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The tax implications of subdividing your backyard

Subdividing your PPOR (principal place of residence) is a strategy we often get asked about. If you're thinking about going down this path, there's a lot to consider before making your decision.

By Pat Mannix and Rebecca Mackie

There are many different strategies with different outcomes, depending on whether you're planning to sell the part with the house, or the vacant land, or build and move in, build and rent out or build and sell straight away. All these are options to consider and each has its own tax issues!

An example of the most common subdivision situation and the capital gains tax and tax deductions is set out below:

SUBDIVIDE AND SELL VACANT LAND

Jacinta purchased a half-acre block with a house in 2012 for $600,000. At that time the house was valued at $180,000 and the land at $420,000. Jacinta incurred stamp duty and conveyancing fees of $32,000.

In 2014 Jacinta subdivided the land into two equal blocks. The costs associated with subdivision totalled $16,000 and included application fees, survey and legal fees. She also paid $2000 to have water and drainage connected.

In January 2015 Jacinta sold the vacant block for $400,000. The main residence exemption can't apply to vacant land so Jacinta will have a CGT liability. She contacted a couple of real estate agents and was advised that the two blocks are equal in value so the original cost of the land can be split equally.

There were real estate agents fees of $10,000 and legal fees of $1000 associated with the sale.

The cost base of the rear block is calculated as follows:

Cost of the land (50% of land value at purchase of $420,000)	**$210,000**
50% of the stamp duty & legal fees on purchase	$16,000
50% of the subdivision costs	$8,000
Cost of connecting water and drainage	$2,000
Agents fees and legal fees on sale	$11,000
TOTAL COST BASE	$247,000
Sale price	$400,000
Less: cost base	$247,000
GROSS CAPITAL GAIN	$153,000

Capital Gains Tax

Jacinta will be entitled to the 50 per cent capital gains tax discount, as she has owned the above land for more than 12 months. The remaining capital gain of $76,500 will be added to her taxable income and taxed at her marginal rate. When we're talking about dates for this CGT discount, we're referring to the contract dates, not settlement dates.

It's important to note that the subdivision itself does not trigger any CGT liability; it's only the actual sale (and change of ownership) that results in a CGT event.

Should Jacinta decide to sell her home in the future, she will still be entitled to the full main residence exemption, assuming she hasn't used the property to produce assessable income.

Other tax considerations

If Jacinta had built on the back block and sold that new property she may have found she had a GST liability to consider as well as tax, which can make a huge difference to your profits. However, if she built on the back and moved in, or rented it out for a few years, then when she sells she shouldn't have any GST liability.

As always, everyone's situation is different and you should discuss your specifics with your accountant and/or financial adviser, crunch some numbers and check out different scenarios before making any decisions.

Pat Mannix and Bec Mackie *have been operating Gatherum-Goss & Assoc for more than seven years and both have extensive experience dealing with tax and structuring advice for investors. For more information, go to www.gatherumgoss.com*