[Insert DD Month YYYY]

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[Insert Client Name]

[Insert Client Position]

[Insert Company Name]

[Insert Company Address]

[Suburb State Post Code]

Dear [Insert Client Name]

**Re: GST issues in property**

**Background**

When undertaking transactions involving real property it is important to consider whether the transaction will give rise to Goods and Services Tax (GST) issues. The GST treatment of property can be complex as the GST treatment can vary depending on the type of property involved and the methodology used for calculating the GST.

**Executive Summary:**

1. We outline below the different types of real property which can be supplied and the GST treatment of each.
2. In certain circumstances, better GST outcomes may be achieved by applying the:-
	1. margin scheme;
	2. supply of a going concern;
	3. supply of farm land for farming.
3. Purchasers of new residential premises or potential residential land are generally required to withhold and remit the GST attributable to the purchase to the Australian Taxation Office (ATO).

**GST overview**

GST is payable on taxable supplies which are supplies:-

* Made for consideration;
* Made in the course of an enterprise;
* Connected with Australia;
* Made by an entity that is registered or required to be registered for GST;
* Not GST-free or input taxed.

The supply of a going concern and the sale of farm land for farming are examples of supplies which are potentially GST-free. The supply of residential premises or residential rent are examples of supplies which are potentially input taxed. Otherwise, where the conditions are met the supply of real property will be a taxable supply.

**Types of property**

*Commercial property*

Commercial property is not defined for the purposes of the GST. Examples of commercial property include retail, office, industrial and farming. A transaction involving commercial property (e.g. a sale or lease of the property) will normally satisfy the elements of a taxable supply, and hence the supplier will typically be subject to GST (assuming that the supplier is registered or required to be registered for GST purposes).

The sale of commercial property which is subject to a lease may be supplied as a leasing enterprise eligible for the supply of a going concern exemption, in which case the supply would be GST-free and the supplier would not be subject to GST. In order for this concession to apply, there are certain conditions that are required to be satisfied. In particular, it will generally be necessary for the commercial property to be sold subject to the existing lease being in place at the time of the supply. The views of the ATO on what would be required to sell a leasing enterprise as a GST-free going concern is outlined in GST Ruling GSTR 2002/5.

Land on which a farming business has been carried on may be eligible for GST-free treatment as a supply of farm land for farming. For an outline of when this concessionary GST treatment is available refer to GSTD 2011/2.

*Commercial residential premises*

The supply of commercial residential premises (by way of sale or lease/rent) is also subject to GST (again, assuming that the supplier is registered or required to be registered for GST purposes).

Commercial residential premises are defined in section 195-1 of *A New Tax System (Goods and Services Tax) Act* 1999 (***GST Act***) to include hotels, motels, boarding accommodation, and similar. In determining whether a property is commercial residential premises, consideration is given to a number of factors including whether the property allows for multiple occupancy, the commercial intention in using the property, the status of occupants (i.e. guests), and the nature of the services provided to guests. The ATO’s view on the application of the GST provisions to supplies of commercial residential premises is set out in Goods and Services Tax RulingGSTR 2012/6 (commercial residential premises) and Goods and Services Tax Ruling GSTR 2012/7 (long-term accommodation in commercial residential premises).

*Residential premises: Non-commercial*

A transaction involving non-commercial residential premises will ordinarily be input taxed, and hence will not be subject to GST, with the exception of the taxable supply of new residential premises which will be subject to GST, as discussed below.

1. The meaning of residential premises

The term residential premises is defined in section 195-1 of the *GST Act* to mean land or a building that is occupied as a residence, or as residential accommodation, or that is intended to be occupied and is capable of being occupied as a residence or residential accommodation.

The ATO has outlined its views on the input taxed supplies of residential premises in Goods and Services Tax Ruling GSTR 2012/5.

1. Claiming input tax credits

Where a supply of residential premises (other than new residential premises) is input taxed, suppliers of residential premises will not be able to claim input tax credits on acquisitions relating to these supplies. This has an impact particularly on developers who intend to lease the residential premises they construct. They will not be entitled to claim input tax credits on construction expenses for new residential premises which will be leased.

