
Goods and Services Tax and Real Property Transactions

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The GST legislation will operate across the full spectrum of real property transactions. The legislation is complex in its application and gives rise to a myriad of issues requiring clarification. The core aim of this paper is to identify and discuss the significant issues for participants in the real property sector. In particular, it focuses on issues associated with sales and leases of commercial and residential premises and specific issues for the construction and property development industry. The transitional rules regarding supplies of real property are also considered.

Throughout the paper, references are made to the decided case law under the New Zealand GST regime to illustrate potential avenues of interpretation.

1. General Discussion on GST

The Goods and Services Tax (GST) is a broad based consumption tax levied pursuant to the provisions of *A New Tax System (Goods and Services Tax) Act 1999 (Cth) (GST Act)*. The *GST Act* received royal assent on 8 July 1999 and is to commence on 1 July 2000.¹ Despite its name the *GST Act* levies the GST on much more than just supplies of goods and services.² Relevantly, the core concept of supply extends to grants, assignments and surrenders of real property.³

The term *real property* is defined broadly to cover not only freehold and leasehold interests but extends to licenses, profits a prendre, easements and option over or in relation to land.⁴

GST is imposed on *taxable supplies*.⁵ This is defined broadly to mean supply for “consideration” made in “furtherance of an enterprise”, which is “connected with

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¹ *GST Act*, s 1-2.

² For a discussion on the constitutional issues associated with the *GST Act* having more than one subject of tax for purposes of s 55 of the *Commonwealth Constitution* refer to: D Cominos and T Dwyer No 25 *Weekly Tax Bulletin* para 25.

³ *GST Act*, s 9-10.

⁴ *GST Act*, s 195-1.

⁵ It is also imposed on taxable importations (Div 13). This paper will only focus on taxable supplies.

Australia”⁶ and the supply is made by an entity that is “registered or required to be registered”.⁷ The amount of the GST payable is 10% of the *value* of the taxable supply or in the alternative 1/11th of the *price* of the supply. Price is the amount of money or GST inclusive market value of property received in respect of the supply.⁸ No GST is payable on input taxed supplies or GST free supplies.

The GST is a value added tax. That is, it is only effectively imposed on the amount of the value added by an enterprise, throughout the production chain, in excess of the cost. Practically, this is effected by allowing a system of input tax credits in respect of *creditable acquisitions* that the enterprise makes.⁹ The amount of the input tax credits broadly equates with the GST paid on the supply¹⁰ such that, in theory at least, there will be no net cost to the enterprise.

Under the *GST Act* an acquisition is a creditable acquisition if it is acquired for a *creditable purpose*, the supply to the enterprise was a taxable supply, the enterprise provided consideration and is registered or required to be registered for GST purposes.¹¹

The requirement of creditable purpose will exclude input tax credits for acquisitions that do not relate to carrying on an enterprise (such as private expenditure). Input tax credits are only allowed in respect of taxable or GST-free supplies that the enterprise makes. No input tax credits are permitted for acquisitions related to making input taxed supplies¹² such as supplies of “used” residential premises or financial supplies.

2. Sales of Commercial Property

2.1 General Treatment

Generally, the sale of commercial real property, such as shops, offices and factories will constitute a taxable supply, giving rise to a GST liability for the vendor (assuming the vendor is registered or required to be registered). The vendor will be required to include 1/11th of the consideration received or receivable in respect of the supply, in calculating the *net amount*¹³ for the applicable *tax period*.¹⁴

Conversely, purchasers of commercial property will, *prima facie*, be entitled to input tax credits in respect of the GST payable on the purchase of commercial property.

⁶ Supplies of real property will invariably be connected with Australia (s.9-25(4)).

⁷ *GST Act*, s 9-75.

⁸ *GST Act*, s 9-75.

⁹ *GST Act*, s 11-20.

¹⁰ *GST Act*, s 11-25. The input tax credit is reduced or denied if the acquisition is only partly creditable (s 11-30) or if a specific provision applies to deny the credit (eg for non-deductible expenditure).

¹¹ *GST Act*, s 11-5.

¹² *GST Act*, s 11-15(2).

¹³ The net amount is the difference between the GST attributable to supplies made during a tax period less input tax credit entitlements attributable for the same period (refer *GST Act*, Div 17). The net amount is the amount that is *prima facie* required to be remitted/refunded to or by the Australian Taxation Office.

¹⁴ The tax period will be quarterly (June, September, December, March) for most taxpayers except taxpayers with an annual turnover exceeding \$20M (refer Div 27). GST Returns (or Business Activity Statements) are required to be lodged with the ATO generally 21 days after the expiration of the entities tax period (refer Div 31).

2.2 *Accruals Basis Vendors and Contracts of Sale*

For vendors of commercial real property, there are important issues as to the tax period in which the GST obligations will arise.

For registered entities entitled to account for GST on a cash basis,¹⁵ GST is payable only to the extent that consideration has been received.¹⁶ For accruals based taxpayers,¹⁷ the liability for GST on a taxable supply is attributable to the earlier tax period in which:

- any of the consideration is received for the supply;
- or an *invoice* relating to the supply issued (s 29-5).

