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GST & property – part I

Landlord and tenant issues

INTRODUCTION

This paper is the first in a two part series. This month I cover several definitional issues that are often raised by clients and participants at seminars; explain how the Div 87 concession affects supplies of commercial residential premises; develop two relevant issues in regard to tax invoices; explain the GST treatment of outgoings affected by Div 81; and highlight three issues relevant to non-resident property investors.

WHAT ARE TAXABLE SUPPLIES?

This paper assumes that readers are well familiar with the threshold elements that define a taxable supply in s 9-5.¹ However, it is worth making the point that it is essential that these threshold tests are considered before delving into a complex analysis of the GST law. If the threshold tests are not met, the more complex GST issues will become irrelevant.

WHAT IS AN ENTERPRISE?

Experience suggests that I should briefly traverse the issue of when a property owner is conducting an enterprise.

Section 38 of the ABN Actⁱⁱ includes certain activities as being an enterprise and excludes others. Included as examples are activities done: in the form of a business; or on a regular or continuous basis, in the form of a lease, licence or other grant of an

interest in property. Activities done as a private recreational pursuit or hobby; or without a reasonable expectation of profit or gain are specifically excluded.

While renting out a property is included in the definition of enterprise, where a property owner does no more than occasionally rent out their home (for example: making the home available to overseas visitors during the Sydney Olympics or Melbourne's grand prix) or merely sells vacant land then that activity does not amount to conducting an enterprise. This issue will be explored in greater detail in part 2 of this paper as the position is less clear when a home-owner subdivides a corner block and sells off one of the newly created lots.

Case study

Greg and Sue run a pastoral property. There are two old cottages on the property, one of which Sue repainted and refurbished with spare furniture from the property's main house. Sue places a sign on the main road advertising this for short-term lease to tourists. The cottage is also used regularly by their friends and relatives at no charge but the cottage is leased out for a fee on average about 20 weeks of the year. There is a reasonable expectation of profit or gain.

Greg and Sue are entitled to an ABN, as a partnership, in respect of the leasing activity.

RENTAL INCOME

At the most general level, where a transaction meets the threshold tests in s 9-5 a supply of:

- residential premises will be input taxed, and
- commercial premises will be a taxable supply.

However, it is not this simple for commercial residential premises. Unfortunately political pressure has made this part of the GST law confusing and resulted in four different GST regimes:

- 1 commercial residential premises that are not commercial accommodation are input taxed;
- 2 commercial accommodation where the s 87-25 election is made will be input taxed;
- 3 commercial accommodation used predominantly for long term accommodation (no s 87-25 election made) – the value of the taxable supply is reduced by 50 per cent and then GST calculated on the reduced value as normal;
- 4 commercial accommodation not predominantly used for long-term accommodation (no s 87-25 election) – GST is payable on the full value of the taxable supply for the first 27 days a

tenant is in residence, reducing to 50 per cent of the value thereafter.

To understand and apply the appropriate GST rules we need to work through the defined terms: residential premises, commercial residential premises, commercial accommodation and long term lease.

RESIDENTIAL PREMISES

Section 40-35 provides that a supply of premises by lease, hire or licence is input taxed where there is the supply of:

- residential premises, except new residential premises;
- commercial accommodation, subject to Div 87; or
- a berth at a marina is supplied for occupation by a ship used as a residence, subject to Div 87.

Long-term leases of residential premises are input taxed usually under the provisions of s 40-70 rather than s 40-35.ⁱⁱⁱ

Section 195-1 defines a long-term lease as meaning a supply by way of lease, hire or licence (including a renewal or extension of a lease, hire or licence) for at least 50 years if:

- at the time of the lease, hire or licence, or the renewal or extension of the lease, hire or licence, it was reasonable to expect that it would continue for at least 50 years, and
- unless the supplier is an Australian government agency – the terms of the lease, hire or licence, or the renewal or extension of the lease, hire or licence, as they apply to the recipient are substantially the same as those under which the supplier held the premises.

Section 195-1 defines residential premises as 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;
- and includes a floating home.

In most cases, the classification of residential premises will be relatively clear. The Macquarie Dictionary defines 'to reside' as being 'to dwell permanently or for a

considerable time'. However the GST definition focuses more on the premises' use for private and domestic accommodation, rather than whether the premises have been used for an extended period of time.

Vacant land can never amount to residential premises by itself. The land must have a building affixed (a caravan at the site is insufficient), and that building must have physical characteristics that enable it to be occupied.

GSTR 2000/20 makes it clear that holiday homes and investment properties do not change their character as residential premises simply because the investment is conducted on a commercial scale and in the course or furtherance of an enterprise. The GST status of the property depends on how it is used by the occupier rather than the purpose for which the owner purchased the property or the legal character of the investor.

