct business with Owner as partners;
2. There is no repetition or regularity of the activity by the parties together involving the:
 - a. Planning, design and completion of the Development works (**Works**); or
 - b. sale of the Lots; and
3. There is no permanency of the activity as it is a single-purpose venture with a finite term and definite end (being sale and retention of the respective Lots).

While not dismissing the other indicia, a business is not expected to be established as being carried on by the mere fact that, for example:

1. there is a significant commercial purpose for the Development;
2. there is a purpose of profit by both parties;
3. there exists a co-operative arrangement between the participants that may commonly occur in the property development industry;
4. the activity is planned, organised and conducted in a “businesslike manner” (being perhaps business-like, but not necessarily a business); and
5. the activity is not a hobby.

The activity is, as set out below, a profit-making venture that is not a business conducted by the parties as partners, and not a business carried on by the Owner.

Therefore, there should be no duty applicable to the rights or interests acquired by the Developer or granted by the Owner as the right to develop the Property is not:

1. a partnership interest;
2. a land-use entitlement;
3. an interest in land; or
4. any other “dutiable property”, as defined in section 11 of the *Duties Act*.

Similarly, there should be no adverse GST or income tax implications arising out of the formation of any partnership as the Owner and Developer are not and will not be in a general law or tax law partnership.

The analysis below is based on the position that the relationship between Owner and Developer does not amount to a partnership for tax law or general law purposes.

TRAP: ‘passive’ landholder gets actively involved in the development

8.4 Relevant Income Tax Principles

8.4.1 General Principles recap

Depending on the facts of a particular case, the relevant laws as well as the Commissioner, through guidance published by the Australian Taxation Office (**ATO**), and the judiciary (Courts and Tribunals), provide that there are three (3) ways in which profits from property development, subdivision and sale can be treated for tax purposes:

- a. On capital account taxed as a capital gain from the ‘mere realisation’ of a capital gains tax (CGT) asset;
- b. On revenue account as a profit-making scheme as a result of an isolated business transaction; and/or

- c. On revenue account from a transaction involving trading stock of an entity carrying on a business of property development.

8.4.2 Capital account

Land held for personal or income-producing activities other than for profit or gain primarily by way of a resale would typically be held on capital account. Assets on capital account are not usually bought or sold regularly as the advantage sought through ownership of a capital asset usually results from holding the land (e.g. rent).

The disposal by a taxpayer of an asset held on capital account, such as land, potentially gives rise to a “CGT event” A1.

A capital gain can arise from that CGT event where the proceeds received for the disposal exceeds the taxpayer’s total cost base of the asset. Where a taxpayer makes a capital gain that gain is generally included in their assessable income.

Broadly speaking, assets used in an enterprising way would most likely not be held on capital account. However, case law suggests that the proceeds from the mere realisation of a capital asset are not considered to be ordinary income despite the realisation potentially being carried out in an enterprising way.

8.4.3 Revenue account

The Commissioner considers that the sale of land will be a profit-making scheme or undertaking if the taxpayer had a profit-making intent at the time the sale transaction (i.e. the scheme/undertaking) is entered into.

The Commissioner has considered whether an isolated transaction was done in such an enterprising, commercial or active manner such as to be assessable on revenue account in *TR 92/3* considered earlier.

Subsequently, and more specifically to property development, the Commissioner published his Draft Property and Construction Website Guidance – which was previously available at <https://letstalk.ato.gov.au/PropDev#eg1> > (***Draft Property Guidance***). Although withdrawn for consultation, this is still the latest and most comprehensive statement published by the Commissioner on the tax implications and considerations pertaining to property development ventures. The Commissioner (at paragraph 16 of the *Draft Property Guidance*) includes the following ‘non-exhaustive indicia’ for consideration of whether a land owner will be seen to be holding a parcel of land (e.g. the Property) on capital or revenue account:

