GST ISSUES FOR FIRST TIME DEVELOPERS

P: 0403 873 498
E: adrian@cartlandlaw.com
A: Unit 5, 72-78 Carrington St
Adelaide SA 5000
PO Box 4124 Norwood South
W: www.cartlandlaw.com

19 February 2020

GST Issues for First Time Developers

OVERVIEW

Inexperienced developers undertaking their first project may include private individuals who see a great opportunity to capitalise on a particular block of land, or an investor who decides to undertake a one-off development project with the intention to only sell enough units to cover the cost of development and to hold the rest as investments. This session considers the specific GST issues that arise with these types of taxpayers, including:

A. Does the taxpayer need to register for GST?

   i. Is the taxpayer carrying on an enterprise - is there an adventure or concern in the nature of trade?

   ii. Pros and cons of registering voluntarily

B. If registration is required, when should it be done?

   i. Advantages of leaving registration as late as possible if margin scheme is available in relation to the property

   ii. Claiming construction costs

C. Key GST issues to consider:

   i. Potential adjustment events if property is held rather than sold

   ii. How long can the development be held for before it stops being new residential premises, and what are the consequences?

DOES THE TAXPAYER NEED TO REGISTER FOR GST?

The GST Act is one of the most eruditely drafted pieces of legislation. It has a logical progression that sets out simple concepts and then builds upon them. It follows the structure of well-considered programming (indeed one of the drafters of the GST Act was a programmer) with routines and sub-routines and exceptions. Accordingly, it is helpful to start at the beginning of the GST Act and then follow it through.

Imposition of GST

1. GST is payable on ***taxable supplies***. What constitutes a ***taxable supply*** is explained in s9-5 of the GST Act, that is:

   1.1. A ***supply*** made for ***consideration***;

   1.2. The ***supply*** is made in the course of furtherance of an ***enterprise*** that you carry on;

   1.3. The ***supply*** is connected with Australia;

   1.4. You are ***registered*** for GST or ***required to be registered*** for GST

   BUT the ***supply*** is not a ***taxable supply*** to the extent that it is ***GST-free*** or ***input taxed***.

2. In relation to Australian real property:

2.1. there will always be the requisite connection with Australia; and

2.2. after the development of real property, the ***supply*** will typically either be the sale of the property or the use of it (by the owner or a tenant under a lease);

I shall therefore turn to the requirement to ***register*** for GST, what constitutes an ***enterprise*** and then to when a ***supply*** of property might be ***input-taxed***.

Requirement to Register for GST

3. A person (including an entity such as a trust or company) is required to be registered under Div 23 of the GST Act when:

3.1. They are carrying on an ***enterprise***; and

3.2. Their GST turnover is above $75,000.

4. A one off property development where the property is to be sold and is an ***enterprise*** will trigger the requirement to be registered because the revenue from the sale will almost always exceed $75,000.[1]

4.1. An ***enterprise*** may consist of an isolated transaction or a dealing with a single asset. For example, an ***enterprise*** may consist solely of the acquisition and refurbishment of a suburban shop for resale at a profit. Where an entity engages in acquiring a single asset for resale at a profit, the activity will be an ***enterprise***, because it is an activity in the form of an adventure in the nature of trade. That ***supply*** must be included in the GST turnover.

4.2. The timing of the requirement to ***register*** will be once it is reasonable to assume that there will be ***supplies*** that exceed $75,000 in value in the current financial year; and

4.3. In relation to the main residence, in the absence of a business activity, there will also be no requirement to be registered for GST when selling this property as it is being used for private or domestic purposes, unless of course the nature of the main residence changes so that there is a business activity.

Property Transactions and Enterprises

5. The question of whether an entity is carrying on an ***enterprise*** often arises where there are 'one-offs' or isolated real property transactions. This is addressed in in *Miscellaneous Tax Ruling MT 2006/1*.

