Presentation Outline
Back to Basics: GST and Real Property - Tips and Traps for Young Players

Presented by Geoff Gartly CA March 2024

The treatment of GST on property transactions can be a complex affair. Is GST registration required, and if so, when? These are just a few questions that can arise when dealing with property transactions.

This session navigates you through the GST issues and requirements about real Property, including:

- *The one-off property transaction. What are the GST requirements?*
- *How do you deal with a property with mixed commercial and residential use?*
- *Settlement adjustments and GST (GSTD 2006/3)*
- *When can the margin scheme be applied to a property sale?*
- *What property sales can benefit from the use of the margin scheme?*
- *Margin scheme requirements, including:*
  - *when you need to look at historical sales records*
  - *the valuation rules*
- *Changing intended use,:*
  - *Renting premises initially intended for sale*
  - *Selling premises originally intended for renting*
- *Case studies:*
  - *GST-free sale of farmland concession*
  - *GST-free going concern concession.*

GST issues in Property

Background

When undertaking real Property transactions, it is essential 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. Today, we explore various examples where GST may apply.

Executive Summary:

1. We outline below the different types of real Property that can be supplied and the GST treatment.
2. In certain circumstances, better GST outcomes may be achieved by applying the margin scheme.
3. From 1 July 2018, 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).

Types of Property and GST implications

The GST of property can be classified into the following categories:

Residential Property: The sale of existing residential premises is exempt from GST. GST is payable on the sale of new residential premises and potential residential Land, subject to certain conditions. Residential rent is also exempt from GST. Your home is exempt; however, a change of use may create a GST transaction.

Commercial Property: GST is payable on the sale and rent of commercial properties. These include office buildings, retail stores, and factory warehouses. Businesses that meet the income threshold registered for GST can claim GST credits for commercial property transactions. Taxpayers do not need to be registered and may not be required to pay GST if it's a one-off event.

New Residential Premises:

They are defined as properties that have not been previously sold as residential premises in the five years since they were built or have undergone substantial renovations. Sales of new residential premises are subject to GST.
This could include off-the-sales property purchased and then later sold.

Residential or commercial Land: This includes Land permissible for residential use but does not yet contain any buildings. GST implications can vary based on whether the sale is for a consumer or business.

Vacant Land: The GST treatment of vacant Land can depend on how the Land is intended to be used. If it's for commercial or new residential premises, GST may apply.

Commercial Residential Premises: These are properties used for commercial accommodation, such as hotels, motels, and hostels. GST is generally applicable to the sale and rent of these premises.

Farmland: The sale of farmland can be GST-free if it has been used for farming for at least five years before the sale and the buyer intends to continue using it for farming.

Going Concerns: The sale of a business as a going concern, which can include Property, can be GST-free, subject to meeting specific criteria, such as the buyer being registered for GST and the sale including everything necessary for the continued operation of the business**.**

Throughout the presentation, we will explore various components concerning property transactions, margin schemes and farmland.

GST and one-off property transactions - *What are the GST requirements?*

There are several factors to review when it comes to one-off property registration:

1. The type of Property and its intended use (see above)
2. The GST threshold and *mere realisation of asset*
3. GST threshold and whether the taxpayer is *carrying on an enterprise.*

The key factor is determining whether the seller is registered or required to be registered for GST.

Suppose the sale of the Property is a taxable supply and exceeds the GST registration threshold (currently $75,000 annual turnover for most businesses). In that case, the seller must be registered for GST if it is a sale of taxable supply.

Calculating GST turnover – per the ATO website

When calculating your GST turnover for registration purposes, **don't include**:

- the sale of existing residential Property
- sales for no payment that aren't taxable (unless made to an associate)
- other property sales that are private and not connected to your enterprise, such as your family home.
- residential rental income.

Is the sale of the taxpayer's property a mere realisation of an asset?

When assets are sold as part of the ordinary course of business, the sale is generally considered taxable and subject to GST.

However, the "***mere realisation***" of assets is a concept used to distinguish between the disposal of assets as part of **normal business operations** and the disposal of assets **in a way that is not part of the usual business activities**, often for the purpose of liquidating assets without the intention to continue or establish a business.

The key distinction here is that the mere realisation of assets may not be subject to GST if it does not constitute an enterprise's taxable supply.

For example, suppose an individual or a non-GST registered entity sells a property merely as a one-time transaction (or in a way that does not form part of their regular business operations). In that case, this sale might be considered a mere realisation and not subject to GST.

Last month (Feb 2024) the Tribunal outlined what may constitute running a property enterprise vs mere realisation of an asset.

Lance and FCT (2024) AATA 11, 5 January 2024.) ***Subdivision and furtherance of an enterprise and GST.*** In this case, the AAT ruled that a subdivided property was sold in "the course or **furtherance of an enterprise**;" therefore, it was subject to GST.

The Taxpayer had argued to the Tribunal that the subdivision and other relevant activities carried out were for "family living arrangements". Mr Lance had acquired a permit to subdivide the Land and an initial permit to build and develop a residential property.

The AAT found that the Taxpayer **had not discharged the burden of showing this was the case**. The AAT concluded that the Taxpayer's activities throughout his ownership of the Property amounted to the carrying on of an enterprise.

Their rationale for this was based on the evidence that Mr Lance undertook the supply of real Property in the course or furtherance of an enterprise being carried on by him.

Mr Lance failed to prove to the Tribunal that all the development works relating to the subdivision of the Property were not carried on in the course or furtherance of an enterprise.

The Tribunal also found that the sale was not an input taxed supply of residential premises because Sutton Farm did not meet the definition of "residential premises" in s 195-1 of the GST Act as the buildings were uninhabitable. (

Things that indicate you are operating a business as a property developer

Here's a breakdown of what typically defines an ongoing enterprise for land transactions:

- type of entity undertaking the subdivision
- types of activities you're involved in
- costs incurred before the sale.
- complexity and steps undertaken
- parties and phases involved
- your relationship with other parties involved in the land subdivision
- timing and actions undertaken for the sale

When considering your land subdivision's income tax and GST implications, it is essential to weigh all the factors together, not in isolation.

