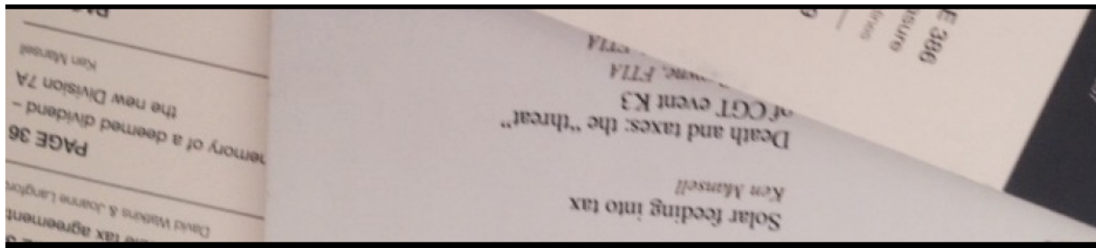
Tax Rambling

The rants of a tax nerd



Property Development – Capital or Revenue?

What do the Tax Acts say? 2

First is that the capital gains tax legislation can apply. 2

The second way of returning the income is under section 15-15. 2

The third occurs where the development has reached the level of what is a business. 3

The Case Law 3

Scottish Australian Mining 3

Federal Commissioner of Taxation v Williams 4

Whitfords Beach 4

Statham v Federal Commissioner of Taxation 5

Stevenson v Federal Commissioner of Taxation 6

But can a property developer have a development on capital account? Glasshouse (FLZY and Commissioner of Taxation) case 6

What does the Commissioner say about all of this? 7

Taxation Ruling TR 92/3 7

Playing games… TA 2014/1 - Capital v Business v Profit Making Intension 8

From the Commissioner - Factors to consider 9

Examples… 14

All in… 14

Flipper 14

Accepting Glasshouse 15

Farmer selling his farm 16

And to end with the classic residential suburban block land subdivision 17

If on Revenue, then we… 18

Revenue as a Profit-Making Undertaking or Scheme 18

Denial of Deductions for Vacant Land 19

What do the Tax Acts say?

There are three ways the Tax Acts can apply to a property development.

First is that the capital gains tax legislation can apply.

While capital gains are included in assessable income, we all know there are a series of exemptions and concessions that make this often the best way to return the income from property development. These include:

- Where the property was acquired pre-CGT (before 20 September 1985) – generally exempt
- Where the property was previously used as a main residence – generally exempt
- Where the property was sold 12-months after acquisition (and is owned by a resident) – 50% discount applies
- Where the property was used in a business – possible small business CGT concessions

So as you can see anything from a complete exemption to a 50% reduction in any tax payable makes this the preferred way of returning income from a property development.

But when can we use this method to return the income from property development?

Only if there is a **mere realisation**, which we will discuss below.

The second way of returning the income is under section 15-15.

This section states "*Your assessable income includes profit arising from the carrying on or carrying out of a profit-making undertaking or plan.*"

So you may not have reached the definition of a business, and the gain on the property may not be enough just to be ordinary income, but if you make income from a **profit making undertaking or plan**, then you merely return the profit as assessable income.