Invoice is defined to mean “a document notifying an obligation to make a payment”.¹⁸ If an invoice has been issued (but no consideration has yet been received) liability for the GST will be brought forward, potentially resulting in a significant cash flow disadvantage to the vendor of the property.

In New Zealand the revenue authorities have attempted to argue that an *unconditional* agreement for the sale and purchase of land is an invoice for GST purposes¹⁹ (but a conditional contract is not) thereby attributing GST liability to the tax period in which the contract was executed.

Whilst the Explanatory Memorandum to the *GST Act* is silent on the point, a contrary view, that an unconditional contract is not an invoice, could be as follows:

- An unconditional contract of sale does not *notify* an obligation to pay, but creates or establishes an obligation to do so;
- “Invoice” in common parlance would not include written contracts;²⁰
- GST liability arises when “an invoice is issued” – a written contract is not “issued” but is merely “signed” or “executed” by the parties, and is therefore outside the ambit of the rule.²¹

It is not clear how the legislation will be applied in Australia in the context of sales of commercial real property. If the legislation is applied strictly, potential cash flow difficulties may arise. Vendors will need to ensure that cash proceeds are received in the tax period in which the contract of sale is executed to avoid cash flow problems.

¹⁵ Entities are entitled to account on a cash basis, where the annual turnover does not exceed \$1M, an entity accounts for income tax purposes on a cash basis or the entity is carrying on an enterprise of a kind expressly permitted by the Commissioner to account on a cash basis (s 29-40). Entities can apply to the Commissioner to account for cash basis.

¹⁶ *GST Act*, s 29-5(2).

¹⁷ If entities not permitted to account for GST on a cash basis.

¹⁸ *GST Act*, s 195-1.

¹⁹ Public Information Bulletin No 173 at 10. This view is based on *Case K24* (1988) 10 NZTC 236 at 238.

²⁰ The weight of this factor alone may be doubtful as technically defined terms should be given their technical meaning: AI Macadam & TM Smith *Statutes* (2nd edn, Butterworths, Australia, 1989) at 181.

²¹ A McKenzie *GST – A Practical Guide* (CCH, New Zealand, 1997) at 403.

Purchasers of commercial property, accounting for GST on an accrual basis, will similarly have input tax credit entitlements brought forward to the earlier tax period in which any consideration is provided or an invoice issued. For these entities it will also be important to obtain a tax invoice²² from the vendor upon execution of the contract of sale. A contract of sale will not meet the requirements of a tax invoice.

2.3 *Deposits under a Contract of Sale*

Deposits paid under an executory contract of sale can also give rise to difficult issues for accrual based GST remitters.²³ Whilst under the general rules, deposits have the potential to trigger GST liability (for the whole of the consideration receivable under the contract) in the tax period in which the deposit is paid, Division 99 acts to suspend the operation of these rules until the deposit has:

- either been forfeited because of the failure to perform the obligation; or
- is *applied* as all or part of the consideration (s 99-5).

The GST payable is then attributable to the period in which the forfeiture or application took effect.²⁴

(a) *Is the amount a deposit?*

In some contracts it will be important to distinguish whether the amount paid is a security deposit or a part payment of the consideration. The distinction is important because:

- Division 99 cannot operate if the amount is not a deposit (in which case the GST liability will crystallise in the tax period in which the amount is received).
- A deposit can be the subject of forfeiture if a purchaser fails to complete a contract of sale, a part payment cannot.²⁵

Consequently, receipt of an amount which is a part-payment of the consideration could potentially place vendors in the disadvantageous position of being liable for the full amount of the GST in an earlier tax period and if the contract does not proceed, being required to refund the part payment.²⁶ Appropriate drafting should assist to ensure the benefit of the Division is obtained.

²² *GST Act*, s 29-70. Entitlement to input tax credits is deferred until a tax invoice is obtained (s 29-10(3)).

²³ For completeness it should be noted that the potential application of Division 99 to deposits received under contracts of sale is subject to some conjecture, because they are potentially not the typical types of security deposits. However, the ATO in their booklet called *Property & The New Tax System* appear to endorse the view that the Division will apply.

²⁴ *GST Act*, s 99-10.

²⁵ WD Duncan & S Jones *Sale of Land in Queensland* (4th edn, LBC Information Services, Sydney, 1996) at 91.

²⁶ The vendor will generally then have an action for damages against the purchaser for breach of contract of sale and perhaps specific performance. If the amount of the payment exceeds 10% of the purchase consideration, the contract will be an instalment contract for purposes of s 71 of the *Property Law Act* 1974 (Qld) which requires vendors to give 30 days before they can terminate the contract and sue for damages. A decreasing adjustment will arise for the vendor equal to 1/11th of the amount required to be refunded (s 19-55). The vendor will be required to issue an adjustment note (s 29-75).

(b) When is the deposit applied as part of the consideration?

