

Property development – topical tax and commercial issues

7 March 2018



A faded, grayscale background image of a mountain peak with a person climbing. The text is overlaid on the image.

**Everything we do
embodies the passion
and entrepreneurial
spirit of our clients.**





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Capital, scheme, or trading stock?

Tax characterisation in property development



What will be talked about

- Tax characterisation in property development
- Single vs multi-stage developments
- Timing of tax payments
- CGT event K4
- Foreign owners
- What the ATO looks for



What will not be talked about



There will be none of this



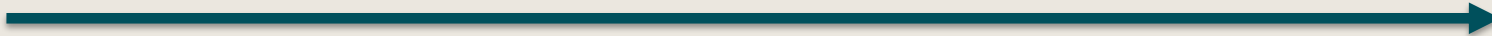
Capital, scheme, or trading stock



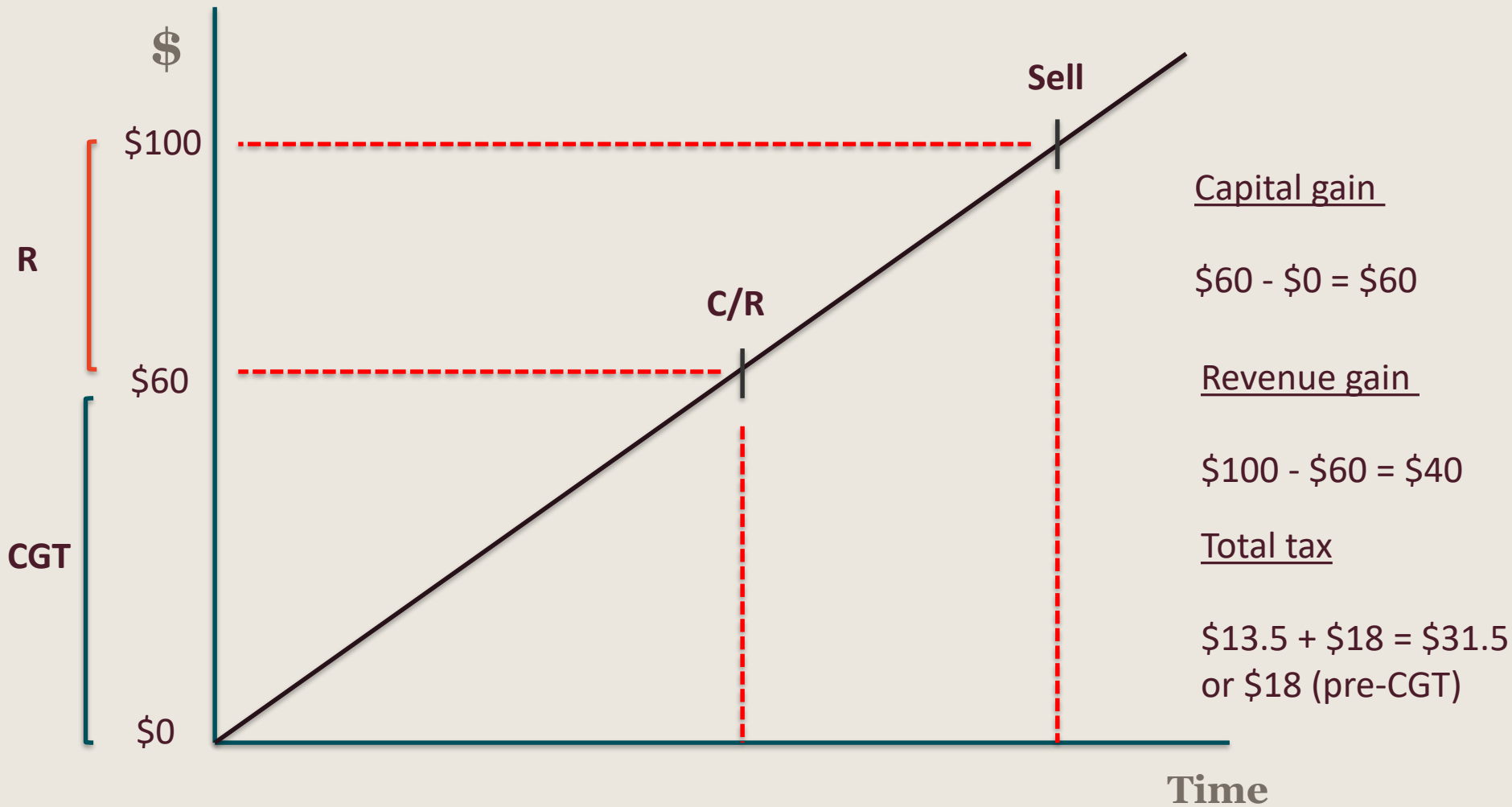
Capital



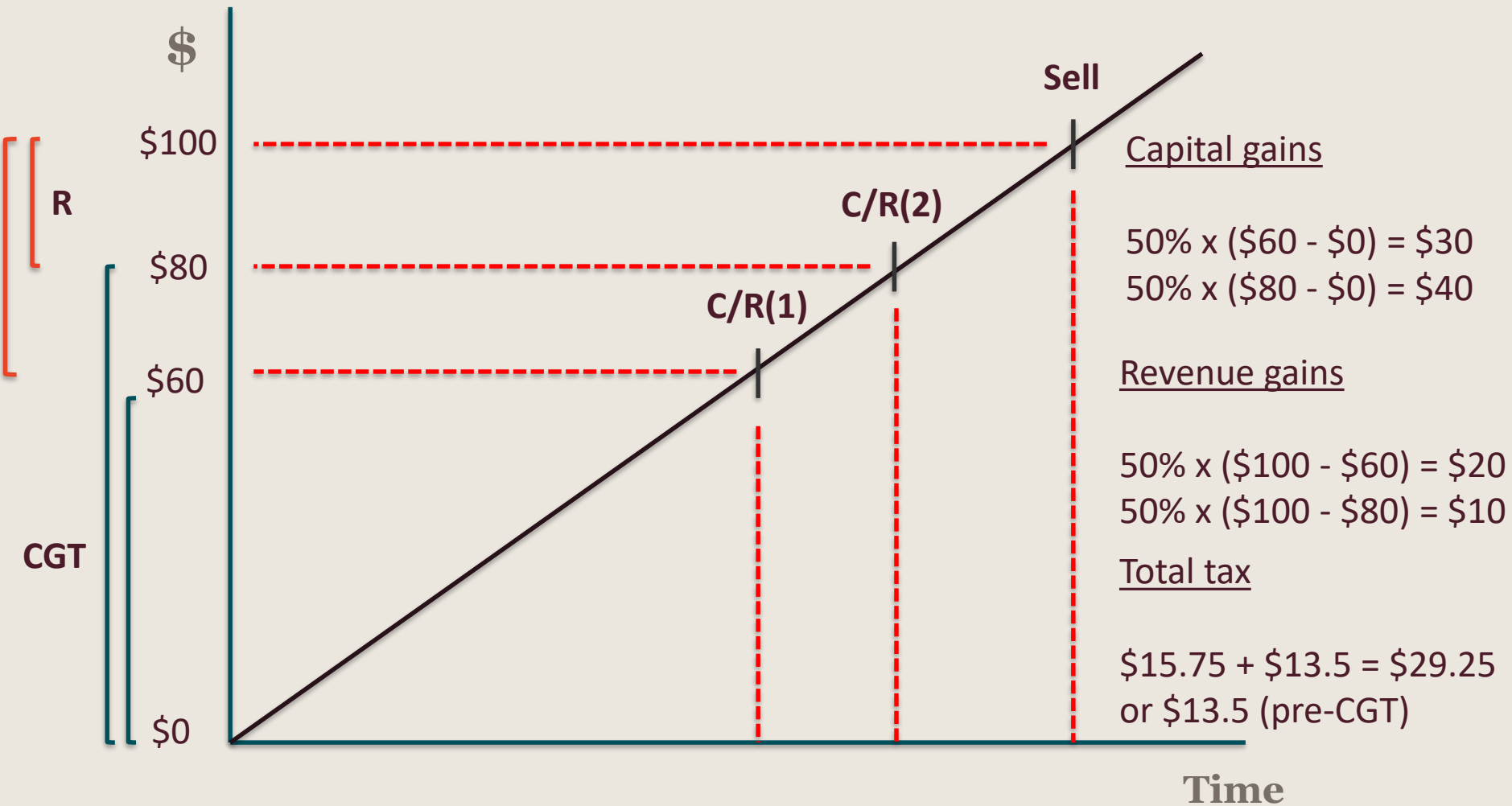
Scheme/trading stock



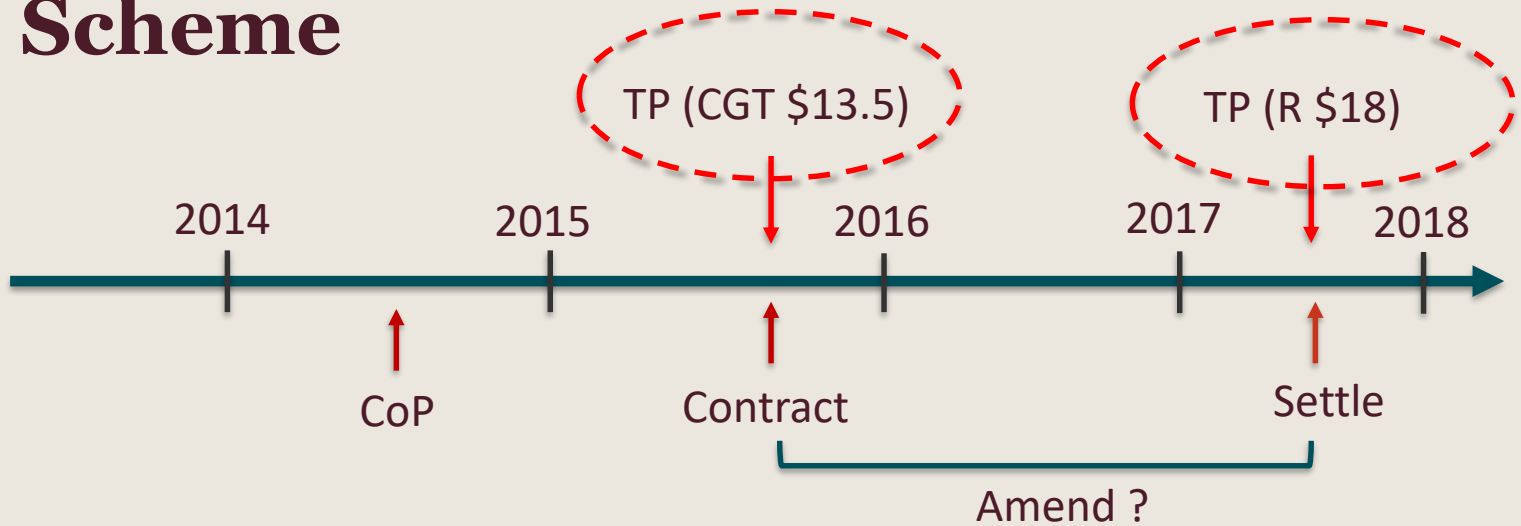
Single stage development



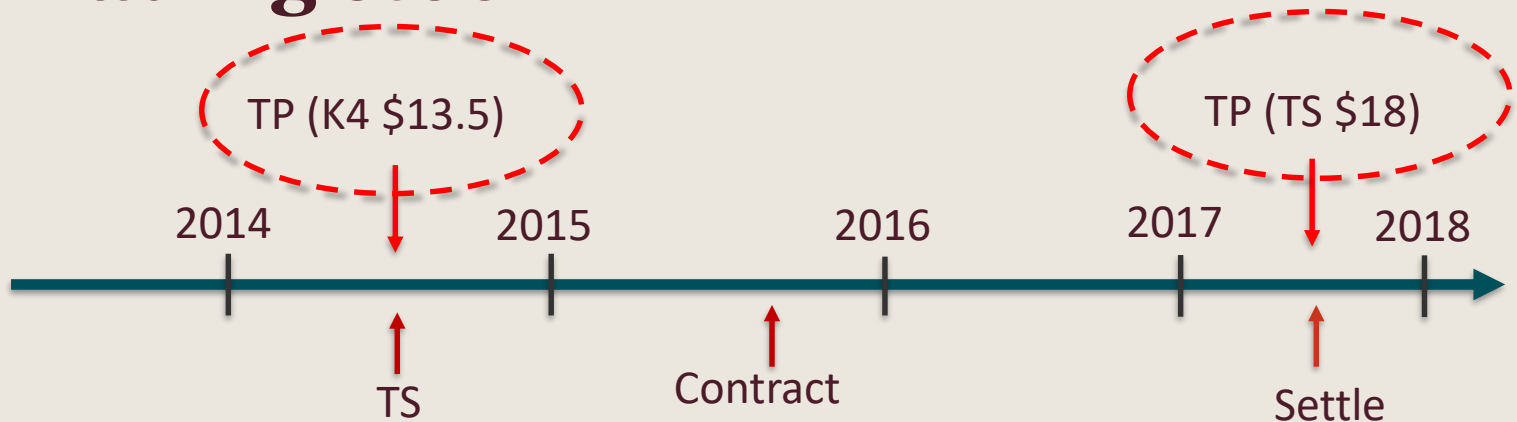
Multi stage development



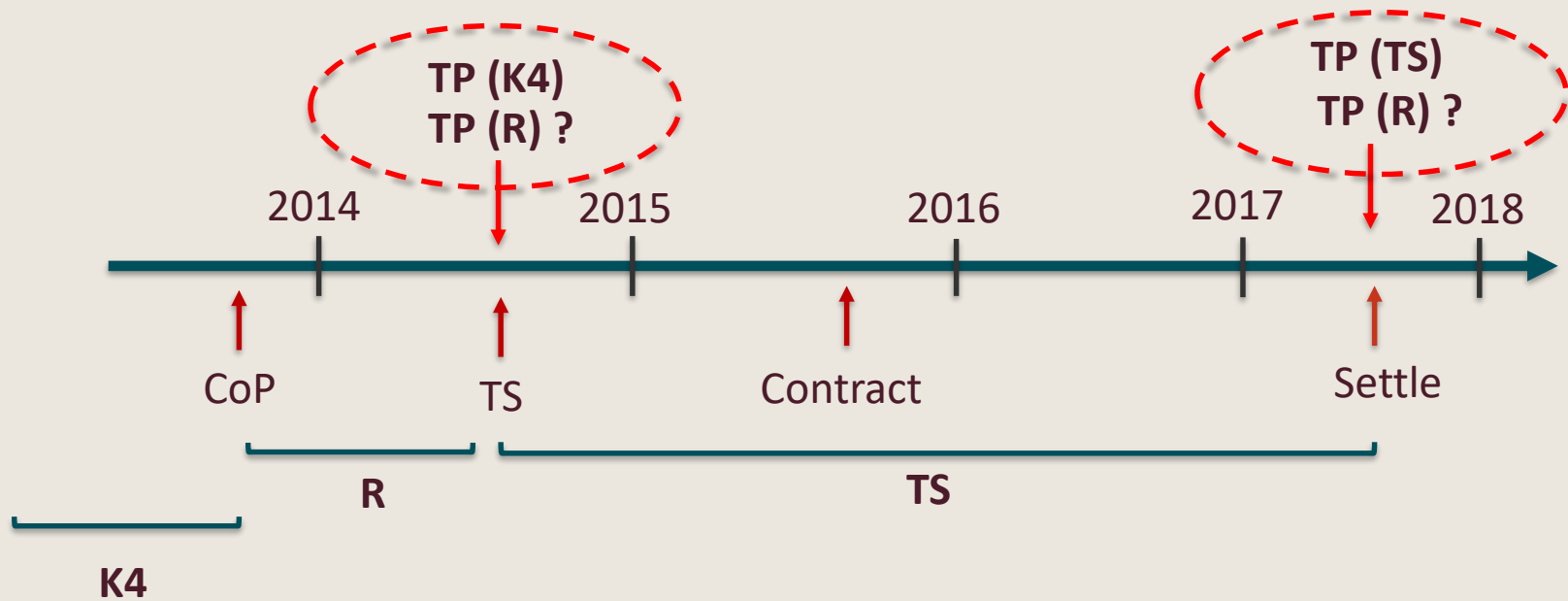
Scheme



Trading stock



Scheme then trading stock



To K4 or not to K4 that is the question



K4

- Market value > cost
- Pre-CGT land
- Small business CGT concessions
- Capital losses

Not K4

- Cost > market value
- Liquidity problems
- Foreigners buying post May 2012

Foreign owners



- **No CGT discount from 9 May 2012**
- **Capital/revenue – timing only**

What the ATO looks for?