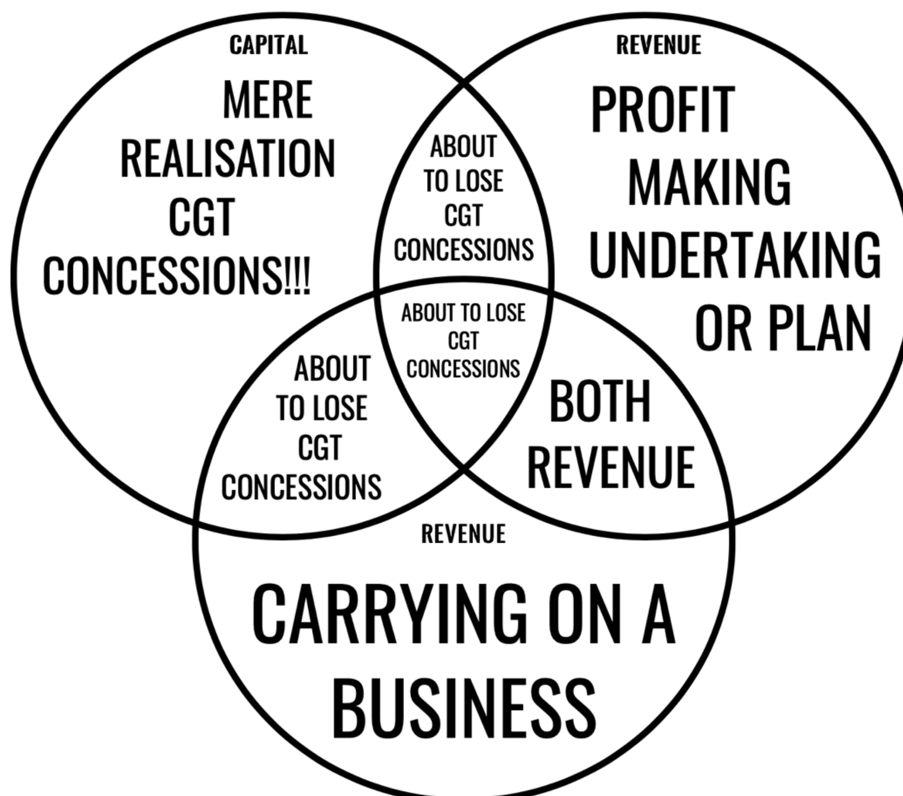
So what is a profit making undertaking or plan? We will consider this below.

The third occurs where the development has reached the level of what is a business.

Where the development and sale occurs as **part of a business**, the property is treated as trading stock and the profits are taxed on revenue account under section 6-5 and the trading stock provisions of Division 70.

But what is a business? we will discuss this later.

So here is the summary of how the income may be returned, and the problems we face advising in this area…



But it is not the law that lets us decide which of these areas the income falls into. We need to consider a wealth of case law going back decades, and we also need to understand the Commissioner's opinion on these issues as well.

The Case Law

Scottish Australian Mining[1]

In this Scottish Australian Mining acquired land to mining coal and ran the mine for 60 years.

[1] Scottish Australian Mining Co Ltd v Federal Commissioner of Taxation [1950] 81 CLR 188.

After there was no more coal, they subdivide and sold the land in a very large development, including remediation, roads, and a railway station.

The Commissioner argued this was either a business or profit-making undertaking or scheme. However, the High Court disagreed.

They stated that the mining company was “merely realising” the land which they had purchased for another purpose, but no longer served that purpose.

The company had done only what was necessary to realize the land to the best advantage, including the building of roads, parks and other amenities. In summary they concluded “It is simply part of the process of realizing a capital asset.”

So our first lesson is there will be no business or profit-making undertaking or scheme where what is done is only what allows the owner to realize the land they purchased for other purposes.

Federal Commissioner of Taxation v Williams[2]

In this case 10 acres of bush land was purchased, left in its current state. Ten years later, after a sale to a spouse 5 years in, and when the suburbs reached the land, the land was cleared, subdivided and sold. It appears that waiting for the suburbs to reach the land was the plan all along.

The Commissioner argued this was a business or as a profit-making undertaking or scheme.

The High Court stated that holding land it until the price of land has risen and then subdividing and selling it is not a profit-making scheme in itself.

The fact that grading, levelling, road building and the provision of reticulation for water and power to enable the land to be sold to its best advantage was done is still a mere realization of a capital asset.

Whitfords Beach[3]

Now it gets messy… in this case a company purchased 1,584 acres of land to secure access to beachfront shacks. 13 years later, the share were sold to experienced developers who intended to undertake a large development.

The Company’s constitution had to be changed to allow this to occur as it stated the company held the land to facilitate access to the beach.

