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GST and property – Part II

Vendor and Purchaser issues

INTRODUCTION

This paper is the second part of what was to be a two part series. Last month I considered various GST issues that affect landlords and tenants and closed with a promise that in this paper I would examine the difficult GST issues that confront property developers. However, before getting into the property development issues I have found it necessary to explore various issues that are relevant to every GST registered taxpayer that makes taxable supplies of land!

This month I will again dwell on a few threshold issues, summarize the attribution rules for bringing to account a GST liability upon the sale of land, examine the GST treatment of forfeited deposits and settlement adjustments and look at several margin scheme issues. This necessarily means that I need to leave an examination of the GST issues that confront property developers to Part 3 of this paper.

THRESHOLD ISSUES

At the most general level, where a transaction meets the threshold tests in s. 9-5[1] a supply by way of either lease or sale of:

- new residential premises, vacant land and commercial premises – will be a taxable supply;
- residential premises – will be input taxed;
- farm land and commercial premises sold as a going concern – will be GST-free.

One of the conditions that must be satisfied to meet the threshold tests is that the supply of a property is made for consideration. However, Div 72 will apply to a property transferred to an associate for no (or inadequate) consideration. Where the parties genuinely deal with each other at arm's length, Div 72 has no effect.

Readers will recall that a supply will only be taxable when it is made in the course or furtherance of an enterprise that the taxpayer carries on and that the definition of enterprise in s. 9-20 is broader than the tests for determining whether a taxpayer is conducting a business for income tax purposes. For GST purposes, an enterprise includes a one off activity in the *form of an adventure or concern in the nature of trade*[2]. This is a technical phrase which will be discussed further in part 3, however it means a person whose occupation has nothing to do with property development can still be subject to GST on the sale of property where they purchase vacant land with the intention of developing it for the purpose of making a profit[3]. Conversely, where a GST registered vendor is doing nothing more than realizing a private asset in the most favourable manner the transaction will not be made in the course or furtherance of a vendor's enterprise[4].

Case study

Graham is a GST registered solicitor who lives in an old house on a large block of land. The garden is becoming too much to maintain so Graham subdivides the lot and sells off half the land. Graham is not subject to GST in respect of the subdivision as the sale is not in the course or furtherance of his legal practice and on these facts it is unlikely to be an activity in the form of an adventure or concern in the nature of trade.

At times it can be difficult to distinguish between a mere realisation of private assets and an adventure or concern in the nature of trade. I will examine this distinction in greater detail in part 3 of this paper.

SUMMARY OF GST STATUS OF VARIOUS SUPPLIES OF LAND

Residential premises

Generally the sale of residential premises is input taxed[5]. However, the sale of commercial residential premises and new residential premises will be taxable supplies [6], except that, the sale of new residential premises will be input taxed if those premises were used for residential accommodation before 2 December 1998 or were used to generate input taxed supplies for five years after the new residential premises were created. The first concession is useful where a vendor stratum titles a block of flats, which were being used

for residential accommodation before 2 December 1998, after the introduction of GST[7].

Vacant land

Vacant land of itself can never have sufficient physical characteristics to mark it out as being able to be or intended to be occupied as a residence[8]. However, a supply of vacant land will be input taxed if the vacant land has been used solely in connection with residential premises (eg: a vacant block of land adjacent to a family home that has been used by the family as a tennis court)[9].

The supply of vacant land by a government will also be GST-free under subdiv 38-N. This means that a developer buying vacant land from the crown cannot receive any input tax credits on the acquisition.

Commercial premises

Supply of commercial premises will always be a taxable supply unless it is GST-free as the sale of either a going concern or farm land.

Going concern exemption

The sale of a property may be GST-free if it is sold as part of a going concern and subdiv 38-J applies. For example, where business premises are sold as part of a sale of the business, or where a tenanted building is sold subject to the tenancies. The sale of a tenanted building on a GST-free basis is considered in GSTR 2001/5.

Farm land exemption

The sale of farm land may be GST-free under subdiv 38-0 where it has been farmed for the last 5 years, and

- it is subdivided and sold for below market value to an associate (s. 38-475); or
- the purchaser intends to carry on a farming business on the land (s. 38-480).

The important factors to consider in determining whether a supply of farm land is GST-free are:

- How has the land been used? (not, who has owned the land). The requirement in s. 38-480(a) of the GST Act is satisfied, regardless of who has been conducting the farming business during the previous 5 years.
- Does the purchaser intend that a farming business be carried-on on the land? The purchaser does not have to carry on a farming business herself.

