

GSTD 2009/D2 - Goods and services tax: are there GST consequences where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5?

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This document has been finalised.

 There is a Compendium for this document: **GSTR 2010/1EC** .



Draft Goods and Services Tax Determination

Goods and services tax: are there GST consequences where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5?

Preamble

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way the law applies. It is not a public ruling or advice for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953*.

You can rely on this publication to provide you with protection from interest and penalties as follows. If a statement in this publication is later found to be incorrect or misleading and you make a mistake as a result of relying on this publication, you will not have to pay a penalty. In addition, if you have relied on this publication reasonably and in good faith you will not have to pay interest charges. However, you will still have to pay the correct amount of tax, provided the time limits under the law allow it.

1. Yes. The arrangement described in Taxpayer Alert TA 2009/5 may give rise to the following GST consequences:

- (a) where the only activity of the associate¹ (A) is constructing, or arranging the construction of, the residential premises for the land owner (B), the associate is not carrying on an enterprise (and consequently not entitled to any input tax credits) under section 9-20 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act);²
- (b) where A is carrying on an enterprise separate from the activities referred to in subparagraph 1(a) of this draft Determination, A may not be entitled to input tax credits under Division 11 for the acquisitions A makes in constructing, or arranging the construction of, the residential premises for B;

¹ The term 'associate' has the meaning given by section 195-1 of the *A New Tax System (Goods and Services Tax) Act 1999*.

² All subsequent legislative references are to the GST Act unless indicated otherwise.

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- (c) where B makes a payment or act that involves A, this may be taken to be consideration for the supply of the construction services by A to B. Accordingly, A's GST liability may be attributable, in accordance with section 29-5, to the tax period when the consideration is received for the supply, rather than when the residential premises are ultimately sold;
- (d) where there is no payment or act by B that involves A prior to the sale of the residential premises, Subdivision 72-A may apply to treat the supply of construction services as a taxable supply. This supply is valued at its GST exclusive market value, with the GST being attributable to A in the tax period in which the supply first becomes a supply that is connected with Australia; or
- (e) the anti-avoidance provisions in Division 165 may also apply.

Background and explanation

2. Taxpayer Alert TA 2009/5 issued on 17 February 2009, and describes an arrangement where an entity uses an associate in an attempt to secure input tax credits for the construction of residential premises to be leased and to defer the corresponding GST payable, in some cases indefinitely. The associate either constructs or arranges for the construction of the premises for the entity, then claims input tax credits for the costs of construction, but does not seek any progress payments from the entity until the premises are ultimately sold, thereby deferring its GST payable. TA 2009/5 indicates that the Commissioner is examining these arrangements.

3. TA 2009/5 applies to arrangements which have the following features:

- B, who may or may not be registered for GST, plans to construct residential premises to lease to third parties.
- B engages A to construct the residential premises.
- A either undertakes the construction or engages an arm's length builder, and claims input tax credits on its acquisitions.
- A will not seek progress payments from, nor issue an invoice to B until the premises are sold.³
- B leases the completed residential premises to third parties (an input taxed supply).
- A only remits GST upon the sale of the residential premises by B.

³ However, there may circumstances where an act or payment by B could be taken to be consideration made by B for the supply by A of the construction services.

Whether the associate is carrying on an enterprise under section 9-20 or is otherwise entitled to input tax credits under Division 11

4. For a supply to be a taxable supply within the meaning of section 9-5, each of the elements of the provision must be satisfied.⁴ In particular, the supply must be made in the course or furtherance of an enterprise carried on by the entity. Section 9-20 defines the term 'enterprise' for the purposes of the GST Act. Miscellaneous Tax Ruling MT 2006/1⁵ provides the Commissioner's view as to when an entity is carrying on an enterprise.

5. In these circumstances, for A to carry on an enterprise it must be found to be either carrying on a business or engaged in an activity in the form of an adventure or concern in the nature of trade.⁶

'an activity, or series of activities, done in the form of a business'

6. MT 2006/1 in paragraph 178 identifies a number of indicators to determine whether an entity is carrying on a business. Having regard to these indicators and, in the circumstances where A's only activity is the provision of construction services to B under the arrangement, A will not be considered to be carrying on an enterprise.