[2] Federal Commissioner of Taxation v Williams (1972) 127 CLR 226
[3] Federal Commissioner of Taxation v Whitfords Beach Pty Ltd [1982] 150 CLR 355

The land was subdivided and sold and based on the above two cases, the taxpayer argued this was a mere realisation… but failed…

... I do not agree with the proposition which appears to be founded on remarks in some of the judgments that sale of land which has been subdivided is necessarily no more than the realization of an asset merely because it is an enterprising way of realizing the asset to the best advantage. That may be so in the case where an area of land is merely divided into several allotments. But it is not so in a case such as the present where the planned subdivision takes place on a massive scale, involving the laying out and construction of roads, the provision of parklands, services and other improvements. All this amounts to development and improvement of the land to such a marked degree that it is impossible to say that it is mere realization of an asset. We need to bear in mind that the subdivision of broad acres into marketable residential allotments involves much more in the way of planning, development and improvement than was formerly the case.

Effectively, the High Court decided that for a profit-making undertaking or scheme to exist, the relevant profit-making motive must exist at the time the land is acquired. The main difference here between Scottish Mining and Whitfords Beach was the intension an acquisition. The main difference between Williams and Whitfords Beach was the size (10 acres v 1,586 acres).

Statham v Federal Commissioner of Taxation[4]

In 1970 the taxpayer acquired a 270 acre farm from his late father. There was no intention to subdivide, develop and sell the land, but rather to farm it. In 1979 the taxpayer attempted to sell the land as they could not farm it due to ill health. They attempted to sell it as a whole but failed.

They then decided to sell the land via a staged subdivision, creating 105 lots over four stages.

The Full Federal Court stated this was a mere realisation, and these were the factors they decided on…

- *a) The owners were at first content to sell the land as one parcel, but were unable to do so;*
- *b) no moneys were borrowed by them, although a guarantee was provided to the Kingaroy Shire Council by way of bank guarantee;*
- *c) only very limited clearing and earthworks were involved;*
- *d) the owners relied upon the Kingaroy Shire Council to itself carry out roadworks, kerbing, electricity and sewerage works which were required to be done;*
- *e) the owners did not erect buildings on the land; not even, for example, a site-office;*

[4] Statham v Federal Commissioner of Taxation [1988] FCA 463

f) *they had no business organisation, no manager, no office, no secretary, and no letterhead;*
g) *Dr. Bickerton maintained his medical practice;*
h) *the owners did not advertise the land for sale;*
i) *apart from the Kingaroy Shire Council's activities, the owners did not engage any contractors, although they did obtain some professional advice;*
j) *the books kept in relation to the sales of land were kept by Mrs. Bickerton; and*
k) *the land was sold simply by listing it with local real estate agents.*

Interestingly, the Court found that the mere magnitude of the realisation does not convert it into such a business, undertaking or scheme; but the scale of the realisation activities is a relevant matter to be taken into account in determining the nature of the realisation. This means large-scale subdivision can be a mere realisation if the taxpayer is relatively passive in the process.

Stevenson v Federal Commissioner of Taxation

In this case the taxpayer owned 476 acres of farmland that was whittled down to 35 acres by government acquisitions, sales to plantation managers and to other third parties.

The elderly taxpayer then decided to sell off all but few acres to live on.

Permission to covert this to residential blocks required substantial works so the taxpayer initially sought to sell the land in total but this failed.

The taxpayer then decided to complete these substantial works himself. This became his main activity and the Courts held that as the taxpayer was heavily involved in the process of realisation of their land this became carrying on a business or a profit-making undertaking or scheme.

The more efforts of the taxpayer, the more likely this is becoming revenue.

But can a property developer have a development on capital account? Glasshouse (FLZY and Commissioner of Taxation[5]) case

In this case, a large property development entity, built and sold a $70 million commercial office building in a separate entity and the AAT found the income should be returned on capital account. How? Well the AAT stated that:

- The taxpayer never intended to sell the commercial development;

[5] FLZY and Commissioner of Taxation [2016] AATA 348

- They used financing accordingly – not the normal financing used for developments that they would sell

- They used real estate agents to find tenants, not buyers, and secured a long term lease with a Government Department

- Then, they received an offer which was simply "too good to refuse".