Whilst it is reasonably arguable that the deposit *will* be applied at settlement (ie, taken into account as part of the consideration for the supply), and the deposit *will not* be applied upon execution of the contract of sale (because such an interpretation would be contrary to the purpose of Division 99), there will be a range of circumstances, where the position remains uncertain.

A non-refundable deposit received under an unconditional contract of sale or where the vendor uses the deposit for his or her benefit prior to settlement provide some examples where the rules are not clear.

It may be arguable that the existence of Division 99 (which operates to stall GST liability) promotes a broad view as to when the deposit is to be applied.

Land law literature states that a deposit paid under a contract of sale serves two purposes:

- security for performance of the contract;
- if the contract is carried to completion, as an offset of the purchase price.²⁷

Accordingly, if a deposit is “security for performance”, then it will remain so until the contract has been performed (at which point the deposit is no longer a bond for performance). Typically, the performance of the contract (and discharge thereof) would occur at time of settlement. It therefore follows that, it is at this time that the deposit is applied as part of the consideration.

This may be so irrespective of whether the deposit has been beneficially used by the vendor, prior to performance of the contract.

This analysis is supported by the fact that prior to completion, the deposit could potentially be recovered by the purchaser, for example, where there has been a total failure of consideration.²⁸ Relevantly, the *Standard Conditions of Contract* for both residential and commercial property (2nd edition), released by the Real Estate Institute of Queensland, provide that the deposit is to be held by the stakeholder until completion (or termination).²⁹ That is, the vendor generally has no entitlement to the deposit until settlement occurs.

2.4 Going Concern Exemption

Sales of commercial property may qualify for the going concern exemption contained in subdivision 38-J. If the specified criteria are satisfied, no GST liability arises for the vendor on the supply and the vendor is entitled to input tax credits in respect of creditable acquisitions related to the making of the supply. The exemption will be

²⁷ Duncan & Jones *supra* n 25 at 86.

²⁸ Duncan & Jones *supra* n 25 at 84, see also s 69(1) of the *Property Law Act 1974* (Qld) which allows a purchaser to recover the deposit in circumstances where the vendor could not obtain a decree of specific performance.

²⁹ Clause 3.4 of both *Standard Conditions*.

important for sales of hotels, motels, caravan parks (including land) retail premises and factories (including land).

Section 38-325 of the *GST Act* defines a supply of a going concern as a supply under an arrangement under which the supplier supplies to the recipient all the things that are necessary for the continued operation of “*an enterprise*” and the supplier carries on or will carry on, “*the enterprise*” until the day of the supply (whether or not as a part of a larger enterprise carried on by the supplier). However, the supply is only GST free if it is made by a registered person and the parties agree in writing that the supply will be of a going concern.

(a) *Sale of Rented Commercial Premises*

The exemption is potentially wide given the definition of enterprise extends beyond generally understood notions of going concern (for example to regular and continuous leasing). Therefore it could potentially apply to disposals of rented commercial premises (provided the recipient is registered or required to be so).

The New Zealand GST regime also contains a going concern provision.³⁰ The relevant cases relating to sales of rented premises focus on the percentage of the premises (such as CBD buildings) that have been let. The rationale being that the higher the percentage, the more likely that a going concern is supplied. For example, in *Case S27*³¹ a commercial building leased to an extent of 42% was held to fall within the provision.

Various New Zealand cases have adopted a strict interpretation of the provision. The vendor in *Case P38*,³² which involved a transfer of a motel that had been developed and decorated and preliminary advertising undertaken, was held not to fall within the provision. Similarly, in *Belton v C of IR*³³, transfer of land, buildings and chattels of a motel property, was held not be within the provision, because vacant possession was required (and at the time there were no forward bookings). Other cases have sought to distinguish between transfers of the *capital asset structure* and the *actual business activity or process*.³⁴

It is not clear whether the Australian judicature will adopt the same strict approach, given that the clear policy underpinning the exemption is to assist in transferring enterprises and not to impose undue requirements, by requiring purchasers to raise additional finance to pay the GST and then be able to claim input tax credits for the GST paid.

(b) *Assets held by Different Entities*

Further issues will arise, where for example, in a group company context, a business is carried on rented premises by one entity but the relevant land (and improvements) is owned by another. In those circumstances the transfer of the land and improvements

³⁰ Refer *Goods and Services Tax Act 1985 (NZ)*, ss 2(1) and (14).

³¹ *Case s 27 (1995) 17 NZTC 7 at 189.*

³² (1992) 14 NZTC 4 at 288.

³³ (1997) 18 NZTC 13 at 403.

³⁴ *Barratt v CIR (1995) 17 NZTC 12 at 373.* In particular the Court indicated that transfer of goodwill, client lists and presence of a restrictive covenant assist to establish a transfer of business.

may not qualify as part of the going concern of the entity which owns the trading business (because the enterprise constituting the business is held by a different entity).

However, in those situations the rented land (and improvements) may separately qualify as enterprise and may therefore be entitled separately to the going concern concession.