Farm homestead

Sale of that part of a family farm that comprises the homestead can be taxed in one of six ways:

- an input taxed supply of residential premises;
- a GST-free supply of potential residential land to an associate under s. 38-475;
- part of a composite GST-free supply in accordance with the subdiv 38-J going concern exemption;
- part of a composite GST-free supply in accordance with the subdiv 38-0 farm land exemption;
- a taxable supply of new residential premises on the full value of the sale; or
- a taxable supply subject to the margin scheme.

Clearly, the GST treatment of the sale of farmland is well beyond the word limit available in this paper!

ABN AND GST REGISTRATION

A vendor will only be required to pay GST upon making a taxable supply of property if the vendor is registered, or required to be registered, for GST. A vendor is only required to register for GST if they are carrying on an enterprise and their annual turnover exceeds the $50,000 registration turnover threshold[10]. While a one-off sale of commercial premises would usually push a small enterprise over the registration threshold, s. 188-25 specifically provides that projected annual turnover does not include:

- the sale of capital assets;
- supplies made solely as a consequence of the taxpayer ceasing to carry on the enterprise; or
- supplies made solely as a consequence of the taxpayer substantially and permanently reducing the size or scale of an enterprise[11].

Capital assets are the assets that are used within a business to generate income.

Case study

George owns two small shops in a strip shopping centre in partnership with his wife and two children. The shops are leased out to tenants and yield an annual rent of approximately $40,000. While the partnership is not registered for GST (because its annual turnover is under $50,000), and does not have an ABN, George runs a market garden business as a sole trader that has an ABN and is registered for GST. The partnership sell the shop for $350,000 and settlement is due to take place in early May.

The partnership is a separate enterprise from the market garden business conducted by George. As such, the partnership is entitled to be obtain an ABN and could elect to register for GST. However the partnership is not required to register for GST because the sale of the shop is the sale of a capital asset and therefore not taken into account when calculating the projected annual turnover.

As the partnership is not registered for GST the sale of the premises will not be a taxable supply. However, if the partnership does not obtain an ABN and quote this number to the purchaser, at or before settlement, the purchaser will be required to withhold 48.5 per cent of the payment that it makes to purchase the shops and remit this money to the tax office. It is an offence for the partnership to use George's ABN.

Generally speaking, a purchaser does not need to withhold tax for non-disclosure of an ABN if:

- the supplier is an individual or partnership that is not conducting an enterprise;
- the supply, for the supplier, is private or domestic. For example, when a sole trader sells her family home;
- the supply is made as part of a private recreational pursuit or hobby. For example, when you buy plans for a beach house from a person who drafts building plans as a hobby;
- the vendor tenders an "ABN safety net letter" provided by the ATO.

As George and his family are conducting an enterprise and the sale of the shops amount

to a supply of commercial premises, which have not been held by the partners for private or domestic purposes, the partnership must apply for and supply an ABN to the purchaser. It can take several weeks for an ABN to issue. If this is likely to delay settlement practitioners should advise their client to apply to the ATO for an ABN safety net letter. This can be done by calling the ATO call centre on **13 24 78** and explaining the situation. You will need to provide the call centre operator with the tax file number of the partnership or one of the partners.

WHEN IS GST PAYABLE?

Notwithstanding the usual attribution rules, that determine the tax period in which a GST liability accrues, the Commissioner has ruled in GSTR 2000/28 that GST payable on the sale of land under a standard land contract is attributed to the tax period in which settlement occurs[12]. This applies to taxpayers who account for GST on both a cash basis and on an accruals basis. However, the ruling does not address the situation in which a taxpayer receives an invoice before settlement. See discussion below regarding invoices.

A standard land contract is a written contract for the sale of land that provides for payment of:

- a deposit that is either to be forfeited if the purchaser defaults or applied as consideration at settlement, and
- the balance of the purchase price upon settlement.

Division 99 provides that the deposit paid by the purchaser is not treated as consideration until it is either forfeited or it is applied as part of the consideration for the supply of land at settlement[13]. Even if the deposit is released before settlement (pursuant to s. 27 of the Victorian *Sale of Land Act*, for example) the Commissioner takes the view that the deposit retains its character as a deposit until it is applied as consideration at settlement.

INVOICES

While GSTR 2000/28 sets out the Commissioner's view that a sale of land contract is not an invoice[14] the ruling does not consider other documents that could be invoices. It is possible that a settlement statement will meet the broad definition of invoice in s. 195-1[15]. If so, in the event that a settlement statement is issued in a tax period before the date of settlement the GST liability will be attributable to the earlier tax period for a vendor who reports GST on an accruals basis. Until this issue is clarified practitioners should resist issuing a settlement statement until the tax period in which settlement actually occurs.