- They used the money to buy other commercial properties to lease out and had held them for almost 9 years.

So the CGT discount on tens of millions of dollars…

What does the Commissioner say about all of this?

Let's be honest… unless you want to take matters to a Court or Tribunal then you will want to understand the Commissioner's views in whether something is a mere realisation, a profit making undertaking, or a business.

And the first place to look is his 1992 ruling on whether profits on isolated transactions are income.

Taxation Ruling TR 92/3

Let's start with some quotes from this Ruling…

"If a taxpayer not carrying on a business makes a profit, that profit is income if:

a) the intention or purpose of the taxpayer in entering into the profit-making transaction or operation was to make a profit or gain; and

b) the transaction or operation was entered into, and the profit was made, in carrying out a business operation or commercial transaction."

38. The intention or purpose of the taxpayer … is not the subjective intention or purpose of the taxpayer. …the taxpayer's intention or purpose discerned from an objective consideration of the facts …

41. The taxpayer must have the requisite purpose at the time of entering into the relevant transaction or operation. If a transaction or operation involves the sale of property, it is usually necessary that the taxpayer has the purpose of profit-making at the time of acquiring the property. However...

42. For example, if a taxpayer acquires an asset with the intention of using it for personal enjoyment but later decides to venture or commit the asset either:

(a) as the capital of a business; or

(b) into a profit-making undertaking or scheme with the characteristics of a business operation or commercial transaction, ...

The profit from the activity is income although the taxpayer did not have the purpose of profit-making at the time of acquiring the asset.

So the big issue is purpose… was there a purpose to develop the land and make a profit when it was purchaced???

Playing games… TA 2014/1- Capital v Business v Profit Making Intension

Taxpayer Alert

TA 2014/1

Trusts mischaracterising property development receipts as capital gains

The Commissioner knows what you are already thinking and knows you are going to try to stay on the right side of TR 92/3 (and the Glasshouse case). So in 2014 he reminded us he knows what we might try and he will not be easily fooled.

In the Taxpayer Alert he states he is looking for arrangements where…

- An entity with experience in either developing or selling property, or in the property and construction industry, establishes a new trust for the purpose of acquiring property for development and sale.
- The trust deed expressly states that hold the developed property as a capital asset to generate rental.
- BUT… It is undertaken in a manner which is at odds with the stated purpose (short term finance, approvals, real estate agents, sold in 13 months…)

From the Commissioner- Factors to consider

The Commissioner has an extensive discussion on small property development on his website. Especially he has a webpage titled *"Tax consequences on sales of small scale land subdivisions"* - https://www.ato.gov.au/General/Property/Tax-consequences-on-sales-of-small-scale-land-subdivisions/ - It starts with…

> *When you acquire the land as a home, farm or other capital asset, your purpose and the steps you take to sell the land determines whether the gain for income tax purposes is:*
>
> - *a capital gain*
> - *ordinary income from a profit-making undertaking.*
>
> *The following factors will help you work it out:*
>
> - *type of entity undertaking the subdivision*
> - *types of activities you're involved in*
> - *costs incurred prior to the sale*
> - *complexity and steps undertaken*
> - *parties and phases involved*
> - *your relationship to other parties involved in the land subdivision*
> - *your purpose in buying the land*
> - *timing and steps undertaken for the sale*
>
> *This information is a guide only and provides additional detail in general terms for each of the factors in TR 92/3 Income tax: whether profits on isolated transactions are income.*

The type of entity undertaking the subdivision

More likely to be a capital gain if	More likely to be ordinary income if
› You are an individual and the subdivision and sale was driven by personal reasons. For example, a simple division and sale of part of land you no longer need. › You do not have a history as a developer. › If you own or control a business, it does not carry out any land dealing or development activities.	› A business entity (such as a partnership, trust, company) is established, acquires property with the intention of making a profit and enters into a small-scale development.

