



Navigating your property's tax journey

Thursday, 16 November 2023
11:30am – 12:30pm (AEST)



David Montani
National Tax
Director

Webinar will commence soon

Advisory. Tax. Audit.



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Introduction

- Property often large part of your wealth
- Whether business, investment or private, attracts tax attention
- Recent changes, contain traps
- Risks, decisions
- Look ahead with confidence, not back in anguish

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Today's session

- Abolition of family home tax exemption for foreign residents
- Limiting deductions for “vacant” land
- Fully taxed profits vs partially taxed capital gains
- GST issues
- Moving business premises to low-tax superannuation environment
- Consequences of changing purpose of land
- States/Territories
- Risks, traps, options, clarity, decisions

Family home loses tax-exempt status

Family home exempt no more

Foreign resident

- Sale contracts executed from 9 May 2017
- Claimed not retrospective
- Claimed reduce pressure on housing affordability

"An outrageous piece of legislation"

Bob Deutsch, Senior Tax Counsel, The Tax Institute

Family home exempt no more

Foreign resident

- Family home generally exempt from CGT
- No exemption if a foreign resident
 - Any family or friends moving overseas?
- Ask this question: Foreign resident at time of sale?

No

- CGT rules apply as normal

Yes

- No exemption; fully subject to CGT
- No recognition of history as family home
- Absence rule N/A

Exception

Pass “life events test”

- Foreign resident ≤ 6 years

AND

- You, spouse or minor child expected to die within 2 years; or
- Spouse or minor child dies; or
- Relationship breakdown

Example 1

Move overseas, sell house

- Josh's story:
 - Purchased home 1 October 1985 for \$70,000
 - Moved overseas 1 October 2023, became foreign resident
 - Rented out his house – aware of the absence rule
 - Sold house 1 October 2024 for \$1,070,000
 - \$1 million capital gain
- Foreign resident at time of sale? Yes

Example 1

Move overseas, sell house

- Assume does not pass life events test
- Josh's home for 38 out of 39 years; absence rule...
 - All irrelevant
- \$1 million capital gain not exempt

	\$
Capital gain	1,000,000
Less 48.72% discount	<u>(487,179)</u>
Net capital gain	<u>512,821</u>
Tax at foreign resident rates	<u><u>210,969</u></u>

- Too late for any other outcome

Example 2

Intending to move overseas

- Dial it back to April 2023
- Josh seeks advice *ahead* of upcoming October move
- Options:
 1. Sell while still Australian resident
 2. Keep as per Example 1
- Question seeking to answer:
 - Would future growth in value overcome tax impost?
 - If yes – Option 2
 - If no – Option 1

Example 2

Sell or keep?

- Need 3 things:
 1. Estimated current value
 2. Predicted future value
 3. Agree time-value discount rate
- Josh says:
 1. \$1 million
 2. \$1.4 million in 5 years
 3. 5%

Example 2

Sell or keep?

- Option 1 (Sell): \$1 million
- Option 2 (Keep, sell in 5 years):

	\$
Sale proceeds	1,400,000
Estimated tax	<u>(314,247)</u>
After-tax sale proceeds	<u>1,085,753</u>
Discounted to today's dollars	<u><u>850,716</u></u>

- Option 1 is better
 - But, more to it...

Example 2

Other factors

- Where invest \$1 million, what return? (Option 1)
 - Rental return higher? (Option2)
 - Make up \$150k shortfall?
- House might not sell before leaving
 - ...and if it does, where will Josh live until he leaves?
- Sentimental value?

Example 2

Option 3

- Intend to return to Australia?
- Re-establish tax residency
- Foreign resident at time of sale? *No*
 - Normal CGT rules apply as if abolition rules don't exist

Example 2

Option 3

- Back within 6 years?
 - Absence rule – fully CGT exempt
- Back after 6 years:
 - Mostly CGT exempt

Other issues

Sell while foreign resident

- Cost base:
 - Records?
 - Acquired after 20 August 1991
 - Non-capital costs of ownership
- 12.5% CGT withholding if sale price of \$750k+
 - Residents need clearance certificate from ATO

Decision-making framework

- Sell?
- Keep?
- Other factors

- Informed decision

Other family home issues

Tax exempt?