5.1. The issue to be decided is whether the activities are an enterprise in that they are of a revenue nature as they are considered to be activities of carrying on a business or an adventure or concern in the nature of trade (profit making undertaking or scheme) as opposed to the mere realisation of a capital asset.[2]

5.2. The cases of *Statham & Anor v. Federal Commissioner of Taxation* (Statham) and *Casimaty v. FC of T* (Casimaty) provide some guidance on when activities to subdivide land amount to a business or a profit-making undertaking or scheme. In these cases, farm land was subdivided and sold. Minimal development work was undertaken to meet council requirements and to improve the presentation of certain

[1] GSTR 2001/7

[2] In an income tax context a number of public rulings have issued outlining relevant factors and principles from judicial decisions. See, for example, TR 92/3, TD 92/124, TD 92/125, TD 92/126, TD 92/127 and TD 92/128.

allotments. On the particular facts of these cases the courts held that the sales were a mere realisation of a capital asset.

5.3. From the *Statham* and *Casimaty* cases a list of factors can be ascertained that provide assistance in determining whether activities are a business or an adventure or concern in the nature of trade. If several of these factors are present it may be an indication that a business or an adventure or concern in the nature of trade is being carried on. These factors are as follows:

5.3.1. there is a change of purpose for which the land is held;

5.3.2. additional land is acquired to be added to the original parcel of land;

5.3.3. the parcel of land is brought into account as a business asset;

5.3.4. there is a coherent plan for the subdivision of the land;

5.3.5. there is a business organisation - for example a manager, office and letterhead;

5.3.6. borrowed funds financed the acquisition or subdivision;

5.3.7. interest on money borrowed to defray subdivisional costs was claimed as a business expense;

5.3.8. there is a level of development of the land beyond that necessary to secure council approval for the subdivision; and

5.3.9. buildings have been erected on the land.

5.4. In determining whether activities relating to isolated transactions are an enterprise or are the mere realisation of a capital asset, it is necessary to examine the facts and circumstances of each particular case. This may require a consideration of the factors outlined above, however there may also be other relevant factors that need to be weighed up as part of the process of reaching an overall conclusion. No single factor will be determinative rather it will be a combination of factors that will lead to a conclusion as to the character of the activities.

<u>Land bought with the intention of resale</u>

6. In isolated transactions, where land is sold that was purchased with the intention of resale at a profit (which would be ordinary income) the Commissioner considers in *MT 2006/1* that these activities are an enterprise. This would be so whether the land was sold as it was when it was purchased or whether it was subdivided before sale. An enterprise would be carried on in this situation because the activities are business activities or activities in the conduct of a profit making undertaking or scheme and therefore an adventure or concern in the nature of trade.

Examples of subdivisions of land that are enterprises

6.1. Example 28 *MT 2006/1*:

"Stefan and Krysia discover that the local council has recently changed its by-laws to allow for smaller lots in the area. They decide to take advantage of the by-law change. They purchase a block of land with the intention to subdivide it into two lots and to sell the lots at a profit. They carry out their plan and sell both lots of land at a profit.

Stefan and Krysia are entitled to an ABN in respect of the subdivision on the basis that their activities are an enterprise being an adventure or concern in the nature of trade. Their activities are planned and carried out in a businesslike manner."

6.2. Example 29 *MT 2006/1*:

"Tobias finds an ocean front block of land for sale in a popular beachside town. He devises a plan to enable him to afford to live there. He decides to purchase the land and to build a duplex. He plans to sell one of the units and retain and live in the other. The object of his plan is to enable him to obtain private residential premises in an area that would otherwise be unaffordable for him.

Tobias carries out his plan. He purchases the land, and lodges the necessary development application with the local council. The development application is approved by the council, Tobias engages a builder and has the duplex built. He sells one unit, and lives in the other.

Tobias is entitled to an ABN. His intentions and activities have the appearance of a business deal. They are an enterprise."