The types of activities you're involved in

More likely a capital gain if	More likely ordinary income if
› You are not engaged in business, or your business activities are not related to property development or property transactions. › You have not previously been involved in commercial property transactions or developments in any capacity. › You originally acquired the land primarily for investment purposes only, such as to earn rental income.	› You have had previous commercial property transactions. › You operate a business related to property development, construction, or sale. › You originally acquired the land with an intention to undertake development activities.

The costs incurred prior to the sale

More likely a capital gain if	More likely ordinary income if
› The development cost is low compared to the value of the undeveloped land. › You were exposed to minimal financial risk in undertaking the activities leading to the sale.	› The development cost is significant compared to the value of the undeveloped land. For example, attributable to building on the land. › You were exposed to significant financial risk in undertaking the activities leading to the sale. For example, mortgaging the land to finance the activity.

The example the Commissioner gives here is clear…

Claude purchased his home on a single title from a private seller on 1 July 2001 for $300,000. The house was situated on the front portion of an 800m² block. Claude wished to remain in this home however maintaining the big backyard became a burden. On 1 July 2020,

Claude began detailed research and spoke with multiple local real estate agents to understand if he could subdivide his backyard to build a new house and sell it. Claude decided to subdivide, build a house, and sell the newly created subdivided development. To do this, he:

- *lodged an application for subdivision and received council approval*
- *engaged a project developer to prepare and submit a development application AND **build the new house**.*

Claude funded the development expenses through a bank loan and expected the sale of the new house to pay the loan out in full. He engaged a local real estate agent to sell the new house.

Once the backyard got its own title, it became its own asset and was no longer part of Claude's home as a domestic asset. Because Claude's transaction is more complex than just selling the vacant lot, his activities amount to a development activity. The sale of the backyard became a profit-making activity once Claude made the decision to embark on that activity.

The complexity and steps undertaken

More likely a capital gain if	More likely ordinary income if
› The land sale involved – a single transaction – the sale of an unimproved block. › The cost of development is low compared to the value of the undeveloped land.	› The land was purchased for the purpose of subdivision and sale. An indication of this is if you sought approvals soon after the land was acquired. › The land sale involved significant improvements. For example, to improve its condition to maximise profit, or the construction of houses, other buildings, roads or other community services to individual lots. › The overall project involved the purchase and development of neighbouring blocks. › The subdivision was subject to a decision by a government authority to rezone the land, that you or related parties lobbied for. › The costs of development are significant compared to the value of the undeveloped land.

The parties and phases involved

More likely a capital gain if	More likely ordinary income if
› It is a straightforward one-off transaction between you and a purchaser. › The only element of the arrangement is an agreement to transact and sell land in its existing state. › There are no other parties involved in finalising the sale (except for real estate agents and conveyancers). › If you were approached by a third party to facilitate a sale, rather than actively marketing the property.	› You transacted with multiple parties (such as architects, property developers and consultants) through various agreements to prepare the land subdivision for eventual sale. › The sale relied on a number of additional steps and was significantly more complex than a standard residential sale. › Engage a developer to carry out a development activity for a fee.

Your relationship to other parties involved in the land subdivision

More likely a capital gain if	More likely ordinary income if
› Type of parties involved were limited to those such as real estate agents, conveyancers and surveyors. › The arrangement is non-commercial and more in the nature of a family dealing (such as selling a granny flat previously used by a family member).	› Where professional third-party experts (such as architects, developers and consultants) act on your instructions, their business activities are taken to be your activities.

Your purpose in buying the land

More likely to be a capital gain if	More likely to be ordinary income if
› The land was purchased – exclusively for private purposes, such as your family home or holiday home, and was held for a significant period – as a rental investment property that was held for a significant period – as a farm for the purpose of farming activities.	› The land was purchased: – to be developed – for land banking (holding for future development).