- Subdividing
- Demolish
- Build on back, sell front

Limiting deductions for “vacant” land

Background

- Deductions allowed for land used to earn income. E.g.
 - Rent income
 - Develop to sell for profit
- ATO difficulties
 - Solution – deny deductions
- Disincentive for land banking, speculative holding

Relevant expenses

Holding land

- Interest, other ongoing costs
- Borrowing costs
- Rates
- Land tax
- Insurance
- Maintenance
- Loss from profit-making undertaking

When deductions denied

“Vacant”

- Land has:
 - No **substantial and permanent structure** on it...
 - ...that is in use of available for use...
 - ...with an independent purpose.
- Qualifier bolted onto every provision in tax laws that allow a deduction

When deductions denied

- From 1 July 2019
- All land; no grandfathering
- Own land and leasing
- Exceptions

Substantial and permanent structure

- Building or other structure
 - Significant size/value, relative to property
 - Fixed and enduring
-
- In use, or available for use
 - Independent purpose, not incidental (e.g., shed, garage)

Substantial and permanent structure

Examples

- Commercial building
- Commercial car parking complex
- Woolshed
- Grain silo
- Residential house (subject to additional conditions)

Residential house

Additional conditions

- Where you construct or substantially renovate
- Substantial and permanent structure **only if**:
 1. Lawfully able to be occupied; **and**
 2. Rented, or available for rent
- Need occupancy permit (where apply)

Residential house

Additional conditions

- N/A where:
 - Buy land with house already on it, and
 - Don't substantially renovate it

Exceptions

Deduction denial rules N/A

- Two exception categories:
 - Particular types of entities
 - For the rest; particular circumstances

Exceptions Entities

- Companies
- Non-SMSFs
- Others

- Still need to satisfy a law allowing deduction
 - No qualifier bolted on

Exceptions Circumstances

- Applicable to remaining types of entities:
 - Most trusts
 - Individuals
 - SMSFs
 - Others

Exceptions Circumstances

- Land used in carrying on a business, including by related party. Eg:
 - Commercial premises
 - Large-scale property development
- Natural disaster / other exceptional circumstances
- Primary producers
- Leased under arm's length dealing, used in carrying on a business