Purpose and Nature of the Land Sale: The sale of Land is more likely to be considered part of an ongoing enterprise if the Land was acquired, developed, or held with the intention of selling it as part of a business strategy.

This includes property development businesses, real estate investment businesses, or any other business where land transactions are a regular part of operations.

Frequency and Volume of Transactions: Regular and repeated land transactions indicate an ongoing enterprise. A single sale of Land is less likely to be considered an ongoing enterprise, whereas frequent sales suggest a business activity.

Nature of Activities: Activities that add value to the Land, such as development or subdivision, can indicate an ongoing enterprise, mainly if these activities are carried out to sell the Land for profit. How complex are they

Intention at Time of Acquisition: If the Land was initially acquired with the intention of resale at a profit or as part of a business strategy, this could indicate an ongoing enterprise. The entity's intentions at the time of acquiring the Land are relevant. This may include your finance application and borrowings.

ATO's views in GST Ruling GSTR 2001/7. This is ATO ruling opinion "capital assets" relate to the "profit-yielding subject" of the enterprise and are distinguishable from "revenue assets", which are incidental to the carrying on of a business.

Additional detail in general terms for each of the factors in Taxation Ruling 92/3 Income tax: whether profits on isolated transactions are income.

Administrative Appeals Tribunal (**AAT**) case of *Ian Mark Collins & Mieneke Mianno Collins ATF The Collins Retirement Fund and Commissioner of Taxation (Taxation)* [2022] AATA 628 (**Collins**)

The question addressed in this case was whether Collins, the Taxpayer, was required to be registered for the sale of Land or a mere realisation of the land"?

Facts

Mr and Mrs Collins acquired two parcels of Land in 1986 and 1992 (**Land**) and carried on a nursery business on the Land.

In 2004, Collins sold the nursery business but kept the Land, which was rented out.

Collins was registered for GST and charged it on the rentals.

- 2014 Collins transferred the Land to his SMSF
- In 2015, the Taxpayer submitted a development application ('DA') to the local authority, seeking approval to subdivide the Land into rural residential lots.
- 2016: the DA approved the subdivision, and he then cancelled the GST registration.
- In 2017, a plan subdividing the Land into residential lots was registered, and the Taxpayer sold 10 of these lots for $1 million each.

Decision in Colins Case

The Tribunal found the taxpayer failed to discharge its evidential burden and was therefore required to be registered for GST concerning land sales.

About the capital asset point:

- The AAT acknowledged that, unlike the income tax enquiry, which focuses on the seller's intention at the time of acquisition (in 2014), the GST law is concerned with the seller's intention ***at the time of the supply*** **(in 2017).**
- Mr Collins acknowledged that by the time the tenant vacated the Property in August 2016, it was intended that the Land would be subdivided and the lots sold.
- The Taxpayer incurred over $4.5 million in costs to achieve the subdivision and actively engaged in the subdivision process, including extensive marketing (as reflected in the marketing materials), and the Land was sold for it.
- The fact that the Taxpayer had no professional experience in property development and engaged others to market and undertake the subdivision was not considered persuasive considering the other factors above.

About the ceasing to carry on an enterprise / substantial reduction in size of activities point:

- The **land development enterprise did not cease before the last of the lots were sold**,
- The sale of Land is an inherent feature of a land development enterprise, which underpins the enterprise's ongoing conduct. Accordingly, the sales of the Land could not have occurred as a consequence of the enterprise ceasing.
- The sales of the Land were made in the course of and as a consequence of carrying on the enterprise, not as a consequence of a reduction in its size or scale. The Taxpayer's interpretation would mean land developers could escape GST.

Principles

The key points to derive from the Collins case are:

- While income tax focuses on the profit-making intention at the time of acquisition, GST law focuses on the profit-making intention at the time of supply,

- It is difficult for taxpayers who conduct land development enterprises to assert that land sales can be made solely due to ceasing to carry on an enterprise or reducing its enterprise.

- Activities by an SMSF constitute an enterprise under the GST law. There is no need for the activities to be in the form of a business. Therefore, most SMSFs will carry on an enterprise for the GST law.

- As the case points out, thinking you can avoid GST by cancelling the GST registration doesn't make you exempt from GST.

Mum and Dad's subdivision of home and land.

As practitioners, we get asked if the subdivision of our Land at home and sale will be subject to GST.

Mum and Dad may have GST obligations and entitlements if you subdivide and sell Land with **the intention of profit and in the course of carrying on a business** or as a business or commercial transaction.

Even with a one-off transaction, you may still be required to register for GST because your one-off property transaction may have the characteristics of a business deal. Mere realisation and sale as they are downsizing may pass the test as a one of sale. But every case is different, so document your findings.

Commercial and residential premises MIXED.

The supply of commercial and 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).

Section 195-1 of A New Tax System (Goods and Services Tax) Act 1999 (GST Act) defines commercial residential premises as hotels, motels, boarding accommodations, etc. In determining whether a property is commercial or residential premises, consideration is given to several factors, including whether the Property allows for multiple occupancies, 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 Ruling GSTR 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. Hence, it will not be subject to GST, except for the taxable supply of new residential premises, which will be subject to GST, as discussed below.

i. 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.

In *Sunchen Pty Ltd v Commissioner of Taxation* [2010] FCAFC 138, the Full Federal Court held that this definition requires consideration of the **objective physical characteristics of the Property rather than of the purchaser's subjective intended use.** In that case, the Property was subject to a residential lease when sold. However, the purchaser argued that the sale was subject to GST as they intended to develop the Property into commercial premises. The Court rejected this argument, deciding that the premises had all the attributes of residential premises, so the sale was input taxed.

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

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.

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 the 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.

New residential premises

As noted above, the supply of new residential premises (by way of sale) is subject to GST. The term' new residential premises' means premises that have not previously been sold as residential premises or are subject to a long-term lease (i.e. a lease of at least 50 years). Premises substantially renovated or built to replace demolished premises can also be new residential premises for these purposes.

