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GST for property developers

Key issues facing practitioners dealing with property developers in respect of GST

This article discusses some of the key issues that practitioners should be aware of when providing advice on the GST implications of property development. These include:

- The latest GST Ruling from the ATO on new residential premises;
- GST treatment of developer contributions;
- GST treatment of house & land packages and "off the plan" sales;
- Creation of GST Groups and GST Joint Ventures; and
- Legislative requirements in respect of "change of use" adjustments.

Note that this article only aims to highlight these issues. Further, it is also critical for practitioners to take into consideration the income tax consequences and their interaction with the GST. This aspect of the property development is not covered in this artcile.

REVIEW OF THE NEW GST RULING ON NEW RESIDENTIAL PREMISES

The ATO's view in regard to new GST and residential premises is set out in the recently released GSTR 2003/3. The first draft ruling (2001/D3) was strongly criticised by the tax profession. However, most of the industry's concerns were then addressed in the second draft ruling GSTR 2002/D4. The final ruling deals with the circumstances in which the sale of real property is considered a sale of new residential premises.

GSTR 2003/3 sets out a few preliminary issues concerning the operation of s 40-75:

- Section 40-75(1) will only apply where the premises are residential premises, as defined in s 195-1. This refers to land or a building that is occupied as a residence or is intended to be occupied, and is capable of being occupied as a residence.
- If substantial renovations occur or premises have been built to replace demolished premises, the premises will be new residential premises even if they have been previously sold as residential premises.

> "to be new residential premises... neither construction of a building... nor substantial renovation is required..."

- If substantial renovations occur or premises have been built to replace demolished premises, the new residential premises will include both the land and the building, pursuant to s 40-75(3). This means that GST will be payable on the value of both the new home and the old land.

Residential premises not previously sold as residential premises – section 40-75(1)(a)

The ruling considers residential premises as a "package" comprising both land and buildings. In each case, it is necessary to determine if the particular package has previously been sold as residential premises.

A change in the size of the land may or may not render the residential premises new residential premises.

Where land with a residential building has previously been sold as residential premises and the area of land is reduced in size, the sale of the smaller package will not be a sale of new residential premises. This is because the parcel of land that includes the house is part of a package of land that had previously been sold as residential premises.

Where land with a residential building has previously been sold as residential premises and the area of land is increased, there is a different residential premises package. Further, where the sale is made in the course or furtherance of an enterprise, the ATO considers that an apportionment of the supply is required.

Case study – increase in size of land

A house is located on a quarter acre lot with a house situated upon it. The owner purchases the vacant land adjacent to the quarter acre lot and merges the two titles together.

The residential premises that consisted of the house upon the quarter acre lot, has now become a new, larger package of a house upon land. Upon sale, where the sale is made in the course or furtherance of an enterprise, the two components – the "old package" and the "new land" added to that package" – will be treated as a composite supply for GST purposes. That part of the supply that comprises the old house and quarter acre will be input taxed while that part of the supply that comprises the vacant land will be a taxable supply.

If real property was previously sold only as commercial property, for example as a warehouse, the sale of the converted residential premises will be new residential premises. It should be noted that neither construction of a building to replace demolished premises nor substantial renovations is required, merely the first-time sale of the premises as residential premises.

The process of strata titling of apartment blocks will, of itself, not create new residential premises. For the same reasons the subdivision of land that includes residential premises, of itself, does not create new residential premises.

New residential premises created through substantial renovations – section 40-75(1)(b)

Under s 40-75(1)(b), new residential premises will be created through the process of substantial renovations of a building. The Act defines "substantial renovations" in s 195-1 as:

"renovations in which all, or substantially all, of a building is removed or replaced. However, the renovations need not involve removal or replacement of foundations, external walls, interior supporting walls, floors, roof or staircases."

This definition requires a consideration of what work has been done to the building by the current owner since it was acquired. It is noted that in the context of this provision, an individual strata title unit or apartment is a "building" and its structure is enclosed within the external walls of the unit.

Two key criteria are identified as essential for substantial renovations to occur:

- the renovations need to affect the building as a whole; and
- the renovations result in the removal or replacement of substantially all of the building.

Whether substantial renovations have occurred should be based upon consideration of the changes made to the building in its entirety. These should directly affect most rooms in a building; the renovation of only one part of the premises would not constitute substantial renovations.