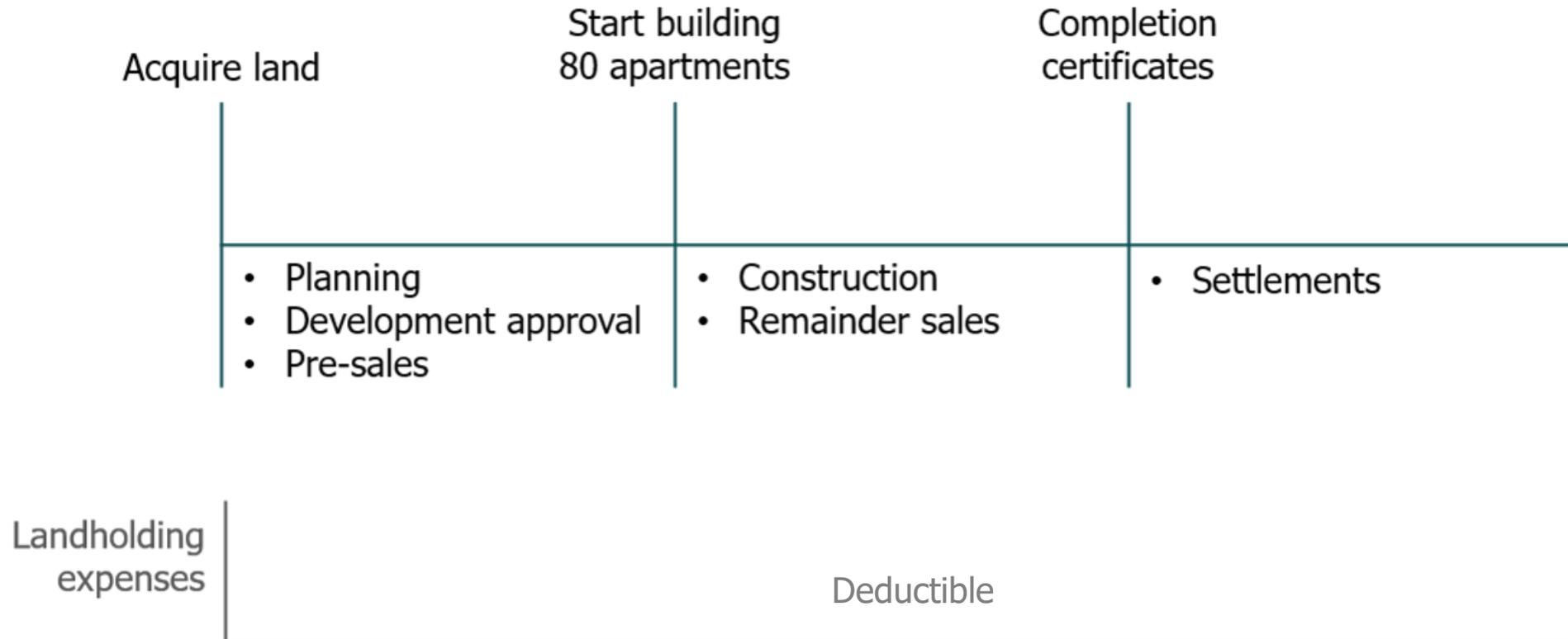
Example 3

Substantial property development

- Property development in a discretionary trust
- Substantial size and scale
- Amounts to [carrying on a business](#)
 - Circumstances exception applies

Example 3

Substantial property development



Example 4

Build house to rent

- John purchases vacant land
- Engages a home builder to build a house
- Engages a real estate agent to seek a tenant for the completed house

- Interest on borrowings
 - Only part funding land is holding cost

Example 4

Build house to rent

	House completed	Occupancy permit	Listed with agent
No structure			
Building house			House rented (or available for rent)
Landholding expenses	Not deductible		Deductible

Example 5

Smaller-scale development

- Ray and Debra own a residential rental property
- Old, small house on a large block
- At end of current lease term, decide to develop site
- Demolish house, subdivide, build two units for sale
- Profit-making undertaking
 - Not a business

Example 5

Smaller-scale development

	Acquire property	Tenants out	Demolish House	Occupancy permit	Assessable profit
			No substantial & permanent structure		
	Rented out		Subdivide and build two units	Market units for sale	
Landholding expenses		Deductible	Not deductible		

Not rented/available for rent



Treatment of denied deductions

- Not carried forward, no deduction in future
- Land acquired after 20 August 1991:
 - Most add to land's cost base, re calculating capital gain
 - But cannot create or increase a capital loss
- Land acquired before 20/8/91, no tax recognition

Smaller-scale developments

Warning

- Develop for sale
- Profit-making, but not a business
- Houses/units for sale – ie, not for rent
 - Still “vacant” land
- If make a loss, no deduction

Smaller-scale developments

Structure decision

- Trust, individual – vacant land rules apply
- Company – exempted
- Income tax, not CGT
 - 50% discount irrelevant
- Choose company over trust?

Capital gain or profit?

- CGT vs income tax
- “Flippers”

Realising an investment? ...or making a profit?

- Mere realisation of capital asset vs intent to make a profit
 - Capital gain vs profit
- How much is taxed?
 - Capital gain: Possibly only 50% of it
 - Profit: All of it

Realising an investment? ...or making a profit?

