CHANGES IN PURPOSE

TYPICALLY, DEVELOPERS WILL AIM TO STRUCTURE A PROPERTY DEVELOPMENT WITH ONE OF THREE DESIRED OUTCOMES IN MIND:

- **develop, and sell all;**
- **develop, sell some, and retain the rest;**
- **develop, and retain all.**

Where this intention is known prior to undertaking the development, the legal structure and funding arrangements can be planned out well in advance to ensure the success of the desired outcome is optimised.

Complexity arises however when a developer has a change in intention parrtly through the development. Whilst this may arise as a result of personal preference, it is typically as a response to changes in market conditions (both positive and negative), changes in council policy, zoning or FSR, business performance, or demands from third parties (creditors, banks) or investors.

When such a change occurs, the level of risk can develop whilst many developers are well-versed in the immediate economic considerations, those that fail to obtain specialist advice typically find themselves running into lesser known income tax, tax planning, GST or stamp duty hurdles that catch them off-guard.

> The changes in intention typically manifest in two different scenarios

Firstly, where property that was acquired with the intention to 'develop and sell', due to changes in market conditions (decrease in sale price, purchaser defaults on completion and/or increase in rental yield), the intention changes to 'develop and retain', typically as a long-term investment.

Secondly, where property that was acquired with the intention to 'develop and retain', due to changes in market conditions (increase in sales price and/or decrease in rental yield), changes in zoning, an increase in FSR, or as a result of pressure from creditors, banks or investors, the intention changes to 'develop and sell' Under each of these scenarios some of the following more common income tax, GST and stamp duty considerations may come into play.

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CAPITAL V REVENUE

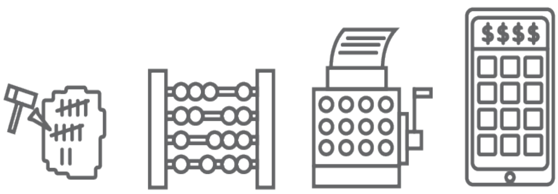
Property that was acquired with an intention to develop and sell will typically be held on 'revenue account', meaning that any profit or loss on disposal may give rise to ordinary business income, or an allowable deduction.

Alternatively, property that was acquired with an intention to develop and retain will typically be held on 'capital account', meaning that any gain or loss on disposal may give rise to a capital gain or capital loss.

> Where the intention for the property subsequently changes, it is often the case that the character of the property from an income tax standpoint also changes. That is, property that was held on revenue account may now be held on capital account, or vice versa.

Distinguishing between gains and losses on revenue account or capital account is important. Whilst revenue gains are taxed as ordinary business income, capital gains may be eligible for capital gains tax (CGT) concessions or discounts (such as the 50% CGT discount available to individuals and trusts).

Similarly, whilst losses on revenue account can typically be applied against all forms of revenue gains and capital gains, capital losses can only be applied against capital gains. That is, capital losses cannot be applied to reduce revenue gains.



THE MAIN ISSUES THAT MANIFEST AS A RESULT OF THE ABOVE ARE THAT:

- gains that were going to be made on capital account may now be made on revenue account, with the result being that capital gains tax concessions or discounts are no longer available (or only available in part);
- gains that will now be made on capital account may be made by an entity that is not eligible for a CGT discount (e.g. a company);
- or losses that now arise on capital account may be of no use if future gains are likely to be made on revenue account.

To address the above, options may be available to developers to restructure the ownership of property at the time that a change of intention occurs to ensure that tax preferred outcomes can be achieved in the future. As alluded to above, specialist advice should be sought prior to undertaking any restructure.

GST AND RESIDENTIAL PROPERTY

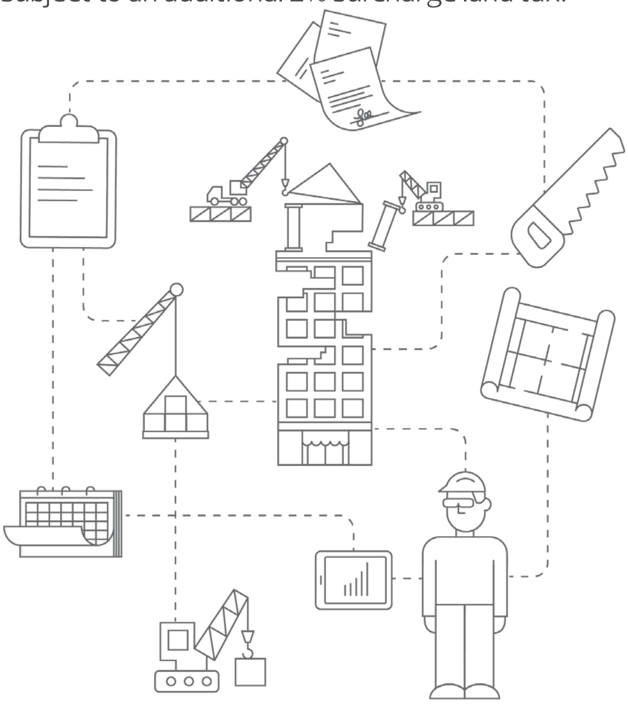
Where new residential property has been developed for resale, GST can typically be claimed on the costs incurred to undertake the development (known as credible acquisitions).
Should the developer subsequently decide to retain the residential property and apply it to derive residential rent (being an input taxed supply), a 'change in

creditable purpose' may arise, with the unfortunate consequence that some of the GST previously claimed in relation to the development of the property is required to be repaid to the ATO.

If the new residential property is retained and solely used for the purpose of deriving residential rent for a continuous period of five years, it is likely that the entire amount of GST claimed in relation to the development will be required to be repaid to the ATO.

CLAWBACKS OF EXEMPTIONS FOR FOREIGN PERSON OF SURCHARGE PURCHASER DUTY AND LAND TAX

As many developers would be aware, a 'foreign person' (including a company or trust) that acquires residential property (including vacant land that is zoned or otherwise designated to be used for residential purposes) in NSW may be required to pay an additional 8% surcharge purchaser duty in addition to the standard transfer duty that applies. Similarly, foreign persons that hold residential land in NSW may also be subject to an additional 2% surcharge land tax.



In 2017, amendments were made to provide 'Australian-based developers' who are 'foreign persons' with an exemption from both surcharge purchaser duty and surcharge land tax. To be eligible for the exemption, the Chief Commissioner must be satisfied that the land will be used for the purpose of 'construction and sale of new homes', or the 'subdivision and sale for new home construction.'

> As with all exemptions, the devil is in the detail. To satisfy the requirements under the 'construction and sale of new homes', the new home must not be used and occupied for any purpose (other than a display home) before the completion of the sale.

Putting this in context, should an Australian-based developer who is a foreign person initially receive an exemption from surcharge purchaser duty in respect of a property purchase subsequently decide to retain the newly developed home and use it to derive residential rent, it appears that the above requirement will not be met, as the new home will be used and occupied for the purpose of deriving residential rent.

As such, the exemption may be revoked resulting in the developer subsequently being hit with both surcharge purchaser duty and surcharge land tax.

For further information please contact our team at:

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