Practice note

Work associated with the renovations but not directly attributable to the building itself is excluded – for example landscaping, as it is not work to a building. In the same vein, additions made to the premises can usually be ignored, as these works are unlikely to be renovations.

The Commissioner accepts that cosmetic work by itself cannot give rise to substantial renovations. However, where structural or non-structural work amounts to substantial renovations that create new residential premises, any cosmetic work undertaken will form part of the new residential premises.

Structural work includes (GSTR 2003/3 para 70):

- alterations to, or replacement of, foundations;
- replacement, removal or alteration of floors or supporting walls, or parts thereof (interior or exterior);
- lifting or modifying roofs;
- replacing existing windows and doors such that it is necessary to alter brickwork.

Non-structural work includes (GSTR 2003/3 para 74):

- electrical rewiring;
- replacement, removal or alteration of non-supporting walls, or parts thereof (interior or exterior);
- plastering or rendering an entire wall or walls;
- plumbing;
- the removal or replacement of kitchen cupboards, bathroom fixtures, etc;
- removal or replacement of air-conditioning or security systems.

Cosmetic work includes (GSTR 2003/3 para 77):

- painting;
- sanding floors;
- removing and replacing worn or out-of-date fittings;
- replacing curtains or carpets.

Practice note

You only need to consider those renovations that have been completed at the time of sale. This means that there might be times when the best tax outcome would be achieved by a developer selling an old house "as is" and entering into a separate contract with the purchaser to complete the renovations after settlement on the house.

You also only need to consider renovations by the current owner. Substantial renovations may take months or several years to complete. The time frame over which the works are completed will not impact on whether or not the renovations will be considered to be substantial.

New residential premises that have been built to replace demolished premises on the same land – section 40-75(1)(c)

New residential premises will include residential premises that have been built, or contain a building that has been built, to replace demolished premises on the same land. As "demolish" is not defined in the GST Act, it takes on its ordinary meaning. In the context of the legislation, demolish in reference to premises means pulling down or removing the existing building. However, premises may be demolished without the complete removal of all of the building; some existing foundations may be retained.

DIVISION 82 & DEVELOPER CONTRIBUTIONS

The grant of the right to develop the land, by the council, and transferring the land to the council are both non-monetary supplies for GST purposes. In the ordinary course of events, these supplies would be taxable and the value attributable to the supplies would be the market value of each supply,

pursuant to s 9-75. Practitioners may also refer to GSTR 2001/6 which considers how the grant of the right to develop land should be valued.

However, a new Div 82 has been insterted into the GST Act with retrospective effect back to 1 July 2000. This Division provides that:

- a supply, by an Australian government agency, of a right to develop land is not treated as consideration for the supply of an in-kind developer contribution (see s 82-10(1)). This change will absolve developers from the need to remit GST on the value of planning approvals when supplying capital works;
- an amendment be made to remove any past and current obligation for local authorities to remit GST on the value of capital works received as consideration for the supply of a planning approval; and
- the supply of an in-kind developer contribution will not be a taxable supply (s 82-5(1)).

WHAT IS THE GST TREATMENT OF HOUSE & LAND PACKAGES AND OFF THE PLAN SALES?

House & Land packages

Most contracts in regard to the sale of a house and land package will comprise two supplies; the supply of a block of vacant land and a separate supply of building services. The contract usually provides for the payment of a deposit upon executing the contract, payment for the land prior to commencement of the building works and then progress payments in regard to the building services. This usually means that the purchaser will be the owner of the land from the date of settlement on that part of the transaction therefore title to the subsequent building works will automatically vest in the purchaser as those works are affixed to his or her land. In this event, where the property developer accounts for GST on an accruals basis, GST will be attributed in the following manner:

Initial deposit

Where a builder takes a deposit as security for the performance of an obligation, Div 99 will attribute that receipt to the tax period in which the deposit is applied as consideration for the supply. This is true even if the deposit is released to the vendor before settlement on the land or completion of the building works (as applicable). If the deposit is for the supply of land GST will usually be attributable to the date of settlement on the land. If the deposit is in relation to the building services, GST should be attributed to the tax period in which practical completion of the building works is achieved. However, these two conclusions will depend on the terms of the contract between the parties.