- a. Whether the landowner has held the land for a considerable period prior to the development and sale
- b. Whether the landowner has conducted ... other non-development business activities, on the land prior to beginning the process of developing and selling the land
- c. Whether the landowner originally acquired the property as a private residence or for recreational purposes

- d. Whether the landowner originally acquired the property as an investment, such as for long term capital appreciation or to derive rental income
- e. Whether the land has been acquired near the urban fringe of a major city or town
- f. Where the property has recently been rezoned, whether the landowner actively sought rezoning
- g. And whether any of the following has occurred:
 - 1. A potential buyer of the property made an offer to the landowner before the landowner entered into a development arrangement
 - 2. The landowner was unable to find a buyer for the land without subdivision
 - 3. The landowner applied 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
 - 4. The landowner has registered for GST on the basis that they are carrying on an enterprise in relation to developing the land
 - 5. The landowner has registered a related entity for GST that will participate in (or undertake) the development of the land
 - 6. The landowner has a history of buying and profitably selling developed land or land for development
 - 7. The operations are planned, organised and carried on in a businesslike manner (by the Owner)
 - 8. The scope, scale, duration and degree of complexity of any development
 - 9. Who initiated the proposal to develop the land for resale
 - 10. The sophistication of any development or other pre-sale arrangements
 - 11. The level of active involvement of the landowner in any development activities
 - 12. The level of legal and financial control maintained by the landowner in a development arrangement
 - 13. The level of financial risk borne by the landowner in acquiring, holding and/or developing the land
 - 14. The value of the development or other preparatory costs relative to the value of the land

More recently, on 18 January 2023 the Commissioner published some guidance considering 'Tax consequences on sales of small scale land subdivisions' at <https://www.ato.gov.au/General/Property/Tax-consequences-on-sales-of-small-scale-land-subdivisions/>

While the guidance expectedly deals with most of the issues in this paper, interestingly the Commissioner spends some time on evidencing intention of landholding use/application. His guidance is extracted below:

Evidence you need to determine intent and purpose

Even when a land subdivision involves your family home, you need to keep evidence of the subdivision process.

Written records are the best evidence of your purpose and intention and are much more valuable than what you can remember in hindsight.

8.4.4 Capital and Revenue Account elements not mutually exclusive

Where a property is originally held on capital account, it can become revenue in nature (either as trading stock or an asset held for a profit-making purpose outside the ordinary course of any business activity). This may occur when there is a change in purpose or intention in respect to the use of that property (e.g. for development, subdivision and subsequent sale).

As has already been considered above, a capital asset may commence to be held on revenue account (trading stock or other revenue asset) and vice versa.

8.5 Application of Income Tax principles to the Property

8.5.1 General Income Tax implications

In the present case, the transaction involves a CGT asset (the Property) which has always been held by the Owner for personal or private use. We consider that the Property should be capital in nature for the Owner as it has been held for several years without the Owner behaving in a way which would reflect that of a profit-making intention from the realisation of the Property.

It is arguable, although tenuously, that the Owner is deriving capital proceeds from the “mere realisation” of the part of the Property referable to the sale Lots in the most advantageous manner. The Commissioner has issued a favourable private binding ruling (**PBR**) (Authorisation Number [1051417438986](#)) relatively recently (24 August 2018), applicable to similar circumstances as those surrounding the Property and the PDA.

The above is a potentially arguable, yet somewhat uncertain and potentially more aggressive, position. The conservative position is that the Owner, by entering into the PDA, is committing a CGT asset (the Property) to a profit-making adventure (the PDA directed towards sale of some Lots). This accords with the views expressed in *NF Williams* and *McClelland*, cases cited with approval by the Court in the preeminent case on the matter, *Whitfords Beach* and in turn cited by the Commissioner in *TR 92/3* at paragraph 41.

8.5.2 Developer Fee

The PDA provides that the Developer Fee is equal to the after-GST sale proceeds from Lots sold, less \$2 million to be retained by the Owner.