- Spectrum
- Contrast:
 - Spruce up a rental property before selling
 - Example 5 – demolish rental, build units for sale
- Evidence
- Rule of thumb

- New residential, potential residential land – 10% GST withholding

Flippers

- Purchase house, genuinely establish as your family home
- Spend money on renovating
- Sell for more than acquisition and renovation costs

- Exempt from CGT?
- What about income tax?
- And GST?



Questions

Other property issues

- Business premises
- GST
- Travel/depreciation deductions denied
- Downsizer contributions
- FIRB approval

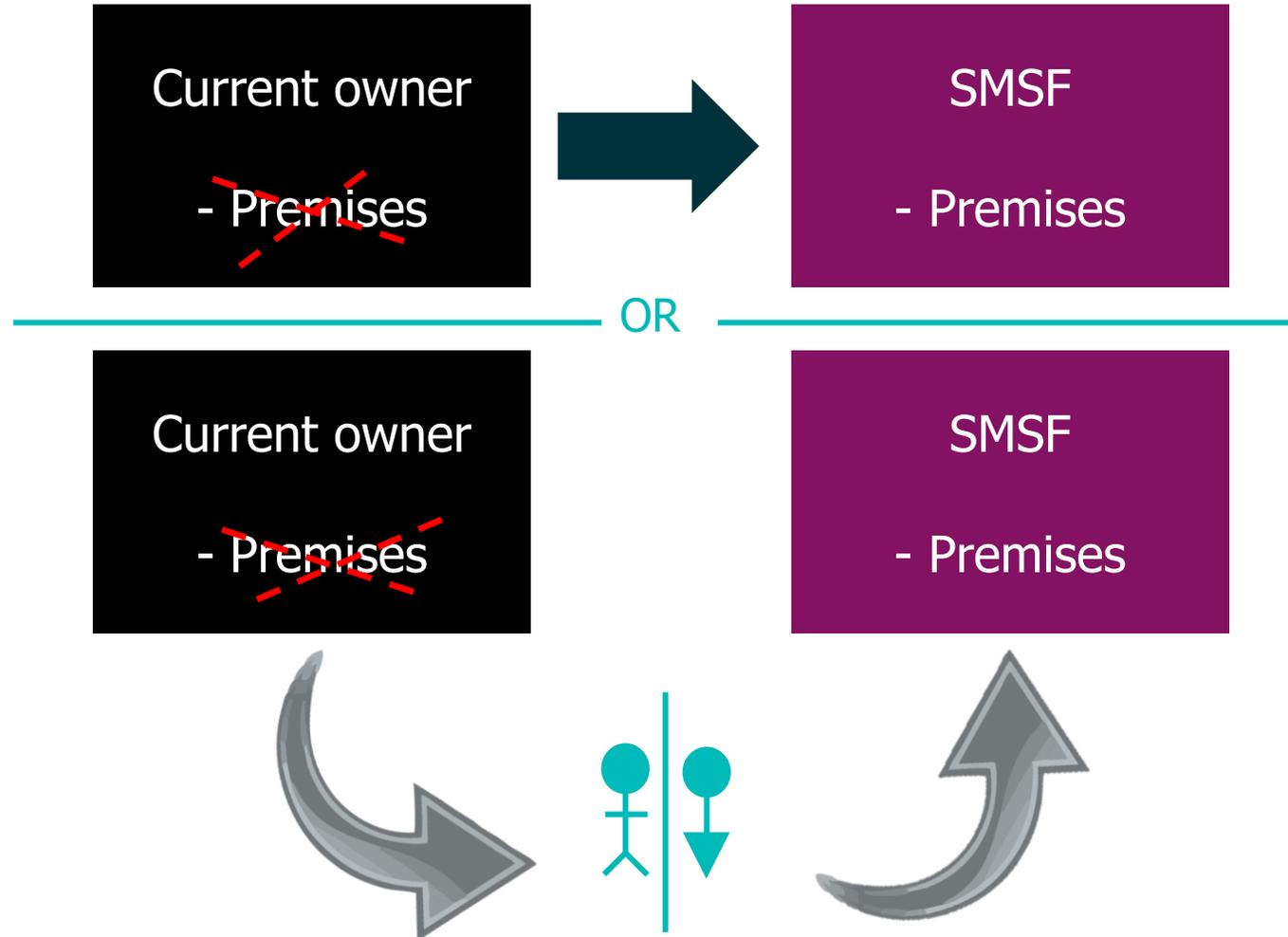
Business premises

- Not part of business
- Commercial property investment
- Security of tenancy

Business premises

- Longer-term retirement asset?
- Superannuation environment: 0% – 15% tax
 - Note, incoming additional tax on super balances >\$3m
- Possible to move to SMSF tax effectively

Business premises



Business premises

- Need to address:
 - CGT – concessions to reduce/eliminate
 - GST – ensure GST-free
 - Transfer duty, if applicable – exemptions
 - SMSF regulatory
- Cost v benefit
 - Pay-back period
- SMSF may be able to borrow – release cash

GST margin scheme

- GST liability not usual $1/11^{\text{th}}$ of sale price
 - $1/11^{\text{th}}$ of “margin”
- Why exists
- Conditions to qualify
 - Seek advice **before you purchase land**, get terms right
- 7% withholding rate

Build residential for sale, then rent

- Claim GST credits for construction costs, etc.
- Change in purpose – from solely sell to:
 - a) Solely rent; or
 - b) Mixed – renting as holding pattern, still intend to sell
- Adjustments to reverse GST credits
 - a) Entirely
 - b) Progressively. 5-year rule
- Difficult to move from profit basis to capital gain

Residential properties

Denied deductions

- Travel, depreciation
- Claimed improve housing affordability

Residential properties

Travel

- Not deductible, full stop
- Exceptions:
 - Carrying on a business (any entity)