If the true nature of the deposit is a part payment, or advance payment, in regard to one of the supplies, then Div 156 will attribute this payment to the tax period in which the relevant supply is made.

Monies paid at settlement on the land

GST will usually be payable on the value of the land component of the transaction in the tax period in which settlement occurs, as this is the date on which the supply of the land is made to the purchaser. However, as this part of the transaction is for the supply of real property the margin scheme may be available to reduce the GST liability.

Payment for the building works

As the provision of building services does not amount to a supply of an interest in, or right over, land the margin scheme cannot be used in regard to this supply. Title to the completed building works passes to the owner of the land as the works are completed therefore the supply of building services is being made on a progressive or periodic basis. In this event Div 156 will treat these services as separate supplies for the purpose of the GST attribution rules. Therefore GST will generally be attributed to the tax period in which the builder raises an invoice for each stage of the building works.

Off the Plan Sales

Some house and land packages provide for a deposit and progressive payments to be made to the builder but title to the land does not pass to the purchaser until completion of the building works. In this event, Div 156 will not apply and GST will be attributed in accordance with Div 29. This type of contract is commonly known as an "off the plan" sale. Tax Determination 18 describes this type of transaction as follows:

> "An 'off the plan' purchase occurs where the acquisition of land or land and building cannot be completed until certain events have happened. For example, where the owner of the land has not completed all capital works required before building can commence such as finalisation of boundaries, roads and telephone and electricity connections. Another example of where an 'off the plan' purchase can occur is where an apartment block is in the course of construction.
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> In these cases, the purchaser enters into a contract, usually paying a deposit on signing the contract, with settlement and payment of the balance of the purchase price not occurring unless a specified event happens. This could be the finalisation of all capital works needed before building can commence or the completion of the building or apartment."

In contrast to a house and land package, an off-the-plan sale is only one supply. On the strictest of terms, prior to settlement, the supply is that of a contractual right to acquire the property if, and when, the building works are completed. At settlement, a sale off the plan is the supply of new residential premises by the property developer.

Sale before completion

If a purchaser sells his other interest before the building has been completed the purchaser may be selling their rights under the contract to a new purchaser. A common scenario for large inner city unit developments is for the developer to sell a number of premises off the plan to a marketing company (in order to reach pre-sales targets required by financiers). The marketeer will then on-sell the premises before they have to pay the balance of the purchase price. In this event the on-sale would be in the course or furtherance of an enterprise, and subject to GST if the marketeer was registered or required to be registered.

If the purchaser was a property developer or builder, who often bought properties off the plan with the intention of selling them

again before completion (presumably at a profit) and before they had to come up with the balance of the purchase price, the sale of the rights would be in the course or furtherance of an enterprise. Therefore, the sale would be subject to GST assuming the purchaser was registered or required to be registered.

The on-sale amounts to a disposal, by way of assignment, of the marketeer's contractual right to the premises; not a supply of residential premises. Therefore the on-sale will not be an input taxed supply of [second hand] residential premises under s 40-65. This is because the definition of residential premises is limited to land or a building. Where the subject matter of the on-sale is merely a disposal of contractual rights, the transaction will not amount to the supply of land or buildings. This said, depending on the facts, the margin scheme may be available to the marketeer as the definition of real property in s 195-1 includes "any interest in or right over land or a personal right to call for or be granted any interest in or right over land". In contrast, the definition of residential premises is limited to "land or a building that is occupied as a residence . . . "

The Commissioner accepts that if the contractual interest is subsequently disposed of because of one of the following reasons, the supply is not made in the course or furtherance of an enterprise (refer to Property and Construction Industry Partnership – Issues Register – Section 12.4):

- change in financial circumstances such that the purchaser cannot afford to go ahead with the purchase;
- the purchaser changes his or her mind about the judicious nature of the investment and sells to avoid making a loss or greater loss at a later point in time; or
- the purchaser decides he or she does not want to live in the premises.

An alternative strategy would be for the marketeer to actually complete the purchase of the unit from the developer and then on-sell the premises to the final 'consumer'. In this event, the second sale will not be a sale of new residential premises because the marketeer took delivery of title to the premises, which will mean that the on-sale will be in regard to premises that have previously been sold as residential premises.

