GSTR 2008/D5 - Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose

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Draft Goods and Services Tax Ruling

Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose

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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.

What this Ruling is about

1. This draft Ruling explains the Commissioner's view of when an adjustment for a change in extent of creditable purpose arises under Division 129 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) in relation to acquisitions made in constructing new residential premises.

2. This draft Ruling provides guidance on how to determine the extent to which an acquisition made in constructing new residential premises is applied for a creditable purpose where the new residential premises are being held for sale as part of an entity's enterprise, but prior to their sale the new residential premises are rented for a period of time.

3. Unless otherwise stated, all legislative references in this draft Ruling are to the GST Act.

Date of effect

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

5. The final Ruling 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.

Transitional arrangements

6. The Commissioner's previous view on the application of Division 129 where an entity constructs new residential premises for sale but subsequently rents the premises was set out in *Property and Construction Industry Partnership – Issues Register – Section 04 – Adjustments for Input Tax Credit Claims* (Issues Register). An entity that has calculated Division 129 adjustments in relation to a particular acquisition based on the Commissioner's previous view in the Issues Register[1] will be protected in respect to what it has done up to the date of issue of the final Ruling. In addition, if an entity has relied on the Commissioner's previous view in the Issues Register to make Division 129 adjustments with respect to an acquisition, prior to the date of issue of the final Ruling, the entity can continue to calculate subsequent Division 129 adjustments relating to that particular acquisition on the basis of the Commissioner's previous view.

7. If an entity revises prior adjustments[2] relevant to an acquisition, based upon the views in this draft Ruling or the final Ruling, the entity will also be required to calculate all adjustments arising in relation to that acquisition on that same basis.

Background

8. An entity that is registered or required to be registered for GST is liable for the GST payable on the taxable supplies that it makes. An entity is also entitled to input tax credits for creditable acquisitions made in carrying on its enterprise.[3] An entity may also be entitled to an input tax credit for the GST payable on goods it imports in carrying on its enterprise (creditable importations).[4]

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[1] As it existed prior to 19 August 2008. Refer to Issues Register and a link to its history at http://www.ato.gov.au/businesses/content.asp?doc=/Content/24437.htm.
[2] An entity may not be able to revise adjustments where the relevant tax periods are outside the relevant time limits specified in section 105-55 of Schedule 1 to the *Taxation Administration Act 1953.*
[3] Section 11-20.
[4] Section 15-15.

9. The amount of the input tax credit to which an entity is entitled depends on the extent to which the acquisition or importation is for a creditable purpose. The Commissioner's view is that the creditable purpose tests in sections 11-15 and 15-10 focus on an entity's intended use of an acquisition[5] or, in other words, an entity's planned use.[6] After an acquisition or importation is made, the extent to which it is actually applied or used for a creditable purpose may be different from the intended use. This means that the original input tax credit may have been too much or not enough. Adjustments for changes in the extent of creditable purpose are provided for in Division 129.

10. An entity that is registered for GST may construct new residential premises for the purpose of sale as part of an enterprise that the entity is carrying on and would be entitled to input tax credits for the acquisitions relating to the construction of the new residential premises. However, circumstances may arise such that the premises are rented prior to their sale. In such a case, consideration must be given to the application of Division 129. This is because the sale of new residential premises is a taxable supply[7] but the rental of new residential premises is an input taxed supply[8] and an acquisition is not applied for a creditable purpose to the extent that its application relates to making input taxed supplies.[9]

Previous Rulings

11. The Commissioner's previous view on the application of Division 129 to circumstances where an entity constructs new residential premises for sale but subsequently rents the premises was set out in section 4 of the Issues Register.[10] This view was amended with effect from 19 August 2008. The Commissioner's view currently set out in the Issues Register will be withdrawn when the final Ruling is officially released.

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[5] See paragraph 49 of Goods and Services Tax Ruling GSTR 2008/1 Goods and services tax: when do you acquire anything or import goods solely or partly for a creditable purpose?
[6] See, for example, paragraph 17 of Goods and Services Tax Ruling GSTR 2006/4 Goods and services tax: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.
[7] Section 40-65.
[8] Section 40-35.
[9] Section 129-50.
[10] Refer to Issues Register on the Tax Office website and a link to its history at http://www.ato.gov.au/businesses/content.asp?doc=/Content/24437.htm.

Other Rulings

12. The views expressed in this draft Ruling when finalised may impact on other GST public rulings addressing the meaning of 'apply' in the context of Division 130. The relevant GST public rulings are:

- paragraphs 74 to 81 of Goods and Services Tax Ruling GSTR 2003/6 Goods and services tax: transfers of enterprise assets as a result of property distributions under the *Family Law Act 1975* or in similar circumstances;
- paragraph 163 of Goods and Services Tax Ruling GSTR 2004/6 Goods and services tax: tax law partnerships and co-owners of property; and
- paragraphs 4 and 5 of Goods and Services Tax Determination GSTD 2003/2 Goods and services tax: are there GST consequences when a partner in a partnership takes goods held as trading stock for private or domestic use?

13. The relevant paragraphs of the GST public rulings referred to in paragraph 12 of this draft Ruling will be reviewed during the process of finalising this draft Ruling. Any relevant addenda to the GST public rulings will be published when the final Ruling is officially released. As explained in GSTR 1999/1, you can continue to rely upon the Commissioner's views in GST public rulings regarding the application of Division 130 until addenda to these GST public rulings are officially released.

Legislative context

14. An entity is entitled to input tax credits for any creditable acquisition that it makes.[11] An entity makes a creditable acquisition if:

- the entity acquires anything solely or partly for a creditable purpose;
- the supply of the thing to the entity is a taxable supply;
- the entity provides, or is liable to provide, consideration for the supply; and
- the entity is registered or required to be registered.[12]

15. The meaning of 'creditable purpose' is given by section 11-15. Similar provisions apply in relation to creditable importations.[13] However, under the GST Act adjustments may arise for input tax credits to which an entity was previously entitled.

[11] Section 11-20.
[12] Section 11-5.
[13] Sections 15-5, 15-10 and 15-15.

16. An adjustment under Division 129 arises for an acquisition[14] in an adjustment period where:

- there is a difference between the actual application and the planned (or intended) application of the thing for a creditable purpose, or
- there is a difference between the actual application of the thing up to the end of one adjustment period and the actual application of the thing up to the end of the previous adjustment period.[15]

17. Division 129 provides for adjustments in relation to things in tax periods that are adjustment periods.[16] The number of adjustment periods that relate to a thing are determined by the GST-exclusive value of the acquisition or importation. The number of adjustment periods for acquisitions (that do not relate to business finance)[17] are set out in the following table.

GST-exclusive value of the acquisition or importation	Adjustment periods
$5,000 or less	Two
$5,001 to $499,999	Five
$500,000 or more	Ten

18. However, an adjustment cannot arise under Division 129 for an acquisition (that does not relate to business finance) unless the acquisition had a GST-exclusive value of more than $1,000.

