



Fully Taxable Profit or 50% CGT Discount?

I have got to say the most common question I am asked is whether the ATO would consider a subdivision a profit making business or merely realising an asset. If the land is sold in a profit making enterprise then it is business income, fully taxable, which means no 50% CGT discount. The 50% CGT discount is only going to be available if you are merely realising an asset you have held for purposes other than profiting from its sale. It all boils down to proving what your thoughts were when you purchased the property. Onus of proof is on the taxpayer.

Doyle and the Commissioner of Taxation 2020 AATA 345 show how difficult it is to prove you did not buy with the intention of selling for a profit when you are operating a profitable development business. I think Doyle was pushing it to argue that he was merely realising an asset as he regularly developed land for resale and there was ample evidence that he had considered the resale value including to help convince the bank to lend him money. Nevertheless, he claimed that this time he had bought the blocks with the intention of building commercial properties and leasing them. That is not for resale at a profit but to earn investment income.

The AAT member basically didn't believe the taxpayer's claim considering all the evidence showing the group were considering either sale or lease. That is the bottom line but nevertheless, there are some key points made that are relevant to developments of any size.

From Doyle and Commissioner of Taxation (Taxation) [2020] AATA 345 (5 February 2020)
<http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/cth/AATA/2020/345.html>

DETERMINING WHETHER PROCEEDS OF SALE ARE CAPITAL IN NATURE

17. A financial gain will be income if it arises in the ordinary course of the taxpayer's business. It may also be income if it arises from an isolated business operation or commercial transaction entered into otherwise than in the ordinary course of carrying on the taxpayer's business but with the intention or purpose of making a profit or gain. Whether it does depends on the circumstances of the case, and generally if the circumstances give rise to an inference that the taxpayer's purpose in entering into the transaction was to make a profit or gain, the profit or gain will be income.^[11]

18. If the decision to sell an asset is taken *after* its acquisition, there having been no such intention at the time of acquisition, the profit will be capital because it proceeds from a mere realisation (unless the asset is a revenue asset for other reasons). However:

[I]t is quite another thing if the decision to sell is taken by way of an implementation of an intention or purpose, existing at the time of acquisition, or profit-making by sale, at least in the context of carrying on a business or carrying out a business operation or commercial transaction.^[12]

21. The Applicant contends, and the Respondent does not dispute, that for the purposes of determining the Applicant's intention at the *time of acquisition*, the time a property is acquired is when the contract to purchase that property was entered into. I respectfully agree. The Applicant's intention at the relevant time may be gleaned not only from evidence of representations and conduct leading up to, and contemporaneous to, the acquisition of each property. It could potentially be gleaned from the representations and conduct of the Applicant and the Doyle Group after acquisition of each property.

26. In *Moana Sands Pty Ltd v Federal Commissioner of Taxation*^[22] the taxpayer had acquired beachfront land with the twofold purpose of working and/or selling the surplus sand and holding the land until it became appropriate to sell it at a profit. The land was ultimately resumed by the government which paid compensation for it. In a joint judgment, the Full Federal Court held that an intention to sell need only be a purpose and need not be the sole or dominant purpose.

31. I respectfully accept the Respondent's submission, and therefore it is incumbent on the Applicant to prove that profit by way of sale was not one of the ways he had in mind that he could realise a financial gain from each property at the time the relevant trusts acquired each property.

34. The relevant standard of proof is the civil standard, specifically, the balance of probabilities

Certainly, it was a very smooth process from buying to reselling if there was no intention to resell. Lucky maybe once but in this case there were 3 different developments that turned over very quickly. In November 2004 the first contract to purchase was signed. By mid 2005 further properties were purchased and in December 2005 another lot was purchased. Initial borrowings were short term. August 2007 negotiations began to sell the properties. Here is a bit of a time line from the case:

39. On 30 May 2006, the Doyle Group prepared a draft Masterplan for land sales only for discussion purposes. It predicted returns on sales in three stages over a six year period.

40. At some time prior to 20 June 2005, the Doyle Group applied to Capital Finance Australia Limited (CFAL) for finance. The CFAL summary of terms and conditions states that the loan was to acquire Lots 1 and 992, and that *"The loan will be repaid from the sale/refinance of security properties"*.

41. On 28 June 2006, the Doyle Group prepared a draft feasibility study based on land sales in three stages over a period of *"5 years + approvals"*.

45. On 2 November 2005, the Doyle Group sent an email to its legal advisers stating:
As discussed, please find attached the draft feasibility for the Bromelton project ("Option 3" indicates it is the combination of land sales, D&C and ground leases) which shows the lots to be sold/retained etc and likely values of these.

49. In press releases issued on 11 April 2006, the Doyle Group represented that the Swan Creek Industrial Precinct would be developed and *"will be purpose-built to provide owners and tenants with*

direct access to standard gauge rail".^[48] This statement was repeated in an article in the local newspaper, the Beaudesert Times, on 3 May 2006.^[49]

50. On 30 May 2006, the Doyle Group prepared a feasibility study that provided for revenue being derived from land sales only.^[50]

51. On 27 June 2006, CFAL extended and increased the loan facility provided to the Bromelton Trust to \$8,700,000 repayable in full by 30 June 2007.^[51]

52. On 28 June 2006 the Doyle Group prepared a feasibility study^[52] that provided for revenue to be derived from:

stage 1: 30% D & C with the remainder to be leased; and

stage 2 and 3: 40% D & C with the remainder to be sold as freehold;

Similar activities were undertaken on another two properties in other areas during this period. No development or construction was actually undertaken on the land before it was sold at considerable profit. Nevertheless all of the points above suggest it was purchased as a business making venture.

Then the taxpayer tried the excuse that he foresaw the GFC in 2006 so knew he had to sell and reduce his debt even though he had only bought the properties a year or so earlier. Makes you wonder how the banks missed it, doesn't it?

So, I ask you dear reader what do you think they were thinking at the time of purchase? I think they could see great potential in the land every which way. Well Doyle claimed they intended to rent out land and buildings with just the possibility of having to sell off a few lots to reduce debt. His argument was that he sought advice to use a unit trust so the 50% CGT discount would be available, which would not be the case if a company was used instead or if he didn't hold the properties for the long term. Choosing a trust he said instead of a company shows he was in it for the long term despite all the talk about selling.

The AAT member stated:

211. Considering the totality of the evidence I find that, at the time each property was acquired by its respective trust, the Applicant's purpose was to develop the property and put it to a commercially advantageous use, which could have been selling, leasing or a combination of both, depending on factors such as whether investors could be secured. Accordingly, each property was acquired as part of a profit-making scheme that included, as one of its purposes, profit making by sale.

The AAT member concluded at the very least selling the land for a profit was an option seriously considered at the time of purchase and that is enough. There is no need that it be the only option considered. I think it was a fair outcome so be careful what you think!