(c) Going Concern Used for Input Taxed Supplies

Where commercial property sold under the going concern provision is to be used for purposes of making input taxed supplies, GST liability will arise for the purchaser under Division 135 of the *GST Act*. This will be relevant where, for example, commercial offices are acquired to be refurbished and sold as residential units or commercial premises are acquired by a bank.

The purchaser will have an increasing adjustment to take into account the proportion of supplies that will be made through the enterprise, that are likely to be input taxed.³⁵ The adjustment is designed to ensure that a proportionate amount of the GST is borne for acquisitions that relate to making input taxed supplies.³⁶

(d) Fail-safe Clauses

Vendors will need to ensure that the requirements of the exemption are fully satisfied prior to proceeding with the transaction. An erroneous assumption as to its availability may render the vendor liable to GST on 1/11th of the consideration received in respect of the supply.³⁷ Practically, vendors should ensure that the contract of sale contains a fail-safe clause, in the event that the concession is subsequently denied.

3. Commercial Leases

Assuming all the registration requirements are met, commercial leases will be subject to GST in the normal way. Landlords will be liable for GST on 1/11th of the rental income received. Commercial tenants will typically be entitled to input tax credits in respect of the GST paid on the rental (subject to satisfying the “creditable acquisition” criteria).

3.1 Periodic and Progressive Supplies

Commercial landlords and tenants who account for GST on a cash basis will respectively have GST obligations and entitlements only when the rental is actually received or paid.³⁸

The *GST Act*, through Division 156, attempts to achieve a similar result for landlords and tenants accounting on an accrual basis. In particular, Division 156 spreads the GST liability in respect of the rental over the term of the lease as if there were a separate supply of premises for each tax period by the landlord (s 156-5). The GST liability arises periodically when the rental is received.

³⁵ Increasing Adjustments are added to the net amount worked out for a tax period (*GST Act*, s 17-10).

³⁶ Explanatory Memorandum para 6.255.

³⁷ Importantly, the *GST Act* does not contain any statutory right of recovery of the GST payable if the vendor fails to collect the GST. Inequitably, the purchaser is still entitled to a windfall credits equal to 1/11th of the consideration payable – irrespective of the fact that the landlord did not charge the GST. Furthermore, the purchaser can legally compel the vendor to provide a tax invoice (s 29-70(2)).

³⁸ Division 29.

Similarly, commercial tenants accounting on an accrual basis are only entitled to input tax credits to the extent that consideration has been provided in the tax period. This is achieved by deeming “*acquisition*” of the rented premises to be a separate acquisition for each of the tax periods.

3.2 *Outgoings*

The treatment of outgoings such as repairs, electricity, rates, etc will depend on the terms of the specific contractual arrangements between the parties. If the tenant is liable for the outgoings, they will prima facie be entitled to the input tax credits in respect of payments for those outgoings (assuming the supply was taxable to the tenant; if the supply was GST free, such as potentially for rates, land tax and water, then no input tax credits will arise).

If the landlord incurs the expenditure, then the landlord will be entitled to the input tax credits. If however, the landlord is entitled to recoup the expenditure from the tenant pursuant to the contractual arrangements, there will be a further taxable supply by the landlord (being the release of the tenant from an obligation to further reimburse the landlord).³⁹ The landlord will be liable for GST on 1/11th of the reimbursement received from the tenant.

3.3 *Lease Incentives*

(a) *Cash Incentive*

A cash incentive paid to a commercial tenant for agreeing to enter into a lease will normally be subject to GST. The agreement to enter into the lease will be a taxable supply by the tenant.⁴⁰

Conversely, the landlord will be entitled to an input tax credit in respect of the amount of the cash paid, in the period in which the payment is made. The input tax credit will be equal to 1/11th of the consideration paid.

(b) *Fit-outs (Provided to Tenant)*

As with the cash lease incentive, GST will be payable by the tenant on the value of the fit-out and the lessor will be entitled to a GST input tax credit.

However, the tenant will have received no cash for the lease incentive and therefore may not have enough cash to pay the GST liability. This has the potential to cause significant cash flow problems. If the lessor pays an amount to the lessee to meet this GST liability this could be a separate supply itself. The amount may need to be grossed-up.

An alternative approach to this problem would be to reach an agreement with the tenant that the tenant agrees to lease a fitted out space.

³⁹ GST Act, s 9-10(g)(i).

⁴⁰ In *Case S41* (1995) 17 NZTC 7 at 280 it was held that a supply was made by a person who received a lease inducement payment in return for agreeing to rent the commercial premises.

(c) *Rent-free periods*

Whilst the specific circumstances of each case will need to be separately examined, the supply of the premises for a rent-free period should not attract GST. This is on the basis that no consideration has been received by the landlord for the supply of the premises.⁴¹

3.4 *Retail Shop Leases*

Landlords of leases regulated by the *Retail Shop Leases Act 1994 (Qld) (RSL Act)* face additional difficulties. One problem arises where rent is calculated as a percentage of turnover. Section 25 requires the lessee to provide a monthly certificate specifying the turnover of the business, which is then used to determine the rental payable. The definition of turnover in the *RSL Act* excludes taxes imposed at the point of sale.⁴² Therefore GST will be excluded. For the landlord, rental income will be based on GST exclusive turnover (which will be much less).

