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Are you in the business of renovating properties?

Work out if your renovation is classified as 'a profit-making activity' and how it may affect your obligations.

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If you renovate one or more properties, you need to work out if you:

- are in the **business of renovating properties**
- are carrying on a **profit-making activity of property renovations**, also known as 'property flipping'
- are a **personal property investor**
- have undertaken renovations that constitute substantial renovations.

Your conclusion will affect your **tax obligations and entitlements**.

To decide whether or not a property has been substantially renovated, read from paragraph 53 of **GSTR 2003/3** *Goods and services tax: when is a sale of real property a sale of new residential premises?*

For more information, see:

- **Capital gains tax**
- **Are you in business?**
- **Capital gains tax property exemption tool**.

For help applying this to your own situation, phone **13 28 61**.

Property renovating as a business or profit-making activity

Factors to consider when working out whether you're in a property renovation business or profit-making activity.

Being a personal investor

If you're not intentionally investing to profit from property, you may still be a personal investor.

How the difference affects your tax

The costs and sale receipts from property investment will be treated differently depending on circumstances.

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Property renovating as a business or profit-making activity

Factors to consider when working out whether you're in a property renovation business or profit-making activity.

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Example: renovation business

Example: renovation as a profit-making activity

The importance of each factor can vary depending on individual circumstances, but some of the questions you need to ask about your property renovating activities are:

- Are they regular and repetitive?
- What is their size and scale?
- Are they planned, organised and carried on in a business-like manner?
- Are they carried on for the purpose of making a profit?
- Do you rely on the income you receive to meet your and your dependants' regular expenses?
- Are they of a similar kind and carried on in a similar manner, to the activities of other property renovating businesses?

However, you are likely to be carrying on a profit-making activity if you acquire a property with the intention of renovating and selling it at a profit, and you go about the process in a business-like way.

Example: renovation business

Tony is a carpenter. After reading the *Investors Club News*, he decides to purchase a property. He thoroughly researches the real estate market, attends investment seminars and records the information he's found.

The property Tony purchases is in a good location but he pays a reduced price because it needs extensive renovation. Using his knowledge and contacts within the building industry, Tony quickly completes the renovations and sells the property at a generous profit.

Using the proceeds from the sale Tony purchases two more houses that require renovation.

Tony sets up an office in one of the rooms in his house. He has a computer and access to the internet so he can monitor the property market. Tony's objective is to identify properties that will increase in value over a short time once he has improved them. He leaves his job so he can spend more time on his research and renovations.

Tony's activities show all the factors that would be expected from a person carrying on a business. His property renovating

operation demonstrates a profit-making intention, and there is repetition and regularity to his activities. Tony's activities are also organised in a business-like manner.

Therefore, Tony is regarded as being in the business of property renovation.

Example: renovation as a profit-making activity

Fred and Sally are married with two children. They renovated their home, substantially increasing its value. After watching many of the home improvement shows and seeing how other people have bought, renovated and sold properties for a significant profit, they decide to investigate the purchase of another property to renovate and make a profit.

They consider many properties, costing out the renovations, costs of buying and selling, and timeframes to complete the renovations. Their research shows that they could make a significant profit.

They sell their current home and purchase a new property which they move into while completing the renovations. They plan out the renovation in stages, including the costs and any contractors needed to complete the work. The renovation runs to schedule and when completed they list the property for sale. The property sells for a profit.

The property renovation activities were planned, organised and carried on in a business-like manner; the purpose of buying the property was to renovate it and make a profit; and the renovations were carried on in a similar manner to other property renovation businesses.

Therefore, Fred and Sally have entered into a one-off profit-making activity.

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Being a personal investor

If you're not intentionally investing to profit from property, you may still be a personal investor.

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A personal investor can be described as buying and renovating a property without the intention of selling it, but subsequently gaining a profit from its sale regardless.

Example: personal investor

Doug is a sales representative. He gets an investment loan and buys a property that he intends to rent out. He wouldn't consider selling the property unless the price rose significantly.

The property requires renovation before it would attract desirable tenants. Doug renovates the property after work and on weekends. Over the period of the renovation, the real estate market booms and Doug decides to sell the property.

Doug would **not** be considered to be in the business of property renovation because:

- he didn't intend to make a profit from buying, renovating and selling the property when he bought it.
- he didn’t rely on the income of the sale to meet regular expenses, as he has income from his job.
- his renovation activities were not carried out in a business-like manner.

Doug didn't buy the property with the aim to sell it at a profit, and didn't carry out a one-off profit-making activity. Therefore, Doug is regarded as a personal investor.

