

A taxing matter – GST fundamentals in property transactions

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Structure Outline

1. Scope/limitations
2. Suggested process
3. Property a taxable supply?
4. Seller registered (or required to be reg.) for GST?
5. Property as a *GST-free Going Concern*
6. farmland exemption
7. Getting it wrong
8. Margin Scheme
9. Price plus / includes GST
10. Apportioning where “mixed supply”
11. “plan B” and cascading GST clauses

1. Scope/limitations

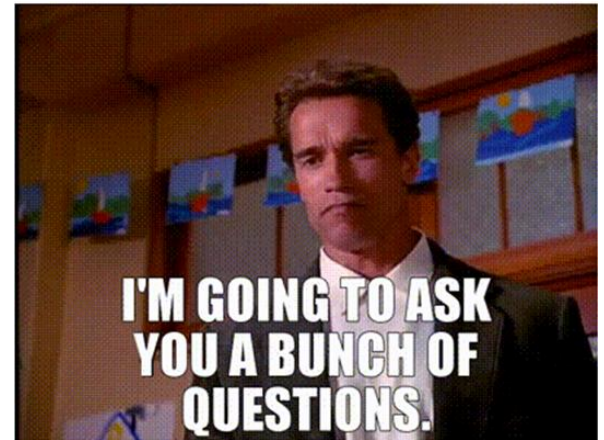
- (i) Focus on property sales/purchases for early career property lawyers
- (ii) Finite / plain English general overview
- (iii) “80/20 rule” for issues selected (nearly everything has exceptions)
- (iv) detailed resources available elsewhere:-
 - (a) firm precedents/policies;
 - (b) supervisor guidance;
 - (c) **issue-specific personal research (Eg GST rulings and commentary);**
 - (d) additional training/seminars;
 - (f) client’s accountant (if area-specific knowledge held);
 - (e) \$1,000/h revenue law experts

[“GST Withholding” not covered in this session]



2. Suggested process

- (a) Is the supply of the property a taxable supply?
- (b) If so, does the Seller have to remit GST?
- (c) does *GST-free Going Concern* apply (or can it?)
- (d) does *farmland exemption* apply?
- (e) does/can/should *Margin Scheme* apply?
- (f) *Price plus GST* or *Price includes GST*?
- (g) If mixed supply - apportionment
- (h) If doubt – “plan B” and cascading clauses.



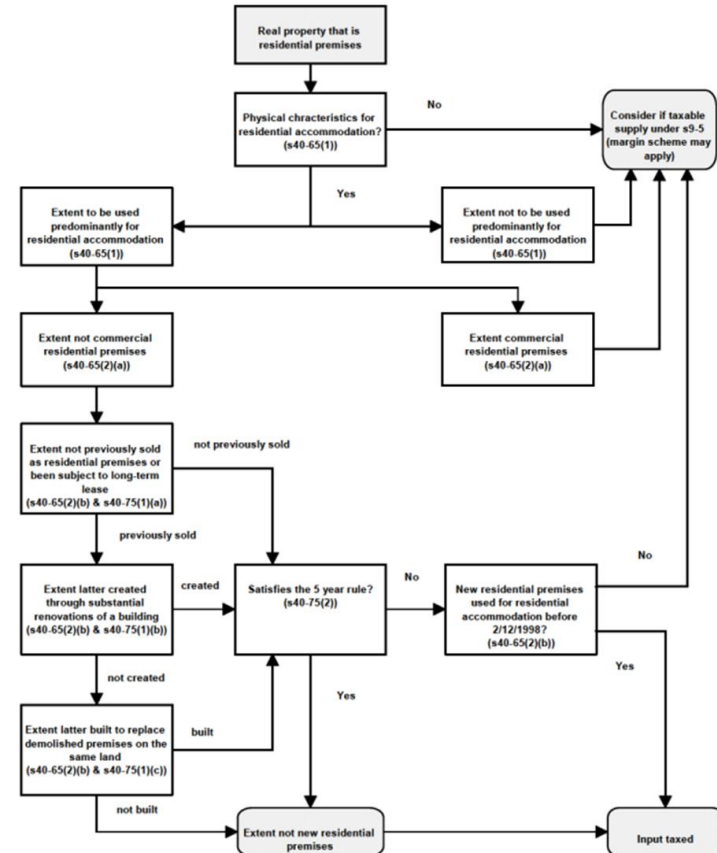
2. Suggested process (cont.)

