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'Mum and Dad' land developers can have their cake and eat it too!

You may expect the subdivision of a single parcel of land into 20 plus lots for individual sale to constitute a profit making business activity and therefore the sale proceeds to be subject to income tax and GST. However this is not necessarily the case!

We have recently been involved with two separate applications for ATO 'Private Rulings' on behalf of clients in order to obtain (binding) clarification into the tax implications of their subdivisions.

These applications involved the subdivision of acreage blocks into 36 and 22 lots respectively. In both cases it was argued that the subdivision should not amount to a profit making business, but rather was the **"mere realisation"** of a capital asset to its full potential.

We were ultimately successful in obtaining favorable 'Private Rulings' from the ATO on both occasions and accordingly, notwithstanding the fact they will generate very substantial sales proceeds, **these clients will pay absolutely no tax or GST on the sale of these blocks**.

In making its decision the ATO accepted the arguments in Miscellaneous Taxation Ruling MT 2006/1, and GSTD 2006/6. Additionally in the ATO accepting that the subdivisions constituted the **"mere realisation"** of a capital asset it was relevant that:

- The land was not originally acquired with the intention of future subdivision;
- The subdivision was an isolated transaction (i.e. no history of property development);
- No structured business organisation involved;
- The level of development (including roads and other infrastructure) was not excessive and was consistent with minimum DA requirements;
- The land was owned for a substantial time before the decision to subdivide was made (over 30y ears in both these cases).

Whilst these 'Private Rulings' can only be relied upon by the particular clients we are comfortable of obtaining favorable rulings in the future assuming similar circumstances.

Child Maintenance Trusts (CMT)

The use of a Child Maintenance Trust (CMT) can be a very tax effective means of providing for the maintenance of children following a family breakdown.

Essentially a CMT arrangement can have significant tax advantages when compared to a parent or guardian meeting maintenance obligations from their after tax income.

The requirements to be satisfied in order to be recognised as a CMT for tax purposes are summarised as follows:

- There is a transfer of property to a trust as a result of family breakdown
- The income derived from this property is applied for the benefit of a child or children affected by the family breakdown
- All of the income is generated on the basis of arms length investments
- At the time of vesting (winding up) the trust, ownership of the assets must pass to the child or children in their own right.

Where these requirements are satisfied, the resultant income is classified as 'excepted trust income' and therefore taxed at full adult tax rates rather than penalty rates that would otherwise apply to income of a beneficiary under 18 years.

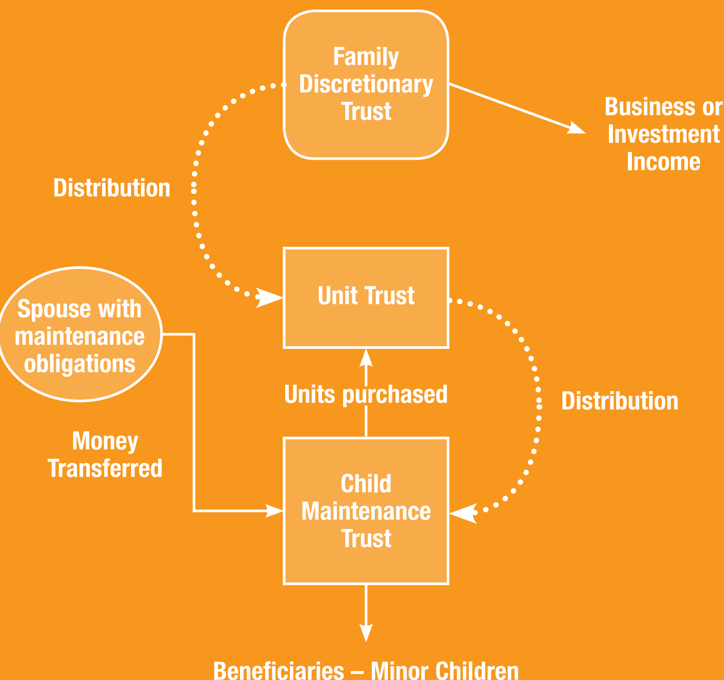
A CMT therefore has most relevance to high net worth individuals who are able to permanently divest themselves of income producing assets, their maintenance obligations then potentially met by the investment income generated utilising the tax free and low income tax rates.

CMT – Tax Benefit without transferring significant assets (TR98/4)

In TR 98/4 the tax office give apparent approval for an arrangement whereby maintenance obligations to the CMT are predominately sourced from related trusts rather than from significant assets held directly. TR 98/4 requirements are summarised as

- A new trust (CMT) is established for minor beneficiaries for whom a parent has maintenance obligations
- A unit trust is established in which the CMT subscribes for units
- The unit trust is added as a beneficiary of an existing discretionary trust that derives income from business or investment activities
- The discretionary trust distributes an amount to the unit trust sufficient to meet the maintenance obligations
- The income of the unit trust is then distributed to the CMT and applied for the benefit of the child or children in accordance with maintenance obligations, and taxed to the trustee at full adult tax rates (i.e. with $6,000 tax free threshold)

This is shown diagrammatically below.