6.3. Example 30 in *MT 2006/1*:

"Steven buys a 100 hectare property. He believes that the property may be suitable to be developed as a resort. After investigation he decides that it would be more profitable to subdivide and sell the property. He decides to subdivide the property into one hectare lots and sell these.

He engages a town planner and a surveyor to survey the 100 hectare property and to establish how many hectare lots it can be subdivided into. Steven then approaches the local shire council and is advised that he may subdivide his property into 65 one hectare lots.

However, Steven must satisfy various shire council conditions if he wishes to obtain development approval. They are:

> *the making of new sealed roads with kerbing and channelling within the subdivision;*
>
> *the provision of water, electricity and telephone services to the new lots;*
>
> *the provision of culverts and other storm water drainage works; and*
>
> *the transfer of certain areas of land to the shire council for parks, environmental and other public purposes.*

Steven consults his accountant and legal advisers. Together they prepare a comprehensive business plan for the project. They approach a commercial lender to arrange a substantial loan, secured by the property, to cover all development costs and related expenses.

After gaining development approval from the council, Steven then engages a project manager who arranges for all the survey and subdivisional works to be carried out. Contractors are engaged to put in the roads, complete all the necessary drainage works and install the water, electricity and telephone services.

Steven also investigates a marketing strategy that will provide the best return for his project. Sales agents are retained to carry out the marketing program which involves a comprehensive advertising campaign using a promotional estate name, 'Bush Turkey Hill'.

Steven is entitled to an ABN on the basis that the subdivision is an enterprise and it is more than a mere realisation of a capital asset. Significant factors that are relevant which lead to this conclusion are as follows:

there is a change of purpose for which the whole property is held;

there is a comprehensive plan for the development of the property;

the subdivision is developed in a businesslike manner for example there is a project manager, significant development costs, a comprehensive marketing campaign including an estate name for the land; and

a substantial loan has been taken out to finance the development.

6.4. Example 31 *MT 2006/1*:

Prakash and Indira have lived in the same house on a large block of land for a number of years. They decide that they would like to move from the area and develop a plan to maximise the sale proceeds from their land.

They consider their best course of action is to demolish their house, subdivide their land into two blocks and to build a new house on each block.

Prakash and Indira lodge the necessary development application with the local council and receive approval for their plan. They arrange for:

their house to be demolished;

the land to be subdivided;

a builder to be engaged;

two houses to be built;

water meters, telephone and electricity to be supplied to the new houses; and

a real estate agent to market and sell the houses.

Prakash and Indira carry out their plan and make a profit. They are entitled to an ABN in respect of the subdivision on the basis that their activities go beyond the minimal activities needed to sell the subdivided land. The activities are an enterprise as a number of activities have been undertaken which involved the demolition of their house, subdivision of the land and the building of new houses.

Examples of subdivisions of land that are not enterprises

6.5. Example 32 *MT 2006/1*:

Astrid and Bruno live on a large suburban block. The council has recently changed their by-laws to allow for smaller lots in their area. They decide to subdivide their land to allow their only child, Greta, to build a house in which to live.

They arrange for the approval of the subdivision through the council, for the land to be surveyed and for the title of the new block to be transferred to Greta. She pays for all the costs of the subdivision and the cost of her new house.

Astrid and Bruno have not carried on an enterprise and are not entitled to an ABN in respect of the subdivision. It is a subdivision without any commercial aspects and is part of a private or domestic arrangement to provide a house for their daughter.

6.6. Example 33 in *MT 2006/1*:

Ursula and Gerald live on a 2.5 hectare lot that they have owned for 30 years.

They decide to sell part of the land and apply to subdivide the land into two 1.25 hectare lots. The survey and subdivision are approved. They retain the subdivided lot containing their house and the other is sold.

Ursula and Gerald are not carrying on an enterprise and are not entitled to an ABN in respect of the subdivision as the subdivision and sale are a way of disposing of some of the land on which their home is situated. It is the mere realisation of a capital asset.

