

15 May 2026

Mr Dean Karlovic

Australian Taxation Office

Email: [Dean.Karlovic@ato.gov.au](mailto:Dean.Karlovic@ato.gov.au)

Dear Mr Karlovic,

**RE: SUBMISSION ON DRAFT PRACTICAL COMPLIANCE GUIDELINE PCG 2026/D2**

I refer to the Australian Taxation Office's invitation in paragraph 60 of ***Draft Practical Compliance Guideline PCG 2026/D2*** (the "Guideline") for comments on the application of Part IVA of the ***Income Tax Assessment Act 1936*** (Cth) (the "ITAA 1936") to property development arrangements involving long-term construction contracts.

**The Developer Does Not Derive Income Before Completion**

1. The PCG asserts at paragraph 42 that "it is likely that income has been derived by the developer progressively". The PCG offers no authority for this proposition. This proposition is implicit in the Commissioner's characterisation of there being an issue with the developer deriving income at a period subsequent to the developer claiming deductions for outgoings in paragraph 19 and the Red Zone examples. I submit that the proposition is contrary to authority:
  - 1.1. Under section 6-5 of the ***Income Tax Assessment Act 1997*** (Cth) (the "ITAA 1997"), assessable income includes ordinary income derived during the income year. The question for a developer on an accruals basis is therefore not whether work has physically progressed, but whether, in the relevant income year, an amount has been derived according to ordinary concepts, including by reason of a presently existing right to payment. The High Court in *Henderson v Federal Commissioner of Taxation* (1970) 119 CLR 612 ("*Henderson*") established that, for an accruals-basis taxpayer, fees are derived when they have matured into recoverable debts. The ATO's own materials state the *Henderson* principle by reference to fees that have "matured into recoverable debts". That is the relevant test for present purposes;
  - 1.2. That is the position the Commissioner himself adopted in Taxation Ruling TR 93/11. Paragraphs 3 and 12 of TR 93/11 state the Commissioner's view that, for an accruals-basis taxpayer, income is derived when a recoverable debt is created; paragraph 12 of TR 93/11 states:

*A fee is 'recoverable' in the relevant sense even if time to pay has been allowed (Henderson's Case per Barwick CJ 119 CLR at 651; 70 ATC at 4020; 1 ATR at 601).*

- 1.3. In other words, derivation depends on the right to be paid, not on work performed. Paragraph 4 of TR 93/11 adds a qualification: the terms of a contract or arrangement are "only indicative" and must be considered with all relevant facts and circumstances. Paragraphs 5 to 7 of TR 93/11 are instructive on the range of possible contractual outcomes: a recoverable debt may arise only when the client is billed; or only when work is wholly completed; or progressively on the occurrence of nominated periods, actions or events, depending on what the contract provides. That contractual framework is precisely why the Guideline should not assume progressive derivation without identifying a contractual trigger for payment. That qualification is important: the ATO may contend that a PDA's completion-payment clause is not conclusive if, in substance, rights to payment or reimbursement accrue earlier. On the proper construction of a PDA that confers no entitlement to bill before completion and no certification milestones, no income has been derived. The Commissioner's assertion at paragraph 42 of the Guideline that income is "likely" to have been derived progressively cannot be reconciled with this authority. The Guideline does not identify, on any view of the contract, that the developer has acquired a presently existing right to be paid. Without that right, no income has been derived.
- 1.4. The Full High Court in *Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation* (1965) 114 CLR 314 ("*Arthur Murray*") applied the same approach in the converse direction. The taxpayer received fees in advance for dance lessons not yet given. The Court held the fees were not derived on receipt. Barwick CJ, Kitto and Taylor JJ said (at 318):
- the question is whether, in the circumstances, it may properly be held that receipt without earning makes income.*
- 1.5. Their Honours answered no. Receipt without earning does not make income. The corollary I draw, consistently with *Henderson* and TR 93/11, is that performance alone should not be treated as derivation unless the taxpayer has received an amount or obtained a presently existing right to receive it. The Court further explained:
- in determining whether actual earning has to be added to receipt in order to find income, the answer must be given in the light of the necessity for earning which is inherent in the circumstances of the receipt.*
- 1.6. Where a developer is performing under a property development agreement that provides for payment only on completion, the developer has neither received the contract sum nor earned a right to it. There is nothing that is income.
- 1.7. Taxation Ruling TR 2018/3 does not assist the Commissioner. The Ruling identifies two acceptable methods for income recognition under long-term construction contracts. The basic approach states at paragraph 7:
- All payments received or receivable are returned as assessable income in the year in which they are derived and expenditure is deductible in the year in which it is incurred.*
- 1.8. TR 2018/3 does not assist the Commissioner unless the actual PDA gives rise to amounts received, receivable, billed, billable, certified, or otherwise derived by the developer in the relevant income year. The question is the anterior one: is there an amount that, on the proper construction of the contract, is derivable progressively?