This leads to the classic example… From the ATO…

> *Mr and Mrs Block purchased a house to live in on a large block of land in 2000. In 2017, they applied to subdivide the land for development. They planned to demolish the house and build 3 townhouses:*
>
> *one townhouse for Mr and Mrs Block to live in*
> *one townhouse to rent out*
> *a third townhouse to be sold at a profit.*
>
> *They hired an architect to design the townhouses. They engaged a developer to obtain the permit and subdivide the land. They funded the development using a bank loan and the property was used as security. The loan application and finance terms supported this.*
>
> *The townhouses were completed in late 2018. Mr and Mrs Block planned to move into one townhouse. They hired a real estate agent to rent the second townhouse and sell the third.*
>
> *However, an unexpected change in their circumstances occurred. Mr Block fell ill and had to move into a nursing home. Following their financial planner's written advice, they funded this move by selling all 3 townhouses in early 2019, making a substantial profit.*
>
> - *The land subdivision and sale is not carrying on a business.*
> - *The gain from the sale of the townhouse built to sell is ordinary income, from a profit-making undertaking or scheme.*
> - *The gain from the 2 townhouses not built to sell is not part of a profit-making undertaking and is the realisation of the capital value of those assets.*

The timing and steps undertaken for the sale

More likely a capital gain if	More likely ordinary income if
› The land is owned for a significant period and used, for example, as a house or farm. This is evidence you acquired the land for those purposes.	› The land was owned for a short period before being sold.

Examples…

Many of these examples are taken from the now retracted…

Draft Property and Construction Website Guidance

All in…

A residential cul-de-sac in suburban western-Sydney had several properties, all owned by independent individuals. All residents held each of their residential properties as main residences. Two of the homeowners received an expression of interest from a developer to purchase and subdivide both of their homes into lots. The homeowners were not in the market for selling. The two homeowners resolved that selling all of the houses in the cul-de-sac in one transaction would result in significant profits.

They then encouraged their neighbours to sell, claiming that the 'main-residence exemption' would apply. They asked the developer to conduct surveys and test the market, and to present them with the findings. The developer acquired all the properties for an immediate payment and a commitment to pay substantially more subject to certain Council approvals - these were successful. Only one of the residents involved had a rental property located elsewhere, and none had entered into a development agreement in the past. A single solicitor to review and process the property sales.

Our position

259. In this case, by taking all of the facts into consideration, it is arguable that while the owners engaged in some organising and discussions to facilitate the arrangement, the low level of sophistication, the limited activities (such as meetings with the neighbors) and agreeing to let the developer undertake surveys and testing would not constitute a change of intention to that of a business or profit-making undertaking.

Flipper

Two investors acquired 5 large outer suburban blocks each over a period of time from 2009 to 2014. In general, they acquired one block per year, where the acquisitions were funded with borrowings, rented out, developed and flipped

Our position

180. Weighing all of the facts together, it is arguable that the owners entered into carrying on a business from the time they acquired the first property, despite rental income being earned in the interim years. The properties at that point in time would be trading stock. In the alternative, it is arguable that they entered into a profit-making undertaking or scheme at that time (i.e. when they acquired the first of the adjoining lots) to develop the properties for sale. In this regard, it is sufficient that the intention to develop and profitably sell the land in the future was at least one of multiple intentions of the landowner (i.e. it is not necessary that a profitable sale was the sole or dominant purpose for entering into the transaction).

Accepting Glasshouse

The Developer Group undertake construction projects for clients on the client's land and also purchase properties for themselves on which they build for resale. They also build for long term rental which they have leased between 2 and 10 years. When the taxpayer group purchases a new property they establish and hold it in a separate discretionary trust.

The Developer Group purchased an industrial zoned property on which to construct a factory and created a new trust to hold that property. The purchase of the property was not financed from the working capital of that part of the group that ordinarily undertakes development, but was financed by a third party in line with other longer rental/lease holdings of the group.

The Trust has no employees and engages the services of Construction Co Pty Ltd to construct and manage the development of the factory. Construction Co Pty Ltd charged the trust a commercial rate for the construction and achieved a commercial profit from the construction.