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Property Development Agreements – are they dead and buried?

What is (and isn't) a Property Development Agreement?

What is a Property Development Agreement?

- An agreement for the development of real property in exchange for payment of a fee

Is it the same as a Joint Venture Agreement?

- No, the land owner remains passive – there is no contribution of land by a land owner into a venture undertaken “jointly”

Is it the same as a Project Management Agreement?

- No, the Developer develops the land in its own right – it does not “manage” the development on behalf of the land owner.



What types of real property can a Property Development Agreement be used for?

Is a Property Development Agreement limited to particular types of real property?

- No, Property Development Agreements can be used for development of any real property
- Can be used for land or built form
- Can be used for residential, commercial, industrial or other types of property development



What types of real property can a Property Development Agreement be used for?

Where are we seeing Property Development Agreements negotiated today?

- Land which requires significant (and longer term and costly) planning work prior to development – rezoning, remediation, change of use etc
- Built form property developments (medium density residential in particular)
- Land owner driven Property Development Agreements

Where aren't we seeing Property Development Agreements negotiated?

- Where there is limited potential “upside” for land owners
- Where development of the particular property is imminent and the land is seen to be at its “full” value



Frequently negotiated commercial terms

- Retention of land by land owners
- Development Fee – calculated on what basis?
- Cashflow – loans to land owners, in advance of sales proceeds
- Security – existing and proposed



Retention of land by land owners

Why retain any part of the land?

- Many land owners are not interested in retaining a part of the developed land
- Others want to retain the “family home”
- Some land owners want to retain a part of the land for future development

Challenges

- Who pays for the servicing of these retained lots – especially if it is not to an existing home?
- What about the GAIC liability on the retained lot (and other development contributions/costs)?
- Does the Developer get paid a development fee for the retained lot?



Development Fee – calculated on what basis?

Typical bases for calculation of the development fee:

- There isn't one, but some are more common than others
- Fixed fee and cost plus – uncommon
- Based on a percentage of net revenue
 - Currently most popular (particularly when prompted by a Developer)
 - Protects the Developer from cost overruns – risk shared by the land owner
 - Exposes land owners to risks of the development
- Based on a percentage of gross revenue
 - More popular when development costs are known
 - An opportunity for Developers who can control development costs
 - More certainty for the land owner – but certainty is dependent on the Developer's lender being on the same page



Cashflow – loans to land owners, in advance of sales proceeds

- An upfront payment on execution of a Property Development Agreement
- Putting the land owner in the same (or similar) position as if they had “sold” the land – but it’s not a deposit!
- Depending on the amount advanced, a willingness to give the advance is likely to tie in to security provided
- Interest on borrowings to fund a loan – not the same as interest on development costs
- Repayable from sale proceeds – but what if the Property Development Agreement is terminated before there are sales proceeds (or there are insufficient sales proceeds)?



Security – existing and proposed

What is the security given in relation to?

- Securing all of the land owner's liabilities under the Property Development Agreement
- Security for the Developer's borrowings from third party lenders for development costs and/or loans to land owners

What are the extremes?

- First ranking mortgage in favour of the Developer
- No security in favour of the Developer

Most likely compromise position?

- A charge giving a right to caveat (to notify the Developer of proposed dealings with the land) – but limited right to sell

Challenges

- What if the land owner has a pre-existing mortgage?



Growth Areas Infrastructure Contribution (GAIC)

What is GAIC?

- A contribution of (generally) \$110,930 per hectare, triggered on transfer (dutiable transaction), subdivision and some building permits

Why is GAIC relevant?