Where the answer is yes, TR 2018/3 governs the timing of derivation and the completed-contracts basis is unacceptable. Where the answer is no, there is no amount to defer, and TR 2018/3 has no purchase. The Guideline at paragraphs 42 and 43 assumes the answer to that anterior question without identifying any contractual trigger that would produce a progressive entitlement on the PDA in question. I acknowledge that TR 2018/3 states that the completed-contracts basis, and a variation that claims deductions as incurred while deferring contract amounts until completion or substantial completion, are unacceptable for long-term construction contracts. My submission is not that a taxpayer may adopt such a method contrary to TR 2018/3. It is that the Guideline should identify the legal source of the developer's progressive entitlement before treating physical construction progress as progressive derivation. TR 2018/3 also confirms at paragraph 9 that assessable income includes amounts "billed or billable" for work carried out and certified, and that a taxpayer cannot defer assessment by postponing billing where there was a contractual entitlement to bill. That confirms that the test is entitlement-based. Paragraphs 42 and 43 of the PCG do not identify any specific contractual trigger (no billing right, no certification milestone, no progress-claim provision) that would cause income to be derived before completion under the actual PDA. Without identifying that trigger, the Guideline cannot rely on TR 2018/3 to support progressive derivation. Indeed, paragraph 15 of TR 2018/3 confirms that work in progress under a long-term construction contract is not trading stock under the income tax law:

*Work-in-progress does not represent trading stock. Work-in-progress is not on hand in the sense contemplated by Subdivision 70-C of the ITAA 1997.*

- 1.9. TR 2018/3 paragraph 15 confirms that work in progress under a long-term construction contract is not trading stock on hand for the purposes of Subdivision 70-C of the ITAA 1997. That confirmation is relevant to the trading stock analysis below; it does not displace the anterior question whether income has been derived.

### **The Development Costs Do Not Capitalise to the Landowner's Trading Stock**

2. The Guideline's second substantive premise, embedded in the trading stock observations at paragraphs 19 and 41, is that the landowner should recognise an annual uplift in the value of trading stock attributable to the development. I submit that this premise is contrary to the operation of section 70-45 of the ITAA 1997 in any case where the developer (and not the landowner) has incurred the construction outgoings:
  - 2.1. Section 70-45(1) of the ITAA 1997 provides that the value of trading stock at the end of an income year is the cost, the market selling value, or the replacement value at the taxpayer's election. Section 70-35 adjusts assessable income by reference to the difference between the opening and closing values of trading stock held at year end, with the value determined under section 70-45 at the taxpayer's election. Section 70-35 applies where the taxpayer carries on a business and holds trading stock on hand at the start and end of the income year. This analysis assumes that the land is trading stock on hand of the landowner and that the landowner is carrying on a relevant business. If either assumption is not satisfied on the facts, for example, where the land is held on capital account, the trading stock analysis must be addressed separately: see, by analogy, *Morton v Commissioner of Taxation* [2026] FCAFC 31 (O'Callaghan J, Derrington and McEvoy JJ agreeing). The analysis in this section concerns the cost method under paragraph 70-45(1)(a). The position where the landowner elects market selling value or replacement value under paragraphs 70-45(1)(b) or (c) is a separate question that is addressed in connection with the counterfactual analysis below: a postulate that the landowner *would have* made a different statutory election cannot, by

reason of section 177C(2), ground a tax benefit. Different consequences may arise if the landowner elects market selling value or replacement value under paragraphs 70-45(1)(b) or (c), because section 70-35 then brings to account the difference between opening and closing trading stock values regardless of cost incurred. The cost element under paragraph 70-45(1)(a) refers to the cost incurred by the holder of the trading stock. Whether a particular outgoing forms part of cost is a question of who has incurred the relevant expenditure on the relevant trading stock asset.

- 2.2. The High Court in *Federal Commissioner of Taxation v James Flood Pty Ltd* (1953) 88 CLR 492 (“*James Flood*”) set out the principle that informs whose outgoing an item is. Their Honours, citing *New Zealand Flax Investments Ltd v Federal Commissioner of Taxation* (1938) 61 CLR 179, 207 (Dixon J), said (at 506):

*To come within that provision there must be a loss or outgoing actually incurred. ‘Incurred’ does not mean only defrayed, discharged, or borne, but rather it includes encountered, run into, or fallen upon. It is unsafe to attempt exhaustive definitions of a conception intended to have such a various or multifarious application. But it does not include a loss or expenditure which is no more than impending, threatened, or expected.*

- 2.3. In *James Flood*, the High Court held that a taxpayer has incurred a liability only where it has completely subjected itself to that liability. Although *James Flood* concerned deductibility, the same “incurred” concept applies where the Commissioner’s trading stock analysis depends on identifying whose outgoing has entered into the cost of the relevant trading stock. The question remains whether the landowner, as holder of the land, has a presently existing liability for the construction expenditure. Where the developer enters into subcontracts with builders and other trade contractors as principal on its own account, the developer has completely subjected itself to the resulting liabilities. Those outgoings are incurred by the developer and fall to be dealt with in the developer’s tax position. They do not form part of the landowner’s cost of trading stock merely because the expenditure improves land owned by the landowner.

