GSTR 2009/4EC - Compendium

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Ruling Compendium – GSTR 2009/4

This is a compendium of responses to the issues raised by external parties to draft GSTR 2008/D5 – Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose.

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

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	**Ruling appropriate publication for this issue** It is considered that a Ruling is the appropriate kind of publication for dealing with this issue (ATO ID 2008/114 issued on 19 August 2008 and earlier Tax Office Update dated 19 August 2008 which announced that the revised view would be published as a draft GST Determination).	The Tax Office notes that the comment supports a Ruling as the appropriate product to address this issue.
2	**Meaning of the word 'apply'** Appreciate the change in view by the Commissioner of Taxation (Commissioner) with reference to the meaning of 'apply', namely, that there is an application of new residential premises for a creditable purpose to some extent when the premises are held for sale, notwithstanding that the premises may be rented as residential accommodation and not sold as at the relevant time.	The Tax Office notes that the comment supports the view taken in the Ruling on the meaning of 'apply'.

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3	**'Supply' cannot include an attempt to supply** This proposal appears to be a reaction to high level lobbying. It certainly didn't come from anyone who had to actually administer the law and probably not from anyone in a small accounting practice. Simply, the draft Ruling interprets 'supply' as including an attempt to supply. It is an extension of the meaning of the word that exceeds any realistic interpretation. You can't make a supply without actually supplying something – just offering to do so is insufficient. If you want to collect Goods and Services Tax (GST) on property sales, you'll withdraw this ruling because most of the industry will be doing their utmost to make sure you don't, or at least the more honest ones will be making sure that they defer their liability far longer than you have ever contemplated.	The Tax Office notes that the comment raises concerns with the ability to administer and comply with the views set out in the Ruling. It is acknowledged that Division 129 of *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)[*] is complex in its application to the property industry. However, it is considered that the interpretation taken in the Ruling recognises the requirement to make increasing adjustments where a thing acquired for a creditable purpose has been applied in relation to making input taxed supplies while also recognising that the entity may still be holding the premises for a creditable purpose. This means that a 100 per cent increasing adjustment is not an appropriate reflection of the entity's extent of creditable purpose. Accepting that the entity has had a dual application consequently leads to a requirement for apportionment and therefore increases the complexity of applying the adjustment provisions. However, it is considered that this is required by the legislation. The term relevant to the interpretation of Division 129 is 'apply'. The meaning of 'apply' is given in section 129-55. While the meaning of 'apply' includes supplying a thing, the meaning is much broader and given that it is an inclusive definition, this also includes its ordinary meaning. The Ruling does not interpret 'supply' as intending to supply something but rather takes the view that for the purpose of Division 129 'apply' includes holding a thing for the purpose of sale. It is also noted that an objective assessment of all the facts and circumstances is necessary to establish that an entity is in fact holding premises for the purpose of sale. The concept is to be distinguished from the holding of an investment asset for sale at some undetermined time in the future.

[*] Unless otherwise stated, all legislative references in this Compendium are to the GST Act.

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4	**Complexity of the view** Commented on the complexity of relying on the interpretation in the draft Ruling and asked whether a client could rely on the previous view and make a 100% increasing adjustment. It was felt that doing this may be less costly to the taxpayer taking into account compliance costs.	The Tax Office notes the complexity of applying Division 129 but notes that this arises from the operation of the legislation. However, the Commissioner considers that the view set out in the Ruling is the preferred interpretation of Division 129 in the context of new residential premises constructed for sale but subsequently used to make input taxed supplies by way of lease, as it recognises the dual application of the premises to both creditable and non-creditable purposes.
5(a)	**Transitional arrangements** ***Where a taxpayer has relied on the Commissioner's previous view*** Paragraphs 6 and 7 of the draft Ruling. At paragraph 6, it is stated that 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 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, 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.	As noted in paragraph 7 of the draft Ruling the Commissioner accepts that an entity may revise prior adjustments in accordance with the view in the Ruling. The transitional issue on the interaction between Division 129 and subsection 40-75(2) has been considered in the final Ruling. Consistent with the approach to the previous view on Division 129, if under the previous view the entity was considered to have applied the premises solely to making input taxed supplies by way of lease, this period will also contribute to a 5 year continuous period for the purposes of subsection 40-75(2). The Commissioner is not seeking to downplay or discourage an entity from revising previous Business Activity Statements (BAS). The option has been given so that taxpayers that have made all increasing and decreasing adjustments under the previous view (or are expected to make relevant decreasing adjustments in the next adjustment period and do not wish to revise previous BAS) are not required to revise their previous BAS. However, it is considered that an entity must make all increasing and decreasing adjustments in relation to an acquisition consistently under either the previous view or under the revised view set out in the Ruling.