- Only applies to land in the growth areas (where many Property Development Agreements are relevant)
- Not a deal maker or a deal breaker – but needs to be managed

Particular issues

- GAIC deferral is generally not relevant for Property Development Agreements – but staging is critical
- Land retained by the land owner – who should pay the GAIC?
- School sites



Economic entitlement

Relevant legislation

- Section 81 *Duties Act 2000*

Threshold issues

- A person (the Developer) acquires an economic entitlement
- In a private landholder
- The economic entitlement amounts to an interest of 50% or more

How does this apply to Property Development Agreements?

- Where the economic entitlement amounts to an interest of 50% or more – calculated by reference to the proceeds of sale of the land

Risk

- Duty is assessed on the value of the land the subject of the economic entitlement





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Duty and land tax issues with property development and foreign purchasers



Overview

- Moving properties into trusts and super funds duty free
- Partitioning – can you have your cake and eat it too?
- Maintaining the primary production land tax exemption during the development of farm land
- Ensuring trusts are not foreign trusts for duty and land tax surcharges



Moving properties into trusts and super funds duty free

- Is an existing developable property in the right structure?
 - For federal tax purposes
 - For land tax purposes
 - For GST purposes
- If not, can it be moved into a new structure?
- The biggest concern in moving to a new structure can be triggering duty



Moving properties into trusts and super funds duty free

Super funds

- There is a duty exemption for transfers of property from individuals to an SMSF (section 41 Duties Act)
 - Only applies to contributions not sales
- Sales to SMSF will trigger duty
 - Payment of duty can be deferred under a terms contract
- Can do a part contribution and part sale and receive a partial duty exemption



Moving properties into trusts and super funds duty free

Super funds

- Other issues to consider
 - Contribution caps (including SBTC cap)
 - The work test
 - Prohibition against acquiring assets from a related party and the business real property exemption (section 66 SIS Act)
 - Capital gains tax
 - Transfer must be from the member (not a company or trust)
 - ATO's concerns with property development in an SMSF
 - How a development will be funded in an SMSF



Moving properties into trusts and super funds duty free

Trusts

- Generally transfers of property from individuals to a trust triggers duty
- Limited exemptions
 - Farming property to a “farming trust”
 - Transfers to testamentary trusts via a deceased estate
- More generous duty exemptions apply to transfers of assets *out of* trusts
 - However, strict rules apply – different rules for unit trusts, fixed trusts and discretionary trusts
 - SRO administer the exemptions very strictly – especially in relation to the no-consideration requirement



Partitioning – can you have your cake and eat it too?

- Allows two or more parties to acquire specific parts of an un-subdivided property
- How it works - the parties enter into a partition agreement
 - Under the agreement each party is allocated a lot under the proposed development of the property
 - When the plan of subdivision is lodged each party receives a certificate of title for their particular lot without triggering additional duty
- However, duty can be triggered if a party receives more than what is set out in the partition agreement in dollar terms – duty is only triggered on the amount received in excess of the agreed partitioned amount



Partitioning – can you have your cake and eat it too?

- Uncertainty in relation to affect of partitioning on common property
- Generally all parties need to be on title (in their respective shares)
- This can raise issues
 - Banks may be reluctant to lend to multiple parties
 - GST and income tax partnership issues
 - Multiple parties signing each legal document
- A potential alternative – land held by a single landowner
 - Land held on separate bare trusts for each owner
 - Can raise its own issues



Partitioning – can you have your cake and eat it too?

- Example
 - Sue, Bill and Sam wish to buy 2 neighbouring residential properties
 - They plan to demolish the houses and build an apartment block with 9 apartments
 - They want to keep 3 apartments each
 - They have plans drawn up
 - They enter into a partition agreement and allocate on the plan which 3 lots they will take post completion
 - Upon the completion of the development and lodgement of the plan of subdivision they each receive their respective title to their apartment
 - No duty is triggered on the lodgement of the plan of subdivision
 - Contrast without a partition agreement would have triggered 2/3's duty



Maintaining the primary production land tax exemption during the development of farm land

There are 3 primary production land tax exemptions

1. Properties outside of Greater Melbourne (section 65)
 - Land must be used primarily for primary production
 2. Properties inside of Greater Melbourne but not urban zoned (section 66)
 - Land must be used primarily for primary production
- Both tests reasonably easy to meet
 - Doesn't matter who is doing the farming
 - Look at actual activities on the land not future use (CCSR v Metricon)
 - Examples of failing the test
 - Farm land that also had a nursery on it
 - Land where activities just amounted to land maintenance
 - Land with a couple of sheep on it