Developers who develop properties using development lease arrangements have previously experienced some difficulties. 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, before this, the developer enters a short-term development lease, which requires the developer to undertake the development under a development plan. Once the development has taken place, the development lease is surrendered, and the Land will be supplied to the developer by selling the freehold interest or granting 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 whether a premises are new residential premises.

How do you deal with a property with mixed commercial and residential use?

A practical approach is needed here as per the ruling of GSTR 2006/4

Determine the Extent of Each Use %

How to approach an allocation between Commercial and Residential Use:

- Keep good records. You need to accurately determine the proportion of the Property used for commercial purposes (subject to GST) and the proportion used for residential purposes (usually GST-free).

- Use Basis for Allocation: The allocation can be based on floor area, value, or another reasonable basis that accurately reflects the respective uses of the Property.

Also, note where the mix changes so your apportionment approach may be based on area and time

GST Treatment mixed property recap

Commercial Use: The commercial portion of the Property is subject to GST. If you sell or lease a part of the Property for commercial purposes, you must include GST in the price and can claim GST credits on related purchases or expenses.

Residential Use: The sale or lease of residential premises is generally exempt from GST. However, there are exceptions, such as new residential premises or commercial residential premises, which may be subject to GST.

Ensure it is documented in the contract so both parties agree on the approach.

Under the ruling, you can choose your own method!

You may choose your own apportionment method, but the method you choose needs to be fair and reasonable in the circumstances of your enterprise. It must appropriately reflect the intended or actual use of your acquisitions or importations.

The 'fair and reasonable' principle was used by the High Court in Ronpibon Tin v. FC of T,[16] in the context of the apportionment of expenditure serving more than one object 'indifferently'.[17]

In that case, the High Court did not apply this principle concerning allocating specific acquisitions wholly to specific ends or to apportion items of expenditure 'distinct and severable parts of which' can be identified as being devoted to such particular lots.

The Commissioner's view is that the 'fair and reasonable' principle applies equally to the choice of method for allocating or apportioning acquisitions in all circumstances.[18]

Following the principles set out by the High Court, the apportionment method you choose needs to:

- be fair and reasonable.
- reflect the planned use of that acquisition (or, in the case of an adjustment, the actual use); and
- be appropriately documented

Settlement adjustments and GST (GSTD 2006/3)

In most cases, settlement adjustments will not be listed in the Property Sale Contract.

In GST Determination GSTD 2006/3, the ATO has stated that it is necessary to consider any entitlement adjustments when determining the total consideration received.

The consideration may be either monetary or non-monetary, or both. The consideration will not always be the price shown on the contract as, on settlement, adjustments are commonly made for rates, land tax and other outgoings.

For example, if you receive an additional amount to cover the council rates you have paid, you will need to increase your consideration by that amount.

Per the footnote in the Ruling - Even if settlement adjustments are considered adjustments for the GST Act's purposes, they ordinarily occur on the date of the supply and consequently are in the same tax period.

In the ruling the commissioner discusses an alternative view that considers settlement adjustments for rates paid in advance as not changing the consideration for the land supply.

However, the Commissioner does not accept this view in the GST context, emphasising the importance of the nature of the supply and the relationship between the payment and the supply.

Example applying GSTD 2006/3

Supplier (Seller): Andy
Recipient (Buyer): Mandy
Property: A block of land
Contract Price: $1,000,000
Settlement Adjustments: Rates notice paid by Andy before settlement Calculated to be $435

Details:
Andy sells a block of land to Mandy.
The agreed purchase price is $1,000,000.
Before the settlement, Andy ahs already paid the rate and this amounts to an adjustment of $435

Calculation of Consideration:
Initial Selling Price: $1,000,000
Rates Adjustment Calculation: $435
Adjusted Consideration:
Selling Price: $1,000,000
Plus Rates Adjustment: $435
Total Consideration for GST purposes: $1,000,435

GST Implications:
According to GSTD 2006/3, the total consideration for GST purposes includes the initial selling price plus the adjustment for rates.

In this case, the total consideration is $1,000,435, which is the amount on which GST would be calculated. The example demonstrates how settlement adjustments, like rates or land tax paid by the seller, are factored into the total consideration for the supply of real property.

The GST payable by the buyer is based on the total consideration, which includes these adjustments. This example aligns with the principles set out in GSTD 2006/3, illustrating how adjustments made at the time of property settlement can affect the total consideration for GST purpose.

When can the margin scheme be applied to a property sale?

What property sales can benefit from the use of the margin scheme?

The margin scheme can benefit property sales where:

1. ***The property is sold as part of a GST-free supply:*** *Certain types of property sales, such as selling* ***a going concern*** *(e.g., sale of a business), a farm, or a commercial property leased as residential accommodation, may be GST-free. In such cases, the margin scheme can calculate the GST payable on the sale.*
2. ***The property was purchased under the margin scheme:*** *If the property was acquired under the margin scheme, the seller can use it for its subsequent sale. This is often the case for properties purchased from a vendor using the margin scheme or when buying a property from someone not registered for GST. If you were charged the total rate of GST when you initially purchased a property, the margin scheme* ***can't be used*** *when you sell it.*
3. ***The property is a second-hand property:*** *The margin scheme is primarily used for second-hand residential properties or vacant land. It allows sellers to pay GST on the margin (i.e., the difference between the sale price and the purchase price) rather than the total sale price. This can be beneficial when the property has increased in value, but the seller wants to minimise the GST payable on the sale.*

4. ***The property is not eligible for the total input tax credit:*** *If the seller is unable to claim the full input tax credit on the property (e.g. because it was acquired before they were registered for GST), they may opt to use the margin scheme to calculate the GST payable.*

It's important to note that the margin scheme is optional, and sellers must meet specific eligibility criteria to use it. Additionally, applying the margin scheme can have implications for both the seller and the buyer and must be agreed upon in the property contract.