Non-complying use: A vacant house in an area that is now zoned for industrial use could (depending on the facts) still come within the definition of residential premises. The problem with premises not complying with the relevant zoning rules is that it will fail the second limb of the test, as the planning rules usually mean the house is not legally capable of being occupied as a residence. If the relevant authority has permitted non-complying use of the premises, as residential premises, you could argue that the authority is estopped from denying the owner the right to continue using the premises as residential premises. In regard to rental properties, as soon as a tenant is in residence the house becomes occupied as a residence and supply of the premises to the tenant will therefore come within the first limb of the test and be input taxed.

COMMERCIAL ACCOMMODATION

This term primarily encompasses short term travel accommodation such as a hotel, motel, or serviced apartment and is defined in s 87-15 to mean the right to occupy any part of commercial residential premises where that right also includes the supply of any of the following:

- cleaning and maintenance;
- electricity, gas, air-conditioning or heating; or

- telephone, television, radio or similar items.

The supply of these ancillary services is subject to the same concessional treatment as the supply of commercial residential premises under Div 87, discussed below.

Section 195 defines commercial residential premises as being any of the following:

- a hotel, motel, inn, hostel or boarding house;
- premises used to provide accommodation in connection with a school (eg: boarding school accommodation);
- a ship or a marina in certain prescribed circumstances;
- a caravan park or a camping ground, and
- anything similar to residential premises described in the above.

Hotels - there is some uncertainty as to the correct treatment of the supply of a hotel (or motel etc) by way of lease to an entity who will operate the premises as a separate enterprise. A strict reading of the legislation is that there is no precondition that the owner must operate the hotel as a business. Therefore, it appears that the concessional GST treatment in Div 87 should be available to the owner of the premises, as well as the tenant operating the business.

Serviced apartments – although it appears at first that serviced apartment may not come within the definition of commercial residential premises, the Commissioner has taken a broader approach in GSTR 2000/20. The line the Commissioner draws is between residential premises and commercial residential premises. Factors that tend to indicate that serviced apartments are residential premises rather than commercial residential premises are:

- no, or irregular, cleaning service to the apartments;
- multiple owners of apartments;
- management located off premises;
- kitchen facilities in the apartment;
- no room service or restaurant on premises, and

- no other services offered to the residents that are similar to those provided by other commercial residential premises.

Caravan parks and camping grounds are specifically provided for in the definition of commercial residential premises and the ATO has agreed that "home parks", where relocatable homes are rented, fall within the definition of caravan park and are therefore also commercial residential premises.

Case study

Tony operates a large caravan park located within the boundaries of a National Park. The caravan park contains a fully equipped medical centre and during peak times of the year a group of doctors take it in turns to stay at the residence behind the caravan park's office block. This residence is also leased by Tony from the relevant government authority however it is physically separate from all the caravan park buildings and has a separate entrance. The doctors are provided with free accommodation in exchange for providing medical services each morning and being available for emergency incident response.

If the premises that are made available to the doctors are part of the caravan park then they are commercial residential premises and the supply of these premises would be a taxable supply.

However, in this case the accommodation was a completely separate house behind the caravan park so it is a supply of input taxed residential accommodation.

Note: The doctors will receive no input tax credits on the input taxed supply of the residential premises however they have made a supply of locum services to Tony which, being a taxable supply, creates a GST liability. See GSTR 2001/6 for a discussion of the GST implications of non-monetary consideration.

DIVISION 87 CONCESSION

Division 87 allows a supplier to elect (it is actually an opt-out rule) to reduce the value of a supply of commercial residential premises, thus reducing the amount of GST payable on the supply.

Where the commercial accommodation meets the following tests, the value of the taxable supply can be reduced by 50 per cent. The supply must be:

- provided to an individual as long-term accommodation, and

- provided in commercial residential premises that are predominantly for long-term accommodation.

Long-term accommodation is accommodation for a continuous period of 28 days or more in the same premises. At least 70 per cent of the residents must be provided with long-term accommodation for the commercial residential premises to be used predominantly for long-term accommodation.

When commercial accommodation is not predominantly for long-term accommodation, GST is payable on the full value of the supply for the first 27 days of each individual's stay but can be reduced by 50 per cent for each day from then on.

As noted above, s 87-25 allows the taxpayer to opt out of Div 87. If this election is made the supply will be input taxed (pursuant to subdiv 40-B) therefore the supplier will be denied input tax credits. It is important to note that once an election has been made it is irrevocable for 12 months from when the election is made.

TAX INVOICE REQUIREMENTS

Section 156-22 specifically provides that a supply by way of lease, hire or licence is subject to the progressive or periodic payment provisions found in Div 156. Each periodic or progressive payment is treated as an individual supply and is taxable accordingly.

