


TA 2014/1 - Trusts mischaracterising property development receipts as capital gains

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Taxpayer Alert

TA 2014/1

FOI status: may be released

TITLE: Trusts mischaracterising property development receipts as capital gains

Taxpayer Alerts are intended to be an early warning of our concerns about significant or emerging higher risk planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes arrangements where property developers use trusts to return the proceeds from property development as capital gains instead of income on revenue account.

What is the issue?

This Taxpayer Alert describes an arrangement whereby a trust (commonly a special purpose or new trust) undertakes property development activities as part of its normal business. The developed property, which could be either commercial or residential in nature, is subsequently sold and the proceeds are returned on capital account, resulting in access to the general 50% capital gains discount.

The proceeds are not returned as ordinary income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997), either on a gross basis (as part of a business of property development, where the underlying property constitutes trading stock for the purposes of section 70-10 of the ITAA 1997) or on a net basis (as part of a profit making undertaking).

Description

This Taxpayer Alert applies to arrangements which display all or most of the following:

1. An entity with experience in either developing or selling property, or in the property and construction industry, establishes a new trust for the purpose of acquiring property for development and sale.
2. In some cases the trust deed may expressly state that the purpose of the trust is to hold the developed property as a capital asset to generate rental income. In other cases the trust deed may be silent as to its purpose.

3. Activity is then undertaken in a manner which is at odds with the stated purpose of treating the developed property as a capital asset. For example:
 - Documents prepared in connection with obtaining finance for the development may indicate that the dwellings constructed on the land are to be sold within a certain timeframe and that the proceeds are to be used to repay the loan.
 - Communication with local government authorities overseeing building approvals may describe the activity as being the development of property for sale.
 - Real estate agents may be engaged early in the development process, and advertising to the general public may indicate that the dwellings/subdivided blocks of land are available to be purchased well in advance of the project's completion, including sales off the plan.
4. The property is sold soon after completion of the development, where the underlying property may have been held for as little as 13 months.
5. The trustee treats the sale proceeds as being on capital account, and because the trustee acquired the underlying property more than 12 months before the sale, it claims the general 50% capital gains tax discount (in other words, it treats the gain/profit in respect of each sale as a discounted capital gain).

What are the ATO's concerns?

The ATO considers that arrangements of this type give rise to various issues relevant to taxation laws, including whether:

- (a) the underlying property constitutes trading stock for the purposes of section 70-10 of the ITAA 1997 on the basis that the trustee is carrying on a business of property development,
- (b) the gross proceeds from sale constitute ordinary income under section 6-5 of the ITAA 1997 on the basis that the trustee is carrying on a business of property development,
- (c) the net profit from sale is ordinary income under section 6-5 of the ITAA 1997 on the basis that, although the trustee is not carrying on a business of property development, it is nevertheless involved in a profit making undertaking.

What is the ATO doing?

The ATO has commenced a number of audits and has made adjustments to increase the net income of a number of trusts. Audit activity will continue.

What should you do?

If you have entered into a similar arrangement to that described in this alert you may wish to seek independent professional advice. If you would like to correct something in your tax return, more information is available on our website ato.gov.au and search for [Correcting your tax return or activity statement](#).

You may also ask us for our view through a private ruling or contact the officer named in the Taxpayer Alert. More information on private rulings is available on our website ato.gov.au and search for [How to apply for a private ruling](#).

Frequently asked questions

Who should I contact if I have information about the arrangement?

If you have any information about the current arrangement, phone us on 1800 060 062. Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 68 (Fast Key Code **3 4**).

Can I self-amend?

If you detect an error you may self-amend to correct your tax return, if within the time period allowed by the law. Self-amending to correct your tax return will avoid penalties.

More information on correcting your return and amendment periods is available on our website ato.gov.au and search for [Correcting your tax return or activity statement](#).

How do I make a voluntary disclosure?

Any penalty relating to your involvement will be significantly reduced if you make a voluntary disclosure. Generally, the reduction is greater if you make the disclosure *before* we notify you of an examination of your tax affairs (eg an audit).

More information on voluntary disclosures is available on our website ato.gov.au and search for [Make a voluntary disclosure](#) or phone **13 28 61**.

What penalties could apply?

If you participate in an arrangement similar to that described in this Taxpayer Alert, and do not have a private binding ruling or class ruling in respect of your arrangement, it is possible that you may become liable to penalties (in addition to being required to pay any tax that is avoided) should the ATO review your tax affairs.

More information on penalties is available on our website ato.gov.au and search for [Penalties and interest](#). In deliberate cases, penalties of up to 75% of the tax avoided can apply.

For further information see Miscellaneous Tax Ruling [MT 2012/3](#).

Where can I find out more about Taxpayer Alerts?

Further information on Taxpayer Alerts, including circumstances in which one may be withdrawn, can be found in Law Administration Practice Statement [PS LA 2008/15](#).

A full list of [Taxpayer Alerts](#) issued by the ATO is available on our website, ato.gov.au.

Amendment history

| Date | Comment |
|-----------------|-------------------------------------|
| 19 January 2024 | Updated ATO tip-off hotline numbers |

References

Subject References:

- capital gains
- property development receipts
- special purpose trusts

Legislative References:

Income Tax Assessment Act 1997

- [Section 6-5](#)
- [Section 70-10](#)

Related Practice Statements:

- [PS LA 2008/15](#)

Related Rulings/Determinations:

- [MT 2012/3](#)
- [TR 92/3](#)

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