 - Corporate tax entities (companies, etc.)
 - Non-SMSFs
 - Other entities

Residential properties

Second-hand assets

- No depreciation deductions
- Includes when purchase established rental
- No deduction for loss on sale
- Deduction still allowed:
 - Purchase depreciable item new
 - Build to rent
 - Purchase spec-built new home
 - Same exceptions as travel

Superannuation

Downsizer contributions

- 55+
- Up to \$300,000 pp
- Owned property 10 yrs+
- Full or partial family home exemption

Foreign Investment Review Board

- Foreign purchaser may require approval to purchase land

Build-to-rent accommodation

2023 Budget announcement

- Encourage housing supply
- New construction commenced after 9 May 2023
 - Building depreciation rate increase from 2.5% to 4%
- Managed investment trust payments to non-residents
 - Withholding rate reduced from 30% to 15%
- Eligibility conditions include:
 - 50+ dwellings
 - 10-year ownership period
 - Min 3-year lease terms

State/Territory taxes

State/Territory taxes

- Transfer duty
- Land tax
- Surcharges for foreign buyers/owners

- Victoria
 - Windfall gains tax

State/Territory taxes

Surcharges

- Revenue NSW, 21 February 2023:
 - Announced no longer impose surcharges on buyers/holders from certain countries
 - Inconsistent with non-discrimination clauses in Double-Tax Agreements
 - Extension of High Court decision in *Addy v FCT* [2021] – “backpackers tax”
 - New Zealand, Finland, Germany, South Africa, India, Japan, Norway, Switzerland, Chile, Turkey, UK and Israel
- Refunds may be available

State/Territory taxes

Other states/territories?

- Victorian SRO, 15 March 2023:
 - Will continue to impose surcharges
- Other states/territories:
 - Silence

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Conclusion

- Property
 - Traps, risks, opportunities
- Seek advice in advance
 - Know where stand, options
 - Informed decisions
- Starts with a conversation

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