19. Subsection 129-40(1) sets out a method statement for determining whether an entity has an increasing or decreasing adjustment under Division 129. The actual application of a thing is determined in accordance with step 1 of the method statement which requires an entity to work out the extent (if any) to which it has applied the thing acquired or imported for a creditable purpose during the period of time:

(a) starting when the entity acquired or imported the thing; and

(b) ending at the end of the adjustment period.

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[14] Adjustments under Division 129 can also arise in relation to importations. Therefore, for the purposes of this draft Ruling a reference to an acquisition is equally applicable to an importation.

[15] See paragraph 45 of Goods and Services Tax Ruling GSTR 2000/24 Goods and Services Tax: Division 129 – making adjustments for changes in extent of creditable purpose.

[16] The operation of Division 129 including the identification of adjustment periods for an acquisition or importation is discussed in GSTR 2000/24.

[17] 'Relates to business finance' in relation to an acquisition has the meaning given by subsection 129-10(3). Such acquisitions are not addressed in this draft Ruling.

20. Step 2 of the method statement provides what is the 'intended or former application of the thing'. The intended or former application of a thing is either:

- the planned application for a creditable purpose as at the time the entity acquired the thing (that is the intended application); or
- if there has been a previous adjustment under Division 129 for the thing – the actual application of the thing in respect of the previous adjustment period (that is the former application).[18]

21. Subsection 129-50(1) provides that an entity applies a thing for a creditable purpose to the extent that the entity applies it in carrying on its enterprise. However, subsection 129-50(2) provides that an entity does not apply a thing for a creditable purpose to the extent that the application relates to making supplies that are input taxed or the application is of a private or domestic nature.

22. Subsections 129-50(1) and 129-50(2) include the term 'apply'. The meaning of 'apply' in relation to a thing acquired or imported is set out in section 129-55 as including:

(a) supply the thing; and

(b) consume, dispose of or destroy the thing; and

(c) allow another entity to consume, dispose of or destroy the thing.

23. In the circumstances considered in this draft Ruling the nature of supplies of residential premises and new residential premises is also relevant. A supply of residential premises by way of lease, hire or licence is input taxed if the requirements of section 40-35 are satisfied.

24. Also, a sale of real property is input taxed to the extent that the property is residential premises to be used predominantly for residential accommodation (regardless of the term of occupation).[19] However, the sale is not input taxed to the extent that the residential premises are:

(a) commercial residential premises, or

(b) new residential premises other than those used for residential accommodation (regardless of the term of occupation) before 2 December 1998.[20]

25. 'New residential premises' has the meaning given by section 40-75. Given the exception in subsection 40-65(2), a supply of new residential premises is a taxable supply if the requirements of section 9-5 are satisfied.

[18] See paragraph 56 of GSTR 2000/24.
[19] Subsection 40-65(1).
[20] Subsection 40-65(2).

Ruling with explanation

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

26. 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.

27. 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.[21] 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.[22]

28. Alternatively, if an entity constructs new residential premises for the purpose of sale but intends to rent 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.[23]

Example 1 – partly input taxed and partly creditable planned use

29. *Kim is a property developer. Kim recognises that the market for selling new residential premises has slowed significantly but is expected to pick-up in approximately two years. She decides to build new residential premises for sale as part of her property development enterprise but makes a decision to rent the premises until the market improves.*

30. *The acquisitions Kim makes in constructing the new residential premises are for two purposes – being the making of an input taxed supply of residential premises by way of lease*[24] *and a taxable supply of new residential premises.*[25]

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[21] See GSTR 2008/1 for a discussion of the creditable purpose tests in section 11-15.
[22] If prior to completion of construction the entity decided to use the premises for residential rental rather than for the purpose of sale then some of the acquisitions may not be made solely for a creditable purpose. Refer to paragraphs 28 and 32 of this draft Ruling.
[23] See section 11-30.
[24] Section 40-35.
[25] Paragraph 40-65(2)(b) and section 9-5.

31. *Kim's acquisitions are made in carrying on her enterprise and are for a creditable purpose except to the extent they relate to the making of the input taxed supplies. That is, the acquisitions are partly creditable.*[26] *Kim will need to determine the extent of creditable purpose using a fair and reasonable method of apportionment.*

32. If an entity constructs new residential premises to use solely by way of leasing the residential premises, and this planned use is supported by an objective assessment of the surrounding facts and circumstances, the entity's acquisitions will relate solely to making supplies that would be input taxed,[27] and will not be made for a creditable purpose. The entity will not be entitled to input tax credits in relation to the acquisitions.[28] Although the acquisitions in these circumstances are not creditable acquisitions, adjustments can still arise under Division 129 if the entity subsequently applies the residential premises for a creditable purpose.[29]

When is a thing applied in carrying on an entity's enterprise?

33. At the end of each adjustment period[30] for relevant acquisitions, an entity will have to consider whether or not it is required to make an adjustment under Division 129 for a change in extent of creditable purpose.

34. To ascertain whether an adjustment arises for a change in creditable purpose under Division 129 it is necessary to determine the extent to which a thing[31] has been applied for a creditable purpose up until the end of the relevant adjustment period.[32]

35. Subsection 129-50(1) provides that an entity applies a thing for a creditable purpose to the extent that the entity applies it in carrying on its enterprise. However, subsection 129-50(2) provides that an entity does not apply a thing for a creditable purpose to the extent that the application relates to making supplies that are input taxed or the application is of a private or domestic nature. The meaning of the term 'apply' is central to determining the extent to which an acquisition has been applied for a creditable purpose, and whether or not an adjustment arises under Division 129.

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[26] Section 11-30.
[27] Section 40-35.
[28] For further detail on creditable purpose in the context of Division 11 refer to GSTR 2008/1.
[29] Refer to paragraphs 13 and 14 of GSTR 2000/24.
[30] Section 129-20.
[31] For discussion on the meaning of a 'thing' in the context of Divisions 11 and 129 see paragraphs 64 to 66 of this draft Ruling.
[32] Step 1 of the method statement in subsection 129-40(1).

36. The meaning of the term 'apply', in relation to a thing acquired or imported, for the purposes of the GST Act is provided in section 129-55 (set out in paragraph 22 of this draft Ruling). The meaning of apply in section 129-55 is an inclusive definition. Therefore, in addition to the specific references incorporated in the provision, the meaning of apply in section 129-55 also encompasses the ordinary meaning of the term. The ordinary meaning of 'apply' relevantly includes 'to put to use; employ'[33] or 'to devote to some specific purpose'[34] or 'make use of as relevant or suitable; employ'.[35] This indicates the similarity and relevance of 'use' to the meaning of 'apply'.

37. In accordance with the specific references to supply, consume, dispose of and destroy in section 129-55, a thing will be applied in carrying on an entity's enterprise when it is sold, or otherwise disposed of in the course of the entity's enterprise. For example, the sale of a thing constituting part of an entity's trading stock will be an application of that thing pursuant to section 129-55.