- 2.4. The Commissioner himself has accepted in Taxation Ruling TR 94/26 at paragraph 6 that:

*Whether there is a presently existing pecuniary liability is a question which must be determined in light of the particular facts of each case, and especially by reference to the terms of the contract or arrangement under which the liability is said to arise.*

- 2.5. Whether the development outgoings are the developer’s outgoings or the landowner’s outgoings depends on the contractual arrangement. Where the developer is the principal under the construction contracts, the outgoings are the developer’s. They are deductible to the developer under section 8-1 of the ITAA 1997 against the developer’s assessable income (which includes the development fee payable by the landowner). They do not capitalise to the cost of the landowner’s trading stock under section 70-45 because the landowner has not incurred them.

- 2.6. This is not an artefact of the structuring; it is the operation of the trading stock provisions on a straightforward set of facts. The Guideline at paragraph 41 acknowledges as much in respect of Example 6:

*Although the landowner elects to use the cost method under paragraph 70-45(1)(a) of the ITAA 1997, no income is returned by the landowner under the trading stock*

*provisions because, under the scheme, the relevant costs are treated as not having been incurred, and therefore not brought to account, until the project is completed.*

- 2.7. With respect, the costs are not “treated” as not having been incurred by the landowner. They have not been incurred by the landowner. They have been incurred by the developer and fall to be dealt with in the developer’s tax position. They do not form part of the landowner’s cost of trading stock merely because the expenditure improves land owned by the landowner. The Guideline’s framing seems to suggest that the costs ought to have been brought to account by the landowner; I submit that they ought not to have been, because the landowner did not incur them.

### **No Substantive-Law Mismatch Capable of Supporting Its Part IVA Analysis**

3. The Guideline’s red zone identifies a “timing mismatch between income recognition and deductions claimed” as one of the cumulative red zone features (paragraph 19). The Guideline acknowledges at paragraph 21 that the substantive provisions are to be considered first:

*When examining and analysing the application of Part IVA to arrangements considered high risk under this Guideline, generally we will consider the application of the relevant substantive provisions of the law that may be applicable to the arrangement first. For example, whether income has been recognised correctly by the developer or whether the trading stock provisions have been applied correctly by the landowner.*

- 3.1. If the substantive provisions are applied as I have set out above, there is no mismatch. The developer has deductions when its outgoings to subcontractors are incurred, and assessable income when its right to be paid by the landowner crystallises (which, under a payment-on-completion contract, is on completion). The landowner has its own land at its own cost as trading stock, with the trading stock cost increasing only by amounts the landowner itself has incurred. The two parties’ tax positions are not mismatched. They are simply the application of two different provisions to two different sets of facts at two different times. That outcome does not, of itself, identify a Part IVA tax benefit. If the Commissioner contends that the arrangement produces a tax benefit, the Guideline should identify the relevant taxpayer, the precise tax benefit, and the reasonable alternative postulate by reference to which the tax benefit is calculated; and
- 3.2. The Guideline does not engage with this point. Each of the red zone examples assumes the substantive provisions produce something other than what they produce. I submit that the Guideline must, before invoking Part IVA, identify the substantive law foundation for the proposition that there is a mismatch to cancel. I submit that there is no such foundation.

### **No Tax Benefit or Reasonable Alternative Postulate**

4. Even if a substantive law foundation could be found for the Guideline’s premises (which I deny), Part IVA also requires the identification of a tax benefit under section 177C of the ITAA 1936. A tax benefit can only be identified by reference to a counterfactual, being an alternative postulate against which the tax position under the actual scheme is to be compared. I submit that none of the candidate counterfactuals implicit in the Guideline can be sustained:

#### **The Counterfactual Problem**

- 4.1. The Guideline does not expressly identify the counterfactual on which its Part IVA analysis depends. The red zone examples at paragraphs 38 to 54 describe the arrangements the Guideline treats as high risk. By comparing those examples with the

green zone and with the Guideline's own commentary, it is possible to identify the counterfactuals the Commissioner implicitly has in mind. I address the three candidate counterfactuals that emerge from that analysis.