6.7. Example 34 in *MT 2006/1*:

A number of years ago Elsie and Karin purchased some acreage on which to keep their horses, which they rode on weekends. Karin now accepts a job overseas and they decide to sell the land.

They put the land on the market with little success. The local real estate agent then advises that it would be easier to sell the land if it was subdivided into smaller lots. They arrange for a development application to be lodged with the local council and obtain approval to subdivide the land into nine lots. Elsie and Karin arrange for the land to be surveyed. The land has a road running along its boundary and has some existing services such as electricity. Only minimal activity is required to subdivide the land.

Elsie and Karin are not entitled to an ABN. The sale is not considered to be an enterprise and is the mere realisation of a capital asset.

6.8. Example 35 in *MT 2006/1*:

Oliver and Eloise have lived on a rural property, Flat Out for the last 30 years. They live a self-sufficient lifestyle. As a result of a number of circumstances including their advancing years, Oliver's deteriorating health, growing debt and drought conditions they decide to sell.

Oliver and Eloise put Flat Out on the market and are unable to find any buyers. They then receive advice from the real estate agent that they may be able to sell smaller portions of it. They initially arrange for council approval to subdivide part of Flat Out into 13 lots. They undertake the minimal amount of work necessary and sell the lots. They continue to live on the remaining part of their property.

A few years later Oliver and Eloise decide to sell some more land to meet their increasing debt obligations. They arrange for council approval to subdivide another part of Flat Out into four lots. Again they undertake the minimal amount of work necessary to enable the lots to be subdivided and arrange for the real estate agent to sell these lots.

Three years later Oliver's and Eloise's personal and financial circumstances are such that they again decide to sell some more land. They arrange for further council approval to subdivide part of their remaining property into three lots. Again they undertake the minimal amount of work necessary to enable the lots to be sold and arrange for the real estate agent to sell the lots.

Over the years involved Oliver and Eloise have subdivided 30% of Flat Out. They continue to live on the remaining part of their property.

Oliver and Eloise are not entitled to an ABN as they are not carrying on an enterprise. They are merely realising a capital asset. In this example the following factors are relevant:

There is no change of purpose or object with which the land is held - it has remained their home.

There is no coherent plan for the subdivision of the land - the subdivision has been undertaken in a piecemeal fashion as circumstances change.

A minimal amount of work has been undertaken in order to prepare the land for sale. There has been no building on the subdivided land. The only work undertaken was that necessary to secure approval by the council for the subdivision.

<u>GST Margin Scheme</u>

7. Division 75 sets out the basis on which the margin scheme can be applied to a taxable supply of real property, including new residential premises, by a taxpayer carrying on a property development enterprise:

7.1. Typically, the margin scheme can be applied where the taxpayer and the recipient of the supply have agreed in writing that the margin scheme will apply to the supply of real property. In most instances, this will be recorded in the contract for sale of land by offer and acceptance with an appropriate GST annexure. However, in some instances, the agreement in writing to apply the margin scheme may be recorded in a subsequent deed between the parties to rectify the original contract where the GST annexure was not completed at the time of signing the contract.

7.2. Typically the GST margin scheme applies with the effect that the taxpayer only pays GST in respect of a taxable supple of real property on the difference between their cost of acquiring the relevant real property and the consideration received from the sale of the real property.

7.3. However, you cannot apply the margin scheme to a supply of real property where the taxpayer acquired the real property by way of:

7.3.1. GST-free supply of a going concern;

7.3.2. GST-free supply of farming land;

7.3.3. A supply from an entity that was registered or required to be registered for GST, and that entity had acquired it through a taxable supply on which GST was worked out without applying the margin scheme;

7.3.4. Inheriting the property from a deceased estate that acquired it under the circumstances listed above.

7.4. Applying the margin scheme may prove problematic where a small scale subdivision is carried out on land that was held by a taxpayer prior to 1 July 2000.