Secondly, the Act allows the landlord to recover defined "outgoings"⁴³ and "rent". The statutory definition of outgoings does not expressly cover GST payable by the landlord.

Both of these issues are likely to cause considerable difficulties for landlords, especially where leases do not otherwise contain tax indemnity provisions.

For completeness it should be noted that amendments to the legislation are currently proposed which should overcome the problems highlighted above.

4. Residential Property

4.1 *Sales of Residential Property*

The GST treatment of residential property differs depending on whether it is a supply of new residential, "used" residential or of commercial residential.

Sales of new residential premises (eg, house and land packages sold by developers) will generally constitute taxable supplies chargeable with GST on 1/11th of the consideration received by the developer. In most cases, purchasers will be private individuals who will not be able to recover the GST paid.

In contrast the supply of "used" residential premises⁴⁴ by registered entities will be input taxed, to the extent that the premises are to be used *predominantly* for residential accommodation.⁴⁵

Input taxed means the supplier is not liable to charge GST on the supply, but no input tax credits arise for the supplier for acquisitions relating to the supply. For example, no

⁴¹ The author has received written confirmation from the ATO that GST would not normally apply to rent free periods.

⁴² *Retail Shop Leases Act 1994 (Qld)*, s 9(2)(g).

⁴³ *Ibid*, s 37.

⁴⁴ Being land and buildings used as residential premises and intended to be so occupied (s 195-1).

⁴⁵ *GST Act*, s 40-65.

input tax credits can be claimed for the GST paid on the real estate agents or solicitors fees.

Interestingly, s 40-65 which provides for input taxation, states that input taxation only applies where the residential premises are *to be used* predominantly for residential accommodation. Therefore, the focus will be on the prospective use of the premises by the purchaser. Input taxation will arguably not apply, for example, where a property developer acquires private residence for purposes of demolition and a new development.⁴⁶

Dispositions of *commercial residential premises* (which covers hotels, motels, boarding houses and caravan parks) will also be subject to GST in the ordinary way.⁴⁷ However, it will be important to consider the potential application of the margin scheme and the going concern concession in relation to these sales.

4.2 Residential Leases

Leases of residential premises (other than commercial residential premises) are input taxed. Therefore, no GST will apply to rentals paid on houses, flats and units used for residential accommodation. Notwithstanding this, rentals are expected to rise as GST paid by the landlord will be a *permanent* cost to the landlord, as the landlord is specifically prohibited from claiming input tax credits. Landlords will seek to increase prices to recover the additional costs.

Similarly, leases of *commercial accommodation* will be input taxed where the lessor elects not to apply the concessional treatment provided in Division 87 of the *GST Act*. In comparison, leases of commercial residential premises are fully taxable unless the special provisions in Division 87 apply.

Division 87 provides for reduced GST liability calculated on 50% of the value of the taxable supply. This is provided the commercial accommodation (which includes commercial residential premises) is *predominantly* used for *long term accommodation*. The latter expression is defined to mean that 70% or more of the individuals are provided with accommodation for a continuous period of 28 days or more.

Where premises are *not* used predominantly for long term accommodation, the concession applies after the first 27 days of the period of the stay. That is the full amount of the rental received in the first 27 days will be subject to GST. This concession will be relevant where, for example, a commercial hotel provides long term accommodation to tenants.⁴⁸

Division 87 will also be important for retirement village operators and caravan park proprietors supplying long term accommodation. They will be able to choose between input taxation (and consequential loss of credits) and concessional GST treatment under Division 87. The EM states that for these entities Division 87 will provide

⁴⁶ There will be no GST liability for the private resident given that he or she is unlikely to be registered for GST purposes.

⁴⁷ Section 40-65.

⁴⁸ Explanatory Memorandum para 6.141.

administrative ease in calculating the GST liability in respect of accommodation provided.

The decision to elect Division 87 should be considered carefully because once the election is made it applies to *all* supplies of commercial accommodation until the election is revoked.⁴⁹

5. Construction and Property Developments

As discussed above, sales of general commercial, new residential and commercial residential premises by registered suppliers (including developers) will be subject to GST in the normal way.

However there are a number of specific GST issues relevant to entities involved in property developments and construction.

5.1 *Payment Procedure Under a Construction Contract*

For various contractors and sub-contractors the ordinary payment procedure under standard construction contracts will generate some difficult issues. By way of example, *Australian Standard Construction Contract AS 4300* provides the following procedure before a contractor is to be paid⁵⁰:

- (a) claims for payment are to be submitted by the relevant contractor;
- (b) claims are to be certified by issue of “payment certificate”;
- (c) payment is made by the Principal (Head Contractor).