38. In accordance with the ordinary meaning of 'apply', a thing that is being held in connection with an entity's enterprise, even though it may not yet have been supplied, consumed or physically utilised, will have been devoted to or put to use in the entity's enterprise. In other words, the thing will have been applied in the entity's enterprise if an objective assessment of the facts and circumstances demonstrates that the thing has been allocated or dedicated to a particular use (or uses) in the enterprise. For example, the holding of trading stock for the purpose of sale in an entity's enterprise will be an application of the trading stock. Similarly, the holding of spare parts in reserve to repair enterprise machinery, as required, will be an application of the spare parts.

Determining the extent to which new residential premises have been applied for a creditable purpose

39. Applying the analysis at paragraphs 33 to 38 of this draft Ruling, new residential premises held in connection with an entity's enterprise are being applied in carrying on the entity's enterprise. For the purpose of considering whether or not any adjustment arises under Division 129, in relation to new residential premises, it is necessary to determine the extent to which that application is for a creditable purpose.

[33] *Macquarie Dictionary*, 2005, 4th edn, The Macquarie Library Pty Ltd, NSW.
[34] *Macquarie Dictionary*, 2005, 4th edn, The Macquarie Library Pty Ltd, NSW.
[35] *The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne.

40. The sale of new residential premises is a taxable supply.[36] Therefore, the holding of new residential premises for the purpose of sale as part of an entity's enterprise, as objectively evidenced, will be an application of the premises for a creditable purpose. However, the supply of residential premises by way of lease is an input taxed supply.[37] Consequently, 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.[38]

41. New residential premises will not be applied for a creditable purpose, to any extent, when they are being used exclusively as part of an enterprise of leasing residential premises. However, the new residential premises would not be precluded from being applied for a creditable purpose in the future if the entity subsequently decided to sell the new residential premises as part of its enterprise activities and, as objectively evidenced, the entity commenced holding the new residential premises for the purpose of sale.

42. The analysis at paragraphs 39 to 41 of this draft Ruling, in part, focuses on whether or not the new residential premises are being held for the purpose of sale. A distinction can be made between things that are being held for the purpose of sale or exchange as part of an enterprise being carried on by an entity, and things such as business plant and machinery used by an entity in carrying on an enterprise.

43. For example, a property developer involved in leasing residential premises and selling new residential premises may have a motor vehicle that is used exclusively by the manager of the leasing arm of the enterprise for the purpose of managing the residential leases. The property developer may intend to sell the motor vehicle in 3 years time and replace it with a new motor vehicle. The motor vehicle is not being held for the purpose of sale, but rather is being used by the property developer in carrying on its enterprise relating to leasing residential premises. The motor vehicle is not being applied, to any extent, for the purpose of sale.

[36] Sections 40-65 and 9-5.
[37] Section 40-35.
[38] Subsection 129-50(2).

44. The concept of holding a thing for the purpose of sale or exchange as part of an enterprise is similar to holding a thing for the purpose of trade.[39] The characteristics of trade, including the 'badges of trade', are discussed in the context of an adventure or concern in the nature of trade at paragraphs 243 to 261 of Miscellaneous Taxation Ruling 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. MT 2006/1 discusses a number of factors which help identify whether or not an entity is engaged in trade or, rather in the context of this draft Ruling, holds a thing for the purpose of sale or exchange, including:

- the subject matter – if a thing provides either a regular or periodic income (such as through rental income) or personal enjoyment to the owner it is more likely to be an investment rather than a trading asset; however, a large quantity of goods is likely to point towards trade;
- the length of period of ownership – trading assets are generally traded within a short time after acquisition;
- the frequency or number of similar transactions – the greater the frequency of transactions the greater the likelihood of trade;
- improving a property beyond merely preparing it for sale – this suggests an element of trade;
- the circumstances responsible for a sale; and
- motive (if an objective assessment of the other factors is not conclusive).

Example 2 – premises not held for the purpose of sale as part of an enterprise

45. *Leaser Pty Ltd (Leaser) holds new residential premises as part of an enterprise of leasing residential premises. It intends to sell the premises after ten years to fund the purchase of new premises.*

[39] Refer to comments of Bowen CJ in *Re Ku-ring-gai Co-operative Building Society (No. 12) Ltd* (1978) 36 FLR 134 at 139.

46. *Leaser is not holding the premises for the purpose of sale as part of its enterprise. The premises is a capital asset held for the purpose of deriving income from leasing, that is, it is more like an asset being held for investment purposes. In this case the length of time for which Leaser intends to hold the premises also suggests the premises are not being held as a trading asset. Leaser is applying the premises solely in relation to making input taxed supplies of residential leasing. The intention to sell the premises in the future is not an application for a creditable purpose.*[40]

Demonstrating that new residential premises are being held for sale in an entity's enterprise

47. An objective assessment of the facts and circumstances will demonstrate whether or not new residential premises are being held for the purpose of sale or exchange as part of an entity's enterprise.

48. Although any one factor may not be sufficient on its own, the following are some examples of objective facts and circumstances that may assist to demonstrate that new residential premises are being held for sale or exchange as part of an entity's enterprise:

- business plans or minutes of meetings supporting the holding of the premises for sale;
- finance documents supporting the planned sale of the premises;
- past activities of the entity in carrying on the enterprise of selling new residential premises;
- marketing of the premises for sale, such as, listing the premises for sale with a real estate agent or agents, advertising the premises for sale in relevant publications or via Internet advertising websites for real property, arranging 'open for inspection' times, and showing prospective buyers through the premises; and
- in the case of a building or complex made up of multiple stratum units, actual arm's length sales of some of the listed units (although, in some cases this may be countered by evidence that the entity only intended to sell some of the premises while intending to rent others).

[40] In these circumstances, subsection 40-75(2) may apply when the premises are finally sold such that the premises are not new residential premises and the sale of the premises will be input taxed. Refer to paragraphs 106 to 109 of this draft Ruling and paragraphs 89 to 93 of Goods and Services Tax Ruling GSTR 2003/3 Goods and services tax: when is a sale of real property a sale of new residential premises?

49. Similarly, evidence that the premises has been applied, to some extent, in relation to making input taxed supplies includes, for instance:

- business plans or minutes of meetings demonstrating that the entity has determined to use the premises for rent;
- finance documents supporting the intention to rent the premises;
- periods of actual rental of the premises; and
- marketing of the premises for rent.

Dual applications of new residential premises

50. The phrase 'to the extent' in subsections 129-50(1) and 129-50(2) recognises that a thing may be applied partly to a creditable purpose.

51. An entity may apply new residential premises for the creditable purpose of sale where the premises are being held for sale or exchange as part of the entity's enterprise, whilst concurrently applying the new residential premises for the non-creditable purpose of making input taxed supplies of leasing under section 40-35.

52. For example, an entity may construct new residential premises for the purpose of sale and the premises may continue to be held for sale or exchange as part of the entity's enterprise of constructing new residential premises for sale; however, due to a downturn in the property market, the entity may also make the premises available for rent for a period until the market conditions improve. This will be a dual application of the premises during the relevant period being the period of time between acquisition of the thing and the end of the adjustment period. An apportionment between the different applications will be necessary to determine the extent to which the new residential premises have been applied for a creditable purpose during the period of time that is relevant for step 1 of the method statement in subsection 129-40(1).

