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This new booklet came about after discussions with a solicitor. It will include various articles on areas where our professions overlap. We will welcome any contributions from solicitors, please do not hesitate.

Important

This booklet is simply a collection of Newsflash articles relevant to investors. The articles are transferred from Newsflash into this booklet so it is best read from the back page forwards to ensure you are reading the latest article on the topic first. Note that the information contained in this booklet is not updated regularly so it is important that you seek professional advice before acting on it.

Life Tenancy

TR 2006/14 www.law.ato.gov.au/atolaw/view.htm?DocID=txr/tr200614/nat/ato/00001 is the ATO ruling on life tenancy. It is so difficult to follow and appears to contradict itself that we suggest taxpayers get a ruling from the ATO before relying on it.

Life tenancies are usually created in a will, giving the beneficiary (Life Tenant) the right to live in a property or to receive income from an investment. Once the tenant dies ownership of the asset transfers to the remainderman, another beneficiary of the will. This arrangement is common when a parent remarries, they leave their new spouse a life tenancy in the family home with the deceased's children being the remaindermen.

A problem arises if the life tenant decides they would like to move or give up their rights. This can be seen as a disposal of an asset at market value to the remaindermen, for CGT purposes. The value of the asset would be the rent or in the case of shares the expected dividend multiplied by the life tenants life expectancy. The life tenant could be trapped by in a home that is no longer suited to their needs because they cannot afford the CGT.

Reviewing the Contract

I have seen contracts that state that if the ATO decides that the sale should be subject to GST then the purchaser must pay an extra 10% of the purchase price. This is not even good if your client is the seller because of the difficulties in actually recovering the money. Better to get it right from the start.

A margin scheme clause means that the buyer is not entitled to claim back the GST on the purchase. That is fine if the purchaser is simply purchasing the property as a residential rental or own home. Anything other than that then the purchaser is likely to be better off if the margin scheme did not apply. This should be taken into account when negotiating the price.

Going concern clauses are extremely dangerous. They mean that the purchaser does not qualify to claim back any GST on the purchase price but if they change the use or sell the property they may well have to pay the ATO another 10% of the purchase price even though they paid full market value. Generally a contract with a going concern clause should be for 10/11ths of the actual market value.

If the property is going to be used as a main residence it is import to have a vacant possession clause. If they do not move into the property as soon as practical after settlement they will only be entitled to a partial main residence exemption. If the seller has a tenant in the property under a lease, it is better to delay settlement until the tenant has moved out.

Real Estate Development Tax Table

The following table is certainly not the be all and end all of the issue. It is intended as a quick heads up that may be useful to refer to when a client is buying a property. At a glance it gives you an idea of the tax consequences of developing Real Estate.

Situation	CGT 50% Disc After 12mths	GST Applies Unless Rental For >5years	GST Applies	Normal Income
Buy with the Intention of Selling for Profit (if this applies go no further)			x	x
Buy as a domestic rental and no real changes	x			
Buy as a domestic rental and add 2 rooms	x			
Buy as domestic rental but do substantial reno	x	x		
Buy Land & Build Domestic Rental (Not GST Reg)	x			
Buy Land & Build Domestic Rental (GST Registered)	x	x		
Rental then small Sub & sell blocks (Not GST Reg)	x			
Rental then small Subdivision & sell blocks (GST Reg)	x		x	
Buy as Rental later Subdivide & Build houses to rent	x	x		
Buy as Rental later Subdivide & Build Houses to sell	x		x	x
Rental later large Business like Subdivision sell blocks	x		x	x

Where both CGT 50% discount and normal income apply the CGT discount only applies to the gain up until the time of the change of use.

GST and Vacant Land

The ATO issued an Addendum to GSTR 2003/3 pointing out that the exemption from GST on domestic properties that are not brand new does not apply to the sale of land cut off from such a property.

Even if you are registered for GST you do not have to charge GST on the sale of a house if it is not the first time it has been sold as a residential property. Note if you undertake substantial renovations that affect every room in the house then the next sale of the house will be subject to GST because it is considered new again.