Some taxpayers have developed complex structures aimed at overcoming this limitation. However, Taxpayer Alert TA 2009/5 serves as a reminder that the ATO may seek to apply the general anti-avoidance tax provisions of Division 165 of the *GST Act* to such arrangements. Similarly, Goods and Services Tax Ruling GSTR 2010/1 discusses the application of Division 165 where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5. Hence, taxpayers should ensure they have a valid commercial reason for any structure implemented.

1. New residential premises

As noted above, the supply by way of sale of new residential premises is subject to GST. The term ‘new residential premises’ means premises that have not previously been sold as residential premises or subject to a long-term lease (i.e. a lease of at least 50 years). Premises which have been substantially renovated or built to replace demolished premises can also be new residential premises for these purposes. For guidance on when a supply is of new residential premises see GSTR 2003/3.

There have previously been some difficulties experienced by developers who develop properties using development lease arrangements. A development lease arrangement involves the supply of land by the landowner by way of sale or grant of a long-term lease to the developer. However, prior to this, the developer enters into a short-term development lease, the terms of which require the developer to undertake the development in accordance with a development plan. Once the development has taken place, the development lease is surrendered and the land will be supplied to the developer by way of sale of the freehold interest or grant of a long-term lease. Developers then sell the residential premises to the public. Development lease arrangements do not prevent land from being new residential premises. Similarly, subdivisions will not, by themselves, impact on whether a premises are new residential premises. For a discussion of the related GST concepts, see GSTR 2015/2 and GSTD 2021/1.

*Vacant land*

A transaction involving vacant land will normally satisfy the elements of a taxable supply, and hence the supplier will typically be subject to GST (assuming that the supplier is registered or required to be registered for GST purposes).

**The margin scheme**

If your supply of real property is subject to GST you may choose (if available) to calculate your GST liability under the margin scheme. This scheme allows you to calculate GST on the difference (or margin) between the consideration you receive for the supply, and your acquisition cost. It will generally result in a better GST outcome than would be the case if you do not use the margin scheme and the supply of real property was merely treated as a taxable supply. However, the scheme can be less attractive for purchasers, as it prevents their acquisition from being a creditable acquisition, meaning they cannot claim any input tax credits for GST embedded in their purchase price.

*Choosing to use the margin scheme*

It is important to note that the margin scheme cannot be used in circumstances where you were charged the full rate of GST when you originally purchased the property, e.g. you did not acquire the property under the margin scheme.

Further, the margin scheme can only apply to sales of real property and supplies of real property by way of long-term leases. It cannot apply to short-term leases.

If you wish to use the margin scheme you must first agree with the purchaser to do so. This agreement must be recorded in writing and must be made before the supply occurs.

*Calculating GST under the margin scheme*

We have mentioned that GST is calculated based on the difference between the consideration you receive and your acquisition cost. In GST Determination GSTD 2006/3 the ATO has stated that it is necessary to take into account any settlement adjustments when determining the total consideration received. For example, if you receive an additional amount to cover council rates you have paid you will need to increase your consideration by that amount.

If your property was originally purchased prior to 1 July 2000 you must calculate your margin based on an approved valuation at this date, rather than on your acquisition cost. There are quite specific rules regarding the manner of this valuation, which are set out in Margin Scheme Valuation 2009/1 which applies from 1 March 2010.

The GST payable is 1/11th of the margin calculated. This amount is your GST liability. Input tax credits are available in respect of the costs of construction (excluding the land which is subject to the margin scheme).

**Adjustment events on change in creditable purpose**

Division 129 of the *GST Act* can apply if there has been a change in creditable purpose. For example, where a developer constructs a new residential property with the intention to sell but a decision is made to offer the property for lease. In such a case, an adjustment is required to take into account that input tax credits will have been claimed in respect of the construction costs. Similarly, if a new residential property was constructed with the intention of leasing the property, but it is subsequently sold within five years of construction, an adjustment event will be required to allow input tax credits to be claimed. Special rules apply to determine the adjustment and the adjustment periods to which the adjustments will apply. These special rules are discussed in GSTR 2009/4, including examples of how to calculate adjustments.