7.4.1. GSTR 2006/7 provides guidance in this regard and states that a taxpayer will be taken to have acquired the property for its market value as at 1 July 2000 for the purposes of applying the margin scheme (para 45A and section 75-11 GST Act).

7.4.2. As we move further and further from 1 July 2000, it becomes more difficult to obtain reliable valuations of property going back so many years.

7.5. Where a property is subdivided after its initial acquisition, the cost of acquiring the land is generally apportioned across each of the subdivided lots according to the proportionate amount of land that each subdivided lot bears to the original land. This is known as a the "*profits emerging basis*".

7.6. It is a condition of applying the margin scheme that the buyer and seller must agree in writing to apply the margin scheme (section 75-5). In some instances, particularly with a smaller scale development, the mum and dad investors may not have realised at the time that they were required to be registered for GST and hence did not apply the margin scheme in writing.

7.6.1. This is a scenario that is becoming quite prevalent where an ATO audit of property sales by particular taxpayers identifies that they were in fact carrying on an enterprise, much to their surprise, and the taxpayers are then assessed to pay GST in respect of the sale price of each subdivided lot (often including a new dwelling).

7.6.2. Where this occurs, taxpayers are often unaware that they may be able to still obtain the benefit of applying the margin scheme where they can get the purchasers of the property to agree to execute a deed which rectifies the original contract by the parties now agreeing to apply the margin scheme.

7.6.3. In many cases the taxpayers are not only left paying GST on the full sale price, but are also left short changed as they did not previously lodge a BAS and claim their input credits for their creditable acquisitions. Taxpayers must act quickly in such circumstances so that any input credits may be claimed within the 4 year limitation period.

7.7. Under s75-10 the amount of the margin on a property acquired pre-1 July 2000 will be calculated as the difference between a valuation of the property and its sale price. The date of valuation will typically be 1 July 2000 however if the supplier is not registered or required to be registered until after 1 July 2000 then the valuation will be at the date of registration. Therefore when property prices are increasing there may be an incentive on the development of property held since before 1 July 2000 to delay GST registration as long as possible to secure the highest valuation and hence lowest margin.

CONSTRUCTION COSTS - DEVELOPMENT COMPANY STRUCTURE

8. There are some interesting taxation benefits from utilising a Development Company structure, also known as a 'WIP Company'. This structure operates as follows:

Holding Company

8.1. A holding company ("Hold Co") is formed, which will responsible for three primary aspects of the venture:

8.1.1. To hold the Land as trading stock until the development is completed;

8.1.2. Engage Dev Co to develop the Land; and

8.1.3. To sell the Land to investors for profit.

Development Company

8.2. A Development Company ("Dev Co") will be formed and will undertake the development of the Land:

8.2.1. A development agreement will be drawn stating that:

8.2.1.1. All development costs will be paid for by Dev Co; and

8.2.1.2. As consideration for incurring the development costs Dev Co will have the first rights to proceeds from the sale of the Lots including a developer margin;

8.2.2. Dev Co will conduct the enterprise of developing the Land, and will be entitled to input tax credits on creditable acquisitions because it will be making taxable supplies of development services to Hold Co;

8.2.3. The Lots owned by Hold Co will have lower cost bases as a result of the development being undertaken by Dev Co, as compared with if Hold Co undertook the development.

8.2.4. Dev Co will be taxed on the profit from the sale of the Lots owned by Hold Co at the company tax rate; and

8.2.5. The simplest way to capitalise Dev Co is through a loan from Hold Co, which can be repaid as the Lots are sold. The profits can be distributed out of Dev Co or Hold Co as franked dividends.

Outcomes of the Structure

8.3. This structure will have two primary outcomes:

8.3.1. Expenses incurred during development will not form part of Hold Co's trading stock cost base; and

8.3.2. Profits do not have to be accounted for on a profit emerging basis.

Expenses – Trading Stock

<u>Alternative</u>

8.4. If Hold Co completed the development in its own right, it would hold the land as trading stock. Any investment or increase in the value of the trading stock would increase the cost base of the Land. The total investment into the Land through the course of the development will be apportioned to each Lot sold. This will result in profit being calculated on the difference between the adjusted cost base and the sale price at the time of sale.