7. Specifically, there is a lack of commercial substance associated with the terms under which payment is purportedly made by B to A in respect of the only activity conducted by A, namely the construction services. Not only is it possible that many years (an indeterminate period) could elapse between the provision of the construction services and payment but, as the trigger event for payment is entirely dependent on B's decision to sell the premises, it may be that A never receives any payment for the construction services it provides to B.

8. Consequently, consideration for the supply of the construction services by A cannot be accurately ascertained. Moreover A cannot sue B for any payment until such time as B decides to sell the premises. In other words, consideration is to be made at the discretion of the recipient rather than the supplier.

9. The lack of any commercial substance to the supply of the construction services is indicative of a lack of an apparent profit motive by A, or likelihood of making any profit. This occurs because of the contrived and artificial nature of the arrangement that exists between the two associates. It could not reasonably be expected that parties dealing at arm's length in the general business community would contract under the same or similar commercial terms as those agreed between A and B.

10. There is also a lack of repetition or regularity of the activities undertaken by A, or if regular, they are always for the same land owner, B.⁷

⁴ Section 9-5 of the GST Act states that you make a taxable supply if:

- a) you make the supply for *consideration; and
- b) the supply is made in the course or furtherance of an *enterprise that you *carry on; and
- c) the supply is *connected with Australia; and
- d) you are *registered, or *required to be registered.

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

⁵ MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purposes of entitlement to an Australian Business Number.

⁶ Paragraphs 9-20(1)(a) and (b) respectively.

⁷ Even if it could be argued that an enterprise can still exist where there is a lack of regularity of activities, the activity must still reasonably be intended to be profit making (see *Federal Commissioner of Taxation v. Swansea Services Pty Ltd* [2009] FCA 402).

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11. Accordingly, while there may be activities undertaken by A, that is, the provision (or arranging for the provision) of construction services, the apparent lack of a profit motive and the scale of activities leads to a conclusion that A is not carrying on an 'enterprise'.

'an activity, or series of activities, done in the form of an adventure or concern in the nature of trade'

12. Ordinarily, the term 'business' would encompass trade engaged in, on a regular or continuous basis. However, an adventure or concern in the nature of trade may be an isolated or one-off transaction that does not amount to a business but which has the characteristics of a business deal.⁸ For the reasons noted in paragraphs 7 to 10 of this draft Determination, the circumstances of the arrangement indicate that the transaction lacks any commercial substance and does not exhibit the characteristics of a business deal.

Consequences of A not carrying on an enterprise

13. Once it is established that A is not carrying on an enterprise, its GST registration will be cancelled.⁹ Consequently, A will not be able to claim any input tax credits under Division 11 on the acquisitions it makes in undertaking, or arranging for, construction services.

14. Where A is registered and carries on an enterprise separate from the activity outlined in subparagraph 1(a) of this draft Determination, the Commissioner may also deny entitlement to input tax credits under Division 11 for the costs of construction A incurs in relation to the supply of construction services provided to B. In this situation, the Commissioner considers that the acquisitions are not made by A in carrying on its enterprise. Accordingly, such acquisitions are not made by A for a creditable purpose within the meaning of section 11-15.

Whether any act or payment by the land owner causes the associate's GST liability to be attributable to a tax period prior to the sale of the residential premises

15. Where B makes any payment or act that involves A, such payment or act could be construed as consideration (or part of the consideration), within the meaning of section 9-15, for the supply of the construction services by A. The circumstance may arise where B provides funds to assist A in meeting its financial obligations in relation to the costs of construction of the residential premises. Such payment may, depending on the terms and conditions that surround it, be consideration for the supply of construction services made by A to B. However, if the arrangement between B and A is a genuine loan agreement, payments made under the loan agreement will not be consideration for the supply of construction services by A.

16. Where the payments made by B are consideration for the supply of construction services, A's GST liability is attributable, in accordance with section 29-5, to the tax period when the consideration is received for the supply of construction services to B. Such period may be prior to the sale of the residential premises.

17. Depending on the facts of the arrangement, Subdivision 72-C could apply where there is inadequate consideration provided by B to A.

⁸ See also paragraphs 233 to 261 of MT 2006/1.

⁹ See Division 25.

Whether Division 72 applies to the supply made by the associate to the land owner

18. There may be circumstances where there is no consideration provided under the arrangement. In such cases, Division 72 must be considered.