53. A dual application of new residential premises may also arise in an adjustment period where the premises are applied exclusively for the creditable purpose of sale for part of the relevant period and applied exclusively in relation to making input taxed supplies of leasing residential premises under section 40-35 for the remainder of the relevant period. Again, an apportionment between the different applications will be necessary to determine the extent to which the new residential premises have been applied for a creditable purpose during the period of time that is relevant for step 1 of the method statement in subsection 129-40(1).

54. Furthermore, there may be situations where during the relevant period an entity may have applied the premises to a dual concurrent application for part of the time and applied the premises exclusively to sale and/or rent for part of the time. This essentially combines the situations described in paragraphs 51 to 53 of this draft Ruling.

55. Where an apportionment is necessary, the entity will have to apply a fair and reasonable method of apportionment. For further details see paragraphs 75 to 105 of this draft Ruling.

Example 3 – dual concurrent applications – new residential premises applied for creditable and non-creditable purposes at the same time

56. *Dee Veloper Pty Ltd (Dee Veloper) constructs a building of six stratum units. During the construction stage Dee Veloper planned to sell each of the premises upon their completion. However, by the time the premises are almost complete the market has slowed significantly. Dee Veloper decides to lease each of the six stratum units until the market improves.*

57. *Dee Veloper has a history of constructing and selling new residential premises. Its business plan is to construct and sell premises as quickly as possible to permit it to raise capital to commence new projects. Dee Veloper has decided to enter into six-month lease agreements with tenants as it hopes that the market will improve before too long. The tenants have been notified of Dee Veloper's continuing intention to sell the premises and the lease agreements allow for the early termination of the lease upon notice in the event of a sale. Dee Veloper's financing arrangements with respect to the project entail an interest only loan based upon the new residential premises being sold within the next twelve months. Dee Veloper's cash flow projections relating to the project demonstrate that Dee Veloper intends to commence marketing the premises for sale one month prior to the expiry of the lease agreements with tenants. This evidence objectively supports Dee Veloper's ongoing plan to sell the premises.*

58. *Dee Veloper is applying each of the premises in carrying on its enterprise. This includes the application of the new residential premises to the purpose of sale. However, Dee Veloper is also applying each of the premises in relation to making input taxed supplies of leasing.*[41] *Dee Veloper is required to determine its extent of creditable purpose by apportioning between its creditable and non-creditable purposes on a fair and reasonable basis.*

[41] Section 40-35.

59. *However, the extent to which the premises were applied for a creditable purpose would be different if the facts were changed as follows. After six months of leasing the premises Dee Veloper decides that it would be more profitable to continue to lease the premises indefinitely and changes its business plan in accordance with this decision. Dee Veloper also revises its financing arrangements and commences making principal and interest repayments of the loan. Dee Veloper undertakes no marketing of the premises for sale after the decision to lease has been made. From this time Dee Veloper no longer holds the premises for the purpose of sale as part of its enterprise. The premises would be applied from this time solely in relation to making input taxed supplies of residential rent.*

Example 4 – consecutive different applications – new residential premises applied for a creditable purpose and then for a non-creditable purpose

60. *Bilder Pty Ltd (Bilder) constructs new residential premises with the intention of selling the premises as soon as possible following completion. The premises were completed in September and Bilder had started marketing the premises for sale in August. However, by the end of November Bilder had been unable to sell the premises. Bilder investigated the market for leasing similar premises and decided that it could profitably retain the premises and use them solely for leasing.*

61. *In December Bilder commenced leasing the premises for residential accommodation. Bilder took the premises off the market and no longer planned to sell the premises at any particular time. Since this time Bilder has devoted the premises solely to making input taxed supplies.*

62. *Up until the end of November Bilder was holding the premises for the purpose of sale as part of its enterprise. This is an application for a creditable purpose. From December when Bilder commences leasing the premises, Bilder is not applying the premises for a creditable purpose to any extent. Therefore looking back over the relevant period in its entirety, Bilder has applied the premises for a creditable purpose for part of the period, and for the remainder of the period Bilder has applied the premises for a non-creditable purpose. At the end of the relevant adjustment period Bilder is required to determine its extent of creditable purpose by apportioning between its creditable and non-creditable purposes on a fair and reasonable basis.*

Calculating adjustments under Division 129

63. This section of the draft Ruling provides guidance on the following issues which are relevant to calculating adjustments under Division 129:

- identifying 'the thing' (paragraphs 64 to 68 of this draft Ruling);
- identifying the types of different acquisitions that may be subject to adjustments under Division 129 (paragraphs 69 to 74 of this draft Ruling); and
- identifying reasonable methods of apportionment to calculate an entity's extent of creditable purpose (paragraphs 75 to 105 of this draft Ruling).

The meaning of 'the thing' for the purposes of Divisions 11 and 129

64. Divisions 11 and 129 operate in respect of a 'thing'. Before applying each Division, an entity must determine what is being acquired. For example, where an entity contracts for the construction of a house, the entity is acquiring the house and not all the individual elements that go into the construction of it. If an entity is the builder who constructs the building, it is the individual acquisitions of goods or services that the entity acquires that are the 'things' for the purposes of Divisions 11 and 129 (for example, 1,000 bricks, 100 litres of paint or the services of the electrician). It is necessary to identify the actual acquisition that the entity has made.

65. However, to determine how an entity has applied the thing acquired it is necessary to look at how the thing into which the acquisition has been incorporated has been applied. For example, to determine how bricks have been applied it is necessary to determine how the building in which they have been incorporated has been applied. Where the method statement in subsection 129-40(1) refers to 'thing' it is not referring to bits and pieces of the building, but to the thing to which the original thing has been incorporated.

66. While it is necessary to look at the application of the 'thing' into which the individual acquisitions have been incorporated, it is the individual acquisitions that are subject to adjustments under Division 129. Also, section 156-20 provides that for the purposes of Division 129 an acquisition by an entity that accounts otherwise than on a cash basis that is made:

(a) for a period or on a progressive basis; and

(b) for consideration that is to be provided on a progressive or periodic basis;

is treated as if each progressive or periodic component of the acquisition were a separate acquisition.

Example 5 – Division 129 and acquisitions made on a progressive basis

67. *An entity enters into a contract for the construction of new residential premises. The contract price is $220,000 (GST inclusive). Under the contract, the consideration is to be provided in four progress payments based on stages of construction as follows:*

Progress payment 1 – $45,000

Progress payment 2 – $45,000

Progress payment 3 – $65,000

Progress payment 4 – $65,000

68. *The acquisition is made on a progressive basis as the contract provides for stages of supply during the course of the supply.*[42] *Also, the consideration has been provided on a progressive basis that reflects the stages of the supply.*[43] *For the purposes of Division 129, each of the four progress payments is treated as a separate acquisition. Five adjustment periods will apply to each progress payment and the first adjustment period for each progress payment is the tax period ending 30 June which commences at least 12 months after the end of the tax period to which the progress payment is attributable.*

How does Division 129 apply with respect to the different types of acquisitions that can relate to the construction, sale and rental of new residential premises?