> "members of a GST group are jointly and severally liable to pay any amount payable by the representative member under the GST law"

SIMPLIFYING GST OBLIGATIONS THROUGH THE CREATION OF A GST GROUP OR GST JOINT VENTURE

GST Groups

Companies, trusts or partnerships with common ownership or membership often operate as a group and make supplies and acquisitions from each other. When one member makes a taxable supply to another member, it will generally pay GST on that supply while the member that makes the acquisition will generally be able to claim an input tax credit. If these entities form a GST group, inter-group transactions will be ignored for GST purposes. This can simplify the group's GST accounting procedures, save costs and improve cash flow.

Companies can form a GST group if each company in the proposed GST group:

- is a member of the same (at least 90 per cent owned) group;
- is registered for GST;
- has the same tax periods;
- accounts for GST on the same basis (that is, cash or non-cash);
- does not belong to any other GST group; and
- has not branched for GST purposes.

Trusts and partnerships may also become members of a GST group if they satisfy the regulatory requirements, which are currently being finalised.

GST groups are effectively treated as a single entity for GST purposes. Transactions between group members are not treated as taxable supplies, so no GST is payable and no input tax credits can be claimed on these transactions.

One entity, known as the "representative member", manages the GST affairs of the group and is responsible for lodging a collective business activity statement and attending to all GST administrative matters.

When members make supplies or acquisitions or taxable importations outside the group, the representative member is responsible for all GST payable and is entitled to all input tax credits on those transactions. While the representative member is responsible for paying GST, the members of a GST group are jointly and severally liable to pay any amount payable by the representative member under the GST law.

GST joint ventures

It is interesting to note that a joint venture is not an entity. This is a significant point when advising property developers, as this structure is a relatively common feature of the industry. This means that each member of a joint venture must separately account for GST, which can be somewhat onerous, particularly when various joint venturers make supplies to each other.

The practical solution is found in Div 51 which provides that entities engaged in certain joint ventures can have the joint venture approved as a GST joint venture. The effect of forming a GST joint venture is that one member (known as the joint venture operator) pays the GST and is entitled to the input tax credits on supplies, acquisitions and importations it makes on behalf of the other joint venturers in a manner similar to the way in which the representative member of a GST group accounts for GST.

Supplies made by the joint venture operator to a participant in the GST joint venture, for the purpose of the joint venture, will not be subject to GST.

Subject to certain conditions, s 51-5 provides that the Commissioner must approve two or more entities as the participants in a GST joint venture if the joint venture is a joint venture for the exploration or exploitation of mineral deposits, or for a purpose specified in the

regulations. Regulation 51-5.01 provides that joint ventures involved in the "design, building or maintenance of residential or commercial premises" may form a GST joint venture. However, before accounting for GST on this basis the joint ventures is required to make a formal application to the Commissioner asking him to exercise his discretion to approve the creation of a GST joint venture.

What are the participation requirements?

Members of the joint venture, other than the joint venture operator, must:

- participate in, or intend to participate in, the joint venture;
- be a party to a joint venture agreement with the other participants;
- be registered for GST; and
- account on the same basis as all the other participants.

The GST Act recognises that the joint venture operator may be a professional joint venture manager and not actually be a participant in the joint venture. For this reason, the joint venture operator is only required to fulfil all the participation requirements if they are also a participant in the joint venture.

If the joint venture operator is not a participant in the joint venture, the joint venture operator only needs to:

- be registered for GST; and
- account on the same basis as all the other participants.

The joint venture operator pays the GST and is entitled to the input tax credits on supplies, acquisitions and importations it makes on behalf of the other joint venturers for the purpose of the joint venture.

It will also be responsible for any adjustments relating to these supplies, acquisitions and importations (though other rules apply when a participant leaves a GST joint venture).

The joint venture operator will submit a business activity statement (BAS) at the end of every tax period. The BAS will include a net amount of GST payable or input tax credits claimable as a result of transactions made on behalf of the members of the GST joint venture. The net amount will include any adjustments relating to transactions made in previous tax periods.

DIVISION 129 & CHANGE OF USE ADJUSTMENTS

Provision has been made in Div 129 for adjustments to be made in circumstances where, after a creditable acquisition has been made, the extent to which that acquisition is applied or used for a creditable purpose varies from the intended use (see GSTR 2000/24).

Section 11-15 defines "creditable purpose" as follows:

- You acquire a thing for a creditable purpose to the extent that you acquire it in carrying on your enterprise.