What is margin scheme?

What is the margin scheme when it comes to GST and Property?

The margin scheme is an alternative way of calculating GST payable when a seller sells a property as part of a business and where GST was not applied at purchase.

The scheme reduces the GST you must pay – called the "margin."

Calculation
The "Margin is calculated on the difference between the sale price and the purchase price of the Property (if the Property is acquired before 1 July 2000, the value of the Property on July 2000)

The use of the Margin Scheme is subject to the eligibility criteria*:*

To be eligible to apply the margin scheme, the following needs to be adhered to :

- *You or your entity must be registered for GST.*
- *The sale of your Property must be a taxable supply*
- *You must **not have paid GST** when you purchased the Property OR the previous owner used the margin scheme, and they sell to you then can't use*
- *There must be a written agreement between you, the seller and the purchaser before settlement.*

(You can also check from the ATO determination tool [at GST property decision tool | Australian Taxation Office (ato.gov.au)]()

When can you not apply the margin scheme?

You can't use the margin scheme:

- if you purchased the Property as **fully taxable and the margin scheme wasn't used**
- if you weren't registered or required to be registered for GST at the time of your sale
- for sales on or after 17 March 2005, if you
  - purchased the Property as fully taxable, and the margin scheme wasn't used
  - inherited the Property from a person who wasn't eligible to use the margin scheme
  - obtained the Property from a fellow member of a GST group who wasn't eligible, and they purchased it from an entity that wasn't a member of the GST group
  - were a participant in a GST joint venture and obtained the Property from the joint venture operator who purchased the Property through an ineligible sale.

- if you're selling Property originally purchased or entered into a contract to purchase, on or after 9 December 2008 and the
  - The entity you bought the Property from wasn't eligible
  - The property was purchased as part of an ongoing concern
  - property was purchased as GST-free farmland

What property sales can benefit from the use of the margin scheme?

The Margin Scheme can be used when selling commercial and residential properties, new residential premises, vacant land, investment properties, and properties held for resale purchased or built after 1 July 2000.

Usually, the amount of GST is calculated as 1/11th of the total sales price.
The benefit of using the Margin Scheme is it reduces GST Liability.

(For Purchaser, When buying Property, where margin scheme was used, you cannot claim a GST credit for the GST included in the purchase price, even if it was for business purposes.)

Note upon settlement the purchaser only needs to withhold 7% instead of 10% of the sale price to remit as GST withholding at settlement

Margin scheme requirements, including:

- *when you need to look at historical sales records*
- *the valuation rules*

Method calculation depends on purchase date

1. Consideration method

For properties purchased before or after 1 July 2000. The margin is the sale price less purchase price. Cost for developing the property and other expenses is not included and must be claimed separately on the activity statements and tax returns.

2. Valuation method

For properties purchase prior to 1 July 2000. The margin is the difference between sales price and approved valuation of the property at 1 July 2000

Method depends on purchase date:

When selling property using the margin scheme that you originally purchased or held an interest in:

- **after 1 July 2000** – you must use the Consideration method
- **before 1 July 2000** – you can use either the Valuation method or the Consideration method.

Contract of sale

A Property sales contract should include:

- if the contract price includes GST or not
- if the margin scheme applies and, if so, the margin rate. This may be in a separate written agreement.

Imperative that both purchaser and seller agree in writing.

Looking at historical sales records

This is crucial when dealing with the Margin Scheme for Goods and Services Tax (GST) for several reasons.

The Margin Scheme is a way of calculating the GST and relies party on historical records

Use Historical records to establish whether the property sale qualifies for the Margin Scheme. Eligibility may depend on how and when the property was previously acquired and also if full GST had been paid

Calculating the Margin: The Margin Scheme taxes the difference between the sale price and the purchase price of the property, rather than the full sale amount. Historical sales records are necessary to accurately calculate this margin.

Property Acquired Before GST Introduction: If the property was acquired before the GST was introduced (1 July 2000), historical sales records help establish the property's value at that time, which is necessary for margin calculations.

Subsequent Sales: If the property has been sold multiple times under the Margin Scheme, it's important to look at the historical sales records to ensure the margin is correctly calculated each time, considering the previous sale margins. – see above

Please note if any adjustments or corrections need to be made to past GST returns, historical sales records will be necessary to make accurate recalculations.

Which GST Valuation Method for Margin

If you're using the valuation method to sell Property under the margin scheme, you must use an approved valuation method.

There are three valuation methods available for the calculation of the Margin Scheme

- a valuation by an approved valuer
- a valuation based on the payment the seller receives under a contract of sale (if the contract was entered into before the valuation date)
- A state or territory department prepares a valuation for rating or taxing purposes.

For properties that are partly completed at the valuation date, use the value in writing from a professional valuer.

Components of a valuation

A valuation must include **all of** the following:

- objectively show the valuer undertook the valuation process according to industry practices.
- be documented and explained well enough for another valuer to understand how the outcome was worked out and replicate the process.
- You must have a valuation by the due date for lodging your activity statement for the tax period the sale applies to. One-liner Real Estate letters are sufficient.

The Valuation date

Generally, the valuation date is either:

- 1 July 2000 if you held or owned the Property **before 1 July 2000** and were registered (or required to be registered) for GST at that date
- The date you were registered (or required to be registered) for GST if you held or owned the Property before 1 July 2000 and weren't registered (or needed to be registered) until after that date.

Note: Even though you must value a property as it was at the valuation date, it doesn't have to be done on that date.
Value of property interest that existed at the valuation date.

If the Property that existed at the valuation date is different to the interest you're selling, you:

- **must get a value of the interest that existed at the valuation date**
- **need to apportion that value on a reasonable basis.**

There are specific rules regarding the manner of this valuation, which are set out in Margin Scheme Valuation below

- MSV 2005/3 *Margin Scheme Valuation Requirements Determination*
- MSV 2009/1 *Margin Scheme Valuation Requirements Determination*
- MSV 2020/1 *Margin Scheme Valuation Requirements Determination*

There are several GST determinations concerning the margin scheme valuations used. Practitioners and Property developers should be aware of the ATO's draft GST Determination for Margin Scheme Valuations.