- 4.1.1. The first candidate is that the developer would have invoiced progressively rather than on completion. This is the implicit counterfactual in red zone Example 6 (paragraphs 38 to 44), where the PDA permits the developer to invoice progressively but the developer chooses not to do so. The Guideline states at paragraph 44:

*The ATO's approach will be the same regardless of whether this outcome arises because the developer elects not to issue invoices progressively despite being permitted to do so, or because the PDA prohibits the issuing of invoices until project completion.*

- 4.1.2. Payment on completion is a routine commercial term in property development agreements between unrelated parties. The Guideline offers no analysis as to why the same term should be treated as a scheme feature when adopted between related parties. Where payment on completion is the term agreed by the parties, the developer's entitlement to payment crystallises only on completion, and the substantive law produces the income recognition outcome the Guideline labels as a problem (see preceding section). The counterfactual that the developer "would have" invoiced progressively is unsupported by any feature of the actual contract; it is simply a counterfactual that produces the result the Commissioner wants;

- 4.1.3. The second candidate, implicit in red zone Examples 6 and 7 (paragraphs 38 to 54), is that the landowner would have elected market selling value or replacement value under section 70-45(1) rather than cost, thereby recognising annual increases in the value of trading stock as assessable income. Section 70-45 confers an express statutory election. Section 177C(2) of the ITAA 1936 provides:

*a reference to the obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as not including a reference to the obtaining by the taxpayer of a tax benefit in connection with a scheme where ... the tax benefit is attributable to the making of a declaration, agreement, election, selection or choice expressly provided for by this Act, the Income Tax Assessment Act 1997 ... [and] the scheme was not entered into or carried out for the purpose of enabling the taxpayer, or any other taxpayer, to take advantage of the provision of this Act, the Income Tax Assessment Act 1997 ... under which the declaration, agreement, election, selection or choice is made.*

- 4.1.4. Section 177C(2) therefore requires two inquiries. First, is the asserted tax benefit attributable to a statutory choice expressly provided by the Acts, here the cost election under paragraph 70-45(1)(a)? Second, was the scheme entered into or carried out for the purpose of creating the circumstances necessary to enable that choice? The taxpayer's election to use cost under section 70-45(1)(a) is exactly the kind of statutory choice section 177C(2) protects. Where the land was held as trading stock before the property development agreement was entered into, and the landowner's election is merely the ordinary annual election conferred by section 70-45, the election is not a product of the scheme. The Commissioner should not identify a tax

benefit merely by postulating that the landowner would have made a different statutory election. A counterfactual that the landowner would have made a different election that produced more tax cannot ground a tax benefit; and

- 4.1.5. The third candidate, implicit in red zone Example 7 (paragraphs 45 to 50), is that the landowner and developer would have operated as a general law partnership applying the trading stock provisions. The Guideline expressly reserves the right to recharacterise the arrangement as a partnership at paragraph 50 where indicia of partnership exist. This candidate is not an alternative postulate at all. It is a different transaction. I address it separately below.

#### **The Partnership Postulate Is a Different Transaction**

- 4.2. A general law partnership is a fundamentally different commercial arrangement from a property development agreement. The default consequences are governed by the relevant **Partnership Act** of the State or Territory in which the partnership is formed, not by the parties' development agreement. Section 24 of the **Partnership Act 1891** (SA) provides:

*Subject to any agreement, express or implied, between the partners — (a) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses, whether of capital or otherwise, sustained by the firm ...*

- 4.3. That default rule of equal sharing is not the cost-plus return contemplated by a property development agreement. Beyond the profit share, the partnership characterisation has further differences: contribution of the land to the partnership may have transfer duty consequences depending on the jurisdiction and the beneficial interests created or altered; would expose the land to the partnership's creditors and to claims by the developer's personal creditors through the developer's share of the partnership; would alter the security position of any existing financier; and would attach potential partner-liability consequences to the partners under the applicable **Partnership Act** of the applicable State or Territory and equivalents;
- 4.4. The High Court in *Federal Commissioner of Taxation v Peabody* (1994) 181 CLR 359 ("*Peabody*") held that the alternative postulate in a Part IVA analysis must be a "reasonable expectation" of what would have happened in the absence of the scheme. The Court (Mason CJ, Brennan, Deane, Dawson, Toohey, Gaudron and McHugh JJ) said (at 385):

*A reasonable expectation requires more than a possibility. It involves a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable.*