8.5. This means that Hold Co will pay tax as each Lot is sold despite the fact that an accounting profit may not yet have been achieved.

Suggested Structure

8.6. Under the structure suggested; initially as a lot is sold to an investor the entire sale amount will be paid to Dev Co as per the development agreement. Hold Co will continue to pay Dev Co the full proceeds of any sale until their obligation to pay Dev Co under the development agreement is completely satisfied.

8.7. Once the development agreement has been satisfied, Hold Co will pay tax on each lot sold and will be taxed on their profit. The cost base will be calculated as the original undeveloped value of the land.

Overall effect of the Development Company Structure

8.8. The structure will essentially ensure that tax on profits will only be paid when Hold Co is generating accounting profits.

Worked Example

8.9. If the Land is worth $10,000,000 and the cost to develop 10 lots is $10,000,000. The lots will be sold for $2,500,000 each. The total venture will net $5,000,000 in profit.

8.9.1. Scenario 1 - Hold Co only: as each Lot is sold Hold Co will pay tax on the apportioned $500,000 profit on each sale, however Hold Co will not have completely covered their costs until 8 properties have been sold. Net tax: $1.5 million at 30% rate.

8.9.2. Scenario 2 - Hold Co + Dev Co: Hold Co will only pay tax once the $10,000,000 development costs under the development agreement have been paid to Dev Co causing a tax timing benefit in that tax profit will be aligned with accounting profit. This means that Hold Co will not begin to pay tax on sales until the 4th property has been sold. From that point onwards Hold Co will pay tax on $833,333 profit for the remaining 6 properties. Net Tax $1.5 million at 30% rate.

8.10. If the development and the sale of the Lots is not all completed in one financial year then there will be a potential additional benefit, in that Dev Co will receive deductions for the development costs, but they will not cause an increase in the value of the trading stock held by Hold Co. This is particularly useful if there is other income that Dev Co received that the deductions could offset, e.g. from a previous development. By multiple developments through Dev Co it may be possible to continually defer tax.

8.11. Because the profit in the Lots is only realised upon disposal (unlike increased value of trading stock) then if disposal is delayed then so too is taxation. The common problem of a developer being unable to sell the final properties in a development becomes a taxation benefit.[3] If the final Lots were held on capital account rather than as trading stock other discounts may apply, the most advantageous of which is where Hold Co is

[3] More technically there is no tax ***benefit*** in the Part IVA sense because there is not any less tax paid – it is merely delayed until the realisation event.

an individual owner/developer and retains a Lot as a ***main residence*** which is exempt from taxation.

GST ADJUSTMENT EVENTS AND THE 5 YEAR RULE

9. There is the possibility to change the nature of newly constructed residential developments from ***new residential premises*** which are ***taxable supplies*** to ***non-new residential premises*** which are ***input taxed supplies*** however there will be ***adjustments*** to ***input tax credits*** that were claimed on the development:

Five-year rule:

9.1. ***Residential premises*** are not ***new residential premises***, if after five years, the premises have "only" been used for making supplies that are ***input taxed*** because they have been the subject of a lease (40.35(1)(a))[4]. Essentially if you rent the apartment for five years the commissioner will, by default, assume that your creditable purpose is the renting of apartments not the construction and sale of new apartments and you are not able to claim any input tax credits. If you had previously claimed these input tax credits you may have to make adjustments that effectively reverse these credits, as you are not entitled to GST credits for things purchased to make input taxed supplies.

Commencement and Duration of the Five-year period

9.2. Subsection 40-75(2) provides an exception to the meaning of ***new residential premises*** in 40-75(1). Subsection 40-75(2) requires that for the period of at least 5 years the premises have been used only for making input taxed supplies under paragraph 40-35(1)(a). This requirement will be satisfied where the premises have been leased for a continuous period of at least 5 years[5] between when they were built and when they were sold.