These valuations may require them to obtain new or 'confirmed' valuation reports to support the application of the margin scheme for sales of real property incurred outside of the three-month transitional period.

Adjustment events on change in creditable purpose – DIV 129

The Division 129 of the GST Act can apply if there has been a change in creditable purpose.

This division applies to residential Property in which rent is classified as input taxed and the Property was being built for sale.

A developer may have had a change of heart, or the market has changed, delaying the sale for a while.

Tip – practitioners should encourage your property developer to develop a long-term plan. Watch for changes of use, and regular contact with your client allows you to assist them meet their GST and cashflow planning. Having back GST credits can impact a developer's cash flow plans if not managed.

GST Registration: If you are registered for GST or required to be registered due to the level of your taxable activities, including property rental, you must account for GST on your transactions if you are a property developer.

GST collected or paid is not required if you become a residential landlord.
This may apply where a developer constructs a new residential property intending to sell it, but a decision is made to offer the Property for lease. This often occurs due to changes in market conditions.

In these circumstances, an adjustment is required to consider that input tax credits will have been claimed regarding 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.

Residential Premises: Renting out residential Property is generally exempt from GST in Australia. However, changing the use of new residential premises from selling to renting within five years of completion may trigger GST implications.

The ATO considers this a change in creditable purpose, and you may need to adjust the GST credits you have claimed on construction or purchase costs. Typically, when there is a change, it's almost completion, and credits have been claimed on construction costs.

The sale of new residential premises is a taxable supply, and a developer is entitled to claim input tax credits for creditable acquisitions for the construction costs.

However, if a developer chooses to rent out the premises until the market improves, the use of the premises (compared to the prior intended use) changes, and Division 129 GST adjustments may be required to repay some, or all of the input tax credits previously claimed. Each acquisition is considered individually, which can make Division 129 adjustments complex throughout construction.

Adjustments for changes in intended use are made annually, with the first adjustment period being the tax period that ends on 30 June and commences at least 12 months after the end of the tax period in which the acquisition was made. For example, the adjustment period for an acquisition made in August 2019 will not be until 30 June 2021.

The number of adjustment periods required is based on the GST-exclusive value of the relevant acquisition. Concerning construction property transactions, the most common are:

GST-exclusive value of the acquisition	**Adjustment periods**
Not more than $1,000	0
$1,001 to $5,000	2
$5,001 to $499,999	5
$500,000 or more	10

Acquisitions related to the development, such as the purchase of the Land and the progressive contract price paid to a builder, may be required to be apportioned to determine the extent to which the expenditure relates to the intended sale of the Property.
ow the change of use adjustment works

The Commissioner in GSTR 2009/4 accepts that developers constructing residential premises may have a dual planned use for the premises – the premises can be applied to creditable and non-creditable purposes at the same time.

Per the ruling, a good summary with an explanation as follows:

Determining whether an acquisition made in constructing new residential premises is a creditable acquisition for the purposes of Division 11

23. Prior to an entity considering whether or not it has to make adjustments under Division 129, the entity will have ***determined its planned extent of creditable purpose for a thing to determine its entitlement to input tax credits under Division 11 for the acquisition of the thing****. This planned extent of creditable purpose for which the entity acquired the thing is an important element in determining whether an adjustment subsequently arises under Division 129.*

24. If an entity constructs new residential premises and the entity plans, as evidenced by an objective assessment of the facts and circumstances, to only sell those premises by way of a taxable supply as part of its enterprise, the acquisitions made in constructing the premises will be for a creditable purpose.[22] Assuming all of the other requirements in section 11-5 are satisfied, the acquisitions will be creditable acquisitions and the entity will be entitled to input tax credits.[23]

25. Alternatively, if an entity constructs new residential premises for the purpose of sale but intends to lease the premises for a period of time prior to the sale, and an objective assessment of the facts and circumstances supports this dual planned use, the entity's acquisitions will be partly creditable. The entity will therefore be entitled to only a proportion of the full input tax credit.[24]

An example a developer new residential premises for sale. The premises may continue to be held for sale as part of the entity's enterprise of constructing new residential premises for sale.

Due to a downturn in the property market, the entity may also make the premises available for lease for a period until the market conditions improve. This will be a dual application of the premises during the relevant period (the period between acquisition and the end of the adjustment period).

The Commissioner's view is that where there is a dual purpose, input tax credits may be available to the extent they relate to the planned taxable supply of the premises.

However, the ATO must be satisfied with this dual-purpose and it is up to the taxpayer to prove it to the ATO.

If the dual purpose cannot be proved, an adjustment must be made to return all input tax credits claimed concerning the premises being leased out. This happened in the case of AAT Case [2009] AATA 569, Re **GXCX and FCT**.

Per the ruling, the holding of new residential premises for the purpose of leasing, or the supply of new residential premises by way of lease, will be an application that relates to making input-taxed supplies and will not be an application of the premises for a creditable purpose.[39]

In the Administrative Appeals Tribunal's decision in ***GXCX v. Commissioner of Taxation[41A] (GXCX****), where the Tribunal considered that an intention to sell, at some indefinite time in the future, strata titled residential units that were being leased to tenants, without more, was insufficient to establish that the units were being held for the purpose of sale and applied for the creditable purpose of sale during the relevant adjustment period.*

In GXCX the strata titled units in question were originally constructed for the purpose of sale as part of the taxpayer's property development enterprise. However, the taxpayer subsequently decided to rent the apartments to tenants in the short term. Whilst the taxpayer had maintained an intention to sell the apartments in the medium to long term, when expected capital growth could be realised, the time when the apartments would be sold was not set.