Despite being separate supplies, in GSTR 2000/17^{iv} the Commissioner has accepted that it is not necessary to provide separate tax invoices for each supply. A single tax invoice can be used if it complies with the usual requirements for tax invoices and shows the price of each component of the supply. As there is no particular form that a tax invoice must take, the lease agreement itself can constitute the tax invoice if the agreement contains all the information required to satisfy the tax invoice rules.

Where the price is not the same for every component of the lease, the landlord can meet the tax invoice requirements by providing:

- a schedule attached to the lease setting out the price for each part of the supply. (for example, a schedule setting out the

rent review mechanism where the review is a fixed percentage increase each year); or

- another document can be provided to the recipient once the different components are known. (for example, once the cost of the outgoings are determined). It is important to note that this separate document must also comply with all the tax invoices requirements.

While lease rentals will be a periodic supply GSTR 2000/35^v provides that a lease premium is consideration for a single supply comprising the grant of the lease. This is a separate supply from the actual supply of the premises under the lease and is not a periodic supply even if the premium is payable by instalments. The basic attribution rules apply to the premium meaning the GST must be paid, or input credits claimed, in the earlier of the tax periods in which any of the premium is received or provided, or an invoice is issued.

PAYG WITHHOLDING

A tenant is obliged to withhold 48.5 per cent of the rent payable and remit this under the PAYG withholding rules unless one of the following applies:

- the landlord has given the tenant its ABN, either on a tax invoice or another document relevant to the supply;
- the premises were let through an agent and the tenant has been given the agent's ABN.
- the payment is made by the tenant otherwise than in the course or furtherance of an enterprise carried on in Australia by the payer (for example, ground fees payable by a sporting club); or
- the supply is wholly input taxed (for example, residential premises).

To fully understand the last bullet point requires an analysis of the mixed and composite supply dichotomy, which is beyond the scope of this paper. However, the following case study summarises the issue (see GSTR 2001/8 for further information).

Case study

George is an accountant and registered for GST. In addition to his accounting practice George owns

several residential investment properties. He rents a house, which has an old stable near the front of the property which has been converted into a bungalow, to Arthur, a solicitor. Arthur decides to hang his shingle from the outside of the bungalow and create a home office from which to run his small but growing tax law practice.

The supply of these premises will be a composite supply of residential premises because the predominant use of the premises is still as a residence and therefore essentially of a private and domestic nature outside the course or furtherance of Arthur's enterprise.

The use of the bungalow as an office is only incidental to the use of the premises as Arthur's home, therefore the supply will be wholly input taxed and Arthur would not be required to withhold 48.5% of rental payments.

However, the contrary argument is that the supply of the house is a mixed supply, and GST is attributable to the supply of the bungalow as commercial premises. In this case, Arthur will be required to withhold 48.5% of the rent payable on the premises as a whole if George has not supplied his ABN.

DIV 81 AND RECOVERY OF OUTGOINGS

The supply of premises under a commercial property lease, together with the services required by the tenant to use the premises, is a single supply of real property.^{vi} The fact that the contractual terms of the lease agreement provide that the price for which the lease is granted is made up of several elements does not make each element a separate supply. This issue becomes commercially significant where s 81-5(2) applies. This section of the GST Act has the effect of making certain payments of tax, fees, or charges, exempt from GST by deeming that the payment is not the provision of consideration. If a supply is not made for consideration it can not be a taxable supply.^{vii}

Case study

Mike leases an indoor sports complex in suburban Sydney to Gino at a lease rental of \$8,000 per month plus a contractual right to recover the cost of outgoing such as water rates and water usage charges.

The local authority has not charged GST on the invoice they send Mike, the owner, for water rates and charges.

In due course Mike sends Gino a tax invoice for recovery of the outgoing. Should Mike charge GST on this invoice?

Section 81-5(2) refers to a written determination made by the Treasurer. The current determination is Treasurer's Determination 2000 (No. 3).^{viii} And, for example, Part 2 item 16.5 & 16.7 of the Determination provides that fees payable in respect to water rates, charges and levies by a Local Government Authority in NSW is not consideration. This is why Mike has not been charged GST on his water rates (see case study). As the supply of the sports complex, together with the services such as water, is a single supply of real property Mike is required to pay GST on the gross rental he receives from Gino. This means that, subject to Mike's contractual right to gross up invoices to cover GST, he should charge GST on the invoice that he issues to recover the water rates and usage charge.

NON-RESIDENT PROPERTY INVESTORS

The GST system taxes the supply of goods and services consumed within Australia. In order to do this, one of the threshold tests in s 9-5 requires that the "supply is connected with Australia".

For completeness, a supply of real property is "connected with Australia" if the real property, or the land to which the real property relates, is in Australia. Therefore the sale of real property to non-residents will not be GST-free as an export of goods and services under s 38-190 (1).