In order to qualify for the concession the house and land have to have been sold previously as a package. Vacant land can never qualify for the concession. This is the case even if there was once a house on the land or the block has been cut off from a house and land. Relocating a home onto land and selling it will still be considered the first sale of the house because it is the first time that piece of land and that house have been sold together.

If you buy a house and land, move the house to one side and subdivide the land GST is not applicable to the sale of the house side because that land and house have previously been sold together but of course GST will apply to the separate sale of the vacant land. On the other hand if you add land to an existing house and land package you will have to charge GST on the sale of that part of the land because that land had never been sold with that house before.

Note if you are not registered for GST and you are not selling the land as part of your actual business activity then even though the sale maybe for more than \$75,000 you are not required to register for GST. The \$75,000 threshold, at which you are required to register for GST, only includes turnover that is subject to GST from normal business operations, even domestic rents are not included in this threshold because they are not subject to GST.

GST and Transferring Land Between Co-Owners

The catch when you subdivide land, build a duplex or townhouses with a business partner is that, assuming you jointly owned the original property, then all of the lots or units are going to be jointly owned by you both. If you transfer the titles around so that you each own particular properties individually, then you are making a supply to each other and this may well be subject to GST.

The first question is whether the activity is an enterprise and then whether you are in partnership or merely co owners of the property. In technical terms the word partnership in this article and in the relevant ruling GSTR 2009/2 refers to a general law partnership which is a business enterprise. Co-owners is referring to something less, i.e. not a profit making motive from selling the property. A non profit making motive, from selling, would be when two people buy and develop so they can have a home or rental property each.

If you are in a general law partnership it is the partnership that is supplying the whole property to you not just the other partner's share. So GST would be payable on the whole value of the property (possibly reduced by the margin scheme). Mere co owners of property would only have to pay GST on the fraction of the property transferred and that is only if they are required to be registered for GST which quite often would not be the case for mere co owners because the property is not part of their normal turnover so their turnover is under the \$75,000 threshold.

It is all about your intentions. That age old question of whether you are merely realising an asset or in business to make a profit. A general law partnership is about a profit making venture. So if you purchased the property to hold as a rental or your home you would not be in a general law partnership as the rent is passive investment income. But if you then go into a business by demolishing the rental and building townhouses you are into a profit making venture and GST would apply if you sold the townhouses rather than continue to hold them as rentals. Selling vacant blocks of land can sometimes be considered merely realising an asset rather than a business but only if your original intention when purchasing the property was not to subdivide. Our how not to be a developer booklet (in the freebies section of the web site) discusses the ATO's jagged line on when it thinks you may have crossed over from merely realising an asset. This topic is also discussed in MT 2006/1.

All we are looking at here is what happens when you are doing **more** than merely realising an asset and you want to take away from the project, properties in your individual names rather than just sell off to the public. Remember the most common outcome would be for the partnership to sell to the public or the co-owners to keep the units for rental or private use. We are now really just looking at the unusual circumstances of when the development is business like ie profit making (must register for GST) ie general law partnership but for some strange reason the partners decide to transfer the properties (or at least some of them) out of the partnership and into their own names. In the particular case that led to this article a solicitor decided to transfer the titles around between the owners before the properties were then on sold to the public.

Let's consider a town house development which is business like with a profit motive, yet the partners will take away a townhouse each and sell the rest to the public. For GST purposes this is a supply by the partnership to the partners so the partnership must charge the partners GST. Note for income tax or CGT

purposes the partnership is not even recognised as owning the property, the individual partners are, let's not even go here at this point but it is suffice to say do not apply the GST principals here to any income tax issues.

The GST effect of the partnership being the transferor is that even though one partner might already have their name on half the title, when the townhouse is transferred to them GST would be payable by the partnership on the value of the whole townhouse (though the margin scheme maybe still used to reduce the GST). This is an important reason why you need to avoid being considered a general law partnership if you don't intend on selling the property.