19. Subsection 72-5(1) provides as follows:

- (1) The fact that a supply to your associate is without *consideration, does not stop the supply being a *taxable supply if:
 - (a) your associate is not *registered or * required to be registered; or
 - (b) your associate acquires the thing supplied otherwise than solely for a *creditable purpose.

20. In order to apply subsection 72-5(1), the following elements of the provision must be met:

- (1) there has been a supply to an associate;
- (2) the associate that is the recipient of the supply meets either of the tests prescribed in subparagraphs 72-5(1)(a) or (b); and
- (3) the supply to the associate is without consideration.

21. Firstly, it has already been established that A and B are associates. Accordingly, this requirement is met.

22. Secondly, even if B is registered or required to be registered, the supply of construction services it receives from A will not be used solely for a creditable purpose. That is because the thing acquired by B from the supply of the construction services will be used to make input-taxed supplies of leasing completed premises to third parties.¹⁰ This requirement is also met.

23. Thirdly, it needs to be determined whether there has been a supply by A to B without consideration. The term 'without consideration' in this Division is opposite to the term 'for consideration' in section 9-5. Section 72-5 only applies where there has not been a supply 'for consideration' within the meaning of paragraph 9-5(a). Subsection 72-5(2) provides that section 72-5 has effect despite paragraph 9-5(a).

24. Whether there has been a supply for or without consideration is a question of fact. It is accepted that consideration need not be tendered contemporaneously with the making of the supply, nor need it be quantifiable at that time.¹¹ However, where the consideration receivable is so remote or contingent on the happening of an event that is outside the control of the supplier, it is arguable that such a supply has been made without consideration.

25. Under the arrangement, A does not seek any progress payment from, nor issues an invoice to, B until the sale of the residential premises. Accordingly, any consideration receivable by A is entirely dependent upon the actions of B. As the event that triggers any consideration being received by A for the supply of construction services to B is the sale of the residential premises, it is conceivable that A may never receive any consideration from B.

¹⁰ See subsection 11-15(2).

¹¹ See paragraph 107 of GSTR 2006/9.

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26. Depending on the facts, if there is a high degree of remoteness associated with the receipt of any consideration in relation to the supply, which arises due to the associate nature of the dealings between the parties, it may well be that the supply of construction services under the arrangement is a supply without consideration.

27. In such circumstances, as all the requirements for the operation of subsection 72-5(1) are met, the supply of construction services made by A to B is taken to be a taxable supply.

28. Section 72-10 provides that if a supply is made to an associate without consideration, its value is the GST exclusive market value of the supply, notwithstanding section 9-75 (which generally determines the value of taxable supplies). Therefore, GST is payable by A based on the GST exclusive market value of the taxable supply it makes to B. In addition, the GST payable on such a supply is attributable to the tax period in which the supply first becomes a supply that is connected with Australia.¹²

Whether Division 165 applies to the arrangement

29. Alternatively, the Commissioner will consider the application of the general anti-avoidance provisions in Division 165 to the arrangement as described in paragraph 3 of this draft Determination.

30. The application of Division 165 was considered by the Administrative Appeals Tribunal in *Re VCE and Federal Commissioner of Taxation*¹³ (VCE), the first decision to examine the use of these provisions. Additionally, the Commissioner has set out his views on the application of Division 165 to specific arrangements and these are discussed in a number of rulings and determinations.¹⁴

31. The application of Division 165 requires a careful weighing up of the individual circumstances of each case. Therefore, in the absence of all relevant information, it is not possible to state definitively whether a particular scheme will attract the application of Division 165.

32. For the Division to apply, the following four elements need to be satisfied:

- (1) one or more of the steps in the arrangement is a 'scheme' as defined in subsection 165-10(2);
- (2) a 'GST benefit', as defined in subsection 165-10(1), arises under the scheme;
- (3) an entity gets a GST benefit from the scheme; and

¹² See section 72-15.

¹³ 2006 ATC 187; 63 ATR 1249.