- 4.5. None of these consequences (default equal sharing absent contrary agreement, possible transfer duty consequences, exposure of partnership property to partnership creditors, altered financier and security consequences, and potential partner-liability consequences) is what the parties necessarily bargained for under a cost-plus PDA. None can be predicted with sufficient reliability to be regarded as a reasonable expectation. Section 177CB now frames the postulate inquiry. A reconstruction postulate must be a reasonable alternative to the scheme, having particular regard to the substance of the scheme and the non-tax results and consequences achieved by the taxpayer, while disregarding tax results and consequences. That statutory direction

reinforces the need for the Guideline to identify a commercially realistic postulate, not merely a higher-tax one. The partnership is not a reasonable alternative postulate: it is a fundamentally different commercial bargain;

- 4.6. The Guideline itself acknowledges at paragraph 4:

*The use of PDAs is common in Australia's property and construction sector. Generally, we do not have a concern with this operating model.*

- 4.7. If the property development agreement is the standard commercial structure (as paragraph 4 concedes), the partnership is not an alternative postulate. It is a different commercial bargain that the parties had no commercial reason to prefer and several commercial reasons to reject;

- 4.8. The partnership postulate also fails to identify a tax benefit on a more fundamental ground: in the ordinary case it would produce no different tax outcome. Whether the landowner and developer operate under a property development agreement, or as partners with the landowner continuing to own the land (the Menzies/Walsh characterisation set out in connection with paragraph 50 below), the substantive tax outcomes are the same: the developer is entitled to be paid by the landowner on completion under the PDA or, in the partnership case, the partnership's profits are distributed to the partners in their agreed shares; the developer incurs construction outgoings and is entitled to deductions for them; and the land remains the landowner's property at the landowner's own cost. A different tax outcome arises only if the land has in fact been contributed to the partnership (the third characterisation), in which case the partnership holds the land and the trading stock and CGT provisions operate on it. That is a separate question of fact, depending on the agreement of the parties, the parties' conduct, and their accounts. The Guideline implicitly assumes that contribution to a partnership occurs whenever the parties operate as a partnership. That assumption is wrong. Contribution depends on what the parties have agreed and done; it does not occur by operation of the partnership label.

#### **There Is No Dominant Purpose Within the Meaning of Section 177D**

5. Even if a tax benefit could be identified (which I deny), Part IVA also requires the Commissioner to establish, having regard to the eight matters in subsection 177D(2) of the ITAA 1936, that the dominant purpose of a person who entered into or carried out the scheme was to enable the taxpayer to obtain that benefit. The Guideline does not undertake the section 177D(2) analysis for any of the red zone examples. I submit that, properly conducted, the section 177D(2) analysis does not support a dominant purpose conclusion in respect of properly structured property development arrangements:

#### **Minerva and the Limits of the Dominant Purpose Inquiry**

- 5.1. The Full Federal Court in *Minerva Financial Group Pty Ltd v Commissioner of Taxation* [2024] FCAFC 28 ("*Minerva*") recently restated the dominant purpose principles. At paragraph [60], Besanko, Colvin and Hespe JJ restated the principles from *Commissioner of Taxation (Cth) v Hart* [2004] HCA 26 that neither the obtaining of a tax benefit nor the choice of one transaction form over another because of tax benefits is, without more, sufficient to attract Part IVA; such matters do not "of itself" mean that Part IVA applies, and the conclusion must be reached by reference to the statutory factors in section 177D. The Full Court's core holding is that identifying a lower-tax alternative is not the same as identifying a dominant tax purpose. Each of the red zone examples in the Guideline rests on the underlying proposition that the landowner and

developer could have structured things differently and thereby paid more tax. That is precisely the approach *Minerva* rejects.

- 5.2. The Full Federal Court in *Minerva* further explained the analytical fallacy that affects the Guideline. Their Honours said (at [121]):

*the fallacy in this case is that — contrary to the direction in s 177D(2) — it confines attention to the tax consequences of the actual and ‘counterfactual’ transactions and leaves out of account the commercial advantages and consequences obtained by parties connected with the appellant and flowing from what was done.*

- 5.3. The Guideline’s red zone analysis at paragraph 19 confines attention to five tax-related features of the arrangement. It does not engage with the commercial advantages of the structure: asset protection of the land from development risk; preservation of the land’s capital character where applicable; succession planning; financing requirements (commercial drivers may include financier requirements for separation of land ownership from development activity, or for lending to a corporate developer rather than to a trust landowner); and risk allocation between landowner and developer with cost-plus terms protecting the developer’s margin and capital uplift accruing to the landowner. These are not tax consequences. They are commercial reasons for the structure that the Guideline cannot, consistently with *Minerva*, leave out of account. I do not suggest that the presence of commercial reasons immunises an arrangement from Part IVA. The point is narrower: section 177D requires a holistic evaluation of all eight statutory factors and cannot be satisfied merely by identifying that a higher-tax alternative was available.