GST is payable by a non-resident on the supply of Australian rental property where the non-resident meets the s 9-5 threshold tests. One of these tests is the requirement to be registered. When examining this question for a non-resident do not take into account overseas income in your turnover calculation and remember that, as with all taxpayers, you do not include supplies that are input taxed when calculating the enterprise's current annual turnover.

Reverse charging the GST liability

Division 83 allows a non-resident supplier and the resident recipient of a taxable supply to agree that the resident will pay the GST otherwise owed by the non-resident where the following conditions apply:

- the supplier does not make the supply through an enterprise that the supplier carries on in Australia, and
- the recipient is registered or required to be registered.

In this event, the non-resident does not have to supply a tax invoice and, notwithstanding this fact, the recipient is entitled to claim any input tax credits that are available.

Professional Services provided to Non-Resident Investors

Where an enterprise provides a supply of services to a non-resident, the supply may be GST-free under s 38-190(1). Item 2 in this subsection provides that a supply that is made to a non-resident who is not in Australia when the thing supplied is done, and:

- the supply is neither a supply of work physically performed on goods situated in Australia when the work is done, nor a supply directly connected with real property situated in Australia; or
- the non-resident acquires the things in carrying on the non-resident's enterprise, but is not registered or required to be registered will be GST-free.

The pre-condition that the recipient of the supply is not in Australia at the relevant time requires that neither the recipient, nor a representative acting on behalf of the recipient, is in Australia at the relevant time. Where the recipient is a natural person the ATO will assume that this condition is met if the recipient is not in Australia at the time the supply is made. However, where the natural person has appointed, for example, an attorney to act on her behalf then this assumption is negated. Because a company can only act through its agents, where a recipient is a company a more detailed analysis of the issue would be required. On the facts described in ID 2001/583 the ATO decided that an offshore company that had an Australian subsidiary, and maintained offices in Australia, was not represented in Australia at the relevant time.

A requirement for a supply to be GST-free under para (a) of item 2 is that the supply is not directly connected with real property in Australia. In this regard the services provided by a manager of a specific property in Australia are directly connected with real

property in Australia and are therefore taxable supplies. Similarly, services provided in connection with the purchase or sale of the property will also be taxable supplies.

In contrast, fees payable to an accountant to merely prepare an Australian tax return for a non-resident property investor will be GST-free under para (a) of item 2. This is because the services are neither a supply of work physically performed on goods situated in Australia, nor a supply directly connected with real property situated in Australia. The purpose of preparing and lodging the tax return is to meet the non-resident's Australian tax obligation. This cannot be said to have a direct connection with the underlying real estate.

It is important to note that contrary to the position in general income tax law the term carrying on an enterprise is defined in s 195 to include doing anything in the course of, commencement, or termination of an enterprise. Therefore, a taxpayer is entitled to claim input tax credits generated on the supply of services associated with the purchase or sale of their income producing assets.

Case study

Roti is a resident of New Zealand. During a holiday in Australia about five years ago, Roti purchased a multi story car park in Sydney. Roti has not been back to Australia since he purchased the building and has appointed a well known car park operator to manage his investment (collect parking fees, clean the building, pay outgoings etc) and an accountant based in Parramatta to prepare and lodge his various Australian tax returns. Roti has now decided to sell the building and is registered for GST .

- Will any of the entities engaged by Roti be treated as being his representatives for GST purposes?
- Is GST payable on the supply of services provided by the management company or accountant?
- Will GST be payable on the services provided, in connection with the sale, by Roti's real estate agent and solicitor. If so, can he claim the input tax credit associated with these expenses?

NEXT MONTH

This paper will continue next month with a discussion of some of the difficult GST issues that confront property developers. Subject to space constraints, the following topics will be discussed: when will subdividing the family home amount to the

conduct of an enterprise; use and misuse of the going concern exemption; the continuing relevance of the margin scheme, Div 129, 130 and 132 Adjustments; GST and in-kind developer contributions and, hopefully, an analysis of the long awaited final ruling on the meaning of new residential premises. ■

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*Part II of this article will appear in
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Reference Notes

- Unless otherwise noted reference to a section of an act are a reference to A New Tax System (Goods and Services Tax) Act 1999*
- A New Tax System (Australian Business Number) Act 1999*
- the exception being where the supply is made by the Commonwealth, a State or Territory, in which case the supply will be GST free*
- paras 68 - 70*
- paras 68 - 76*
- GSTD 2000/10 para 1*
- because the definition of taxable supply requires the provision of consideration*
- the full citation is A New Tax System (Goods and Services Tax) (Exempt Taxes, Fees and Charges) Determination 2000 (No. 3). A copy of the Determination can be found at the Treasury website.*