- However, you do not acquire the thing for a creditable purpose to the extent that:
  - the acquisition relates to making supplies that would be input taxed; or
  - the acquisition is of a private or domestic nature.

In practice, the impact of this Div will fall mainly upon:

- sole traders who buy assets such as cars and computers partly for business purposes and partly private purposes; and
- property developers or speculative builders who construct new residential premises for sale, but end up having to rent out some or all of the premises, and thereby make input taxed supplies.

Division 129 requires these taxpayers to refund input tax credits when there is a change in the usage of the goods acquired such that the original input tax credit was overstated (this is called an increasing adjustment). Conversely, a taxpayer will be entitled to a decreasing adjustment where the original input tax credit was under claimed. An increasing adjustment occurs where the actual application of the acquisition to a creditable purpose is less than the intended application, and results in a decrease in available input tax credits, or effectively a repayment of input tax credits already received. Conversely, a decreasing adjustment occurs where the actual application of the acquisition to a creditable purpose is greater than the intended application, resulting in an increase in available input tax credits.

At the most general level, what these rules mean in practice is that if:

- you have acquired something for your business;
- claimed the input tax credit; and
- there is a possibility that it will be used at least partly for personal, input taxed or GST-free purposes over time,

you will have to maintain details of the value of each individual creditable acquisition and the amount of GST claimed. You must then monitor changes in the mix of private and business usage for some time, in order to work out whether you may be required to adjust the input tax credit you claimed up front.

The legislation utilises the concept of "adjustment periods". The length of time that you must keep these records and monitor usage will be determined by the GST-exclusive value of the acquisition under consideration. The number of periods is as follows (s 129-20(3) – note that the reference given applies to non-finance acquisitions):

Value of acquisition	Number of adjustment periods
Below $1,000	0
$1,000 – $5,000	2
$5,000 – $500,000	5
Above $500,000	10

The first adjustment period will be the tax period that ends on 30 June at least 12 months after the end of the tax period to which the acquisition is attributed (s 129-20(1)) and each subsequent tax period ending on a 30 June.

Change in use – subsequent decision to lease the property

If a developer completes a residential development, with the intention of selling the development upon completion, the sale of the new residential premises will be a taxable supply. Therefore, the acquisitions

made by the developer in relation to the development will be creditable acquisitions and will entitle the developer to claim input tax credits for the GST components of the acquisitions.

However, if the developer subsequently decides to rent out some or all of the premises that he builds prior to the sale Div 129 will require an adjustment to be made. This is because renting out residential premises is an input taxed supply. This means that the materials, etc, used to build the premises will now be at least partly used for a non-creditable purpose. Div 129 requires the developer to record an increasing adjustment at the end of the current adjustment period (see/above).

If a single lump sum was paid for the construction of the building (for example if the developer contracted out all development costs to a builder and paid one invoice for the total job), the developer would have claimed one input tax credit. In the more usual scenario, where progress payments have been made, each payment will represent a separate acquisition under Div 156, giving rise to a separate input tax credit. Division 129 may require later adjustments in respect of each progress payment.

However, if the developer actually built the premises himself then he will have made many separate creditable acquisitions (for example the cost of the land and each load of timber, roof tiles, fixtures and fittings, etc) and Div 129 will require each acquisition to be adjusted, and depending on the dollar value of the acquisition the developer will have to continue making the adjustments for up to 10 years.

This issue may result in the developer being required to repay all the input tax credits received in relation to the development. However, it might be possible to reclaim these amounts as a decreasing adjustment when the developer makes a taxable supply of new residential premises.

Threshold value of acquisitions

Division 129 requires adjustments for an acquisition only where the GST-exclusive value of the acquisition was more than $1,000, pursuant to s 129-10(2). This means that if an acquisition for the building cost less than that amount (eg a bucket of nails), and the input tax credit was properly claimed, adjustments under Div 129 will not be required in respect of that acquisition. The input tax credit would not have been properly claimed if the developer's intention at the time of the acquisition was to rent out the premises. In this event, the acquisition was never a creditable acquisition within the meaning of s 11-5 therefore Div 129 is not bought into play. This means the BAS on which the input tax credits where improperly claimed needs to be amended (subject to the slip rules). ◆

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