#### **The Manner Factor**

- 5.4. The manner in which the arrangement is entered into and carried out (subsection 177D(2)(a)) is the most analytically significant of the eight factors. In a properly structured property development agreement, there are no features inexplicable other than by reference to a tax benefit: no round robins of cheques; no deductions materially exceeding cash outlays; no proforma promoter-driven documentation; no passive investors dressed up as direct owners. The arrangement is how property development is actually done, as the Guideline acknowledges at paragraph 4. The form and substance of the arrangement coincide: the landowner owns the land, the developer develops, the builder builds. The timing is driven by planning approvals, financing milestones and construction programs, not by the income year.
- 5.5. This is consistent with the broader pattern of Part IVA decisions. In *Mylan Australia Holding Pty Ltd v Commissioner of Taxation (No 2)* [2024] FCA 253, *Minerva*, and *Commissioner of Taxation v Hicks* [2025] FCAFC 171, affirming *Ierna v Commissioner of Taxation* [2024] FCA 592, the courts rejected Part IVA analyses that treated a lower-tax transaction form as sufficient, without more, to establish dominant purpose. The Commissioner’s application for special leave to appeal from *Hicks* was refused by the High Court on 9 April 2026: *Commissioner of Taxation v Hicks Beneficiary Pty Ltd* [2026] HCADisp 97 (Gageler CJ, Gordon, Edelman, Steward, Jagot and Beech-Jones JJ). The Court stated that the proposed appeal raised no question of principle and had insufficient prospects of success. The common feature of these decisions is that a taxpayer’s awareness of tax considerations is not the same as a dominant tax purpose. Tax awareness is a feature of all commercial decisionmaking. Where the structural choice is driven by financing requirements, asset protection, risk allocation and the parties’ different appetites for risk, the manner factor points away from a dominant tax purpose, not toward it.

### **Morton and the Factual Character of Property Development**

6. The Guideline should also be read against the background of *Morton v Commissioner of Taxation* [2026] FCAFC 31, decided 27 March 2026 (O’Callaghan J, Derrington and McEvoy JJ agreeing). In *Morton*, the Full Federal Court dismissed the Commissioner’s appeal from a finding that the proceeds of sale of subdivided lots developed under a property development agreement were capital receipts on the realisation of a capital asset, and were not assessable income on either the carrying-on-a-business limb or the profit-making undertaking or scheme limb. The Court held that the property development agreement, which appointed the developer to undertake the development with detailed obligations imposed on both parties, did not of itself convert the landowner’s holding into trading stock or convert mere realisation into a business or profit-making scheme. The Full Court gave effect to clause 38 of the development agreement (no partnership, no joint venture, no agency except as expressly provided) and clause 6.3 (the owner has no interest in the development other than its interest in the land), applying *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* (2022) 275 CLR 165. *Morton* is direct Full Court authority that the existence of a PDA between a landowner and a developer, including with the kinds of clauses on which the Guideline relies, does not of itself produce income, trading stock characterisation, or a profit-making scheme. The Court also reaffirmed the *Whitfords Beach* principle, citing Wilson J at 400, that the question is whether the taxpayer has committed the land to a business venture or to a profit-making undertaking or scheme, or has merely sold the land to the best advantage. The tax character of land, proceeds and development activity turns on the taxpayer’s facts, role, intention, conduct and legal rights. The Guideline should not convert concerns arising from particular facts into a general Part IVA risk framework that assumes progressive derivation or annual trading stock uplift without first applying the substantive law to the actual contracts. On *Morton*, the substantive law applied to a PDA of the kind contemplated in the Guideline does not produce the characterisations on which the red zone depends.

### **The Partnership Reservation in Paragraph 50 Is Misconceived**

7. Paragraph 50 of the Guideline reserves the Commissioner’s right to consider whether the parties are operating as a general law partnership for the purposes of determining the correct application of the trading stock provisions. The Guideline implicitly assumes that, if a partnership is found, the trading stock provisions will apply to the land as partnership trading stock and the annual uplift in value will be assessable on the partnership. This assumption does not survive examination:

#### **Harvey v Harvey**

- 7.1. In *Harvey v Harvey* (1970) 120 CLR 529 (“*Harvey*”), the High Court considered a grazing partnership in which one partner (Harold Harvey) owned a property called *Fonthill* and made it available to the partnership for improvement and use. The partnership business included extensive improvement of the property by the expenditure of money, skill and labour. Legal title to the property remained with Harold Harvey throughout. The question was whether the property became a partnership asset in equity, and if not, what became of the accretions to the value of the land produced by partnership activity.
- 7.2. The case produced a 2:1 majority. The majority (Menzies and Walsh JJ) held that *Fonthill* did not become a partnership asset. Menzies J held that, on the parties’ agreement and conduct, *Fonthill* had been retained by Harold Harvey for his son Robin, and to treat the land as a partnership asset would defeat that intention (Menzies J at 555). Walsh J agreed (at 562-563), and then addressed the separate question whether, even where the land remained the property of a single partner, that partner was required to account to the firm for an increase in value produced by partnership effort.