¹⁴ GSTR 2004/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/2: Avoidance of GST on the sale of new residential premises; GSTR 2005/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/9 – exploitation of the second-hand goods provisions to obtain input tax credits; GSTR 2005/4 Goods and services tax: arrangements of the kind described in Taxpayer Alerts TA 2004/6 and TA 2004/7: use of the Grouping or Margin Scheme provisions of the GST Act to avoid or reduce the Goods and Services Tax on the sale of new residential premises; GSTR 2005/5 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/8: use of the Going Concern provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax on the sale of new residential premises; GSTD 2006/5 Goods and services tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4? and GSTD 2007/2 Goods and services tax: what are the results for GST purposes of a charitable institution engaging with an associated endorsed charitable institution in an arrangement described in Taxpayer Alert TA 2007/1?

- (4) it is reasonable to conclude, taking account of the matters in section 165-15, that the dominant purpose or principal effect of entering into or carrying out the scheme was to get a GST benefit.

Element 1: scheme

33. It is considered that all or only some of the elements comprising the arrangement described in paragraph 3 of this draft Determination would constitute a 'scheme' under the broad definition of that term in subsection 165-10(2): see the observations of the High Court in *Federal Commissioner of Taxation v. Hart*¹⁵ in relation to the virtually identical definition of 'scheme' for the purposes of Part IVA of the *Income Tax Assessment Act 1936* and the decision of Deputy President Forgie of the Administrative Appeals Tribunal in *VCE*¹⁶ that specifically dealt with a scheme in the context of the application of Division 165.

34. The scheme in the arrangement may be concisely described as one involving the interposition of the associate in between the land owner and the building entity, the absence of progress payments and invoicing between the land owner and its associate and the subsequent leasing of the premises indefinitely by the land owner.

Element 2: GST benefit

35. Further, it is considered that the arrangement constitutes a scheme which gives rise to a GST benefit under paragraphs 165-10(1)(b) and (c). It is reasonable to expect that had the land owner not interposed its associate between itself and the builder, it would have contracted directly with the builder on normal commercial terms. As a result, the associate would have no input tax credit entitlement and no GST liability. Further, as the acquisition of the building services by the land owner would relate to making supplies that would be input taxed, the acquisitions would not be for a creditable purpose within the meaning of section 11-15.

36. Under the scheme, the associate claims input tax credits on the acquisitions it makes to facilitate its supply of building services to the land owner, and has a corresponding GST liability on that supply. However, by neither seeking progress payments nor issuing an invoice until the ultimate sale of the premises, the associate defers paying the GST indefinitely. The land owner still lacks creditable purpose and thus has no input tax credit entitlement.

37. Therefore, the scheme results in the obtaining of input tax credits by the associate and the deferral of the associate's GST payment. Accordingly, the scheme would give rise to a GST benefit under paragraph 165-10(1)(b) in relation to the obtaining of input tax credits by the associate because it could reasonably be expected that a larger amount would be payable to the associate under the provisions of the GST Act (apart from Division 165) than would have been the case but for the scheme.

¹⁵ (2004) 217 CLR 216 at 234-238 and 260-261.

¹⁶ 2006 ATC 187, 63 ATR 1249.

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38. The scheme would also give rise to a GST benefit under paragraph 165-10(1)(c) of the GST Act in relation to the deferral of the associate's GST payment in that there is an amount¹⁷ payable by the associate that is or could reasonably be expected to be payable later under the provisions of the GST Act (apart from Division 165) than would have been but for the scheme: see the comments of the High Court in *Federal Commissioner of Taxation v. Peabody*¹⁸ on the reasonable expectation test in the context of the definition of 'tax benefit' for the purposes of Part IVA of the *Income Tax Assessment Act 1936*.

Element 3: entity gets GST benefit

39. The associate gets the GST benefit described at paragraphs 35 to 38 of this draft Determination.

Element 4: dominant purpose or principal effect

40. It would also be reasonable to conclude, having regard to the matters set out in subsection 165-15(1), that the sole or dominant purpose of the scheme or part of the scheme, or the principal effect of the scheme or part of the scheme was for the associate to obtain GST benefits. In this context the following general observations can be made:

- the manner in which the scheme was entered into or carried out involves the land owner, who plans to construct residential premises to lease to third parties, contracting with an associated entity for the supply of building services on terms that require neither the land owner to make progress payments during the course of the construction, nor the associate to issue an invoice until the sale of the premises. The absence of progress payments and an invoice allows the associate to delay paying GST on the supply of the building services until the premises are ultimately sold, whilst simultaneously claiming input tax credits during the construction phase on the acquisitions it makes to supply those services;
- the land owner engages its associate to construct residential premises. However the associate generally does not directly provide any substantial building and construction services as it usually engages a third party building entity to undertake all or the majority of the construction;
- the land owner is in a position to control the execution of the arrangement as a whole, which lacks commercial substance or explanation; and
- but for the operation of Division 165, the associate's GST liability on the supply of building services to the land owner is delayed indefinitely.