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5(a) cont	We query whether this approach is consistent with principles of proper taxation as taxpayers that have complied with the Commissioner's previous view will have more than likely overpaid GST pursuant to Division 129 adjustments in the circumstances canvassed by the draft Ruling. Moreover, according to the draft Ruling, the fact they can (and may in fact) continue on the same basis, notwithstanding the Commissioner's change in view would probably have more to do with the Commissioner's view of the application of the 5 year rule in subsection 40-75(2). We would like that transitional implication to also be covered in the Draft Ruling. At present, paragraphs 106-112 deal with that interaction but nowhere does the Commissioner assure those taxpayers that have relied on the previous views with respect to Division 129 and that have effectively made Division 129 adjustments as to what their GST position will be with respect to subsection 40-75(2). We query whether the more likely transitional arrangement to be adopted by taxpayers is that they would seek to revise prior adjustments in order to rely on the Commissioner's revised view of the GST Act, and whether in these circumstances and having regard to the history and contentious nature of the issue, it is appropriate for the Commissioner to downplay and discourage that scenario. Refer paragraph 7 which states: > [i]f an entity revises prior adjustments relevant to an acquisition, based upon the views in this draft Ruling, the entity will also be required to calculate all adjustments arising in relation that acquisition on that same basis.	

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5(b)	***Treatment of taxpayers who didn't follow the previous tax office view and were issued GST assessments when their arrangements are now reflected in the revised tax office view*** We seek clarification from the Commissioner as to what arrangements will be made for those taxpayers who did not rely on the previous view in the Issues Register but adopted a view of the GST law which will now be reflected in the final Ruling and were issued GST assessments (in some cases with the imposition of both penalties and general interest charges) based on the Commissioner's previous view. In this regard, it is noted that the final ruling will explain the Commissioner's view of the law as it applies both before and after the date of issue (paragraph 4). We are concerned that the Commissioner is maintaining both his previous view for some purposes and his revised view of the GST law applying both before and after its date of issue for other purposes.	The Commissioner will consider on a case by case basis in accordance with the current Tax Office policies and procedures the remission of penalties and interest in circumstances where increasing adjustments were assessed following compliance activity. Taxpayers affected in this manner by the revised view are invited to contact the Tax Office to enable their individual circumstances to be considered.

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5(c)	***The interaction between ATO ID 2008/114 and the draft ruling*** We query whether the change in view by the Commissioner on 19 August 2008, as evidenced by ATO ID 2008/114, needs to be specifically referred to in the discussion of the transitional arrangements as there is no specific mention of its existence in the draft Ruling. The ATO Interpretative Decision is now shown as withdrawn with effect from 17 December 2008, being the date of issue of the draft Ruling. The Professional Bodies are concerned that there is a possible hiatus period, namely, between the date of the issue of the ATO Interpretative Decision on 19 August 2008 and the date of issue of the draft Ruling on 17 December 2008, which is not explicable on the terms of the draft Ruling. Refer also to paragraph 11 *'[t]he Commissioner's previous view... was set out in section 4 of the Issues Register. 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.* It is not clear from that sequence of events where ATO ID 2008/114 fits in and which view prevails, particularly as the previous view will only be withdrawn when the final Ruling issues.	It is not considered necessary to refer to ATO ID 2008/114 in the date of effect paragraphs of the Ruling. In accordance with the transitional arrangements set out at paragraphs 5 and 6 of the Ruling, an entity is able to revise previous adjustments in accordance with the views in the Ruling. Given that the views in the Ruling are expressed more broadly than the issue dealt with in the ATO ID, it is considered that the protection offered by the Ruling will apply more broadly than the protection offered by relying on the ATO ID, which was issued on 19 August 2008 and withdrawn upon the publication of the draft Ruling on 17 December 2008.
6	**Previous tax office view is the better interpretation** Commented that the previous Tax Office view in the issues register was the better interpretation of Division 129.	The Tax Office notes this comment. However, it is considered that the revised view in the Ruling better reflects an entity's extent of creditable purpose where it is applying new residential premises to dual purposes in carrying on its enterprise.
7	**How does Division 129 apply if the change in application occurs after the end of the first adjustment period in relation to an acquisition?** It would help if there was an example to clarify the approach to adjustments where the change in application occurs after the end of the first adjustment period in relation to an acquisition, for example, acquisition made in October 2006, first adjustment period ends 30 June 2008, change in application in October 2008, therefore the first relevant adjustment period in which an adjustment must be made is the period ending 30 June 2009.	In such a case the principles discussed in the Ruling apply equally. However, rather than being required to make an adjustment in the tax period ending 30 June 2008, the first adjustment period in which the entity will be required to make an adjustment will be the tax period ending 30 June 2009 (the second adjustment period in relation to the acquisition made in October 2006). Footnote 43 in the Ruling has been added to paragraph 50 to clarify that the principles discussed in the Ruling apply equally in these circumstances.