His Honour rejected the proposition that any such obligation arose as a matter of general principle (at 567). His Honour examined *Burdon v Barkus* (1862) 4 De GF & J 42; 45 ER 1098 and *Pawsey v Armstrong* (1881) 18 Ch D 698, on which a general accounting-for-uplift principle had been said to rest, and held that they support no such principle. Walsh J said (at 567):

*the significant feature of Burdon v. Barkus and of other similar cases is that they have not recognized a general principle that a partner whose property has been increased in value by the expenditure of partnership money is bound to allow the other partner or partners to have a share in the increased value ...*

7.3. Walsh J expressly held that the cited authorities do not support a general accounting-for-uplift principle. They stand for the narrower proposition that a non-landowner partner who has contributed money to improvements may be recouped that expenditure out of what would otherwise have been a share of profits. That is a different thing from giving the non-landowner partner a share of the uplift in value of the landowner's land;

7.4. Three legal characterisations are available where land is used by a partnership, and which applies turns on what the parties have agreed and done:

7.4.1. First, the *Menzies/Walsh* characterisation: the land is made available to the partnership but is not contributed to it; the partnership has no proprietary or equitable interest in the land; the partnership's only claim is for recoupment of expenditure through the partnership accounts;

7.4.2. Second, the *Baumgartner* characterisation: an equitable interest in the land (or in the accretions to it) arises from the parties' dealing because:

7.4.2.1. they engaged in a joint endeavour;

7.4.2.2. an expectation of sharing was induced by the dealing; and

7.4.2.3. it would be unconscionable to deny the equity,

applying *Baumgartner v Baumgartner* (1987) 164 CLR 137.

This produces a remedial constructive trust by operation of law, falling within s 29(2) of the *Law of Property Act 1936* (SA) (or the relevant equivalent in other States and Territories), with no instrument and no transfer duty. The reasoning of Barwick CJ in *Harvey* on the partnership-asset question (at 549-551) was a proto-*Baumgartner* analysis: his Honour found an equity in the partnership over the land based on the partnership's expenditure of money and effort under a shared endeavour. The doctrinal tools for that reasoning were not yet available in 1970, and on the *Harvey* facts the *Baumgartner* conditions were not satisfied in any event (the parties' agreement, conduct and accounts treated *Fonthill* as Harold's property to be retained for Robin, which negates the dealing-induced expectation of sharing the land). The minority reasoning in *Harvey* should be understood in this light; and

7.4.3. Third, the *contribution* characterisation: the land is in fact transferred to the partnership, whether by conveyance of the fee simple, by declaration of trust meeting the relevant writing requirements, or otherwise; the partnership then holds the land and the trading stock and CGT provisions operate on it accordingly.

- 7.5. On the facts of *Harvey*, the Menzies/Walsh characterisation applied. The *Baumgartner* characterisation did not engage: the parties' consistent intention, conduct and accounts treated Fonhill as Harold's property, and there was no dealing-induced expectation of sharing the land or its uplift. The contribution characterisation also did not engage, because Harold did not in fact transfer the land or declare a trust over it. The Guideline's red zone fact pattern does not, on its own description, engage either the Baumgartner or the contribution characterisation: the PDA expressly retains the land in the landowner's name; the parties' conduct and accounts treat the land as the landowner's property; and no instrument transfers the land into a partnership. Whether the parties are in a partnership at all is a different question, addressed below; but whichever way that question is answered, the land has not been contributed to it.

### **Consequences for Paragraph 50**

- 7.6. The decision in *Harvey* is material by analogy. It shows that land used in a partnership business, and improved by partnership expenditure, does not necessarily become partnership property. Whether land has become partnership property depends on the parties' agreement, conduct and accounts. If the landowner and developer are in partnership (which the Guideline reserves the right to argue at paragraph 50), but the land has not been contributed to the partnership, the consequences are as follows:
- 7.6.1. the land is not a partnership asset and is not partnership trading stock;
  - 7.6.2. the accretion in value of the land attributable to partnership-funded improvements belongs to the landowner in their capacity as landowner, not in their capacity as partner;
  - 7.6.3. the partnership has no proprietary or equitable claim over the accretion (the partnership's only claim is to recoupment of its share of the expenditure through the partnership accounts); and
  - 7.6.4. the trading stock provisions in section 70-45 of the ITAA 1997 do not apply to the land through the partnership, because the land is not held by the partnership.
- 7.7. Whether the land has been contributed to the partnership is a question of fact turning on the agreement of the parties, their conduct, and the accounting treatment of the land. Where the property development agreement and the partnership accounts (if any) consistently treat the land as the landowner's property, the *Harvey* majority tells us that it is; and
- 7.8. The Commissioner cannot, on this analysis, find a partnership and infer trading stock characterisation. The trading stock characterisation requires the additional step of finding that the land was contributed to the partnership, which the parties' conduct and accounts will ordinarily not support.

