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Ruling Compendium – GSTD 2014/3

This is a compendium of responses to the issues raised by external parties to Draft Goods and Services Tax Determination GSTD 2014/D2 *Goods and services tax: do payments made by a vendor to a purchaser of real property when the rent received falls below a rental yield guaranteed by the vendor give rise to an adjustment event for the purposes of Division 19 of the A New Tax System (Goods and Services Tax) Act 1999?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the Draft Determination.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	General The Draft Determination is welcomed and when finalised will provide certainty and useful guidance to taxpayers.	Noted.
2	Certainty needed for all real property types The question deals with payments made in relation to real property. The Draft Determination includes one real property example, that is, a residential apartment complex example. The Draft Determination needs to provide certainty for all types of real property. This could be done through either the draft, including a further example where an office building or industrial facility is leased subject to a guaranteed yield that is not achieved. Alternatively, the Draft Determination could be limited to the treatment of the sale of residential premises subject to a rental guarantee and issue a separate Draft Determination in relation to the treatment of an office building or an industrial facility.	An additional example about a shopping centre that is sold subject to a guaranteed rental yield that is not actually achieved has been included at paragraphs 11 to 16 of the Determination.

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3	Sale of commercial premises as a GST-free going concern It would be helpful to include an example of a rental guarantee provided as a part of a sale of a tenanted commercial premises as a GST-free going concern.	An example involving the sale of tenanted commercial premises as a GST-free going concern has not been included in the Determination. Whilst payments made pursuant to a rental guarantee arrangement for premises sold as a GST-free going concern may give rise to an adjustment event under Division 19 of the GST Act, the vendor will not have a decreasing adjustment because they will not have previously attributed a GST liability in relation to the sale of the real property.
4	Application is too prescriptive and limited The Draft Determination is quite prescriptive. It is potentially limiting in the situations to which it applies. A number of situations would benefit from broadening the points listed in paragraph one, a deletion of paragraph five, or the issuance of an additional Determination to cover specific situations. The Draft Determination includes terms that are overly prescriptive and do not align with commercial market practice. The agreement terms are too prescriptive and burdensome. This may not reflect the commerciality of agreements and limits the application of the Draft Determination.	Some aspects of the Determination have been revised accordingly. Refer to the ATO's response to issues 6, 7, 8 and 9 below.
5	Bilateral vendor and purchaser agreement The payments being required to be made pursuant to a bilateral agreement between the vendor and the purchaser of the real property could be expanded to include an agreement between the parent entity of the Vendor or another GST Group member of the Vendor and the purchaser. If the payment was being made by an entity in the same GST Group, the adjustment would appear in the same BAS as if the Vendor had made the payment. Similarly, where the payment is being made by a parent entity, the net financial impact for the two entities is the same. There may be	A key principle underpinning the views in the Determination is that the payments made to the purchaser must be made 'in connection with' the vendor's earlier supply of the real property and that the 'rental guarantee' is integral to the contractual arrangement under which the vendor and the purchaser have negotiated and agreed on the purchase price for the real property. If the relevant agreement is between different entities, for example, between the parent entity of the vendor and the purchaser, the connection between the payments made to the purchaser and the vendor's earlier supply of the real property is