In reaching its decision, the Tribunal referred to the language in Division 129 and the method statement in section 129-40 which focuses on the application of a thing during the period from when it was acquired up until the end of the relevant adjustment period. The Tribunal found that the application of the apartments during the part of the relevant period subsequent to the taxpayer's decision to rent the 22 unsold apartments was entirely for a non-creditable purpose. The Tribunal considered that an intention to sell at some time in the future, without more, did not amount to an application of the apartments.

Change of use adjustments for GST

If an entity is required to apportion its creditable purpose, it must do so by applying a method that is fair and reasonable in the circumstances of each case.

A formula provided in the Ruling is:

"Consideration for the taxable supply of the premises" divided by "consideration for the taxable supply of the premises plus consideration for the input taxed supplies of residential premises by way of lease".

Example: partly input taxed and partly creditable planned use

Jane is registered for GST, constructed new residential premises for sale, and was entitled to full input tax credits on her acquisitions. However, because the market for new premises was slow, Jane leased them for six months before they were sold. Jane received $15,000 in rent over the six months. The premises were sold for $500,000. There had been no private or domestic use of the premises.

I.e. $500,000 sale proceeds plus rent of $15,000

$500,000 + $15,000

= 97.09%

There is adjustment of 100% – 97.09% = 2.91%

At the end of the next adjustment period following the sale, Jane calculates the extent of creditable purpose using the formula above as follows:

A GST adjustment will be calculated using the following formula:

Adjustment = full input tax credit x (intended application for creditable purpose expressed as a % - actual application for creditable purpose expressed as a %)

Tip: The ATO uses data matching tools, including real property transactions from state government title offices, rental bond data and tax returns. Taxpayers need to be aware of their obligations to make Division 129 adjustments when there is a change in the use of residential premises.

Here are key points to consider for such situations when there is a change of use:

Changing the use of a property from selling to renting can have GST implications. A GST adjustment for the GST credits you have previously claimed will be required for properties initially intended to be sold as new residential premises or commercial properties but are now instead rented out.

Margin Scheme: If you initially planned to sell the Property under the margin scheme but instead rent it out, there could be specific considerations regarding the GST treatment and the ability to claim GST credits.

Reporting and Documentation: Proper reporting and documentation are crucial. You must report the GST collected from rent on your Business Activity Statement (BAS) and keep detailed records of the change in use and any adjustments made to GST credits.

Capital Works Deductions: While not directly related to GST, if you're renting out premises, you may also be eligible for capital works deductions for the construction costs over several years, which can affect your tax situation and may change the cost by 1/11 if added back

Renting premises originally intended for sale

The margin scheme is applied to the sale of new residential premises to reduce the amount of GST payable. It does not matter if the purchaser is registered for GST, as they cannot claim back the GST on the purchase of a new residential property.

Regardless of whether total GST or the margin scheme is used as the Property, will not have been acquired for a "creditable purpose" (see s.11-15)

The ATO's view is stated in ruling GSTR 2000/20.

The ruling states that the nature of the premises rather than any subjective intention of the purchaser determines whether or not the supply of existing residential premises will be input taxed.

The attitude of the ATO appears to be that where premises possess the physical characteristics of residential premises, the intention of the purchaser will not change the GST status of the supply. This position appears to be supported by the balance of authorities.

Example: Renting apartments initially intended for sale

- Bob constructs six residential units to sell as part of his business. Bob claims GST credits for all his purchases related to constructing the six units.

- Bob sells four units shortly after completion but cannot sell the other two. Bob decides to stop marketing the two remaining units for sale and start renting them out.

As he is now making input taxed supplies of rent, Bob's original intent to sell the new residential Property as taxable supplies (an entirely creditable purpose) has changed.

Depending on how many adjustment periods each acquisition has, Bob may need to make an increasing adjustment about the GST credits he claimed for developing the two rented units at the following applicable adjustment period.

Example: Selling premises originally intended for renting.

Kevin is a property developer who is registered for GST. He subdivides a property into two lots and builds a residential unit on each lot. Kevin intends to sell one of the units (Unit 1A) and rent out the other (Unit 1B) for at least 10 years. As he has always planned to rent out one of the units, Kevin only claims GST credits in relation to the construction of Unit 1A and pays GST on the sale of that unit.
Three months after Kevin originally rents out Unit 1B he gets an offer to buy the property, which is too good to refuse. Kevin decides to sell Unit 1B rather than rent it out.

GST will be payable on the sale of the property as they are still considered 'new residential property'. As Kevin has used the property differently to his original plan (that is, he will make a taxable sale of the property instead of using the property to make an input taxed supply of residential rent), he will need to make a decreasing adjustment to recover some of the GST credits he did not claim.

Sale of Farmland GST liability

There are several options for selling the family farm and their GST implications:

- Sell as is – as a working farm or as vacant land.
- Put in some infrastructure and rezoning and then sell blocks.
- Complete development, build houses and sell to an end buyer.

Farmland - can it be sold GST-free?

Where farming on the Land for sale **has been carried o**n **for five years** without **any break**, the requirements subject to Section 38-480 of the GST Act[1] will be met, and no GST applies.

The supply of a freehold interest in, or the lease by an Australian government agency of or the long-term lease of, the Land is *GST-free* if:

(a)The land is Land on which a farming business has been carried on for at least five years preceding the supply.

(b) and the recipient of the supply intends that a farming business be carried on on the Land.

For this exemption to apply, the ATO takes the view of the farming business exemption that supply is only 'GST-free if the supplier is registered or required to be registered for GST for the exemption to apply.

If the vendor is neither registered nor required to be registered for GST,

Section 188-25 of the GST Act[2] excludes the proceeds of the sale of a capital asset from projected GST turnover, avoiding the situation where the sale triggers a registered requirement.

[1] Section 38-480 of the GST Act
[2] Section 188-25 of the GST Act

However, the exclusion does not apply where Land is trading stock (for example, Land acquired for resale)

Practice note – the seller's entity must be considered for registration, not what income is derived from the Land. I.e., ATO has identified where taxpayers have misunderstood this concept. So, if you had a company that ran a farming business deriving less than $75,000 in revenue, you might conclude that no registration was required. However, if the taxpayer also sells tractors, all income for that entity is considered in terms of registration requirements. (not just the revenue from the farm)

Practice notes – both parties have to ensure they have met the conditions and, for practical purposes, ensure you note that the business is "farming business" in the contract of sale.