### **Suggested Amendments to the Guideline**

8. If the Commissioner accepts the propositions set out in the preceding sections of this submission, several specific amendments to the Guideline follow. I set them out below in the form of suggested replacement language for the relevant paragraphs of the Guideline. I have framed each as a discrete amendment to a specific paragraph of the Guideline so that the Commissioner can consider each on its merits.

### **Suggested Amendment to Paragraph 42**

- 8.1. Paragraph 42 currently reads:

*Based on the terms of the contract between the landowner and developer it is likely that income has been derived by the developer progressively.*

- 8.2. I submit that paragraph 42 should be deleted and replaced with the following:

*Whether income has been derived by the developer progressively depends on the terms of the contract between the landowner and developer. Where the contract provides for payment on completion, and the developer has not acquired a right to be paid before completion, income has not been derived progressively: see Henderson v Federal Commissioner of Taxation (1970) 119 CLR 612 at 651 (Barwick CJ); Arthur Murray (NSW) Pty Ltd v Federal Commissioner of Taxation (1965) 114 CLR 314 at 318. Where, however, the developer has acquired a right to be paid progressively as work proceeds (whether by reason of contractual milestones, certified progress claims, or other contractual triggers giving rise to a presently existing entitlement to payment), income will have been derived progressively in accordance with section 6-5 of the ITAA 1997.*

### **Suggested Amendment to Paragraph 19**

- 8.3. Paragraph 19 of the Guideline lists the cumulative red zone features. The third bullet currently reads:

*The developer claims deductions for construction costs paid to the builder and other development costs as they are incurred, while recognising income from the landowner only on completion. ... This creates a timing mismatch between income recognition and deductions claimed, resulting in the developer reporting losses during the life of the project.*

- 8.4. I submit that this bullet point should be amended to read:

*The developer claims deductions for construction costs paid to the builder and other development costs as they are incurred, while not recognising income from the landowner until completion. Where, on the proper application of section 6-5 of the ITAA 1997 and the principles in Henderson v Federal Commissioner of Taxation (1970) 119 CLR 612 at 651, the developer has acquired a presently existing right to be paid before completion and has failed to bring that amount to account, the failure may be a red zone feature. We do not consider it a red zone feature for a developer to defer income recognition until completion where the contract genuinely provides for payment on completion and the developer has not otherwise acquired a right to progressive payment.*

### **Suggested Amendment to Paragraph 50**

- 8.5. Paragraph 50 currently reads:

*In the course of conducting the Part IVA analysis, our review of the arrangement may extend to considering whether or not the landowner and developer are operating as a general law partnership, for the purposes of determining the correct application of the trading stock provisions under the tax law.*

- 8.6. I submit that paragraph 50 should be deleted and replaced with the following:

*In the course of conducting the Part IVA analysis, our review of the arrangement may extend to considering whether the landowner and developer are operating as a general law partnership. We acknowledge that the existence of a partnership does not, of itself, mean that the land has become an asset of the partnership: see Harvey v Harvey (1970) 120 CLR 529 at 555 (Menzies J), 562-563 and 567 (Walsh J). Whether land made available to a partnership has become a partnership asset depends on the agreement of the parties, their conduct, and the accounting treatment of the land. Where the land has not been contributed to the partnership, the trading stock provisions do not apply to the land through the partnership, because the land is not held by the partnership.*

#### **Suggested Amendment to Paragraph 4**

- 8.7. Paragraph 4 currently reads:

*The use of PDAs is common in Australia's property and construction sector. Generally, we do not have a concern with this operating model.*

- 8.8. I submit that paragraph 4 should be expanded to acknowledge the commercial drivers of separation:

*The use of PDAs is common in Australia's property and construction sector. The separation of land ownership from development activity may have genuine commercial foundations, including asset protection, risk allocation, succession planning, governance, the parties' different appetites for risk, and financier requirements in particular cases. Generally, we do not have a concern with this operating model. Those commercial features will be relevant to any consideration of dominant purpose under section 177D of the ITAA 1936.*

I would welcome the opportunity to discuss any aspect of this submission with the Commissioner. Please contact the writer at the details above.

Kind Regards,



Adrian Cartland

Principal