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	commercial reasons as to why it may be preferable for the parent entity or another entity in the GST group to provide the rental guarantee. It appears that there is a different GST impact that depends on the structuring of the rental guarantee. Limiting the Determination to rental guarantees provided by a vendor to a purchaser does not cover the full range of rental guarantee arrangements provided in the market.	not immediately apparent. We consider that the question of whether or not payments under such agreements give rise to an adjustment event can only be determined upon an examination of all of the relevant facts and circumstances on a case by case basis. Therefore, the Determination has not been amended as suggested.
6	Guaranteed rental yield must be a genuine representation - unnecessary compliance burden and too difficult in changing market The guaranteed rental yield being a genuine representation of the rental return that the real property is likely to achieve and being representative of how the property is expected to perform in the market place is unnecessary and is an unnecessary compliance burden on the Vendor. How does the vendor substantiate that the guaranteed rental yield is a genuine representation of the rental return? Will this require the Vendor to obtain a valuation or report from an external agent as to the rental yields in an area? There are limited situations when a vendor would not provide a rental guarantee with a genuine representation of the yield. There appears to be an inherent disincentive for guaranteed rental yield not to be a genuine representation. This is placing an unnecessary burden on a vendor. There could be difficulty where the rental guarantee is set for a number of years and there is movement in the market. In January 2014 the genuine representation of the rental yield for Property A was expected to be 7% as there was a limited supply in the market. However, in January 2015, the rental yield had dropped to 4.5%, due to properties similar to Property A becoming	A footnote reference (footnote no. 2) has been included at paragraph 1 of the Determination to clarify that the vendor and/or the purchaser are not required to obtain formal market valuation reports in order to demonstrate that the guaranteed rental yield is a bona fide and reasonable representation of the expected rental return for the real property. The language in the second dot point of paragraph 1 of the Determination, and in paragraphs 33 and 34 of the Determination has also been revised slightly to reflect the view that a guaranteed rental yield will be a bona fide and reasonable representation of the potential rental return provided that it is consistent with the rental return that the parties genuinely consider the real property will potentially achieve. The second dot point at paragraph 1 of the Determination has been revised to say that the guaranteed rental yield should be a bona fide and reasonable representation of the rental yield at the time that the vendor and purchaser enter into the relevant agreement. On this basis, market fluctuations over the period that the vendor has guaranteed the rental yield do not preclude a guaranteed yield from being a bona fide and reasonable representation of the expected rental return.

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	available. If Property A was sold with a two year rental yield guarantee to 7%, in 2015 could the Vendor still substantiate that the rental yield originally offered on the sale of the property was a genuine representation of how the property was expected to perform?	
7	The vendor to act as letting agent creates an artificial bias The requirement that the purchaser allows the vendor to act as letting agent creates an unnecessary artificial bias against the vendor to use an external agent as the letting agent. Regardless of whether the vendor or an external agent becomes the letting agent, the vendor will be the entity that will be liable to provide the additional payment to the purchaser. This seems contrary to good tax policy where there is a different GST outcome based on how a particular commercial arrangement is managed. It is not the case that the purchaser will always appoint the vendor as its sole letting agent (as implied). In the context of commercial premises, the purchaser agrees that it will grant a lease to a prospective tenant that meets certain agreed parameters that are agreed to in a schedule to a Contract of Sale. The vendor retains a control, but not a complete control, over the leasing process. However, the purchaser also retains a degree of control and is not obliged to accept non-complying tenants introduced by a vendor. The vendor may appoint a real estate agent/s because the vendor does not hold a real estate license.	Paragraph 1 of the Determination has been amended to refer to the vendor and the purchaser agreeing that the vendor is responsible for securing a tenant for the premises, and that the vendor may act as a letting agent and/or appoint an external letting agent.