On completion of the factory construction, the Trust leased the property to a third party for a ten year arrangement in line with market value. After 5 years, due to financial circumstances, the trust disposed of the property. The proceeds from sale were then used by the Trust to purchase another property for long term rental.

Our position

196. Taking into account all the facts we consider the sale of the factory occurred outside of the ordinary course of the Developer Group's business of buying, developing and selling property, but rather is part of the Developer Group's other business of long term investment. In reaching the conclusion that the sale of the property did not occur in the ordinary course of the Developers Group's property development business, we considered the following factors significant:
    - The Trust appears to operate independently of the group's property development business, as evidenced by the separate financing and arm's length dealings with the Development Group.
    - Proceeds from the sale were not reinvested into the property development business, but reinvested by the Trust into another long term asset.
    - The property was held for 5 years prior to its sale, suggesting the property more closely aligns with the long term investment aspects of the group, rather than their property development activities.
    - As a commercial rate was charged by Construction Co Pty Ltd, the profit from the sale was mainly due to the capital appreciation of the property, not from the property development aspect.

Farmer selling his farm…

See the difference where the farmer takes on the risk (and the potential reward) of a development…

Our position – Mr Farmer

118. Taking into account all of the facts, while this is a very large development, the landholder did not adopt any risk or participate actively in the development.

119. The risk of the project was effectively borne by the developer, with Mr Farmer guaranteed a minimum return of $80 million, which is reflective of the approximate market value of the property (i.e. the development agreement replicates, via Mr Farmer's entitlement to $80 million representing the agreed value of the land, together with a 10% margin reflecting the uncertainty in the future land value increase, a sale by Mr Farmer at the time it was executed). While Mr Farmer's does have an opportunity to share in profits of the project (i.e. the 10% margin) he is only at risk of not receiving the $80 million in the event the developed lots cannot be sold for that amount (i.e. the cost of the development is borne solely by the developer, who can only profit if the completed lots sold for more than $80 million, plus development costs and will be fully exposed to any losses that might result).

120. The sale consisted of a disposal of property at a point in time that included an element of compensation for delayed payment and recognised the difficulty of valuing property, which was still subject to uncertainties in respect of planning.

121. We consider the sale of the developed lots to be a mere realisation and on capital account (the proceeds are not subject to tax as the land was a pre-CGT asset).

Our position – Mr Farmer

142. While the ATO recognises that Mr Farmer's original intention for acquiring the land was for farming, taking into account a wide survey of facts, we consider that Mr Farmer has entered into the carrying on of a business dealing in land at the point where he formed the intention to commence the property development project.

143. Potentially this would be when he agreed to the developer commencing the planning and permit application process. At this point Mr Farmer has embarked on a definite and continuous cycle of operations designed to lead to the sale of the land.

144. At that point, CGT event K4 occurs and Mr Farmer will need to make a decision to carry the land forward at market value or cost for trading stock purposes (refer to section 70-30 of the ITAA 1997) with the resulting CGT implications.

145. A key factor which separates this case from Example 1 is that Mr Farmer is taking on a significantly greater proportion of the risk of the development, in particular being required to pay the developer the costs of the development, plus an 11% margin. That is, if the proceeds from the sale of developed lots do not exceed the project costs, plus 11%, the developer does not have any exposure to that loss. Correspondingly, Mr Farmer would be required to meet that loss out of any gains on the value of the underlying land. Consistent with the greater exposure to risk borne by Mr Farmer in this example, he also has a great opportunity for reward, being entitled to retain 78% of the development profit.), By contrast, in Example 1 Mr Farmer is guaranteed a return from the sale and the developer takes on the risk.

And to end with the classic residential suburban block land subdivision

In August 2018, Harrison bought his first home on an 810 m2 block of land for $780,000. He has never directly or indirectly (through control of other entities) carried on a land development business or undertaken land development activities.

In late 2019, he made enquires on subdividing the land, with the intent of selling part of the land he did not need, to lessen his home loan burden.