9.3. The period must be a continuous period. A continuous period is **not broken** by short periods between tenancies where the premises are actively marketed for rent following the departure by a previous tenant. However, a continuous period **is broken** when the premises are used for a private purpose or left vacant with no attempt to lease the premises.[6]

Holding for sale:

9.4. ***New residential premises*** will not be applied for a creditable purpose, to any extent, when they are being used exclusively as part of an enterprise of leasing ***residential premises***. However, the ***new residential premises*** would not be precluded from being applied for a creditable purpose if the entity commenced holding the new residential premises for the purpose of sale in the future.[7]

9.5. The concept of holding a thing for the purpose of sale as part of an enterprise is similar to holding a thing for the purpose of trade[8]. An objective assessment of the facts and circumstances will demonstrate whether or not ***new residential premises***

---

[4] Section 40.75(2) *A New Tax System (Goods and Services Tax) Act 1999*
[5] GSTR 2003/3 paragraph 90
[6] GSTR 2003/3 paragraph 91
[7] GSTR 2009/4 – paragraph 38
[8] Refer to comments of Bowen CJ in *Re Ku-ring-gai Co-operative Building Society (No. 12) Ltd* (1978) 36 FLR 134 at 139.

are being held for the purpose of sale as part of an entity's enterprise. There must be satisfactory evidence to support a conclusion that the premises are being held for the purpose of sale. A single piece of evidence may not be sufficient where there is other evidence which suggests a contrary purpose. In such cases all of the evidence must be considered and weighed up in reaching a decision.

9.6. Although any one factor may not be sufficient on its own, the following are some examples of objective facts and circumstances that the Commissioner would expect to be present to conclude that premises are being held for the purposes of sale:

9.6.1. Marketing of the premises for sale, such as listing the premises for sale with a real estate agent, publishing advertisements or arranging ‘open inspections’;

9.6.2. Income tax treatment of the development as trading stock rather than as a capital asset;

9.6.3. Finance documents including loan applications provided as part of the loan application process;

9.6.4. Business plans, feasibility studies or minutes of meetings which support the holding of the premises for sale;

9.6.5. Accounting reports and financial statements;

9.6.6. Past activities of the entity; and

9.6.7. In the case of building multiple premises, the sale of some of those apartments at arms length; (although in some cases there may be evidence to show that only some of the premises were intended for sale whilst the rest were intended to lease).

9.7. On the other hand, evidence that the premises have been applied, to some extent for lease include:

9.7.1. Marketing the premises for lease;

9.7.2. Business plans, minutes of meetings, finance documents etc. demonstrating the entity has determined to use the premises for lease; and

9.7.3. Periods of actual leasing of the premises.

9.8. The actual time between constructions and sale is a relevant factor in determining whether the premises are being held for the purposes of sale. A short time would strengthen this position whilst a long time this may suggest that the entity is holding the premise for investment purposes not for the purpose of sale.

Dual creditable purpose

9.9. If the property is held for a dual creditable purpose, sale and lease, an apportionment will occur if the property is sold within the five-year time period.

9.10. For this purpose it is necessary to:

9.10.1. Identify the relevant adjustment periods if there are multiple acquisitions

9.10.2. Identify the changes in the extent of the creditable purpose

9.10.3. Calculate the adjustments while premises are leased

9.10.4. Calculate the final adjustment when the property is sold.

9.11. Multiple adjustments will be classified as separate acquisitions under the Act[9] for Division 129 purposes

9.12. The extent of the creditable purpose is calculated with the following formula:

9.12.1. $\text{Market Value} - (\text{Market Value} + \text{Rent Revenue}) = \text{x}\%$

9.12.2. E.g. $\$550{,}000 - (\$550{,}000 + \$22{,}000) = 96.15\%$

9.13. Section 129-40 of the Act[10] must then be applied to each acquisition. This involves comparing the intended and actual application of the asset. If the figures differ, then an increasing or decreasing adjustment will be required.