Input tax credits cannot usually be claimed without a tax invoice. While the contract itself can constitute a tax invoice, if it is drafted in a way that satisfies the requirements of sub-regulation 29-70.01, this would mean that the contract probably becomes an invoice for attribution purposes. Therefore, until the issue addressed in the previous paragraph is clarified, practitioners should avoid making the contract a tax invoice and instead make delivery of a separate tax invoice a condition precedent to settlement.

FORFEITED DEPOSITS

The GST treatment of a forfeited deposit, in consequence of a default under a standard land contract, turns on whether the forfeited deposit is:

- consideration received by the vendor for releasing a purchaser from an obligation to complete the purchase[16]; or,
- liquidated damages payable by the purchaser for breaching their contractual obligation to purchase the land.

The Commissioner prefers the first construction as this amounts to a supply and will trigger a GST liability in the tax period in which the deposit is forfeited[17]. However, in my opinion this is incorrect. A standard land contract would ordinarily provide that (in addition to the forfeited deposit) the vendor can look to the defaulting purchaser for any further loss that crystallises when the property is resold. It is also true that if a vendor is able to resell the property without sustaining any loss, due to the first purchaser's default (after taking into account the time value of money, additional advertising and selling agent's fees etc), the original purchaser can bring an action in equity to have the deposit refunded[18].

Therefore, in my opinion the better view is that a forfeited deposit is no more than an amount of liquidated damages. GSTR 2001/4[19] tells us that an amount received on account of damages will not usually be taxable. This is because an award of damages usually lacks sufficient nexus with a supply to bring the payment within the meaning of being consideration for the supply.

To the extent that GSTR 2000/28 and 2001/4 are in conflict, taxpayers are entitled to rely on the later ruling.

SETTLEMENT ADJUSTMENTS

In the Commissioner's opinion, where settlement adjustments have the effect of altering the consideration payable for the supply[20], the GST liability will be fixed by reference to the consideration ultimately arrived at after the adjustments have been made[21]. This is best explained by the following examples. Assume that settlement will occur on 15 April 2002 in each example:

Example 1

Council rates are due and payable in advance for the period to 30 September 2002 and have been paid by the vendor prior to the date of settlement.

In this event, the contract will usually require the purchaser to reimburse the vendor in respect of the period between the date of settlement and the end of the Council's rating period. This has the effect of increasing the consideration for the sale of the land. The amount payable by the purchaser is not in consideration for a second supply (release of an obligation to pay the rates), therefore GST will be payable on the amount of the adjustment.

Example 2

Water rates and usage charges are payable in arrears and were due on 28 February 2002. However, the vendor has not paid these rates prior to the date of settlement.

These charges relate to the period before 28 February and relate to a separate supply made to the vendor, by the relevant authority, during the vendor's occupation of the premises. The purchaser will usually withhold the amount due from the purchase price and pay the money to the water authority. In these circumstances there is no adjustment to the consideration payable for the land because the purchaser is merely applying part of the agreed

purchase price to meet the vendor's pre-existing liability for water rates. Therefore, this situation has no GST consequences.

Example 3

Sewerage charges are payable in arrears and are due on 30 June 2002 and will become the obligation of the purchaser when the charge is levied.

These rates partially relate to usage by the vendor in the period before settlement and partially relate to the purchaser's usage. However, on these facts the debt payable in regard to the vendor's usage has not yet crystallised. The Commissioner appears to argue that the supply made by the relevant authority to the vendor is not a separate supply and therefore the adjustment merely has the effect of varying the consideration payable for the land and will therefore reduce the GST payable on the transaction.

THE MARGIN SCHEME

Under the normal GST rules the amount of GST payable on a sale of land is 1/11th of the sale price. Under certain circumstances a vendor can elect to adopt the margin scheme[22] and reduce the GST to 1/11th of the difference between the GST inclusive selling price and the GST inclusive purchase price paid when the vendor originally purchased the land.

It does not matter if the taxpayer acquired the real property before, or after, the introduction of GST. The margin scheme is available to a vendor who acquires a property:

- pre-GST; or
- post-GST from someone who calculated their GST liability using the margin scheme; or
- post-GST but the vendor did not have a GST liability (eg, the vendor was not registered for GST or it was a private sale by the vendor).

It is important that when practitioners act for a purchaser who is registered for GST, where the supply of the property will be taxable, they require a special condition in the contract that deals with whether or not the vendor will be electing to use the margin scheme. This condition should be negotiated before the parties agree on the purchase price because if the vendor chooses to make this election (and the vendor is free to make the election right up until they lodge their relevant BAS) the purchaser will not be entitled to claim an input tax credit in relation to the acquisition and will be denied access to the margin scheme when they on-sell the property.

