

CGT on subdivided PPOR

Michael Quinn explains capital gains tax implications when subdividing your residential property

The complex web of tax obligations, eligibility for exemptions, concessions and deductions in relation to investment properties and principal places of residence can be daunting at best for many aspiring property investors. And if that was not enough, it gets even trickier if you choose to then subdivide your existing property – particularly in regards to capital gains tax (CGT).

Whether it is your principal place of residence (PPOR) or an investment venture, there are both tips and pitfalls to be aware of. Conditions and criteria differ depending on whether there is a house on the land, and whether you sell the part with the house or the part

without the house. Or perhaps you are planning to build and move in, rent it out, or even sell it straight away. It is hard enough to just explain all of the possibilities – and we haven't even started on the tax bit yet!

It is situations such as these that require the advice of professional accountants, lawyers and finance advisors. With expert advice you can not only achieve your dreams for the property, but you can potentially save fistfuls of cash in the process by legally minimising your payment obligations.

For an example of the most common subdivision situations and the CGT and tax deductions that apply (or do not apply) see the box below.

How it works in real life

A good example of subdivision and sale of land separately from the house is provided below.

Example

Lauren bought a house on a one acre block of land in June 2004 for \$350,000. The house was valued at \$120,000 and the land at \$230,000. When purchasing the property, Lauren incurred \$12,000 in stamp duty and legal fees. Since the purchase, Lauren lived in the house as her main residence.

In January 2005, Lauren subdivided the land into two blocks of equal size. She incurred \$10,000 in survey, legal and subdivision application fees and \$1,000 to connect water and drainage to the rear block. In March 2005, she sold the rear block for \$150,000 (her home being on the front block).

As Lauren sold the rear block of land separately, the main residence exemption does not apply to that land. She contacted several local real estate agents who advised her that the value of the front and back blocks were equal. Therefore, Lauren apportioned the original cost of the land (\$230,000) equally between the two blocks (\$115,000 each). Lauren incurred \$3,000 legal fees on the sale.

The cost base of the rear block is calculated from incurred expenses, as follows:

Cost of the land	\$115,000
50% of \$12,000 stamp duty and legal fees on purchase	\$6,000
50% of the \$10,000 cost of survey, legal and subdivision application fees	\$5,000
Cost of connecting water and drainage	\$1,000
Legal fees on sale	\$3,000
Total cost base	\$130,000

The capital gain on the sale of the rear block is calculated as follows:

Sale price of \$150,000 – Cost base of \$130,000 = Capital gain of \$20,000

When Lauren sells her home (on the front block) she will get the full main residence exemption for it if she wholly uses it as her main residence during all of her ownership period. If the block you are subdividing was purchased or given to you before 20 September 1985, CGT does not generally apply. However, if after that date you had a building (such as a house) constructed on the land or made major renovations to the property, the improvements may be subject to CGT when sold.

Tax deductibility: As it is your PPOR, expenditures on your house are not tax deductible.

Subdividing and selling your current PPOR CGT liability

You are generally eligible for a full CGT exemption upon the sale of your principal place of residence, provided that you satisfy the conditions for the main residence exemption.

However, when it comes to subdividing and selling off individual portions, your eligibility for the full main residence exemption on the sale of the land can be affected if you sell the land that is surrounding or adjacent to your dwelling separately from your home. Land is considered to be adjacent to your home if it is close to, near, adjoining or neighbouring it.

If you sell any adjacent land in a separate transaction from your principal place of residence, then the capital gain that you make on the sale of the land is not exempt from CGT. Land only qualifies for the full exemption when it is sold with the home that is your main residence.

It should be noted that simply subdividing your original piece of land does not result in a CGT event; it is only the actual sale of the individual divisions that triggers a CGT event. As a result you will either make a capital gain or capital loss when you dispose of any of the subdivided blocks.

For the purpose of calculating CGT obligations, the date you acquired the subdivided blocks is considered to be same as the date that you acquired the original whole parcel of land. When calculating the CGT that is payable, the cost base or reduced cost base of the original land is divided between the subsequent blocks on a 'reasonable basis'. That is, the cost base or reduced cost base is not obtained by a revaluation of the blocks at the time of subdivision, but rather as a relevant proportion of the value of the land when it was purchased.

Building a new dwelling on a piece of the subdivided land CGT Liability

Generally speaking, if you choose to build a dwelling on land that you already own, the land does not qualify for a CGT exemption until the dwelling is considered to become your main residence for CGT purposes.

In some instances though, you can

choose to treat the land as your main residence for up to four years before the physical dwelling becomes your main residence. You must acquire an ownership interest in the land (this usually means you have a legal or equitable interest in it or have the right to occupy it) and you must either:

- build a dwelling on the land,
- repair or renovate an existing dwelling on the land, or
- finish a partly constructed dwelling on the land

Then you may be able to elect for this exemption to apply to your situation.

There are a number of conditions that you must satisfy before you can claim the exemption. Firstly, you must finish building, repairing or renovating

is fully exempted and the land proportion is exempted subject to the above conditions.

Tax deductibility

If you choose to treat land and the house you are about to build on the land as your main residence, you are not allowed to deduct the expenses related to either the land or the house at financial year end. However, the costs can be counted into the cost base. They can reduce your capital gain tax liability if you later on decide to rent the new house out. Also, the subdivision and sale of land for the purpose of making a profit and carrying on an enterprise may be considered as ordinary income instead of as a capital gain or loss.

As you can see there are no hard and

When calculating the CGT that is payable, the cost base or reduced cost base of the original land is divided between the subsequent blocks on a 'reasonable basis'

the dwelling and then move into the dwelling as soon as practical after it is finished, and continue to use the dwelling as your main residence for at least three months after it becomes your main residence.

If you satisfy this criteria, the land – including the dwelling that is being built, renovated, repaired or finished on it – is exempt for the shorter of:

- the four year period immediately before the date the dwelling becomes your main residence, or
- the period between the date you acquired the land and the date the dwelling becomes your main residence

However, if after you acquired the land you or someone else occupied a dwelling that was already on the land, the period of exemption starts from the date that dwelling was vacated by the previous owners or occupants.

If you decide to sell both the house and land at a later date and the house has been your main residence before you sell it, the house proportion

fast rules that apply when it comes to CGT and subdivided property. It is for this reason it is extremely important that you seek professional advice if you are considering subdividing your existing land, or if you have already subdivided and are looking to sell some of it off. A lawyer will be able to advise you in relation to contracts and the best way to carry out any required divisions, while tax professionals and financial advisors will be able to assist you with crunching the numbers and maximising your financial gains (or minimising your losses) on any planned transactions. ■

Michael Quinn, Director of The Quinn Group, is an experienced lawyer, accountant and educator. If you would like further information or assistance, Michael and the team of legal and accounting professionals at The Quinn Group can be contacted by calling 1300 QUINNS or visiting the website www.quinns.com.au.