In April 2020, Harrison applied to subdivide his land into 2 separate blocks of 405 m2 each. Approval was granted in July 2020.

Harrison engaged a valuer at that same time, to apportion the block's initial cost of $780,000. The valuer determined that the block containing his home represented 60% of the total value of the land, with the other block representing the remaining 40%.

He then entered a contract to sell that other block for $550,000 in September 2020 (settling in November 2020) and continued to live on the block with his home on it. Harrison incurred subdivision costs of $50,000 and selling costs of $18,000.

Although Harrison is not carrying on a business, the profit could still be income if Harrison purchased the land with the intention of making a profit and made the profit through carrying out an isolated business operation or commercial transaction. However, in this case:

- Harrison purchased the property to be his home
- he had no previous dealings in properties
- the subsequent subdivision of the unimproved block is relatively straightforward
- Harrison has not undertaken further activities to increase the value of the land.

These factors indicate that Harrison's profit was not made in the course of a business operation or commercial transaction.

If on Revenue, then we…

Where a development is s a business, the land will be treated as trading stock and subject to Division 70. The case of Federal Commissioner of Taxation v St Hubert's Island Pty Ltd (in liq) (1978) 139 CLR 210 confirmed that land can be trading stock (TD 92/124).

While it is not in the scope of this paper to cover how Division 70 works, it is worth considering the situation where land held as capital is brought into a business as trading stock. Where a capital asset becomes trading stock, section 70-30 deems the taxpayer to have disposed of the land and reacquired it for an amount equal to either its cost or its market value.

But remember, if market value is elected, then a taxable capital gain equal to the market value of the land on the date it becomes trading stock less the original cost base will occur so only do this if the capital gain can be reduced by concessions (main residence, capital losses, discount…)

Revenue as a Profit-Making Undertaking or Scheme

Profits derived under a profit-making undertaking or scheme are assessed under section 6-5, but the cases, and section 15-15, suggest a net profit is returned.

But the real challenge is making some form of allowance for the value of the land when it was committed to the profit-making undertaking.

Land is acquired for $200,000 and many years later it is committed to a profit-making undertaking when it is worth $600,000. $400,000 is then spent on the development, and it is sold for $2 million.

We first work out the revenue gain from when the land was committed to a profit-making undertaking …

$2,000,000 - $600,000 - $400,000 = $1,000,000

But we also need to consider the capital gain up to the commitment… But the way it works is like this…

Capital proceeds of $2,000,000, less cost base of $200,000, less development costs of $400,000, less double tax rule in 118-20 for amount already assessable (above) of $1,000,000 = Capital Gain of $400,000 (then subject to CGT Discount and any other concession)

Denial of Deductions for Vacant Land

There are limits to deductions that can be claimed for holding vacant land.

But some entities and taxpayers will still be able to claim deductions for costs incurred in holding vacant land. For example, where the entity holding the land is a company, the land is used in carrying on a business, or where exceptional circumstances apply. You can continue to claim deductions for expenses incurred for holding vacant land if you are a:

- corporate tax entity
- superannuation plan (other than self-managed superannuation funds)
- managed investment trust
- public unit trust
- unit trust or partnership where all the members are entities on this list.

Land will be considered vacant during the period the entity held the land if:

- it did not contain a substantial and permanent structure
- it contains a substantial and permanent structure and the structure is a residential premises which was constructed or substantially renovated while the entity held the land and the premises are either
  - not yet lawfully able to be occupied
  - lawfully able to be occupied but not yet rented or made available for rent.

In most circumstances, farmland won't be considered vacant land as it contains a variety of substantial and permanent structures.

The costs involved in holding vacant land include:

- ongoing borrowing costs, including interest payments on money borrowed for the acquisition of land
- land taxes
- council rates
- maintenance costs.

For expenses of holding land to be deductible, they must have been incurred in carrying on a business such as farming or gaining or producing assessable income. These changes operate to limit the deductions that would otherwise be deductible where the land is vacant.