From GSTR 2002/3 (Re sale of resi premises in course of enterprise)



Treatment of the sale of residential premises in the course or furtherance of an enterprise

(Note: This flowchart is a general guide only and should be used in conjunction with the relevant paragraphs of this Ruling)



3. Property a taxable supply?

(a) “*Input-Taxed*” properties:

(i) second-hand *residential premises*

(incl. 2nd hand houses, 2h units, 2h display homes, 2h retirement villages)

(ii) *Financial Supplies* (e.g. disposal of capital in a partnership – perhaps half a commercial property?)



“residential premises” [GSTR 2012/5]

- Look at the physical characteristics (designed/built/modified to be occupied and capable of being occupied)
- Disregard actual use, seller intent, buyer intent, zoning, temporary disrepair, temporary legal impediment to occupation, etc.
- Can include building/s & land, unit & exclusive use parking
- Can include house with home office, house in industrial area with industrial tenant
- Not commercial building with squatter, office building with kitchen & shower, hospital, aged care.



“residential premises” [GSTR 2012/5]

- **Example 7** (building designed as a shop, lived in as a residence):

- (a) Not if merely furnished for use as a residence;
- (b) Yes if physical character of building modified for residential accommodation.

- **Example 8** (doctor modifies house with significant physical modifications incl. office, consulting space, operating theatre, waiting room, storage & sealed car park. Bedrooms used for storage), bathroom, kitchen, lounge, garden unmodified. Must apportion.



- **Example 9** (solicitor converts a room to an office with furniture, equipment, electrical/data points & signage outside. No other rooms modified.) Too little change to alter physical characteristics of the house.

3. Property a taxable supply? (cont.)

(b) Taxable supply properties:

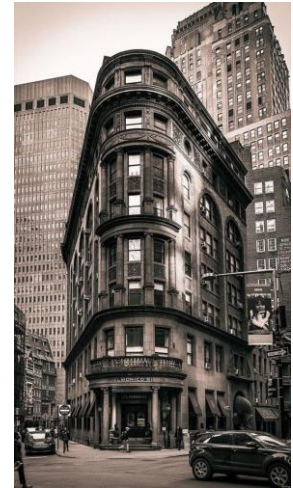
(i) new *residential premises* (incl. created through *substantial renovations*) [GSTR 2003/3]

[5 years of leasing OR previously sold as residence to become not 'new']

(ii) *commercial residential premises*
[GSTR 2000/20] (hotel / motel / inn / hostel /
boarding house / school-related)

(iii) vacant land (incl. in residential area)

(iv) commercial premises



4. Seller registered (or req. to be) for GST?

- (i) Generally **not** required to register if:
 - private use prop transaction (construct/sell family home)
 - only receive residential rent from property
 - one-off transaction (not course of business)

- (ii) May **need to** register if:
 - turnover from property transactions & other taxable transaction > \$75k threshold
 - activity/ies is an “enterprise” [E.g. buy/develop/sell land for profit – even one-off]

- (iii) Seller’s accountant Re Seller’s GST status.



4. **Seller registered (or req. to be) for GST? (cont.)**

(iv) Who should bear risk of GST actually applying?

Seller:

- knows (?) own tax status
- must remit (if GST applies)
- recovery against Buyer under Contract?

Buyer

- Seller warranties @ best Re Seller tax status
(developer/sophisticated Buyer may require to high degree)
- wants certainty “the price is the price”
- may want certainty “can recover GST if paid”



5. Property as a GST-free **Going Concern** [GSTR 2002/5]

- (i) Sale of an enterprise can be GST-free
- (ii) “leasing out a commercial building” is an enterprise
- (iii) **Going Concern** criteria to be met:
 - seller supplies to recipient all things nec. for continued operation of enterprise
 - seller carries on enterprise until settlement
 - supply is for con\$ideration
 - buyer registered for GST
 - agreed in writing “*going concern*”



5. **Going Concern (cont.)** [GSTR 2002/5]