Note that so much of the Developer Fee that is not referable to the profit-making undertaking would not be allowed as a deduction against the profits of such adventure (for example, so much of the Developer Fee as relates to any Lots retained by the Owner).

The payment of the Developer Fee for conducting all Works will be divided proportionate to value between the:

- Completed Apartments that are actually sold (**Sold Apartments**); and
- So much of the Lots retained by the Owner (**Retained Lots**).

The amount of the Developer Fee attributable to the Retained Lots will be included in the cost base of the Retained Lots, together with the cost base of the Property apportioned to the Retained Lots.

The balance of the Developer Fee will be a cost incurred in realising the value of the Property (by ultimately selling the Sold Apartments). The remainder of this part of the paper explores how the realisation of such value will be assessed, i.e. whether that will be as:

1. capital gains;
2. ordinary income from business; and/or
3. profit from isolated transaction on revenue account.

TRAP: passive landholder shares in development risk and reward

8.5.3 Profit from the Profit-making use of the Property as Assessable Income

The profit of such adventure would be:

- a. the proceeds on sale of the Sold Apartments; less
- b. the value of the asset (Property value portion referable to Sold Apartments) committed upon commencing the adventure (entering into the PDA); less
- c. actual costs incurred during the profit-making activity (the Developer Fee referable to the Sold Apartments).

This methodology was provided in conceptual terms in the *NF Williams* and *McLelland* cases, but was expressed far more mechanically and specifically in the *Whitfords Beach* case upon referral back to the Federal Court for determination solely of the manner in which such revenue profit should be calculated.

8.5.4 Value of CGT Asset “committed to” Profit-making Venture

In historical cases, the value of the asset was determined by agreement of the parties or a formal valuation. The concept of “market value” is not defined in the *ITAA 1997* or the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**). Therefore, such term or concept would take its “ordinary meaning”. However, for greater certainty, we note that the Commissioner has published his opinion of the meaning of “market value”: <https://www.ato.gov.au/general/capital-gains-tax/in-detail/marketvaluations/market-valuation-for-tax-purposes/?anchor=Meaningofmarketvalue#Meaningofmarketvalue>.

Therein the Commissioner provides a few definitions (extracted below, with underlining added). Firstly, the Commissioner proffers two (2) definitions within the ambit of “ordinary meaning”:

- For real property:

Valuers of real property adopt the definition used by the International Valuation Standards Council:

... the estimated amount for which an asset should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing, wherein the parties had each acted knowledgeably, prudently and without compulsion.

- For business valuations:

Business valuers in Australia typically define market value as:

the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length.

As this present matter concerns real property, the first definition above should be applied.

The Commissioner also cites the key judicial decision on the “market value” concept by the High Court in *Spencer v The Commonwealth of Australia* [\(1907\) 5 CLR 418](#) at 432 per Griffith CJ, being:

... the test of value of land is to be determined, not by inquiring what price a man desiring to sell could have obtained for it on a given day, i.e. whether there was, in fact, on that day a willing buyer, but by inquiring: What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?

Using these “ordinary meaning” principles and the guidance of the High Court in *Spencer*, it is fair and reasonable to consider that the value of the CGT asset (the Sold Apartments) at the commencement of the PDA would be represented by and be equal to the product of:

- the market value of the Property at the time of entering into the PDA; and
- the floor space area of the Sold Apartments as a percentage of the total floor space area of all Lots and common property.

8.5.5 Dissection of profit on Sold Apartments

Therefore the “profit” from the PDA is the total proceeds received for the Sold Apartments less the value of the asset committed. The difference between the value of the asset committed and its proportionate cost base will be subject to tax on capital account (i.e. CGT).

This leaves a question as to what is the proceeds on sale of the Sold Apartments?