Maintaining the primary production land tax exemption during the development of farm land

There are 3 primary production land tax exemptions

3. Properties inside Greater Melbourne and urban zoned (section 67)

- Very restrictive requirements
- Ownership requirements varies depending on if it is owned by individuals, a trust, a SMSF or a company
- Must be a primary production business carried on by the owner (exemption for SMSFs)
- Primary production business must be the principal business of trust or company
- One of the “owners” must be a full time farmer
- Most difficult requirement to meet is to establish to the SRO’s satisfaction that a primary production business is being carried on



Maintaining the primary production land tax exemption during the development of farm land

Planning around land that will be rezoned

- For land in Greater Melbourne, rezoning from farming to urban growth zone does not become “urban zoned” until a precinct structure plan (PSP) is lodged over the land
 - Therefore giving time to satisfy the stricter requirements under section 67
- Where farm land in Greater Melbourne is going to be developed or sold under a long term settlement, managing the primary production land tax exemption can be very important
- This can include:
 - Is the structure right
 - Is there a primary production business
 - Is the primary production business the primary activity of the trust or company
 - Is one of the “owners” a full time farmer



Ensuring trusts are not foreign trusts for duty and land tax surcharges

- Most States have now brought in a duty and/or a land tax surcharge for the acquisition of land by foreign persons
- In addition, there is the existing FIRB requirements

State	Duty surcharge	Land tax surcharge
Victoria	7%	1.5%
NSW	8%	2%
Queensland	3%	1.5%
South Australia	7%	N/A
ACT	N/A	0.75%
WA	4% (from 1/1/2019)	N/A
Federal	No duty but there are FIRB application fees	No land tax but there is an annual vacancy fee



Ensuring trusts are not foreign trusts for duty and land tax surcharges

In Victoria

- The duty surcharge applies to:
 - Residential land
 - Non-residential when the foreigner forms the intention to construct a residential building on the land or make the land capable of constructing a residential building on the land
- Exemptions
 - If the transfer would otherwise be exempt – eg transfer from an estate
 - Treasurer’s discretion to exempt certain foreigners
- The land tax surcharge applies to *all* land held by the foreigner (absentee owner)
- Exemptions
 - Treasurer’s discretion to exempt certain foreigners



Ensuring trusts are not foreign trusts for duty and land tax surcharges

When will a discretionary trust be a foreign trust

- Victoria
 - For the duty surcharge
 - When a foreigner beneficiary (or associate) can potentially receive a distribution of more than 50% of trust capital
 - For the land tax surcharge
 - If a foreign person is named as a beneficiary of the trust (eg as a primary beneficiary or a member of the additional class of beneficiary)



Ensuring trusts are not foreign trusts for duty and land tax surcharges

- NSW and FIRB
 - When a foreigner beneficiary (or associate) can potentially receive a distribution of 20% or more of trust income or capital
- Queensland
 - When a foreigner beneficiary (or associate) can potentially receive a distribution of 50% or more of “trust interests” – ie trust property
- South Australia
 - If a foreigner is:
 - a trustee
 - a person who has the power to appoint
 - an identified object under the trust; or
 - a taker of default of capital



Ensuring trusts are not foreign trusts for duty and land tax surcharges

Therefore discretionary trusts will need to be amended

- In Victoria for the duty surcharge
 - If it is:
 - buying residential land; or
 - buying non-residential land that will be developed into residential land
 - If there is, or is a possibility, of a foreign beneficiary in the class of beneficiaries
- In Victoria for the land tax surcharge
 - If it will hold land
 - If it has a foreigner named as a beneficiary



Ensuring trusts are not foreign trusts for duty and land tax surcharges

Therefore discretionary trusts will need to be amended

- If amending deeds consider:
 - Is there the power to make the amendment
 - Will the amendment cause a resettlement
 - In NSW can be done retrospectively (up to 6 months)
- This is no longer a theoretical risk



Thank You

Drinks and canapés are served until 8.00pm, so if you have further questions, please come and chat.