- (i) Eg. commercial property with current tenant.
- (ii) Eg. was leased, temporary refurb / temporary vacancy w/ advertising [paras 149-158]
- (iii) Eg. not if Landlord selling property to the Tenant (merger) [paras 108-109]
- (iv) Eg. LandCo sells land & BusCo sells business to single BuyerCo on same smt day (both *Going Concerns*) [paras 137-140]
- (v) Eg. entering (genuine) Agreement for Lease with lease commencing post-settlement. [para 151]



5. **Going Concern (cont.)** [GSTR 2002/5]
- (vi) **Eg. Starting new lease** (to related entity of Buyer) **day b4 settlement**
[paras 131-136]
- very common in practice
 - differing opinions Re details (rent-free period, 'terminate if no smt' clause, insurance, security, short-form lease)
 - Look at arrangement as a whole.

Non-binding Compendium GSTR 2002/5EC:

"In circumstances where an agreement for lease has been entered an enterprise of leasing will be considered to have commenced operation, regardless of whether or not a tenant has entered into possession of the premises. Provided that the enterprise of leasing continues operating up until the day of supply, and the other requirements of section 38-325 are satisfied then the premises will be capable of being supplied as a GST-free going concern."

Cf.

- a lease or AFL which is never intended by the parties to be given effect to as a lease
- a "sham transaction" intended by the parties to have no legal effect

6. Farmland Exemption (s38-480 GST Act)

Two requirements:

- (i) Farming business carried on (on the land) for 5 years b4 supply;
- (ii) Recipient intends that a farming business be carried on (on the land)

“farming predominant activity” /
“essential characteristics of farmland”
test Re other land uses
(incl. private uses)



7. Getting it wrong

Incorrectly treating **input-taxed** property as Taxable / **Going Concern**

Eg. sale of this house as a **Going Concern**
(where some/all actually **Input Taxed**)

Div 135 GST Act, a purchaser becomes liable to pay an **increasing adjustment** if the purchaser is “the recipient of a supply of a going concern...”, or [GST-free farm land]”, and the purchaser “intends that some or all of the supplies made through the enterprise to which the supply relates will be supplies that are neither taxable supplies nor GST-free supplies [for example, residential rent]”.



If Buyer then leases to resident and/or dentist – could be an **Input-Taxed** supply (non-creditable purpose), therefore **increasing adjustment** payable later
(10% x sale price x % of non-creditable use)

8. Margin Scheme

A “reduced GST” way of selling taxable property if criteria met. Common use example:

- (a) Developer buys *input taxed* residences;
- (b) demolishes houses, builds resi units, sells as new residential property;
- (c) Unit sale contracts have “*Margin Scheme* applies” clause;
- (d) At settlement, less than 1/11th of the GST-inclusive Purchase Price is GST (GST is 1/11th of the Margin is remitted);
- (e) Buyer cannot claim a GST credit.



8. Margin Scheme (cont.)

Criteria:

- Seller sells property as part of business and registered for GST;
- Property qualifies for *Margin Scheme* sale (acquisition/history);
- pre-settlement written agmnt between Buyer & Seller to apply *Margin Scheme*

NOTE- can apportion *Margin Scheme* part of amalgamated land.

E.g. calculation of “margin”

- Purchase *input taxed* residences for \$5M
- Build & sell townhouses for (collectively) \$9M
- the “margin” is \$4M
- GST is 1/11th of the margin (\$363,636.36 GST)



8. Margin Scheme (cont.)

Cannot use *Margin Scheme* if:

- prev. seller (to you) not eligible to apply *Margin Scheme*;
- Property purchased “fully taxable” (& GST credit claimed by Seller when they bought it);
- Property purchase as part of GST-free *Going Concern* (& seller couldn't have used *Margin Scheme*;
- Property purchase as *GST-free farmland* (+ factors);
- other inheritance, GST groups, joint venture, related-party & no consideration, time-of-transaction, etc. factors (complex)

Tips: -Resi acquisition for developer – Self-serving Spec Cond “*seller warrants this is an input taxed 2nd hand dwelling*”

- complex acquisition for developer – “*seller warrants is eligible & could apply Margin Scheme*”

9. Price plus GST / price includes GST

GST3 Inclusive or Exclusive Purchase Price:

■ WARNING
GST1 (Goods and Services Tax) Scheme) and

Does the Purchase Price include GST? Mark 1 box only

Yes ☐ If Yes, clause 11.4 (Purchase Price includes GST) applies.

