Accounting | Tax | Consulting | CFO

SUB-DIVIDING FAMILY HOMES

Tax, Accounting, Structuring & Advisory Services

We Help You Grow

Property sub-division is a **highly complex** area with significantly varying tax consequences. It is critical that **proper planning** is undertaken based on individual circumstances before the decision is made. Make you are supported by professionals who are sufficiently equipped with **Industry and Tax Knowledge.**

203 Blackburn Road, Mount Waverly, Vic 3149, Australia
Tel:+61422121439
e-mail: info@edgeadvisoryservices.com

SAVINGS CAN BE ERODED WITH TAX BILLS UNLESS PLANNED………

A TYPICAL EXAMPLE:

Mum & Dad bought the family home in 1998 for A$ 400,000. Land size 900 Sqm with a 20 square 50 years old dwelling standing on one side of the property leaving a reasonable size backyard. They want to capitalize the strength of the current property market by sub-dividing.

SUMMARY:

Profit from selling subdivided land can be **capital gain or ordinary income** depending on circumstances. Any profit is treated as ordinary income (**not a capital gain**) if both of the following apply:

- Intention is to make a profit or gain (as opposed to intention of investment)
- Profit was made in the course of carrying on a business or carrying out a business operation or commercial transaction.

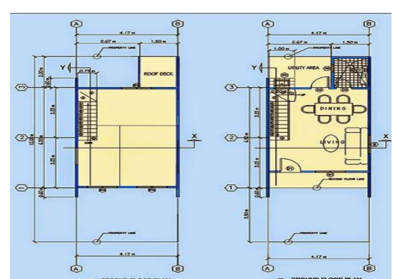
It doesn't need to be a business. It's enough that there was a **'profit motive'** and the activities had characteristics of a business. **Motive is the key here**. It doesn't need to be recorded formally, ATO is likely to determine the motive based on actions taken.

There might be **GST implications**, if it is subdivided and sold with the intention of profit and in the course of carrying on a business or as a business or commercial transaction. Even with a one-off transaction, one **may be required to register for GST** because this one-off property transaction may have the characteristics of a business deal.

Once registered for GST, sale price needs to include GST when sold. GST credits can also be claimed as per normal GST rules. There are several ways of dealing with GST. **Margin Scheme** is one of the alternatives that can be explored to see if it can be applied and if it results in better GST outcome.

COMMON MISTAKES:

- **Making emotional decisions**
- **No feasibility study**- market trend, demographic analysis, costing etc.
- **Not considering tax consequences**- should be planned before the decision is made
- **Not analyzing alternatives** – for example, using equity to buy another one, selling rather than developing etc.
- **No cashflow headroom** – insufficient own fund and limited access to loans



We are here to help……

SCENARAIOS:

This is a highly complex area with significantly different tax outcome. The examples in the table below are just general **guidelines** for conceptual understanding. **These can't be relied upon as tax advice and not summarized to cater for all individual circumstances.** Consulting us with specifics is strongly recommended before making any decision.

No	Scenario	Important Aspects of the Scenario	Possible Tax Consequence
1.1	• **Sub-divide land,** • **Build a new unit on the previously vacant land** • **Sell the new unit immediately** • **Keep the family home intact.**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g. relative market value or based on area). • Most likely intention was to make profit as opposed to mere realization of capital asset.	• Likely to be carrying on a business or commercial transaction • New unit is no longer part of main residence, so no main residence exemption. • No CGT discount, likely to be taxed as ordinary income • Family home retains main residence status • Cost base of the family home is reduced for CGT purpose (by the amount allocated to new unit). • ABN/GST Registration required • Possibility of qualifying for margin scheme
1.2	• **Sub-divide land** • **Build a new unit on the previously vacant land** • **Retain the new unit as rental property** • **Keep the family home intact.**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g relative market value or based on area). • Intention is to derive rental income and possible capital gain in future	• Family home retains main residence status • Cost base of the family home is reduced for CGT purpose (by the amount allocated to new unit). • No CGT until sold • No ABN/GST Registration • CGT discount on future capital gain if held at least 12 months • Tricky issue – Motive is important. A residence can be treated as a new residence for 5 years. If the intention was to make profit then it can be subject to ordinary income as opposed to CGT.
1.3	• **Sub-divide land** • **Build a new unit on the previously vacant land** • **Move into the new unit as main residence** • **Sell the old main residence**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g relative market value or based on area). • Intention is to defer paying tax on immediate sale	• Main residence exemption applies to old family home. • Cost base of the old family home is reduced for CGT purpose (by the amount allocated to new block). • Capital gain on main residence exempt from CGT • Cost base of the new main residence is calculated for future capital gain purpose. • Date of acquisition of new main residence is the date on which original parcel was acquired • Main residence exemption on the new unit is apportioned (gain between the date of original acquisition until it became main residence is subject to CGT, as you can't have two main residences at the same time)

2.1	• **Demolish the old house** • **Sub-divide land** • **Build two units** • **Sell one unit immediately** • **Retain another one as family home.**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g. relative market value or based on area). • Most likely intention was to make profit as opposed to mere realization of capital asset.	• Needs to be rebuilt within four years to maintain main residence status of the vacant land. • One can be treated as main residence but with a reduced cost base. • Other one can be treated as an enterprise. No CGT discount, No Main residence exemption. • ABN/GST registration required.
2.2	• **Demolish the old house** • **Sub-divide land** • **Build two units** • **Retain one as rental property** • **Use another one as family home.**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g. relative market value or based on area). • Intention is to derive rental income and possible capital gain in future.	• Needs to be rebuilt within four years to maintain main residence status of the vacant land. • One can be treated as main residence but with a reduced cost base. • No CGT until the rental property sold • No requirement for GST Registration • CGT discount on future capital gain • Tricky issue - A residence can be treated as a new residence for 5 years. If the intention was to make profit, then it can be subject to ordinary income as opposed to CGT. And this might be subject to GST
3.1	• **Sub-divide land** • **Sell the previously vacant land** • **Keep the family home intact**	• Results in two CGT Assets • Cost base of the land needs to be allocated to each block in a reasonable way (e.g. relative market value or based on area). • Most likely intention was to merely realize a capital asset.	• Cost base of the family home is reduced for CGT purpose (by the amount allocated to new block). • Most likely will be treated as 'mere realization' if no substantial development activity is undertaken. • CGT discount if held for more than 12 months • New land block is no longer part of main residence, so no main residence exemption.