69. There are numerous types of acquisitions that can arise in the course of the construction of new residential premises and in the course of subsequent use of the premises.

70. Many relevant acquisitions will relate to the construction of particular premises. If the constructed premises are applied differently to the intended or former application and provided that the GST exclusive value of the acquisition is greater than $1,000, a Division 129 adjustment can arise in relation to this type of acquisition. Acquisitions that are of this nature would include:

- acquisitions of goods related to the construction of premises, for example, construction materials such as bricks, concrete, roofing, paint, etc.; and
- acquisitions of services related to the construction of premises, for example, services of an electrician, plumber, brick layer or an entire construction contract.

[42] See paragraph 27 of Goods and Services Tax Ruling GSTR 2000/35 Goods and services tax: Division 156 – supplies and acquisitions made on a progressive or periodic basis.
[43] See paragraph 28 of GSTR 2000/35.

71. Some other acquisitions directly relate to either the sale of the new residential premises or the leasing of the premises. These acquisitions would not be subject to an adjustment under Division 129 as a result of a subsequent change of purpose to leasing or sale, for example:

- acquisitions of services related to the sale of the premises, such as real estate agent and marketing services acquired in relation to selling the premises; and
- acquisitions of services related to the leasing of the premises, such as real estate agent and marketing services acquired in relation to the leasing of the premises.

72. A property development enterprise may also involve making acquisitions in the nature of overhead or enterprise costs or acquisitions that relate to making many different supplies as part of the enterprise. Photocopiers and computers acquired for the office, general taxation and legal services, and possibly goods such as tools and machinery (if not related to the construction of particular premises) would be examples of these types of acquisitions.

73. It is possible for a Division 129 adjustment to arise in relation to the types of acquisitions referred to in paragraph 72 of this draft Ruling where there is a change in the extent to which the acquisitions are applied in carrying on an enterprise or in relation to making input taxed supplies. In such a case, the adjustment would not be calculated with reference to the application of particular premises but would be calculated with reference to the application of the things in the enterprise as a whole which may involve making input taxed and taxable supplies.

74. For example, if the entity's enterprise changes from one involving an intention to make only taxable supplies to one involving the making of both input taxed and taxable supplies, for the purposes of Division 129 there will be a corresponding change in extent of creditable purpose of the relevant acquisitions that are in the nature of overhead or enterprise costs.[44]

Reasonable methods of apportionment

75. 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. Guidance on appropriate methods of apportionment for determining extent of creditable purpose is provided in Goods and Services Tax Ruling GSTR 2006/4 Goods and services tax: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose.

[44] See paragraphs 136 to 148 of GSTR 2008/1 for further explanation of overhead or enterprise costs.

76. In circumstances where an entity constructs new residential premises for sale but they are subsequently rented, it is necessary to consider the different applications of the premises up to the end of the relevant adjustment period.

77. If the premises have been applied in relation to the creditable purpose of sale and the non-creditable purpose of making input taxed supplies during the relevant period and the premises have been sold prior to the end of the relevant adjustment period, one reasonable method of apportionment is an output based indirect method.[45] This method is based on the consideration[46] received or liable to be received in respect of any taxable supply as compared to any input taxed supply. Thus, the extent to which new residential premises were applied for a creditable purpose under Division 129 can be determined by the following formula:

$$\frac{\text{Consideration for the taxable supply of the premises}}{\text{Consideration for the taxable supply of the premises plus consideration for the input taxed supplies of residential rent}}$$

Example 6 – output based indirect method after the premises have been sold

78. *Jane is registered for GST and 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 rented the premises for six months before the premises were finally 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.*

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

$$\frac{\$500{,}000}{\$500{,}000 + \$15{,}000} = 97.09\%$$

80. *This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1). Jane's intended application of the thing for the purposes of step 2 of the method statement was 100%. As the actual application of the thing is less than its intended application, Jane has an increasing adjustment for her acquisitions in accordance with step 3 of the method statement.*

[45] See also paragraphs 120 and 143-153 of GSTR 2006/4 for a broad explanation and examples of this type of method.

[46] 'Consideration' in the apportionment methods discussed in this draft Ruling refers to the gross income from the different types of supplies.

81. If the premises remains unsold at the end of the relevant adjustment period the actual consideration for the taxable supply of the premises on sale will not be known. Where the premises have been applied for a creditable purpose, to some extent, for the entire relevant period, using estimated consideration for the taxable supply of the premises on sale (rather than the actual consideration for the sale) in the output based indirect formula set out in paragraph 77 of this draft Ruling will be an appropriate basis of apportionment.

82. For example, during the relevant period between the time of acquisition and the end of the adjustment period being considered, there may be a period of time when the premises are being applied solely in carrying on the enterprise for a creditable purpose, and then for the remainder of the relevant period there may have been a dual concurrent application of the premises to the creditable purpose of sale as well as to the non-creditable purpose of making input taxed supplies. In these circumstances the output based indirect method using the estimated sales consideration will be an appropriate basis of apportionment.

83. The output based indirect method using estimated sales consideration will also be an appropriate basis of apportionment when there has been a dual concurrent application of the premises to the creditable purpose of sale as well as the non-creditable purpose of making input taxed supplies for the entirety of the relevant period.

Example 7 – premises applied for a creditable purpose, to some extent, for the entire relevant period

84. *John is registered for GST and has quarterly tax periods. He constructed new residential premises for the purpose of sale and was entitled to full input tax credits on his acquisitions. One particular acquisition of construction services was made on 1 October 2006 for $55,000 (GST inclusive). The premises were completed on 1 February 2007. John continued to hold the premises for the purpose of sale but also commenced renting the premises for residential accommodation on 1 April 2007. John received rental income of $2,500 per month and expected to sell the premises for $500,000. John has continued to retain the dual concurrent application since 1 April 2007.*

85. *The first adjustment period in relation to the acquisition of construction services is the period ending 30 June 2008. There are 21 months in the relevant period between the time of the acquisition on 1 October 2006 and the end of the first adjustment period on 30 June 2008.*

86. *For the six months from 1 October 2006 to 31 March 2007 John applied the premises solely for a creditable purpose, that is, an extent of creditable purpose of 100%.*

87. *For the 15 months from 1 April 2007 to 30 June 2008 John has applied the premises for both a creditable purpose and a non-creditable purpose. John works out the extent of creditable purpose for the relevant period by using an output based indirect method (using estimated sales consideration) as follows:*

$$\frac{\$500,000}{\$500,000 + \$37,500}$$

= 93.02%

88. *This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).*

89. In circumstances where the premises have not been applied for a creditable purpose, to some extent, for the entire period, the output based indirect method (using estimated sales consideration) would be one possible fair and reasonable basis of apportionment. However, it would need to be modified with an additional time based apportionment to reflect the fact that the premises have been applied for a creditable purpose for only part of the relevant period.