However, if Doug, because of his success with this renovation (either in his own right or with another or others) was to then

undertake another renovation similar to the first with the aim of achieving the same profit levels, he will be regarded as being in the business of property renovation.

If your circumstances are complex and you can't determine whether or not you're in a business or profit-making activity, or whether you have undertaken a substantial renovation for goods and services tax (GST) purposes, you can **request a private ruling** to determine how your income and expenses are treated for tax purposes.

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How the difference affects your tax

The costs and sale receipts from property investment will be treated differently depending on circumstances.

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Carrying on a business of property renovation

If you're carrying on a **business of property renovation**, your position may be briefly summarised as:

- The purchased properties are regarded as trading stock (even if you live in the property for a short time).

- The costs associated with purchasing the properties, and in renovating them, form part of the cost of the properties which are held as trading stock until sold.
- The costs of unsold properties remain in the closing stock on hand amount.
- You work out your annual profit or loss from your business by reducing the receipts (such as money or other goods of value) from the sale of each property by
  - the cost of the properties sold (after adjusting for the difference between your opening and closing stock)
  - other costs incurred in selling the properties and running the business.
- Your business profit or loss is included in your income tax return (a loss can reduce your other income for the year).
- The capital gains tax provisions (CGT) do not apply to assets that are held as trading stock. Further, capital gains tax concessions such as the capital gains tax discount, small business concessions and main residence exemption **do not** apply to any income from these properties.
- You are entitled to an Australian business number (ABN).
- You may be required to register for the GST if you are conducting an enterprise of renovation to real property that is defined as having been substantially renovated.

An enterprise is an activity or a series of activities, done in the form of a business or in the form of an adventure or concern in the nature of trade.

Carrying out a profit-making activity

If you carried out a **profit-making activity of property renovation**, your position may be briefly summarised as:

- Your net profit (or loss) is included in your income tax return – it is calculated as the difference between your receipts (such as money or other goods of value) from the sale of the property and the costs incurred in buying, holding, renovating and selling the property.

- The CGT discount and the main residence exemption do not reduce your net profit.
- If you make a net loss, it can reduce your other income for the year.
- You can also make a capital gain or capital loss from the property – however, your capital gain or capital loss is effectively reduced by any amount of net profit or net loss included in your return.
- In the unusual case that your capital gain exceeds your net profit, other capital gains tax concessions may apply.
- You are entitled to an ABN.
- You may be required to register for the GST if you are conducting an enterprise of renovation to real property that is defined as having been substantially renovated.

An enterprise is an activity or a series of activities, done in the form of a business or in the form of an adventure or concern in the nature of trade.

Personal investor

If you are a **personal investor**, your position may be summarised as:

- You will make a capital gain if your receipts (such as money or other goods of value) from the sale of the property exceed the cost of its purchase and other costs such as those associated with buying and selling the property.
- A capital loss from the sale of your property cannot be offset against other assessable income, but can reduce any capital gains that you make in the same year, or may be carried forward to offset against future capital gains.
- Capital gains tax concessions such as the CGT discount and the main residence exemption may apply to reduce your capital gain.
- Your capital gain or capital loss is taken into account in completing the capital gains tax item in your income tax return.
- You are not conducting an enterprise for GST purposes.
- You will not be required to register for GST.

- If you are registered for GST, you will not be required to include the receipts received from the sale of the property on your GST activity statement.

If you are a personal investor, you may be entitled to an exemption from capital gains tax for your main residence.

Are you entitled to an exemption from tax?

If you are a **personal investor**, you may be entitled to an exemption from capital gains tax. One of the most common exemptions is the main residence exemption.

If the property had a dwelling which you occupied as your home (**main residence**), a full main residence exemption is likely to apply if the dwelling:

- is your home for the full period you own it (ownership period)
- has not been used to produce assessable income – for example, a business is run from it or it is rented out
- is on land that is not more than two hectares (approx. 4.9 acres).

If these conditions apply only partly to your property, a partial exemption may apply.

The capital gains tax property exemption tool can help you work out your proportion of main residence exemption.

Example: personal investor entitled to an exemption from tax

Mary is an advertising executive. She buys a run-down property that is located close to her workplace and moves in straight away. Over the following few years she has a new kitchen and bathroom put in, an internal wall removed to create more space and paints the house inside and out.

Due to a work transfer, Mary sells her home. Although Mary is a personal investor, she has lived in the property for the entire time she owned it, she has not used it to produce assessable income,

and the land area is less than two hectares. Therefore, she is entitled to the main residence exemption from CGT.

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