No ☐ If No, clause 11.5 (Purchase Price Does Not Include GST) applies.

If neither box is marked or if both boxes are marked, clause 11.4 (Purchase Price Includes GST) applies.

11.4 Purchase Price Includes GST

If this clause 11.4 applies, the Purchase Price includes the Seller's liability for GST on the Supply of the Property. The Buyer is not obliged to pay any additional amount to the Seller on account of GST on the Supply of the Property.

11.5 Purchase Price Does Not Include GST

If this clause 11.5 applies, the Purchase Price does not include the Seller's liability for GST on the Supply of the Property. The Buyer must on the Settlement Date pay to the Seller in addition to the Purchase Price an amount equivalent to the amount payable by the Seller as GST on the Supply of the Property.

9. Price plus GST / price includes GST (cont.)

Duoedge Pty Ltd v Leong [2013] VSC 36

- price “\$916,000 GST inclusive”
- Seller produced tax invoice at smt.
- ATO later rejected the Buyer’s claimed GST refund.

Case confirms:

- (a) the Seller bears risk of GST being payable where parties select the “*price includes GST*” in that Vic contract (similar to Qld K);
- (b) the Buyer bears risk of GST being payable if “*price plus GST*” is selected; and
- (c) the provision of a tax invoice does not determine whether a taxable supply has occurred.

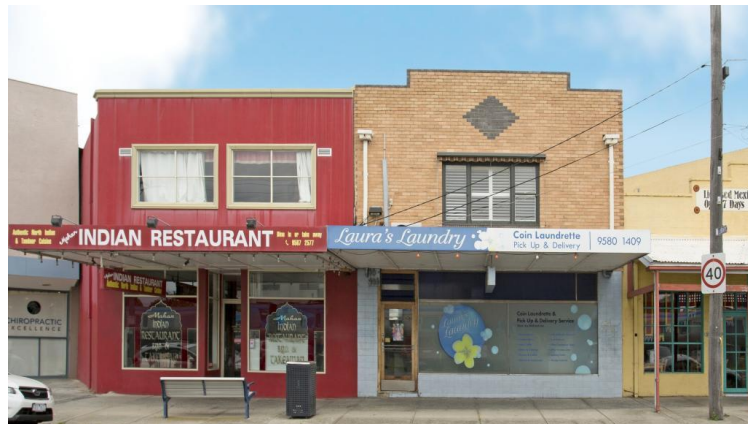
10. Apportioning where mixed supply [GSTR 2001/8]

E.g. sale of building with commercial downstairs & (non-new) residential upstairs (*input taxed*).

(a) Apportion consideration between taxable & non-taxable;

(b) “any reasonable basis” to apportion (supportable on the facts & keep records that explain) eg:

- agreed between parties
- prices “as if each part supplied separately”
- relative rent amts
- relative floor area (if areas of equal value)



10. Apportioning where mixed supply (cont.)

GSTR 2000/20 [para 23]

“23. Whether or not a particular room or part of a house or apartment is to be used predominantly for residential accommodation, as opposed to commercial purposes, is a question of fact and degree.

A home office in a house will not generally be sufficiently separate from the rest of the residential premises to distinguish its use and its **predominant use will still be residential** accommodation. “



11. “Plan B” and cascading GST clauses

Eg:

- (x.1) Buyer and Seller agree *Input Taxed* supply based on phys factors;
- (x.2) If GST applies, Buyer must pay the GST within *n* days of tax invoice;
- (x.3) If must be apportioned, split shall be:
 - (a) what ATO asserts; or
 - (b) (if above NA) as agreed by parties (acting reasonably); or
 - (c) (if above NA) 60% taxable, 40% *input taxed*

Consider

- size/likelihood of risk
- who bears risk?
- post-smt enforcement practicalities
- non-ambiguity of clause (vs ATO audit/misinterpretation)
- developer/sophisticated buyer may insist on certainty or lower price



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