Per the ATO – evidence and reasonable enquiry

The vendor should seek evidence to demonstrate that a reasonable inquiry about the purchaser's intention has been made. What is reasonable will depend on all the circumstances. Usually, this will require the vendor to ask the purchaser whether there is an intention to carry on a farming business.

Elements of farmland business?

Some of the indicators that the ATO considers relevant in determining whether the Land has the essential characteristics of farmland are:

- the area of Land used for farm business purposes concerning the total area of Land
- the value of the Land used for farm business purposes about the total value of the Land
- whether there is a business as opposed to a hobby, recreation or sporting activity.
- The size and scale of all of the activities.
- Whether there is a profit-making purpose and prospect of profit.
- How the Land is treated for accounting purposes
- In limited circumstances, ownership, as noted on the title deed.

Sale of Land – no farming

We can conclude that Land ordinarily categorised as bushland will not meet a farming business's definition. To satisfy the purpose of a" farming business", the Land must be used as a farm. Therefore, if you have farmland and live on the Property but the Land is not used for farming purposes, the sale will not meet the definition of exempt GST farmland.

The phrase 'farming business' is defined by the GST Act. Subsection 38-475(2) of the GST Act[3] states: 'An entity carries on a *farming business* if it carries on a business of:

(a) cultivating or propagating plants, fungi or their products or parts (including seeds, spores, bulbs and similar things) in any physical environment or
(b) maintaining animals for the purpose of selling them or their bodily produce (including natural increase)

A farmland sale included all fixtures attached to the land, including residential property, fences, shearing sheds, workers' cottages, and dams. These fixtures form part of the Land, which is included in any GST-free land supply. The principal residence is included, provided the residence's private use does not cause the Land to lose the essential characteristics of farmland.

The ATO does not accept that cattle agistment is the carrying on of a 'farming business'. Consequently, the supply is not eligible for treatment as qualifying for the farming business exemption. [4]

Land usage is a crucial factor, not necessarily by the owner but by what happens on the Land!

Who is conducting the farming business? An important point to note per ATO ID 2001/291[5]

The essential factor to consider in determining whether a supply of farmland is GST-free under section 38-480 of the GST Act is the Land's use as opposed to the ownership of it.

Therefore, as long as a farming business is conducted on the Land for at least five years immediately before the sale, the requirement in paragraph 38-480(a) of the GST Act is satisfied, regardless of who has been conducting the farming business for those five years.

The land use is the crucial point to note for both the service before and after, not necessarily the owner of the Land.

Conversely, if only one of the paddocks was used for farming and the remainder was not, this too would not meet the criteria of Section 38-480 as the predominant business on the Land was not farming.

[3] Subsection 38-475(2) of GST Act
[4] https://www.ato.gov.au/Business/GST/In-detail/GST-issues-registers/Primary-Production-Industry-Partnership---issue-register/?page=21#gst13_2_2 16.1.2 – Agistment
[5] ATO ID 2001/291

Can farmer Jones meet the five years of continuous farming?

A temporary cease of farming due to ill health can mean the farming business may not occur continuously for five years.

In some cases, a temporary cessation in daily activities occurs due to nature, such as poor weather, holidays being taken, or Land being left rejuvenated. This does not mean the farming business has ceased altogether.

The intention of the legislation would not be to prevent such farmland from being sold GST-free. The lawmakers at least have a heart. Provided paragraph 38-480(b) of the GST Act[6] is also satisfied, as the purchaser also intends for farming to be carried on.

Suppose the ATO becomes aware of a deliberate action to cease farming. In that case, it will conclude that there has been a break in the Land used for the farming business, the five-year requirement would not be satisfied, and no GST exemption on sale can be applied.

If a farm is not farmed continuously for five years, is it still regarded as GST-free?

A break in the carrying on of farming business in the five years before the sale will result in you not meeting the requirements of section 38-480 of the GST Act,

In each case, whether the sale of GST-free farmland will be a question of fact.

'Carrying on' an enterprise, as defined in the GST Act, includes doing anything during the commencement or termination of the enterprise (section 195-1 of the GST Act[7]).

'Preceding' is not defined in the Act. According to the Macquarie Concise Dictionary,' precede' means 'to go before.

Paragraph 38-480(a) of the GST Act refers to five years preceding the supply. It does not say five years if it were the latter, and five years before the sale would suffice.

Therefore, the ATO has specified that the period of five years must mean immediately before the supply. Consequently, the sale would not be GST-free when the farming business had been carried on for five years but not immediately preceding the sale.

[6] paragraph 38-480(b) of the GST Act
[7] section 195-1 of the GST Act

Sale of farmland — temporary cessation of farming activity and the decision to sell the farm.

Ensure that a farming business has been carried on for five years immediately before the sale. Break before the sale does not meet the five-year farming requirement.

Refer to GSTD 2011/2[8] – this example outlines the consequences of a break-in farming for sale.

Example 3- farming business terminated before the sale of the Land

Matt has been carrying on a vegetable farming business for almost five years. The business is no longer profitable, and Matt decides not to continue operating the business. In the subsequent six months, Matt ceases all the routine farming activities on the Land, sells off the farming equipment and finalises all his obligations concerning the farming business. Matt then rents the Land to a neighbour for a purpose unrelated to a farming business. After three months, Matt sells the Land to another entity.

No farming business has been carried out on the Land for those three months before the Land is sold.

Therefore, the sale of the Land is not GST-free under section 38-480 because the Land is not Land on which a farming business has been carried on for five years preceding the supply!

The ruling goes on to say that:

A 'farming business' can be carried on for s 38-480(a) of the A New Tax System (Goods and Services Tax) Act 1999 (GST Act), where there has been a cessation of routine farming activities by the supplier for some time in anticipation of a sale.