In broad terms, where a vendor is selling land acquired before 30 June 2000 the margin is the consideration received for the supply by the vendor less the greater of:

(a) the consideration paid when the vendor originally acquired the property; or,

(b) the value of the land on the later of:

- 1 July 2000; or
- the date the vendor applied for registration.

For land acquired after 30 June 2000 the margin is the difference between the:

- consideration received for the supply, and
- consideration paid when the property was acquired.

Detailed calculation rules are set out in the table in s. 75-10(3) and summarised in para 17 of GSTR 2000/21.

When calculating the margin the consideration for the acquisition of the real property does not include stamp duty paid upon acquisition because stamp duty is an item specified in Treasurer's Determination 2000 (No. 3)[23], therefore s. 81-5 provides that the amount paid for stamp duty is deemed not to be consideration for supply.

Where a valuation is required in order to calculate the margin, that valuation must comply with any requirements determined in writing by the Commissioner[24]. The Commissioner has made two determinations on this issue and these are set out in the two schedules to GSTR 2000/21. Failure to comply with the determinations will result in the margin being calculated based on the original acquisition price even though the property may have been acquired some years before 1 July 2000. Therefore, it is important that when a practitioner briefs a valuer to prepare a margin scheme valuation the valuer is explicitly instructed to ensure their work complies with the Commissioner's determinations.

When must the valuation be obtained? In para 20 of GSTR 2000/21 the Commissioner states:

> "It is sufficient that the valuation is undertaken no later than the end of the tax period in which the GST payable on the supply is attributable."

This statement may amount to a written determination under s. 75-10. If so, the vendor must obtain a valuation no later than the end of the tax period in which settlement occurs or risk the Commissioner setting aside the valuation and assessing GST on the difference between the selling price and original purchase price. However, in my opinion the better view is that the statement in para 20 does not amount to a determination for the purposes of s. 75-10 as it is a less formal, and inconsistent in style and approach, to the two formal determinations that the Commissioner has promulgated in regard to valuation requirements. If I am correct, then a taxpayer only need obtain a valuation prior to the date they lodge their BAS and, if a valuation is not available by the lodgement date, the vendor could self assess using the original purchase price and lodge an amended BAS once the valuation is received.

Division 75 does not give the Commissioner discretion to reject a valuation that complies with the requirements in s. 75-10. Therefore, a taxpayer could "shop around" to find the highest valuation.

PART 3

Part 3 of this paper will go on to discuss some of the difficult GST issues that confront property developers. Subject to space constraints, the following topics will be discussed: isolated transactions (such as subdividing the family home), display homes, house and land packages, options to purchase land, selling off the plan, Div 129 Adjustments, in-kind developer contributions, and hopefully, an analysis of the still long awaited final ruling on the meaning of new residential premises. ■

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Part III of this article will appear in Taxation in Australia, June

Reference Notes

1. *Unless otherwise noted, reference to a section of an act are a reference to A New Tax System (Goods and Services Tax) Act 1999.*
2. *Refer s. 9-20 and MT 2000/1.*
3. *See Jones v. Leeming [1930] AC 415.*
4. *See example 11 in MT 2000/1.*
5. *s. 40-65.*
6. *New residential premises will be examined in part 3 of this paper.*
7. *According to GSTR 2001/3 simply strata titling land is sufficient to create new residential premises however this conclusion has been strongly challenged by the TIA in a submission made to the ATO on this draft ruling.*
8. *Paragraph 25 of GSTR 2000/20.*
9. *Section 9-30(4).*
10. *$100,000 for non-profit bodies.*
11. *Refer GSTR 2001/7 for a discussion of these exceptions.*
12. *Paragraph 72.*
13. *Refer GSTD 2000/1 and para 58 of GSTR 2000/28.*
14. *Paragraph 29 of GSTR 2000/28.*
15. *A document notifying an obligation to make a payment.*
16. *This being a supply in accordance with s. 9-10(2)(e).*
17. *Paragraph 98 of GSTR 2000/28.*
18. *Relief against forfeiture.*
19. *Paragraphs 110 and 111.*
20. *Because the amount owing 'attaches' to the land and becomes a debt payable by the purchaser or allowed by the vendor.*
21. *Property and Construction Industry Partnership – Issues Register – Section 15.4.1 – Sale of real property.*
22. *See div 75.*
23. *The full citation is: A New Tax System (Goods and Services Tax) (Exempt Taxes, Fees and Charges) Determination 2000 (No. 3). A copy of the Determination can be found at: http://www.treasury.gov.au.*
24. *Section 75-10(3)(b).*