For the subcontractors it will be important to resolve whether the “claim” is an invoice for the purposes of the attribution rules, given that some of the subcontractors will be accruals basis GST remitters.

There is an argument that a “claim” is an invoice because it notifies the Head Contractor of an obligation to make the payment. The fact that the obligation to make the payment may not be immediate and could potentially be disputed does not appear to prevent the claim from constituting an invoice (refer definition of invoice).

If the claim is an invoice, additional difficulties may arise where amounts are subject of *retention* by the Head Contractor.⁵¹ In such a case, the subcontractor will be liable to GST on the full amount of the invoice when the total cash receivable until completion of the construction contract will be less.

In GSTR 1999/D7 the Commissioner of Taxation has recognised the inappropriate way that the general attribution rules can operate in respect of retention amounts. The Commissioner has proposed to make a determination which will permit subcontractors

⁴⁹ Revocation is only permitted 12 months after the day on which the supplier made the choice (*GST Act*, s 87- 25).

⁵⁰ AS4300 General Conditions of Contract: Clauses 42 and 43.

⁵¹ AS 4300 Clause 5 provides that retention moneys are for purposes of ensuring the proper performance of the contract.

to attribute any GST liability to the tax period when the retention amount is actually received.

5.2 *Margin Taxation*

The margin scheme in Division 75 will be particularly important for many developers and construction entities. The margin scheme allows for a reduced GST liability in respect of taxable supplies involving sales of freehold land, stratum units and grants and sale of long term leases. The scheme is optional and can be applied on a sale by sale basis.⁵² If the scheme is elected, GST is only payable on the margin, equal to the difference between the consideration received for the supply and the cost incurred.⁵³

However, the margin scheme can only be elected where the relevant freehold interest in the land or stratum unit was acquired other than through a taxable supply. This will be the case, for example, where land is acquired from:

- private unregistered individuals by a property developer (such as rural farmland acquired from an unregistered farmer);
- the Commonwealth, State or Territory if the supply is first supply after 1 July 2000 (Section 38-445);
- land was held by the relevant developer at 30 June 2000.

The downside with the margin scheme is that the acquisition of land, stratum unit or long term lease is deemed not to be a creditable acquisition thereby preventing input tax credits to the acquirer for GST paid on the margin.⁵⁴ Therefore the margin scheme may not find favour among acquirers of commercial property, but would be desirable for supplies of residential land to private individuals.

The margin scheme is applicable to land acquired pre and post 1 July 2000. For land acquired on or before 1 July 2000, the cost for the purposes of working out the margin will generally be the market value of the interest, stratum unit or lease at that time (although market value is not expressly specified).

Accordingly, a valuation of the property will be necessary for purposes of ascertaining the margin. A valuation is not however required to be practically undertaken as at 1 July 2000. It is sufficient that the valuation be undertaken at the end of the tax period in which the relevant supply takes place.⁵⁵

5.3 *Partially Completed High Rises*

The *GST Act* does not provide for the GST liability to be apportioned across the development as a whole.

In circumstances where the development is only partially complete, a literal interpretation of Division 75 suggests that the GST liability arising in respect of sales of

⁵² *GST Act*, s 75-5(1).

⁵³ *GST Act*, s 75-10.

⁵⁴ *GST Act*, s 75-20.

⁵⁵ GSTR 1999/D9.

the various units will differ. For example, without an averaging provision, units that are closer to completion will have a greater value at 1 July 2000, and therefore a smaller margin. This effectively reduces the taxable value of units closer to completion.

It is not clear from the legislation or the explanatory memorandum as to how the regime is to apply in these circumstances.

The ATO in GSTR 1999/D7 have sought to spread the GST liability arising in respect of the project over the whole of the development. This is achieved by determining the extent to which the project is completed (in percentage terms) which is then applied to the sale price of each of the units to be valued.⁵⁶ One consequence of this approach (which is favourable to the GST taxpayer) is that the total valuation of the project (and the value to be allocated to each unit) can exceed the actual costs incurred by the developer, as at that point in time.

5.4 One Off Property Subdivision

There may be scope for “one off” property subdivisions involving a *mere realisation*⁵⁷ of land to escape the GST net. This is because a *mere realisation* may potentially fall outside the definition of enterprise in section 9-20. In particular, it may be arguable that such subdivisions do not constitute a business, are not in the form of “an adventure or concern in the nature of trade” or otherwise done on a regular or continuous basis.

A *mere realisation* of land was held not to be assessable on revenue account in *Statham v FCT*⁵⁸. *Statham's* case involved co-owners of rural property who entered into an agreement - with the local Council to effect the subdivision. The Council undertook all the necessary subdivision works, including the establishment of roads, sewerage and electrical works. The subdivision lots were sold and marketed through a local real estate agent. The co-owners had no active duties in relation to the subdivision. The taxpayer contended that the land had not been committed to a business of land subdivision and had not engaged in any *profit-making undertaking* or scheme. The full Federal Court agreed.