Example 8 – premises applied for 100% creditable purpose for part of the relevant period, and then subsequently applied for 0% creditable purpose for the remainder of the period

90. *Assume the facts are the same as for Example 7 of this draft Ruling. However, rather than continuing to hold the premises for sale as part of the enterprise John decided on 1 April 2007 to hold the premises solely for the purpose of leasing.*

91. *As in paragraph 86 of this draft Ruling, for the six months from 1 October 2006 to 31 March 2007 John applied the premises solely for a creditable purpose, that is, an extent of creditable purpose of 100%.*

92. *For the 15 months from 1 April 2007 to 30 June 2008 John has applied the premises solely in relation to making input taxed supplies, that is, an extent of creditable purpose of 0%.*

93. *John applies a time based apportionment to the application for a creditable purpose to ascertain the extent of creditable purpose for the relevant period (this is because for the rest of the period the extent of creditable purpose is 0%):*

(6 mths / 21 mths x 100%)

= 28.57%

94. *This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).*

Example 9 – premises applied for a creditable purpose, to some extent, for part of the relevant period, and then subsequently applied for 0% creditable purpose for the remainder of the period

95. *Assume the facts are the same as for Example 7 of this draft Ruling. John continued to apply the premises for the dual concurrent application of the creditable purpose of sale and the non-creditable purpose of leasing from 1 April 2007 to 31 December 2007. However, on 1 January 2008 John decided to hold the premises solely for the purpose of leasing.*

96. *For the 15 months from 1 October 2006 to 31 December 2007 John applied the premises for a creditable purpose to some extent. For the remainder of the relevant period John applied the premises solely in relation to making input taxed supplies, that is, an extent of creditable purpose of 0%.*

97. *John works out the extent of creditable purpose for the relevant period in two steps. First, John uses an output based indirect method (using estimated sales consideration) as follows:*

$$\frac{\$500,000}{\$500,000 + \$37,500}$$

$$= 93.02\%$$

98. *John now needs to undertake a further apportionment to reflect the fact that the premises were not held for the purpose of sale for the entire adjustment period. This is calculated by adjusting the percentage in paragraph 97 of this draft Ruling by the relevant proportion of the relevant period for which the premises were being held for the purpose of sale:*

$$93.02\% \times 15 \text{ mths} / 21 \text{ mths} = 66.44\%$$

99. *This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).*

100. In some cases residential premises may also be applied for a private or domestic purpose such as where the entity lives in the premises (a non-creditable purpose). In these situations the apportionment methodologies discussed in paragraphs 77 to 99 of this draft Ruling may be adapted by imputing a market rental to represent the application for a private or domestic purpose and still provide a fair and reasonable apportionment.

Example 10 – application to a private or domestic purpose

101. *Mary is registered for GST and has quarterly tax periods. She constructed new residential premises for the purpose of sale as part of her enterprise. However, due to a change in her personal circumstances, not long after the premises were completed Mary required a place to live for three months. Mary continued to hold the premises for sale as part of her enterprise and continued to market the premises for sale. The market value for rent for similar premises was $2,500 per month. Before the end of the adjustment period Mary sells the premises for $500,000.*

102. *At the end of the next adjustment period following the sale, Mary calculates the extent of creditable purpose using the formula set out in paragraph 77 of this draft Ruling for the output based indirect method but uses the market value of rent as a notional value for her private and domestic application of the premises:*

$$\frac{\$500,000}{\$500,00 + \$7,500}$$

$$= 98.52\%$$

103. *This percentage is the actual application of the thing for the purposes of step 1 of the method statement in subsection 129-40(1).*

Summary of the output based indirect method

104. In summary, one possible appropriate method of apportionment where premises have been applied to both a creditable purpose of sale and a non-creditable purpose of leasing during the relevant period is based on an output based indirect method. This method will apply such that:

- if the premises have been sold before the end of the relevant adjustment period, the output based indirect method can be applied by comparing the consideration received for the taxable supply of the premises with the consideration received for both the taxable supply and the input taxed supplies of leasing (paragraphs 77 to 80 of this draft Ruling);
- if the premises have not been sold but have been applied, to some extent, for the creditable purpose of sale for the entire relevant period, the output based indirect method can be applied using the estimated sales consideration for the premises (paragraphs 81 to 88 of this draft Ruling); and

- if the premises have not been sold but have been applied, to some extent, for the creditable purpose of sale for only part of the relevant period and solely to a non-creditable purpose for part of the relevant period, the output based indirect method can be applied using the estimated sales consideration for the premises but should be modified with an additional time based apportionment (paragraphs 89 to 99 of this draft Ruling).

Other methods of apportionment

105. While the method discussed in paragraphs 77 to 104 of this draft Ruling is suggested as appropriate to provide a fair and reasonable basis of apportionment, other methods may also be acceptable in providing a fair and reasonable basis. The principles discussed in GSTR 2006/4 should be referred to for further information.

Interaction between Division 129 and the '5 year rule' in subsection 40-75(2)

106. It is considered that the term 'used' in subsection 40-75(2) and the meaning of 'apply' for the purposes of Division 129 should be interpreted consistently. This means that if an entity has applied new residential premises for a creditable purpose in accordance with Division 129, the premises will also have been used other than for making supplies that are input taxed under paragraph 40-35(1)(a) and the requirements for subsection 40-75(2) to apply will not be satisfied.

107. The '5 year rule' in subsection 40-75(2) provides an exception to the meaning of new residential premises in subsection 40-75(1). The '5 year rule' is discussed in paragraphs 89 to 93 of Goods and Services Tax Ruling GSTR 2003/3 Goods and services tax: when is a sale of real property a sale of new residential premises? As discussed in paragraphs 89 and 90 of GSTR 2003/3, subsection 40-75(2) requires that for a period of at least 5 years since the premises became new residential premises, the premises have only been used for making supplies that are input taxed under paragraph 40-35(1)(a). If this requirement is satisfied then the premises will not be new residential premises.

108. 'Used' is an important term in subsection 40-75(2). As noted in paragraph 36 of this draft Ruling, there is a strong similarity between the meanings of 'use' and 'apply'.

109. Adopting a consistent interpretation for the term 'used' in subsection 40-75(2) and the term 'apply' in Division 129 is consistent with the policy explained in the Revised Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 8) 2000 (the Explanatory Memorandum), which introduced section 40-75, that new residential premises will not be taxable if an entity is not entitled to input tax credits for acquisitions relating to the construction of the premises.[47]

Example 11 – premises applied for the purpose of sale which do not satisfy the requirements of the '5 year rule'

110. *Matthew constructs new residential premises for the purpose of sale and is entitled to input tax credits on his acquisitions. On completion of the premises Matthew decides to rent the premises because of a downturn in the property market. Matthew continues to hold the premises for the purpose of sale as part of his enterprise. He is therefore applying the premises for two purposes under Division 129. He is required to make an increasing adjustment at the end of the first adjustment period because the actual application is less than the intended application. He will also need to consider whether further adjustments are necessary in each of the relevant adjustment periods.*

111. *Matthew sells the premises six years after they were completed. He has been renting the premises for this whole period. However, the requirements of subsection 40-75(2) are not satisfied because the premises have not only been used for making supplies that are input taxed because of paragraph 40-35(1)(a). The premises have also been used for the purpose of sale because Matthew has been holding the premises for sale as part of his enterprise.*

112. *The premises are new residential premises and, provided all the requirements of section 9-5 are satisfied, Matthew makes a taxable supply of new residential premises when the premises are sold.*

Further examples

Example 12 – property development where premises are constructed for sale but rented prior to sale – worked example

113. This worked example considers a scenario where a property developer constructs new residential premises for sale but leases the premises prior to selling them. The example considers the following issues:

- identifying the relevant adjustment periods for multiple acquisitions;

[47] Paragraphs 1.16 and 1.17 of the Revised Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 8) 2000.