41. It is therefore open to the Commissioner to exercise his powers under section 165-40 to negate the GST benefit obtained by the associate.

¹⁷ The term 'amount' can include a nil amount: section 195-1.

¹⁸ (1994) 181 CLR 359 at 385.

Date of effect

42. This draft Determination represents the preliminary, though considered view of the Commissioner. When the final Determination is officially released, it will explain the Commissioner's view of the law as it applies both before and after its date of issue.

43. The final Determination will be a public ruling for the purposes of section 105-60 of Schedule 1 to the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to which it applies. Goods and Services Tax Ruling GSTR 1999/1 explains the GST rulings system and the Commissioner's view of when you can rely on GST public and private rulings.

Your comments

44. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

45. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

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Subject references:

- anti avoidance
- associate
- associate entity
- creditable purpose
- entity carrying on an enterprise
- input tax credit
- goods and services tax
- GST new residential premises

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- GST enterprise
- GST residential premises
- property development industry
- real estate

Legislative references:

- ANTS (GST)A 1999
- ANTS (GST)A 1999 9-5
- ANTS (GST)A 1999 9-5(a)
- ANTS (GST)A 1999 9-15
- ANTS (GST)A 1999 9-20
- ANTS (GST)A 1999 9-20(1)(a)
- ANTS (GST)A 1999 9-20(1)(b)
- ANTS (GST)A 1999 9-75
- ANTS (GST)A 1999 Div 11
- ANTS (GST)A 1999 11-15
- ANTS (GST)A 1999 11-15(2)
- ANTS (GST)A 1999 Div 25
- ANTS (GST)A 1999 29-5
- ANTS (GST)A 1999 Div 72
- ANTS (GST)A 1999 Subdiv 72-A
- ANTS (GST)A 1999 72-5
- ANTS (GST)A 1999 72-5(1)
- ANTS (GST)A 1999 72-5(1)(a)
- ANTS (GST)A 1999 72-5(1)(b)
- ANTS (GST)A 1999 72-5(2)
- ANTS (GST)A 1999 72-10
- ANTS (GST)A 1999 72-15
- ANTS (GST)A 1999 Subdiv 72-C
- ANTS (GST)A 1999 Div 165
- ANTS (GST)A 1999 165-10(1)
- ANTS (GST)A 1999 165-10(1)(b)
- ANTS (GST)A 1999 165-10(1)(c)
- ANTS (GST)A 1999 165-10(2)

- ANTS (GST)A 1999 165-15
- ANTS (GST)A 1999 165-15(1)
- ANTS (GST)A 1999 165-40
- ANTS (GST)A 1999 195-1
- ITAA 1936 Pt IVA
- TAA 1953 Sch 1 105-60

Case references:

- Federal Commissioner of Taxation v. Hart, (2004) 217 CLR 216; [2004] HCA 26; (2004) 55 ATR 712; 2004 ATC 4599
- Federal Commissioner of Taxation v. Peabody (1994) 181 CLR 359; [1994] HCA 43; (1994) 28 ATR 344; 94 ATC 4663
- Federal Commissioner of Taxation v. Swansea Services Pty Ltd [2009] FCA 402; (2009) 72 ATR 120; 2009 ATC 20-100
- Re VCE and Federal Commissioner of Taxation [2006] AATA 821; 63 ATR 1249; 2006 ATC 187

Other references:

- Taxpayer Alert TA 2004/2
- Taxpayer Alert TA 2004/6
- Taxpayer Alert TA 2004/7
- Taxpayer Alert TA 2004/8
- Taxpayer Alert TA 2004/9
- Taxpayer Alert TA 2005/4
- Taxpayer Alert TA 2007/1
- Taxpayer Alert TA 2009/5

ATO references

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