

Building a Duplex



There are just so many tax traps when building a duplex that you must see a property savvy Accountant before you begin. These issues cover a common wall duplex through to building another house on your land by creating a battle-axe block, too looking at when you create two or more titles with a house on each whether it be by subdivision or strata plan.

Demolishing Your Home:

The big issue here is if you demolish your home you will lose your main residence exemption retrospectively. The main residence exemption attaches to the dwelling not the land. Once that dwelling is destroyed the main residence exemption is lost forever.

The ATO considered this an unintended consequence of the law and issued ID 2003/232 as a concession that in limited circumstances the project could be treated simply as a renovation rather than destroying the dwelling. That ruling has since been withdrawn leaving you two options, work out a way of keeping part of the original home in your new home or apply for your own ruling quoting ID 2003/232. Even though it is withdrawn the ATO did not say it has changed its mind.

Build a Duplex Live in One Sell the Other:

This is where the serious tax bills hit you, as this is a profit making scheme. Here is a quote from MT 2006/1.

<https://www.ato.gov.au/law/view/document?Docid=MXR/MT20061/NAT/ATO/00001>

Entitled to an ABN is ATO speak for GST is payable and the profit on the unit is taxed as normal business income with no 50% CGT discount.

Example 29

273. Tobias finds an ocean front block of land for sale in a popular beachside town. He devises a plan to enable him to afford to live there. He decides to purchase the land and to build a duplex. He plans to sell one of the units and retain and live in the other. The object of his plan is to enable him to obtain private residential premises in an area that would otherwise be unaffordable for him.

274. Tobias carries out his plan. He purchases the land, and lodges the necessary development application with the local council. The development application is approved by the council, Tobias engages a builder and has the duplex built. He sells one unit, and lives in the other.

275. Tobias is entitled to an ABN. His intentions and activities have the appearance of a business deal. They are an enterprise.

276. Further, there is a reasonable expectation of profit or gain (see paragraphs 378 to 405 of this Ruling) as his plan has enabled him to be able to keep and live in one of the units.

The trap here is if poor Tobias does not realise GST applies before he sells the unit then he won't have claimed GST back on the construction costs or put a margin scheme clause in the contract. All his profit may well be lost in GST. Using the margin scheme would have allowed him to only have to pay GST on the difference (margin) between the selling price and half of the original purchase price of the land, but the buyer has to agree.

Building a Battle-Axe:

You are only able to cover one of the dwellings with your main residence exemption and you must have lived in it. Just because the back yard was once part of your main residence does not give it any protection under your main residence exemption because it is no longer attached to that dwelling. You have to go right back to its share of the original price you paid as the first element of your cost base. You may get the 50% CGT discount on the gain up until you committed the land to the project but any gain on the market value from that date is taxed as normal business income, so no 50% CGT discount.

It is the building that makes your activities business like, going beyond that of simply getting the property ready for sale. Generally, if you do nothing more than what the council require to subdivide the block and then sell vacant land, you are not considered to be in business, if you did not originally buy the property to subdivide.

If you buy a property with the intention of developing it and selling it for a profit then you are going to be considered in a business no matter how basic your activity is. If instead you purchased the property as your home and much later, maybe as part of a lawn reduction project decided to cut off the back yard then you are merely realising an asset, not in business. Not being in a business means you can qualify for the 50% CGT discount and may help you with GST.

Here is the tricky bit on GST. Vacant land is subject to GST but if the owner is not registered for GST and not required to be registered for GST then the owner will not have to pay GST. To be required to register for GST your turnover of supplies subject to GST (residential rental income is not subject to GST) needs to exceed \$75,000 (GST exclusive). If you build on the block to sell then the house is your business' trading stock so its sale is counted as part of your turnover and you are required to register for GST. It is the fact you have gone beyond merely selling off an asset to building a spec home. On the other hand if you just sell the land you have cut off from your home block then it is not part of your turnover and does not count towards the \$75,000 test. There is of course a trap for those who may already be registered for GST. Then even the sale of a capital asset such as vacant land is caught for GST. Your only chance here is to argue that the land is not part of the enterprise that is registered for GST.

Alternatively, you could consider selling your original house fully protected by the main residence exemption and move into the new house as your home. Your old house would not be subject to GST because it is not the first sale of that land and building. As long as you legitimately built the new house to live in as your home, its eventual sale will not be subject to GST either. But the new house will be exposed to CGT from the day you originally purchased the property with the main residence exemption only applying to a percentage of the gain. So make sure you keep records of all expenses right down to cleaning materials and lawn mower fuel. There is a small exception if you have owned the whole property for less

than 4 years before you move into the new house. You can cover the new house with your main residence exemption right back to the original purchase date but at the expense of exposing the old house to CGT.

Please note this is all just enough information to help you find a property savvy Accountant, the devil is in the detail.