- identifying changes in extent of creditable purpose;
- calculating adjustments for adjustment periods while the premises continue to be leased; and
- calculating adjustments for the final adjustment period following the sale of the premises.

Facts

114. David, a property developer, is registered for GST and accounts for GST on a quarterly basis. David also accounts on a basis other than cash. The following occurs:

30 August 2006	David acquires a block of land for $220,000 (GST inclusive). The margin scheme was not applied.
10 September 2006	David entered into a contract with a builder to construct new residential premises on the land. The contract price was $198,000 (GST inclusive).
10 October 2006	David made a progress payment of $55,000.
31 January 2007	David made a progress payment of $77,000.
2 April 2007	David made a final payment of $66,000.

115. At the time of purchasing the block of land and throughout the period of construction, David planned to sell the premises on completion and thus make a taxable supply of new residential premises.[48] The acquisitions were creditable acquisitions in accordance with section 11-5. David attributed the input tax credit for the purchase of the land (that is $20,000) to the tax period ending 30 September 2006. As the construction services are a supply on a progressive basis and David provided consideration on a progressive basis, each progress payment and the final payment was attributable separately to the period in which the consideration was provided.[49] That is, for the tax period ending 31 December 2006 David attributed an input tax credit of $5,000, for the tax period ending 31 March 2007 David attributed an input tax credit of $7,000, and for the tax period ending 30 June 2007 David attributed an input tax credit of $6,000.

[48] Sections 40-75 and 9-5.
[49] Assuming David is provided with a tax invoice for each separate payment. See sections 156-10 and 29-10.

116. David started marketing the premises for sale prior to them being completed. However, after the premises have been completed it is clear that the market has slowed significantly. David decides to rent the premises to cover some of the holding costs. The premises are rented from 1 May 2007 until 31 May 2010. David rented the premises for $2,000 per month. However, throughout this period David continued to hold the premises for the purpose of sale as part of his enterprise. This is supported by objective evidence. In particular, David's business plan did not change and was in accordance with past projects where premises were sold as soon as possible. David also continued to market the premises for sale.

117. David finally sold the premises on 31 May 2010 for $500,000.

Identifying the adjustment periods

118. Each of the progress payments will be treated as a separate acquisition for the purposes of Division 129.[50] The first adjustment period is a tax period that ends on 30 June and commences at least 12 months after the end of the tax period to which each acquisition was attributed. The relevant adjustment periods are as follows:

Acquisition date	**Acquisition cost (GST exclusive)**	**First adjustment period**	**Number of adjustment periods**
30 Aug 2006 (land)	$200,000	Tax period ending 30 Jun 2008	5
10 Oct 2006 (progress payment)	$50,000	Tax period ending 30 Jun 2008	5
31 Jan 2007 (progress payment)	$70,000	Tax period ending 30 Jun 2008	5
2 Apr 2007 (final payment)	$60,000	Tax period ending 30 Jun 2009	5

Adjustments for the tax period ending 30 June 2008

119. Throughout the period between the acquisitions and the ultimate sale of the new residential premises David has applied the premises in carrying on his enterprise for the creditable purpose of sale and has also applied the premises in relation to making input taxed supplies of residential leasing. David needs to determine the extent of creditable purpose for each of the acquisitions given the dual application throughout the period. This requires an apportionment on a fair and reasonable basis.

[50] Section 156-20.

120. In relation to the acquisition of the land, from 30 August 2006 to 30 April 2007 the extent of creditable purpose is 100% (as it has been held for the purpose of sale of the new residential premises). From 1 May 2007 until 30 June 2008 there has been a dual application as the new residential premises have been held for the purpose of sale while also being applied in relation to making input taxed supplies of leasing. The extent of creditable purpose for the relevant period can be calculated by applying an output based indirect method (using estimated sales consideration). During this period David has rented the premises for 14 months at $2,000 per month. This is a total gross rental income of $28,000. The estimated selling value of the premises was $500,000. The extent of creditable purpose for the relevant period up to 30 June 2008 is thus:

$$\frac{\$500,000}{\$500,000 + \$28,000} = 94.70\%$$

121. In relation to the progress payments made on 10 October 2006 and 31 January 2007, the process for determining extent of creditable purpose is the same as for the land. As set out in paragraph 120 of this draft Ruling, for the relevant period up to 30 June 2008 the extent of creditable purpose is 94.70% applying the output based indirect method (using estimated sales consideration).

122. David will then need to apply the method statement contained in section 129-40 to each of the relevant acquisitions.

123. Applying the method statement in respect of the land:

Step 1 – The extent to which the thing has been applied for a creditable purpose during the period 30 August 2006 to 30 June 2008 is 94.70%.

Step 2 – The extent to which the thing was acquired for a creditable purpose is 100%, as the planned use at the time of the acquisition was not to make any input taxed supplies.

Step 3 – As the actual application of the thing acquired is less than the intended or former application of the thing, David will have an increasing adjustment.

124. In relation to the progress payments of 10 October 2006 and 31 January 2007, the above steps also result in increasing adjustments.

125. Each increasing adjustment is calculated using the formula:[51]

Increasing adjustment = full input tax credit x (intended application – actual application)

[51] Section 129-70.

126. The increasing adjustment in respect of the land is calculated as follows:

= $20,000 x (100% – 94.70%)

= $1060

127. The increasing adjustment in respect of the first progress payment on 10 October 2006 is calculated as follows:

= $5,000 x (100% – 94.70%)

= $265

128. The increasing adjustment in respect of the second progress payment on 31 January 2007 is calculated as follows:

= $7,000 x (100% – 94.70%)

= $371

129. David has a total increasing adjustment of $1,696 for the tax period ending 30 June 2008 and must include the adjustment in his business activity statement for this period.

Adjustments for the tax period ending 30 June 2009

130. As for the tax period ending 30 June 2008, adjustments need to be considered for each acquisition. This is the second adjustment period for the acquisition of the land and the first two progress payments. It is the first adjustment period for the final progress payment made on 2 April 2007.