The Owner is actually receiving two benefits from the Developer. The \$2 million cash, and the construction of the Retained Lots. Therefore, all of the value of the cash and portion of the Works referable to the Retained Lots will be the total proceeds received for the Sold Apartments.

Nothing in the authorities cited deems a CGT asset to be reclassified (except if it becomes trading stock of a business, which we have dealt with and dismissed above). The relevant judicial authorities, and the Commissioner in *TR 92/3* at paragraph 1, merely consider whether the “profits” from an isolated transaction should be assessed as income under the predecessor to section 6-5.

The Commissioner in *TR 92/3* writes at paragraph 1 (underlining added):

This Ruling provides guidance in determining whether profits from isolated transactions are income and therefore assessable under subsection 25(1) of the Income Tax Assessment Act 1936.

For completeness, former section 25(1) of the ITAA 1936 read:

25(1) [Assessable income to include gross income]

The assessable income of a taxpayer shall include -

- (a) where the taxpayer is a resident - the gross income derived directly or indirectly from all sources whether in or out of Australia*

For comparison, section 6-5 now reads:

Income according to ordinary concepts (ordinary income)

- (1) Your assessable income includes income according to ordinary concepts, which is called ordinary income.*
- (2) If you are an Australian resident, your assessable income includes the * ordinary income you * derived directly or indirectly from all sources, whether in or out of Australia, during the income year.*

The asset therefore is still a CGT asset, with certain “profits” derived from the use of that asset in a profit-making undertaking or “isolated transaction” treated as assessable ordinary income.

Upon entering into the PDA, various rights are granted and undertakings made by the Owner. As these relate to a CGT asset, CGT event D1 (granting of a right) is potentially triggered: [section 104-35\(1\)](#).

However, the PDA requires the Owner to facilitate the sale of the Sold Apartments for completion of its obligations under the PDA. This will result in CGT event A1 (disposal of a CGT asset): [section 104-10\(1\)\(a\) and \(c\)](#).

Section 104-35(5) provides that:

CGT event D1 does not happen if: ...

- (b) the right requires you to do something that is another * CGT event that happens to you ...*

Therefore, CGT event D1 does not happen upon entering into the PDA, but CGT event A1 happens each time a Lot is sold. The proportionate components referable to the CGT component and the profitmaking undertaking are then calculated and subject to taxation in the manner described above.

Note also that no part of the proceeds or profit from the PDA arrangement that is assessed on ordinary income account under section 6-5 will be subject to CGT, due to an “anti-overlap” rule to eliminate double taxation: [section 118-20](#).

Section 118-20 reads:

Reducing capital gains if amount otherwise assessable

- (1) A * capital gain you make from a * CGT event is reduced if, because of the event, a provision of this Act (outside of this Part) includes an amount (for any income year) in:*

*(a) your assessable income or * exempt income ...*

In a series of private rulings, the Commissioner has equated the profit on the isolated transaction to the net capital gain. While not comprehensively dealt with, the Commissioner appears to allow the development costs (in the present case the Developer Fee) to form part of the cost base of the CGT asset (presumably under the fourth element as the “capital expenditure” referenced in the cost base definition at [section 110-25\(5\)](#)):

(5) The fourth element is capital expenditure you incurred:

(a) the purpose or the expected effect of which is to increase or preserve the asset's value

...

As the asset continues to be a CGT asset despite being used in a profit-making undertaking, the Developer Fee should be applied against the Sale Proceeds from the Sold Apartments to reduce the capital gain. The Developer Fee can, despite being incurred as part of a profit-making undertaking, be regarded as a capital expenditure under the indicia per Dixon J in *Sun Newspapers Ltd & Associated Newspapers Ltd v FCT* [\[1938\] HCA 73](#); (1938) 5 ATD 87; (1938) 61 CLR 337 at 363 (which is still applied in judicial and regulatory authorities), where His Honour wrote:

There are, I think, three matters to be considered,

- (a) the character of the advantage sought, and in this its lasting qualities may play a part,*
- (b) the manner which it is to be used, relied upon or enjoyed, and in this and under the former head recurrence may play its part, and*
- (c) the means adopted to obtain it; that is, by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.*

Note that the above did not appear in the judgment as a list, but has been presented that way here for ease of analysis.