Similarly, the New Zealand Court of Appeal in *Newman v CIR*⁵⁹ allowed a builder who outside the course of his work subdivided his property and sold one block to not fall within the GST regime. The Court held that the subdivision activity did not constitute a taxable activity (enterprise) as it lacked repetition.

6. GST, Real Property and Other Legislation

6.1 Trade Practices Act 1974

Suppliers of real property will need to gross-up for GST on taxable supplies or else absorb a permanent cost to their enterprise. However, the amount of the gross-up will be important and landlords should consider potential application of the Price

⁵⁶ GSTR 1999/D9.

⁵⁷ Per Mason J in *Federal Commissioner of Taxation v Whitford Beach Pty Ltd* 82 ATC 4031; Per Lord Justice Clerk in *Californian Copper Syndicate v Harris* (1904) TC 159.

⁵⁸ 89 ATC 4070.

⁵⁹ (1995) 17 NZTC 12 at 097.

Exploitation provisions in the *Trade Practices Act 1974* (Cth).⁶⁰ The broad aim of these provisions is to require the suppliers (such as landlords) to pass on cost savings at least during the transition period and not charge excessive prices (rental) in the guise of the GST.

Relevantly, s 75AU(1) states that a corporation contravenes this section if the corporation engages in price exploitation in relation to the New Tax System changes. Whilst price exploitation is not itself a defined term, guidelines issued by the Australian Competition and Consumer Commission (ACCC), state that as a general rule, businesses should not *increase* the *dollar margin* on their goods and services as a result of the new tax changes alone. Further, prices should be reduced to reflect the effect of tax reductions (if any).

Corporations found in breach face significant penalties of up to \$10 million (\$500,000 for individuals). In addition, breach of s 75AU is an offence. Other remedies such as order for the refund money may also be imposed (Section 80B).

6.2 Stamp Duty

The interaction between the *GST Act* and the *Stamp Act 1894* (Qld) will give rise to *double taxation*, where consideration payable under the contract of sale is GST inclusive.

The *Stamp Act* levies duty on the higher of the consideration "in money or moneys worth" and the full unencumbered value of the property.⁶¹ Given that consideration will normally be GST inclusive, stamp duty will effectively be charged on the GST component.

Similar difficulties arise in respect of leases of commercial real property, as landlords will have grossed up the rental for the GST.

From the author's discussion with the relevant personnel at the Office of State Revenue no legislation is yet proposed to be introduced to alleviate this inequitable result.

7. Transitional Provisions

The transitional provisions contained in *A New Tax System (Goods and Services Tax Transition) Act 1999* ("*Transition Act*") will be relevant for agreements which span the commencement of the principal *GST Act*.

The *Transition Act* contains special timing rules (not found in the *GST Act*) that determine the time a particular supply occurs. A supply or acquisition of real property occurs when the property is "made available" to the recipient.⁶² GST is only payable to the extent that supply of real property is made available after 1 July 2000. Similarly entitlement to input tax credits for acquisitions only arise after that time.

The expression "made available" is not defined and is likely to create continuing uncertainty in many transactions, for example where possession is granted prior to 1

⁶⁰ Similar regimes proposed by State Legislatures – refer Schedule VB of the *Trade Practices Act*.

⁶¹ Item 4 Schedule 1 Conveyance Head of Charge; Section 2A *Stamp Act 1894* (Qld).

⁶² *A New Tax System (Goods and Services Tax Transition) Act 1999*, s 6(3).

July 2000 and settlement occurs post that date or where there are on-sales (such that the first purchaser never obtains physical possession).

Whilst nothing has been officially released by the ATO as to when property is made available, there have been indications that this will occur when full use and enjoyment of the property has passed. Limited rights of occupation or use will not suffice. Typically, one would expect that full use and enjoyment would pass at settlement time.

7.1 *Contracts of Sale*

Contracts of sale of commercial premises, new residential and commercial residential premise, entered into prior to 1 July 2000 but which are "made available" after that date, will be subject to GST. Grandfathering may be available where the contract of sale was entered into before 8 July 1999. However, grandfathering is not contemplated for contracts entered into after 8 July 1999. Therefore, for these latter contracts, GST liabilities will prima facie arise if the real property is made available to the purchaser after 1 July 2000.

7.2 *Commercial Leases*

Section 12 of the *Transition Act* treats a lease which spans the implementation date as a supply for the period of the lease. Therefore, there will be a deemed supply for leases extending beyond 1 July 2000 where a lease spans the implementation date. Accordingly, the receipt of periodic rental after 1 July 2000 will then, prima facie, be taxable.

7.3 *Grandfathering Provisions*

There is scope for grandfathering existing written contracts of sale/leases which have been made prior to 8 July 1999. If these rules apply, then GST will be payable on the supply but input tax credits can continue to be claimed for inputs related to the making of that supply.