131. In relation to the acquisition of the land, from 30 August 2006 to 30 April 2007 the extent of creditable purpose is 100% (as it has been held for the purpose of sale of the new residential premises). From 1 May 2007 until 30 June 2009 there has been a dual application as the new residential premises have been held for the purpose of sale while also being applied in relation to making input taxed supplies of leasing. The extent of creditable purpose for the relevant period up to 30 June 2009 can be calculated by applying an output based indirect method (using estimated sales consideration). During this period David has rented the premises for 26 months at $2,000 per month. This is a total gross rental income of $52,000. The estimated selling value of the premises was $500,000. The extent of creditable purpose for the relevant period up to 30 June 2009 is thus:

$$\frac{\$500,000}{\$500,000 + \$52,000}$$

= 90.58%

132. In relation to the progress payments made on 10 October 2006, 31 January 2007 and 2 April 2007 the process for determining extent of creditable purpose is the same as for the land. As set out in paragraph 131 of this draft Ruling, the extent of creditable purpose is 90.58% applying the output based indirect method (using estimated sales consideration).

133. David will then need to apply the method statement contained in section 129-40 to each of the relevant acquisitions.

134. Applying the method statement in respect of the land:

Step 1 – The extent to which the thing has been applied for a creditable purpose during the period 30 August 2006 to 30 June 2009 is 90.58%.

Step 2 – The intended or former application as calculated above for the adjustment period ending 30 June 2008 was 94.70%.

Step 3 – As the actual application of the thing acquired is less than the intended or former application of the thing, David will have an increasing adjustment.

135. In relation to the progress payments of 10 October 2006, 31 January 2007 and 2 April 2007, the above steps also result in increasing adjustments.

136. The increasing adjustment in respect of the land is calculated as follows:

= $20,000 x (94.70% – 90.58%)

= $824

137. The increasing adjustment in respect of the first progress payment on 10 October 2006 is calculated as follows:

= $5,000 x (94.70% – 90.58%)

= $206

138. The increasing adjustment in respect of the second progress payment on 31 January 2007 is calculated as follows:

= $7,000 x (94.70% – 90.58%)

= $288.40

139. The increasing adjustment in respect of the final progress payment on 2 April 2007 is calculated as follows:

= $6,000 x (100% – 90.58%)

= $565.20

140. David has a total increasing adjustment of $1,883.60 for the tax period ending 30 June 2009 and must include the adjustment in his business activity statement for this period.

Adjustments for the tax period ending 30 June 2010

141. David sold the premises as new residential premises on 31 May 2010. The tax period ending 30 June 2010 is the final adjustment in relation to the acquisitions. Given that the premises have been sold, an output based indirect method of apportionment provides a fair and reasonable basis of apportionment. The apportionment for extent of creditable purpose can be calculated according to the following formula:

$$\frac{\text{Consideration for the taxable supply of the premises}}{\text{Consideration for the taxable supply of the premises plus consideration for the input taxed supplies of residential rent}}$$

142. The premises were sold for $500,000. The premises were rented for a total of 37 months up to the end of May 2010 – a total rental income of $74,000. The extent of creditable purpose under the formula is thus:

$$\frac{\$500,000}{\$500,000 + \$74,000}$$

= 87.11%

143. David will then need to apply the method statement contained in section 129-40 to each of the relevant acquisitions.

144. Applying the method statement in respect of the land:

Step 1 – The extent to which the thing has been applied for a creditable purpose during the period 30 August 2006 to 30 June 2010 is 87.11%.

Step 2 – The intended or former application as calculated above for the adjustment period ending 30 June 2009 was 90.58%.

Step 3 – As the actual application of the thing acquired is less than the intended or former application of the thing, David will have an increasing adjustment.

145. In relation to the progress payments of 10 October 2006, 31 January 2007 and 2 April 2007, the steps in paragraph 144 of this draft Ruling also result in increasing adjustments.

146. The increasing adjustment in respect of the land is calculated as follows:[52]

= $20,000 x (90.58% – 87.11%)

= $694

147. The increasing adjustment in respect of the first progress payment on 10 October 2006 is calculated as follows:

= $5,000 x (90.58% – 87.11%)

= $173.50

[52] In accordance with the formula in section 129-70.

148. The increasing adjustment in respect of the second progress payment on 31 January 2007 is calculated as follows:

= $7,000 x (90.58% – 87.11%)

= $242.90

149. The increasing adjustment in respect of the final progress payment on 2 April 2007 is calculated as follows:

= $6,000 x (90.58% – 87.11%)

= $208.20

150. David has a total increasing adjustment of $1,318.60 for the tax period ending 30 June 2010 and must include the adjustment in his business activity statement for this period.

Summary

151. David's overall GST position in relation to input tax credits and adjustments for the four acquisitions is as follows:

Land:

$20,000 input tax credit (30 Sep 2006 BAS)

$1,060 increasing adjustment (30 Jun 2008 BAS)

$824 increasing adjustment (30 Jun 2009 BAS)

$694 increasing adjustment (30 Jun 2010 BAS)

Net result – $17,422 credit

10 Oct 2006 progress payment:

$5,000 input tax credit (31 Dec 2006 BAS)

$265 increasing adjustment (30 Jun 2008 BAS)

$206 increasing adjustment (30 Jun 2009 BAS)

$173.50 increasing adjustment (30 Jun 2010 BAS)

Net result – $4,355.50 credit

31 Jan 2007 progress payment:

$7,000 input tax credit (31 Mar 2007 BAS)

$371 increasing adjustment (30 Jun 2008 BAS)

$288.40 increasing adjustment (30 Jun 2009 BAS)

$242.90 increasing adjustment (30 Jun 2010 BAS)

Net result – $6,097.70 credit

2 Apr 2007 final progress payment:

$6,000 input tax credit (30 Jun 2007 BAS)

$565.20 increasing adjustment (30 Jun 2009 BAS)

$208.20 increasing adjustment (30 Jun 2010 BAS)

Net result – $5,226.60 credit

Your comments

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

153. 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.

Due date:	**13 February 2009**
Contact officer:	**Steven Fogarty**
Email address:	**steven.fogarty@ato.gov.au**
Telephone:	**(07) 3213 8296**
Facsimile:	**(07) 3213 8588**
Address:	**Australian Taxation Office** **PO Box 9977** **Chermside QLD 4032**

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Commissioner of Taxation
17 December 2008

Previous drafts:

Not previously issued as a draft

Related Rulings/Determinations:

GSTR 1999/1; GSTR 2000/24; GSTR 2000/35; GSTR 2003/3; GSTR 2003/6; GSTR 2004/6; GSTR 2006/4; GSTR 2008/1; GSTD 2003/2; MT 2006/1

Subject references:

- acquisition
- adjustment period
- adjustments
- apportionment
- carrying on an enterprise
- creditable acquisition
- creditable purpose
- decreasing adjustment
- GST lease and real property
- GST new residential premises
- GST residential premises
- increasing adjustment
- input tax credits
- input taxed supplies
- taxable supply

Legislative references:

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- ANTS(GST)A 1999 9-5
- ANTS(GST)A 1999 Div 11
- ANTS(GST)A 1999 11-5
- ANTS(GST)A 1999 11-15
- ANTS(GST)A 1999 11-20
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- ANTS(GST)A 1999 15-5
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- TAA 1953 Sch 1 105-60

Case references:

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