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GST alert

Grant Thornton

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for clients in business.

The large number of **GST and property cases** highlights the pitfalls and problems that the tax poses property developers, advisors and other professionals such as valuers. The following notes outline cases that detail the uncertainty that still exists and some of the issues that need to be dealt with. Two concern the definition of residential property, and two are in respect of the margin scheme.

House, hotel or something else?

The decision in *Marana Holdings Pty Ltd v FC of T* [2004] ATC 5068 has and will cause considerable difficulties to property developers and investors. The scenario was as follows:

- motel converted to strata units
- motel rooms converted to residential accommodation
- residential accommodation sold.

The question that arose was whether the sale of the residential units was the sale of an old residential property, a new residential property or a commercial residential unit. The former is input taxed (not subject to GST on the sale), but GST would be due on the value of the later two scenarios. The Court held that it was the sale of new residential property (and so subject to GST), as it was no longer commercial residential property, but as the earlier occupation (when used as a motel) of the property was temporary it could not be described as being residential until the conversion.

Whilst this may seem to be a logical decision the Government did not like it. To 'clarify' the position (that would seem to have been clarified by the Court), the Government has proposed an amendment to the law, backdated until July 2000. This will treat such premises as being input taxed. There are, of course, winners and losers with this treatment. The winners are those that are selling or letting such properties and now do not need to charge GST. If GST has been charged on such transactions the GST charged should be clawed back from the ATO and repaid to the customer. The losers will be investors that have bought such properties and claimed back GST from the ATO. The ATO is in the process of recovering credits claimed from the ATO and also imposing interest and penalties. The GST reclaimed by the ATO may be clawed back from vendors, if they can be located. Businesses that have made claims for credits that could be subject to challenge by the ATO need to consider their position carefully, especially as they were acting on the basis of a Court decision and are now being adversely affected by retrospective legislation.

A further case has also examined what is to be regarded as a residential property. In *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* ([2006] NSWSC 83, NSW Supreme Court) Landmark believed that it had suffered a loss when the trustees sold property as a taxable supply. The point at issue was whether the vendor could predict that the property was to be used for residential purposes. There had been two private rulings from the ATO that the supply did not need to be taxed, that the supply was input taxed, as there was previous residential use and the properties could be used for residential purposes.

The decision is interesting as it points out that the ATO's ruling on GSTR 2000/20 is inconsistent and is difficult to follow. It does not effectively clarify if a domestic property such as a house that has been used for commercial purposes (such as a

surgery) can be treated as residential premises when sold and there are difficulties in reconciling the various paragraphs concerning the physical characteristics of premises and the actual use of the premises. The decision also highlights the problem that the legislation requires a prediction of future use by the purchaser (the intention to use the premises for residential use).

The Court was not convinced by arguments that objective criteria of the state of the building can formulate what the intended use was, but believed that the future use could only be found from the purchaser (giving clear problems of determining this at an auction). It suggested that vendors of residential premises (that are enterprises) should protect their position through the introduction of terms in respect of use in the sale agreement. In addition, it demonstrates that ATO rulings cannot always be relied on as they may not be valid.

What value for the margin?

The case of *Derring Lane Pty Ltd v Fitzgibbon* [2006] VSC 46, Supreme Court of Victoria) highlights the difficulties that valuations can give when selling properties using the margin scheme. Derring Lane bought vacant land for $2.25m in May 2002. The vendor applied the margin scheme and had engaged Mr Fitzgibbon to provide a valuation. Derring Lane later obtained its own valuation. This valuation of $1.8 million contrasted with Mr Fitzgibbon's valuation of that land at 1 July 2000 of $1.1m. If the correct value was $1.8 million, then too much GST had been charged on the sale, and Derring Lane had overpaid for the property. It sought compensation from Mr Fitzgibbon due to negligent misstatement. The claim was dismissed at the Tribunal level as the purchaser failed to demonstrate any reliance on Mr Fitzgibbon's valuation and this was confirmed at the Supreme Court of Victoria. This case highlights the difficulties of using valuations and the distinct possibility that professional valuers may disagree significantly as to the value.

The ATO has recently altered the legislation regarding what is to be included in the margin and altered the rules for valuations. Some of these are dealt with in earlier GST Alerts and these are available on the Grant Thornton website. Where, however, the acquisition consideration is used to calculate the margin (rather than a valuation) the value to be used is the consideration for the property cost only. It is to exclude the value of improvements, development costs, professional fees, Stamp Duty, option fees etc. This is now explicit in the legislation following the 2005 amendments, but the concept of the acquisition value has been tested in the Courts in the case of *Sterling Guardian Pty Ltd*. In this case the appellant was attempting to argue that the construction costs and the various fees and taxes paid were part of the acquisition cost of the developed property. Thus, the margin should be the difference between the cost of development and the selling price. The Court did not believe that this was the intention of the legislation and held that it was the acquisition cost of the undeveloped land that was to be used as the base cost. The Court pointed out that to allow this argument would be to condone double dipping as there would be a deduction from the margin scheme for the development costs and also input tax credits would be given on these costs.

The Court also pointed out that the argument requiring the development costs be included in the margin valuation had the seeds of its own destruction. One requirement of the margin scheme was that the interest was not to be acquired through a taxable supply (other than one where the GST was worked out by using the margin scheme). The development costs were acquired through a taxable supply so this would mean that if Sterling Guardian were correct in their assertion that these costs were to be part of the base cost for the margin scheme calculation, they would not be able to utilise the margin scheme as they had received a taxable supply and this would give them an increased cost.

Conclusion

Developing case law and legislative amendments (especially retrospective legislation) is increasing complexity. Given the complexity and high values involved, obtaining professional advice is not only prudent but essential when dealing with property to avoid unexpected and unnecessary GST costs.

For further information please contact:

Adelaide
Philip Paterson
67 Greenhill Road
Wayville SA 5034
T 08 8372 6666
F 08 8372 6677
E info@gtsa.com.au

Brisbane
Bob Lunney
Grant Thornton House
102 Adelaide Street
Brisbane QLD 4000
T 07 3222 0200
F 07 3222 0444
E info@gtqld.com.au

Melbourne
Mark Cummings
Rialto Towers
525 Collins Street
Melbourne VIC 3000
T 03 9611 6611
F 03 9611 6666
E info@gtvic.com.au

Sydney
Robert Quant
383 Kent Street
Sydney NSW 2000
T 02 8297 2400
F 02 9299 4445
E info@gtnsw.com.au

Perth
Peter Fallon
256 St George's Terrace
Perth WA 6000
T 08 9481 1448
F 08 9481 0152
E pfallon@gtwa.com.au

Grant Thornton

www.grantthornton.com.au

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