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8	The vendor making a payment ‘equal to’ the difference between the rent received and guaranteed rental yield The vendor may not be required in every instance to pay this amount. For example, a tenanted commercial building (one property title) is sold for \$7.5 million (excluding GST). The expected rental yield is 5%. 60% is tenanted with leases for three or more years. The price referable to the vacant area is \$3 million. The guaranteed rental amount based on a 5% yield is \$150 000. The vendor agrees to guarantee a return of \$150 000 per annum, for two years, in respect of the vacant areas only. The term should be amended to read: ‘the vendor is required to make a payment or payments to the purchaser which are based on the difference between the rent received from the real property (or relevant part of the real property) and the amount of the return that the property (or relevant part of the property) is expected to achieve in the market place (that is, the guaranteed rental yield)’.	The Determination has been amended as suggested. New example 2 at paragraphs 11 to 16 of the Determination also illustrates the practical application of the view in the Determination where the rental yield is guaranteed by a vendor for a part of the premises.
9	The vendor guarantees the rental yield of the real property It may not be the case that the vendor guarantees the percentage rental yield of the real property. Rather, the vendor may guarantee a specific amount which is based on the expected rental yield for part of premises only. The term should be amended to read: ‘the vendor provides the guarantee for a set period of time subsequent to the sale of the real property to the purchaser’.	Item iii of the fifth dot point in paragraph 1 of the Determination has been amended to refer to the vendor guaranteeing the ‘rental amount’ or the ‘rental yield’. New example 2 at paragraphs 11 to 16 of the Determination also illustrates the application of the view expressed in the Determination in a situation where the vendor guarantees a specified rental amount rather than a percentage rental yield.

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10	The agreement is not assignable For commercial premises, a vendor and purchaser can agree that the rental guarantee may be assigned. If the second purchaser is bound by the same terms and obligations as the first purchaser, then the Draft Determination should apply. Any vendor payments should be viewed as being made at the direction of the original purchaser and continue to be seen as an adjustment to the purchase price for the sale to the original purchaser. For example, a tenanted commercial building (one property title) is sold for \$7.5 million (excluding GST). The expected rental yield is 5%. 60% is tenanted with leases for three or more years. The price referable to the vacant area is \$3 million. The guaranteed rental amount based on a 5% yield is \$150 000. The vendor agrees to guarantee a return of \$150 000 per annum, for two years, in respect of the vacant areas only. If the first purchaser sells the building after 12 months, and as part of the sale, assigns the rental guarantee relating to the 40% of the premises that was vacant at the time of the first sale to a second purchaser. The payment under the rental guarantee should be viewed as an adjustment to the price for the first sale. However, the refunded amount is paid to the second purchaser at the direction of the first purchaser. Any question regarding whether the first purchaser makes a taxable supply to the second purchaser by agreeing to assign the rental guarantee is a separate issue. The requirement that a rental guarantee cannot be assigned should be deleted from the Draft Determination.	Former item iv of the fifth dot point in paragraph 1 of the Determination has been deleted. On this basis, the view in the Determination is not precluded from applying in relation to payments made under a rental guarantee agreement by the original vendor to the first purchaser. However, the Determination does not apply with respect to payments made to a subsequent purchaser following the assignment of a rental guarantee agreement. These cases require consideration of all the relevant facts and circumstances.

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11	Attribution for monthly rental guarantee payments explanation required The Draft Determination does not comment on the attribution of an adjustment. The example, at paragraphs 6 to 10, appears to imply that there has been one payment at the end of the rental guarantee period and one adjustment event that has reduced the consideration by \$1800.00. This may not always be the case. A vendor may make monthly payments when the rent received is below the guaranteed rental yield. It would be useful if the Draft Determination could specify whether the adjustments are attributable at the end of the rental guarantee period or on a tax period by tax period basis.	Broader issues about the timing of attribution of increasing and decreasing adjustments are considered to be outside the scope of this Determination. A footnote reference (footnote no. 3) to Goods and Services Tax Ruling GSTR 2000/29 <i>Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25</i> has been added at paragraph 2 of the Determination.
12	Attribution and adjustment note The determination should include a paragraph regarding the attribution of adjustments arising from rental guarantee payments. In particular, when the payment of rental guarantee amounts meet the requirements set out in the Determination, the vendor will have a decreasing adjustment, and will be required to hold an adjustment note. However, an adjustment note is not required for an amount paid in respect of property originally supplied under the margin scheme.	See the response to issue 11 above. Attribution of adjustments and requirements relating to the issuing of adjustment notes for sales of real property under the margin scheme is considered to be outside the scope of this Determination. Therefore the Determination has not been amended as suggested.