The general rule contained in s 13 provides that a supply (after 1 July 2000) is to be GST free to the earlier of 1 July 2005 or when a review opportunity arises. This is defined to mean broadly, the capacity to change consideration because of the imposition of the GST or conduct a general review, renegotiation or alteration of the consideration (whether before or after 1 July 2000).⁶³

The scope for grandfathering is *narrowed* where the recipient of the supply would not be entitled to a full input tax credit in respect of the GST paid pursuant to supply under the contract of sale/lease.⁶⁴ In this situation, grandfathering is only available if the contract of sale/lease has been entered into prior to 2 December 1998. This provision will be relevant where, for example, commercial premises are leased to banks or a residential house and land package is sold to a customer.

Understandably, there will have been a range of circumstances where it would have been difficult for the supplier to determine with certainty whether the recipient is or is

⁶³ *Transition Act*, s 13.

⁶⁴ *Transition Act*, s 13(4).

not entitled to full input tax credit, particularly if monitoring was required on continual basis.

However in GSTR 1999/D11 the ATO have sought to adopt a more lenient approach. In particular the Ruling provides that the recipient's status is only required to be assessed once, at the time the first supply is made after 1 July 2000. In addition if insufficient information is available, then provided the supplier makes the decision on a reasonable basis, then that will suffice.⁶⁵

The scope for grandfathering is *extended* where all the consideration payable pursuant to the lease is paid prior to 2 December 1998.⁶⁶ In these circumstances, the contract of sale/lease is GST free till a review opportunity (if any) arises. This provision is unlikely to be helpful in normal commercial leases or contracts of sale.

7.4 *Review Opportunity*

The crucial issue for contracts spanning the implementation date will be whether they contain a review opportunity. This will require close scrutiny of each of those contracts.

The following is a broad overview of the position adopted by the ATO as to what will or will not constitute a review opportunity in GSTR 1999/D11.

(a) *CPI Adjustment Clause*

These clauses will not constitute review opportunities. The rationale being that a CPI adjustment does not amount to a "general review, renegotiation or alteration of the consideration" or provide the supplier with an opportunity to change the consideration because of the imposition of the GST. The connection between the GST and the CPI increase is considered too remote.

(b) *Fixed Increments*

Fixed increases in rental will not normally constitute a review opportunity, provided the fixed increase is not attributable to the imposition of the GST.

(c) *Outgoings Clauses*

The Commissioner's view broadly is that an outgoings clause will constitute a review opportunity as it provides the landlord with an indirect means for the landlord to change the consideration. However, much will depend on the specific wording of the clause. For example, the Ruling draws a distinction between an outgoing clause which permits recovery of outgoings imposed "*in respect of premises*" and outgoings charged "*on premises*" or "*against the premises*". The latter clauses are not considered review opportunities, on the basis that GST is a tax on the supply of premises not a tax charged on or against the premises.

(d) *Market Review Clauses*

A clause permitting market review will constitute a review opportunity.

⁶⁵ GSTR 1999/D11 paras 37-39.

⁶⁶ *Transition Act*, s 13(3).

8. Construction Contracts

Construction agreements are subject to special concessionary transitional arrangements contained in s 19 of the *Transition Act*. The rules apply where there are written agreements executed before 1 July 2000 and goods or real property are made available after that time. In essence, the GST liability is then limited to any excess of value over the value of “*all work and materials permanently incorporated in or affixed in or site of the building...*” at 1 July 2000.

However, where grandfathering opportunities exist, this date is replaced with the earlier of 1 July 2005 or when a review opportunity arises. The value of the affixed works must be calculated in a manner prescribed by the Commissioner and must generally be conducted prior to the expiration of the first tax period applicable to the taxpayer.

The Commissioner has stated in GST Bulletin 1999/2 that the preferred valuation method is “value of work completed on a trade by trade basis against total value of each trade”. However, there is no requirement that independent valuations be obtained and the valuation may be effected by inhouse personnel who are members of any of the following four professions: an architect, civil engineer, a quantity surveyor or recognised valuer.

Sub-contracted Building Works

It appears from the Explanatory Memorandum that s 19 is only intended to apply to the Head Contract with the owner of the real property.⁶⁷ Therefore sub-contracts for building works will fall outside these provisions. For these sub-contracts the full value of the subcontracted works may be subject to GST. This issue will require further clarification from the ATO.

8.1 Special Sales Tax Credit

There may be difficulties for property developers claiming the special sales tax credit provided in s 16 of the *Transition Act*. The difficulty arises because s 16 provides for a credit only where stock is held at 1 July 2000 for the “*purposes of sale or exchange in the ordinary course of business*”. The ATO may seek to argue that stock held by a construction enterprise is held for purposes of incorporation into building works and not for sale in the ordinary course of business and therefore not eligible for a credit. However, this may be a strict view given that the building works are likely to be ultimately sold.

9. Conclusion

The practical operation of the GST legislation is complex and its application to many familiar transactions can result in uncertainty. Participants in the real property sector need to digest the issues highlighted in this paper and remain abreast as the legislation continues to be applied. No doubt resolution of many of the uncertainties will require legislative guidance.

⁶⁷ Explanatory Memorandum para 2.75.