As the Developer Fee is paid for a permanent improvement of the asset (the Works), is non-recurring and a ‘once-and-for-all’ payment to secure future use and enjoyment (or benefit), the Developer Fee is a capital expenditure under the Dixon J criteria. The capital component of any “profit” from the sale of the Sold Apartments subject to CGT would effectively be the difference between:

- the value of the Property referable to the Sold Apartments at the time of entering into the PDA; and
- the cost base of the Sold Apartments as determined by the relevant portion of the cost base of the Property.

The apportionment of the cost base of the Property as between the Sold Apartments and Retained Lots needs to be calculated and applied “in a reasonable way”: section 112-25(3) Method Statement.

The legislation does not prescribe a “reasonable” manner of apportionment, although the Commissioner has published his views on this requirement in *Taxation Determination* [TD 97/3](#) (at paragraph 5: Note), where he suggests area basis or relative market value basis.¹

These calculations will obviously be very complex and detailed.

8.6 Goods and Services Tax (GST)

8.6.1 General GST principles and relevant authorities

The ultimate sale of each Sold Apartment will be a taxable supply of new residential premises made in the course or furtherance of an enterprise carried on by the Owner (sections 9-5, 9-20, and 40-60 to 40-70 of the *GST Act*). Note that while not engaged in a business of property development, the definition of “enterprise” is so broad so as to capture virtually anything done for a profit or in an enterprising manner, or in adventure or concern in the nature of trade (that is, for the purpose of a sale): for further analysis on this point, see *Miscellaneous Taxation Ruling* [MT 2006/1](#) – ‘The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number’.

The supply of “new residential premises” not exempted from being subject to GST as either a GST-free supply or input-taxed supply (**ITS**): Divisions 38 and 40 of the *GST Act*.

8.6.2 Margin Scheme

As a Taxable Supply of something which was not eligible for any ITC upon acquisition, the supply of the Sold Apartments will be eligible for the Margin Scheme: [Division 75](#), *GST Act*.

The Margin will be based on a calculation:

1. requiring a valuation of the Property as at the later of 01 July 2000 or when the Property entered the GST system (**Margin Valuation**) – this is arguably when the PDA was executed, or some earlier time that the Owner had formed the intention to commit the Property to the enterprise; and
2. an apportionment of the Margin Valuation as between:
 - a. the taxable supplies made (the Sold Apartments); and
 - b. the part of the Property not sold (the Retained Lots).

8.6.3 GST withholding notice

Additionally, there will be an obligation on the Owner as vendor to issue a ‘GST withholding notice’ (**Notice**) pursuant to section 14-255 of [Schedule 1](#) to the *Taxation Administration Act 1953* (Cth) (**TAA**).

¹ *TD 97/3* - ‘Income tax: capital gains: if a parcel of land acquired after 19 September 1985 is subdivided into lots (‘blocks’), do Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997 treat a disposal of a block of the subdivided land as the disposal of part of an asset (the original land parcel) or the disposal of an asset in its own right (the subdivided block)?’ (22 January 1997).

Subdivision 14-E of Schedule 1 to the *TAA* contains provisions imposing obligations on suppliers and purchasers of residential premises, regardless of whether any GST withholding obligation exists. In the case of the Sold Apartments, there will be a GST withholding obligation because:

- the supply is a taxable supply; and
- the supply is of residential premises.

The vendor (Owner) must advise the purchaser, in the Notice, of the GST withholding amount to be withheld (7% of the sale/purchase price as the Owner, as vendor, will be using the margin scheme to calculate its GST liability on the sale of the Sold Apartments).