**Purchasers of new residential premises to remit GST**

Purchasers of newly constructed residential premises or new subdivisions of vacant land will be typically required to remit GST on the purchase price directly to the ATO as part of the settlement process.

The mechanics on how the above GST remittance rules apply are set out in Subdivision 14-E of Schedule 1 to the *Taxation Administration Act 1953*.

The key features of this regime are as follows.

* A purchaser is required to withhold an amount if it is the recipient of a taxable supply of new residential premises (other than new residential premises created through substantial renovation or commercial residential premises), or a subdivision of potential residential land, where the taxable supply is provided by way of a sale or long-term lease. For these purposes, the term ‘potential residential land’ means land, which is included in a property subdivision plan, but which does not contain any buildings that are residential premises or any building that has been used for commercial premises.
* Where there are multiple recipients of the supply each recipient will have an obligation to pay and remit the amount of GST referrable to their proportionate interest in the property. This could arise where property is purchased by parties acting as tenants in common in which case each recipient is treated as having received a separate supply in relation to their proportional interest in the property. However, where the recipients of the supply are joint tenants they are treated as having received a single supply and either joint tenant can discharge the obligation to make the payment.
* The purchaser will be required to withhold 1/11th of the price of the supply and pay that amount to the ATO on or before the day on which any part of the consideration for the supply (other than the deposit) is first provided. This will usually occur on the date of settlement. In addition, where the purchase price is paid in instalments the purchaser must withhold and remit the GST on or before the date of payment of the first instalment of the purchase price which is when consideration for the supply is first provided (other than for the deposit). The price of the supply is typically the price specified in the contract which does not take into an account any potential adjustments on settlement that may occur.
* Where the supply is made under the margin scheme the purchaser will generally be required to withhold 7% of the price of the supply.
* The supplier will be entitled to a credit in its Business Activity Statement in the relevant tax period in which the payment was made equal to the amount paid by the purchaser to the ATO which can be offset against the supplier’s GST liability in respect of the supply of the new residential premises or potential residential land.

The above GST remittance rules will not apply where the recipient is registered for GST purposes, other than when the registered recipient does not acquire the land for a credible purpose, for example where the land has been acquired for the purpose of building a personal residence. Also, where the supply is between members of a GST group, or is made by the operator of the GST joint venture to a participant in the joint venture, then those supplies are not taxable supplies and the above withholding obligations do not apply.

In addition, the remittance rules will not apply where the contract of sale was entered into before 1 July 2018 and consideration was to be first provided before 1 July 2020. There is also separate transitional relief in respect of certain property developments agreements which contain distribution clauses where such contracts were entered into before 1 July 2018.

To help purchasers comply with their obligations to withhold, a vendor is required to give the purchaser a written notice before the date of supply advising whether the purchaser is required to withhold and make a payment to the ATO in respect of the supply. Where the purchaser is required to remit GST, the notice must also provide the supplier’s name and ABN, the amount payable and when the purchaser is required to pay that amount to the ATO.

Importantly, this notification requirement applies to any supply of residential premises by way of sale or long-term lease and is not limited to taxable supplies of new residential premises. For example, if a private individual sells an existing family home or unit to another person then a notification must still be provided. Significant penalties apply where a vendor fails to provide such a notice.

Finally, if the purchaser fails to withhold and pay the required amount to the ATO the purchaser will be liable to a penalty equal to the amount of the withholding obligation. However, a penalty will not be applied where the purchaser relies on a notice provided by the vendor which indicates that the purchaser is not required to withhold an amount provided there is nothing in the contract or any other circumstances relating to the supply which would make it unreasonable for the purchaser to believe that the vendor’s statement is incorrect.

*Contract of sale*

In most states the standard contracts of sale templates developed by the relevant law institute or real estate institute will contain “check boxes” prompting consideration of GST treatment and embedding notification requirements for the purposes of GST withholding. Accordingly, the contract of sale should be reviewed to ensure that it accurately reflects the selected GST treatment.

Please contact me on [insert telephone number of partner] should you wish to discuss any of the issues detailed above.

Yours faithfully

**[Insert name of Partner]**