9.14. The adjustments must be included in the Business Activity Statement for the periods that they occur in.

9.15. There are some interesting examples in GSTR 2009/4.

Example 17 - premises applied for the purpose of sale which do not satisfy the requirements of the '5 year rule'

Matthew constructs new residential premises for the purpose of sale and is entitled to input tax credits on his acquisitions. On completion of the premises Matthew decides to lease the premises because of a downturn in the property market. Matthew continues to hold the premises for the purpose of sale as part of his enterprise and does so until the premises are ultimately sold.[54] He is therefore applying the premises for two purposes under Division 129. He is required to make an increasing adjustment at the end of the first adjustment period because the actual application is less than the intended application. He will also need to consider whether further adjustments are necessary in each of the relevant adjustment periods.

Matthew sells the premises six years after they were completed. He has been leasing the premises for this whole period. However, the requirements of subsection 40-75(2) are not satisfied because the premises have not only been used for making supplies that are input taxed because of paragraph 40-35(1)(a). The premises have also been used for the purpose of sale because Matthew has been holding the premises for sale as part of his enterprise.

The premises are new residential premises and, provided all the requirements of section 9-5 are satisfied, Matthew makes a taxable supply of new residential premises when the premises are sold.

Example 18 - premises held for the purpose of sale for a period of time and then used only to make input taxed supplies by way of lease

[9] Section 156-20, *A New Tax System (Goods and Services Act) 1999*

[10] *A New Tax System (Goods and Services Act) 1999*

Assume the same facts as for Example 17 of this Ruling. However, after continuing to hold the premises for the purpose of sale for six months after starting to lease the premises, Matthew decides to hold the premises as an investment asset to be used only for the purpose of leasing. Matthew continues to make increasing adjustments under Division 129 in each relevant adjustment period on the basis that he is now holding the premises solely for a non-creditable purpose.

Matthew sells the premises six years after they were completed. He has been leasing the premises for this whole period. For the first six months of this period Matthew was applying the premises for a dual purpose. Therefore this period does not count towards a continuous 5 year period of using the premises only for making input taxed supplies by way of lease. However, after this time there is a continuous 5 year period which satisfies the requirements of subsection 40-75(2).

Therefore, while Matthew will have made increasing adjustments under Division 129 for the majority of the input tax credits to which he was entitled on the relevant acquisitions made in constructing the residential premises, the sale of the residential premises will be an input taxed supply of residential premises under section 40-65.

Summary

10. There are three main ways in which the commissioner will deal with properties for the purpose of GST. This treatment is dependent on your objective actions.

10.1. If the properties are constructed for sale and held only for sale i.e. not leased, then

10.1.1. the properties will be treated as ***new residential premises***;

10.1.2. you will be able to claim 100% of your input tax credits;

10.1.3. you will need to collect GST on sale; and

10.1.4. the 5-year period will not commence.

10.2. If the properties are acquired or built for the purpose of leasing the premises, then:

10.2.1. the properties will be treated as ***not-new residential premises***;

10.2.2. you will not be able to claim input tax credits;

10.2.3. you will not need to collect GST on sale; and

10.2.4. there is no need to apply the 5-year rule.

10.3. If the properties are constructed for sale and **held for sale**, but are leased for a non-continuous period of 5 years, then:

10.3.1. the properties will be treated as ***new residential premises***;

10.3.2. you will be able to claim an apportionment of your input tax credits;

10.3.3. you will need to collect GST on sale; and

10.3.4. the 5-year period will commence from when you begin to lease the premises but will end once you cease to lease the premises (and may begin again...).

Note: that the period of 5 years will never be satisfied until leased continuously for 5 years, in theory the premises could be considered ***new residential premises*** for an indefinite period. However, the commissioner may factor in the time period between construction and sale and determine that the creditable purpose of the premises has been for investment not for sale.