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Principle Place of Residence (PPR) Exemption – not always fully utilised

The capital gains tax exemption that applies to someone's own home (known as the "Principle Place of Residence" exemption or "Main Residence" exemption) is often not fully understood by practitioners and accordingly the tax benefit not always fully utilised.

PPR Exemption – Example 1

It is broadly understood that where a property that was originally someone's own home (PPR) is subsequently rented out, the PPR exemption can continue to apply to the property for up to six years assuming the person is not claiming another property as their PPR.

Sarah purchased a home in Brisbane in 2002 for $400,000 which she lived in as her PPR until 2004 when she was transferred to Melbourne for work and rented out this property. In 2006 her work engagement became permanent and so she decided to purchase a home in Melbourne. She continued to rent the Brisbane property until it was ultimately sold in 2008 for $800,000.

The Capital Gain is calculated as follows (ignoring purchase and selling costs):

1/1/2002 Purchase Price $400,000

1/1/2008 Sale Price $800,000

Total Capital Gain $400,000

Less: PPR Exemption (portion of time lived in and rented with no other PPR)

4 years (2002 -2006) / 6 years x $400,000 .... ($266,666)

Capital Gain before 50% general discount.......................... $133,333

Taxable Capital Gain after 50% discount $66,666

However it is not widely understood that where a person owns two properties concurrently, both of which were originally purchased as their PPR, the tax act provides for an 'election' as to which property the PPR exemption is to apply to.

Accordingly in the above example Sarah could, notwithstanding she was living in a second PPR in Melbourne since 2006, elect for the PPR exemption to apply to the Brisbane property for the entire period of ownership. **In so doing the entire gain on the Brisbane property is exempt from tax.**

PPR Exemption – Example 2

This example highlights a common misconception associated with the PPR exemption and tax deductibility where the home (PPR) is partly used for business.

Andrew is an artist who conducts his business from home. He has two rooms (representing 40% of the house) dedicated as a workshop and studio from which he displays and sells his paintings.

Andrew has been advised not to claim any deductions in relation to the holding costs of the 40% used for business so that the entire property is covered by the PPR exemption and therefore entirely capital gains tax free when sold.

Unfortunately this voluntary decision to forego income tax deductions in relation to these holding costs DOES NOT protect the full PPR exemption. The ATO will deny the PPR exemption on that portion used for business **irrespective of whether tax deductions were claimed**.

However assuming structured correctly, Andrew should be able to access the 'Small Business CGT Concessions' in relation to the capital gain on the 40% used for business thus effectively **eliminating capital gains tax on the entire property**.

Accordingly, based on the original advice given to him, Andrew has missed claiming very significant annual tax deductions being 40% of the property, mortgage interest, rates, insurance, repairs and maintenance.

Economic Update from John Spooner

2009 saw the return of the Bull! The Australian share market, as measured by the S&P/ASX200 Accumulation Index recorded a gain of 37% in 2009 - this was the best year for Australian Shares since 1993!

2010 started in a similiar vein but recently we have seen a correction in the market on concerns about Chinese Monetary tightening, Greece's ability to fund its budget deficit and some diasppointing US profit results and economic data. Remember that markets never increase in a straight line and after an almost 60% increase in Australian Shares since March 2009 it is time for a pullback.

For long term investors wanting to add quality investments to their portfolio this correction should be viewed as a buying opportuniity as the broader trend in shares is likely to remain up on the back of improving corporate profits. Investing in diversified, high quality assets for the long term will provide the foundation for investment success. If you would like to discuss your investment strategy feel free to contact the office.

Recently we have met with a number of clients to advise on the best structure in which to hold their Life, TPD, Trauma and Income Protection policies. We have successfully managed to reduce premiums and hold the insurances in more appropriate structures. Please contact the office for a review of your personal insurance situation.

Meet the Team

Business Services – Brisbane

Partner .... Anthony Hoffman
Partner .... Troy Kelly
Manager .... Greg Roberts
Manager .... Thomas Aitkenhead
Senior Accountant .... Craig Mitchell
Senior Accountant .... Michael Kerwin
Senior Accountant .... Claire Waterhouse
Accountant .... Lauren Sarolis
Accountant .... Michelle Condon
Accountant .... Emma Roberts
Accountant .... Gervais Morton
Accountant .... Alexandra Doney
Accountant .... Jasmine Sue
Office Manager .... Lisa Cronin
Admin Manager .... Megan Cowan
Receptionist .... Camryn Stevens

Business Services – Hervey Bay

Manager .... Beshara Smith *(nee Anstis)*
Accountant .... Alice Pearce
Receptionist .... Christie Seng

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Financial Planner .... John Spooner
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