The very fact that you don't intend on selling supports the fact that there is not a general law partnership anyway. Paragraphs 79 to 85 of GSTR 2009/2 recognise that two people can come together to do a development with different purposes in mind. If in this case you were the one building to sell and the other co-owner was building to live in then you really have to look at the one property as two separate assets. The first sale of a new residential property is subject to GST but not any subsequent ones unless it is substantially renovated. So if you received half the property from the other co-owner with no GST being charged because they weren't registered then when you sell only half the property is being sold for the first time so only half of it would be subject to GST. The trap is when you transfer your half of the live in co owner's property to them you will have to charge GST because you built that half with the intention of making a profit as part of your enterprise. So in the end the full GST is paid. Half of the value of your unit on the transfer to the other co-owner of half of their unit and the other half of the GST is paid (on half the value of your unit) when you sell to the public. You only charge half the GST on this latter sale because only half the unit is being sold for the first time. The other half was sold to you earlier by the other co-owner with no GST charged because they did not have a profit making motive so they were not required to be registered for GST.

A joint venture is a different situation to the partnership discussed above though GSTR 2009/2 asserts the transfer should still be a taxable supply despite subsection 51-30 stating that a transfer to joint venturers is not a taxable supply.

Don't forget if you are not already registered for GST and the units are not built to be sold as part of your normal business turnover then their sale will not force you to register from GST because you taxable supplies from your normal turnover are not over \$75,000.

Deceased Estate Tax Return Issues

Tax Rate – Providing the winding up of the estate is not unduly delayed a deceased estate is taxed as an adult resident ie tax free threshold and brackets, for the first 3 tax returns after death. Even though the estate is taxed as an individual the Medicare levy and surcharge are not applicable. Once the 3 tax returns have passed the estate can still apply to the ATO to be taxed at 19%.

HECS – The date of death return will be subject to HECS in the normal fashion, any tax is payable by the estate but HECS not is charged against the deceased estate's tax return so the debt is effectively cancelled on death.

Probate Costs – Can be apportioned amongst the assets of the estate to be claimed against the capital gain made on the sale of any assets, reference ID 2001/729. If the asset is passed to the beneficiary in-specie then the asset's portion of probate costs can increase the beneficiary's cost base, as can any legal fees for sorting out ownership issues, reference ID 2004/425

Bequests – Gifts to a charity made through the will are not tax deductible unless they are made under the cultural bequest program. In the latter case the deduction appears in the deceased's date of death tax return not the estate tax return.

Losses – Both capital and revenue losses accumulated by the deceased at date of death do not transfer to the estate's tax return they are either used against capital gains (in the case of capital losses) or income (in the case of revenue losses) made by the deceased before death or they are lost forever.

Income Received After Death – Even if the income is earned during the time the deceased was alive it still appears in the deceased estate's tax return, not the deceased's date of death return, if it is received after death. For example wages, interest, dividends, termination payments and death benefits. It is all a matter of when the money is received even though the deceased may have been entitled to it before death. Note annual leave and long service leave payments are tax exempt.

How Not To Be A Developer

Our How Not To Be A Developer Booklet has lots of relevant articles for solicitors involved in real estate http://www.bantacs.com.au/booklets/How_Not_To_Be_A_Developer_Booklet.pdf

Ask BAN TACS

For \$79.95 at Ask BAN TACS, www.bantacs.com.au/ask-bantacs.php, you can have your questions regarding Capital Gains Tax, Rental Properties and Work Related Expenses answered. We will include ATO references to support our conclusion. There is also a notice board where some askbantac users have generously allowed their question and answer to be published. Lots of good real life information.

More Information

Please make sure you continue to keep your knowledge up to date by [subscribe to our Newsflash reminder](#). There are many other booklets available on our web site <http://www.bantacs.com.au/booklets.php> in fact the whole web site is full of useful information so also have a look around under topics.

How to Make Sure Your Next Property Is a Good Investment

- Do you really know how much the property is going to cost you to hold?
- What name should the property be purchased in?
- Will this property fit your investment strategy and goals?
- What does the contract say about GST?
- How does the price compare with similar sales in the area?
- If it is negatively geared, how much capital growth is required before you breakeven?
- Do you know what records you need to keep and how?
- Are your financing arrangements maximising your tax deductions?
- What happens if interest rates rise?

.....and the list goes on!

To ensure you don't make a costly mistake with your next purchase make sure you see a BAN TACS Accountant before you sign



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