Whether a farming business continues to be carried on is a question of fact and degree

depending on the circumstances of each particular case.

Make sure you document your situation to show that farming activity took place.

Our example of Steve indicates that each fact must be considered merits, and cessation for too long before the sale would preclude the lands being sold GST-free.

[8] GSTD 2011/2

Subdivided Farmland

Subdivided farmland that you sell or transfer by assigning a lease with an Australian government agency or by assigning a long-term lease is GST-free **if ALL** of the following apply:

- The land could **potentially be used for residential purposes** (but does not contain any residential buildings)
- The land **is subdivided from Land that has been used as a farming business for at least five years immediately before the sale**
- the supply **is made to an associate of the supplier (such as a relative or a closely connected company or trust) for less than market value.**

- Note: A long-term lease means a lease that is for at least 50 years if, at the time of the lease or the renewal or extension of the lease,
- it was reasonable to expect that the lease would continue for at least 50 years the terms of the lease or the renewal or extension of the lease,
- As they apply to the recipient, they are substantially the same as those terms under which the supplier held the premises (unless the supplier is an Australian government agency).

All of the conditions must be met for this exemption to apply.

This exemption ensures the land can be passed or divided amongst family groups.

This is particularly important if you intend to subdivide and sell the farming land as residential land packages to non-related parties such as residential homeowners.

Using farmland for another purpose

Suppose you purchase a GST-free going concern or farmland that includes residential Property (.i.e. leased residential Property for permanent or B&B).

In that case, you must adjust (increase) the GST for any non-creditable purposes for which the residential Property is used.

The 'increasing adjustment' is determined by:

- 10% × the sale price × the proportion of non-creditable use.[9]

[9] https://www.ato.gov.au/Business/GST/In-detail/Your-industry/Property/GST-and-commercial-property/?page=4#Subdividedfarmland

If the ratio of non-creditable use changes over time, you may need to make additional increasing or decreasing adjustments.

Subdivision of farm and sale of Land as residential non-farming

Non-farming use would classify the Land as being used for non-farming purposes. The Land is treated as residential land, non-farming. The owner or developer would treat the development as a business. For GST purposes, the sales will be subject to GST and appropriate GST remitted.

Points to note – refer to the previous presentation, but the margin scheme may apply together to claim credits on each part of the development. Remember to keep appropriate records.

It may be that the farmer sells part of the Land as residential and part as farming. Again, mixed sales will need to be identified on a case-to-case basis.

Conclusion

Clients in the area of primary production will need often meet the GST farmland status, but as an adviser, it is vital to:

- Document the evidence
- Understand the purchasers and sellers use
- Document the use of farmland in the sale contract

If the ATO sends a friendly review letter to your client requesting evidence, it is much more complicated if you haven't taken the time to understand and document your client's position.

Going Concern and the GST exemption

The sale of a property as a going concern in the context of Goods and Services Tax (GST) involves the sale of a business, including all of its assets, in such a manner that the business can continue to operate. In this case specifically property.

TIP – make sure both parties are registered for GST , running a business that has a lease attached to the property that will continue with the new owner.

As a for example, the sale of a business as a going concern is GST-free if certain conditions are met. This means that the seller does not charge GST on the sale. Here is a simplified example to illustrate this concept:

Example: Retail property with a lease to of a Café with as a Going Concern

Sale of rented property to a café retail property

- Conditions for GST-Free Sale to use the concession
- Both Seller and purchaser registered for GST.
- The sale includes everything necessary for the continued operation of the café (e.g., premises lease, equipment, and inventory).
- The seller puts in writing that the sale is of a going concern.
- The seller sells the property to the new owner and the lease continues to operate as a going concern.

Outcome:

This GST-free status benefits both parties: The buyer does not have to pay GST on the purchase price (which can significantly reduce her upfront costs), and Seller simplifies his GST obligations related to the sale. Most contracts would have various GST clauses if for some reason that the GST going concern concession is found not to be met.

Final Run down on property development and issues we have discussed today.

GST on Sale of New Residential Premises: The sale of new residential premises is subject to GST at 10%. New residential premises have not previously been sold as residential premises or have undergone substantial renovations. If the Property you developed qualifies as new residential premises and you sell it within 12 months of renting it out, GST will likely apply to the sale. As the seller, you are responsible for remitting this GST to the Australian Taxation Office (ATO).

In placeGST Credits on Construction Costs: As a property developer, you are generally entitled to claim GST credits included in the purchase price of your construction materials and services, provided you are registered for GST. – claim monthly if you can help with cashflow

If you rent out as a change in use and previously claimed a GST credit for construction, a Div129 adjustment is made.

GST and Rental Income: Renting out residential premises is generally an input-taxed supply, meaning you don't charge GST on the rent you collect. Consequently, you are not entitled to claim GST credits for expenses related to the rental activity.

Margin Scheme: You might be eligible to apply the margin scheme to the sale of the Property. The margin scheme allows you to calculate the GST on the deal based on the Margin between the Property's purchase price or valuation at the time of acquisition and its selling price rather than the total selling price. This can reduce the GST you need to pay, but it requires that specific conditions be met, and you must agree to use the margin scheme before making the sale.

GST Registration: If you are carrying on an enterprise and your GST turnover meets the registration threshold ($75,000 for most businesses), you must register for GST. This is important because your ability to claim GST credits and your obligations to charge GST hinge on your registration status.

Change of use – be careful and adjust if needed

GST Going concern - make sure legit lease in place

Allow for 10% payment to be remitted at settlement (7.5% if margin scheme)

Tip: buyers and sellers must be aware of these requirements to ensure compliance with GST obligations. Buyers, in particular, should ensure they understand their obligations regarding GST withholding to avoid any penalties or interest charges for failing to withhold and remit the GST correctly.

Capital Gains Tax (CGT):Tip it's important to note that selling a property can also trigger CGT implications or income tax depending on how the building development is classified as a business.