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325 | Property Development 101

How should you structure property development?

Property Development 101

How would you structure a property development project for tax purposes? Not that you would ever structure something just for tax. Of course tax is just one factor of many you need to consider.

In this episode let's look at the basics. What types of developers are there and what are their tax needs? Should you use a unit trust or a company? Where is the line between capital and income? And when would you use a call option or a bare trust?

These are just some of the questions Andrew Andreyev of Andreyev Lawyer in Sydney will discuss with you in this first episode about property development.

Here is what we learned but please listen in as Andrew explains all this much better than we ever could.

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Property Development

Property development is a huge topic. You have Mums and Dads who subdivide their block all the way to large ASX-listed national companies. So to ring-fence, this, let's just look at the residential development.

Types of Developers

There are five types of developers – roughly speaking – just to break this huge topic into smaller chunks.

1 – Amateurs

First or second timers as a side hustle and not their main income, for example, mum & dads subdividing their block or a tradie or accountant with some previous exposure, a day job and a passion for property.

2 – Professional Builders

The second group are professional builders who are usually on a fixed fee or materials+plus contract arrangement and want to go beyond that running the show. They often do 2-storey developments or up to 10 allotments.

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3 – Mid-Tier

The mid-tier group often do urban multi-story (3 to 15, possibly up to 20 residential floors) with a project value of $20m to 45m, 2 or 3 stage subdivisions and in-fill urban development.

4 – Big Privates

Then you have the big private family-owned development companies, like the Meritons. They are doing land banking, 10 to 40 storey buildings and broad acres subdivisions.

5 – Listed National Developers

And then there are the ASX listed large national developments. Lend Lease, Sunland, Peet, Cedar Wood – major national developers.

Common Issues and Interests

There are some issues that affect all five groups.

1 – Capital v Income
2 – Holding Costs
3 – Funding (Capital or Debt)
4 – Asset Protection
5 – Losses

1 – Capital v Income

Property development is usually on income and rarely on capital. The only time it would be definitely on capital is if you renovate or extend your own home.

So you have three stages. Land coming into the property development, construction and then the land coming out of the property development.

1 – At the beginning, you have a capital asset, for example, a farmer with land held in a separate trust or a family with a corner block held in individual names.

2 – Then you have the capital asset coming into the development phase and changing from a capital asset to income, along with the relevant CGT event. This is a very active time of getting planning permits, engaging builders and trades, actually building the thing.

3 – And then you have the disposal or change of use, where the property goes from income back to capital.

2 – Holding Costs

While you hold the property on income, it is inventory, so you get a tax deduction for the costs you incur but then you have to add back the change in inventory. But it does give you the opportunity to recognise losses.

3 – Funding

Property development comes with funding constraints, especially among the smaller groups. Funding comes either through debt (banks and suppliers), equity (investors as shareholders or unit holders) or through a partnership with another party.

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4 – Asset Protection

The banks will often take security over the whole group and not just the particular project.

The mid-tier developers usually have a treasury/holding company at the top that pulls the profits out of the project companies below and hence protects them from creditors of those companies.

Then you have a development company that actually runs the different development projects and then – to the side as sister companies to the development company – you have a separate special purpose vehicle (SPV) for each project. The SPV's are there to ring-fence each project from other creditors.

5 – Tax Losses

And then for tax you consolidate the whole group so that any losses in a SPV can be offset with any profits in other companies.

And if you are in a partnership with another party, you make it a partnership of companies or trusts so that each partner can use their share of losses in other projects.

So this is just a short summary of the learnings we took away from this episode. Please listen in since Andrew Andreyev goes into a lot more detail in this episode and explains this much better than we ever could.

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