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8	**Example of a further apportionment where some residential premises in the development are sold and others let** A further example could be included addressing situations where a developer builds 4 units, sells 3 and has a change in application in relation to 1 – an additional apportionment for some acquisitions may be required.	It is agreed that a further step in calculating the apportionment to determine the actual application of a thing for certain acquisitions may be necessary in these circumstances. Examples have been added to the Ruling to address these circumstances – see paragraphs 108 to 120 of the Ruling.
9	**The interaction between the 4 year time limit for amendments in section 105-50 of Schedule 1 to the *Taxation Administration Act 1953* (TAA) and Division 129 of the GST Act** Questioned the interaction between the 4 year time limit for amendments in section 105-50 of Schedule 1 to the TAA and Division 129 of the GST Act and how an entity should revise previous BAS if it has failed to make adjustments in an adjustment period that is now outside the 4 year time limit but there are still some adjustment periods that apply.	The Tax Office considers that this issue is outside the scope of this Ruling. However, some guidance on the application of section 105-50 of Schedule 1 to the TAA is provided in Law Administration Practice Statement PS LA 2009/3 Time limit on recovery by the Commissioner.
10	**Where residential premises are used for purposes other than as residential premises** Residential Premises may not be predominantly used for residential accommodation There is an assumption throughout the draft Ruling that the rental of new residential premises is an input taxed supply in all circumstances under the terms of section 40-35. See, for example, paragraphs 10, 23, 29, 32 and 40 of the draft Ruling. This is because of the repeated references to the sale of new residential premises being a taxable supply but the rental of new residential premises being an input taxed supply, without any reference to the terms of section 40-35(2) and the possibility that residential premises may be used for other purposes including office accommodation.	The Tax Office's view on the meaning of residential premises is considered in Goods and Services Tax Ruling GSTR 2000/20 Goods and Services Tax: commercial residential premises. Furthermore, the Tax Office's view on the decision in *Toyama Pty Ltd v. Landmark Building Developments Pty Ltd* [2006] NSWSC 83; (2006) 2006 ATC 4160; (2006) 62 ATR 73 (*Toyama*) in relation to the phrase 'to be used predominantly for residential accommodation' is set out in the Decision Impact Statement (DIS 4541/02) related to that case. It is the Tax Office's view that an objective approach is required to the interpretation of the phrase 'to be used predominantly for residential accommodation' and that this is to be based on the physical characteristics of the premises (see paragraphs 19 and 20 of GSTR 2000/20). It is not considered that this Ruling is the appropriate publication for further explanation of this issue. GSTR 2000/20 and the DIS 4541/02 relating to the *Toyama* case provide some further explanation.

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10 cont	It will be remembered that section 40-35 states that *'[a] supply of premises which is by way of lease … is input taxed if: (a) the supply is of residential premises…'* Significantly, subsection 40-35(2) relevantly qualifies the above, as follows: *'[h]owever, the supply is input taxed only to the extent that the premises are to be used predominantly for residential accommodation (regardless of the term of occupation);'* We consider that it is important that the Commissioner recognises in the draft Ruling that, besides being residential premises, the premises must also be predominantly used for residential accommodation to be input taxed supplies of residential premises. It is not appropriate, for example, in paragraph 23 of the draft Ruling to state that *'a supply of residential premises by way of lease, hire or license is input taxed if the requirements of section 40-35 are satisfied'* without specifically referring to the requirements of subsection 40-35(2). We suggest that paragraph 23 needs to be expanded to explain the usage test, as discussed in the *Toyama case,* paragraphs 82, 95 and 96 and, more recently, in the *South Steyne Hotel case*, paragraphs 48-49. We suggest that an example which would be helpful in this draft Ruling is the lease by a building company of new residential premises as a display home or display apartment to the developer of the new residential premises for the purpose of promoting sales of other new homes and apartments in the same complex. We consider that such premises are not used predominantly for residential accommodation and in no circumstances involve the making of input taxed supplies.	

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11	**Meaning of sale 'or exchange'** Paragraphs 42, 44, 47, 48 and 51 of the draft Ruling. We query the relevance of new residential premises that are being held for the purpose of the sale *or exchange* involved as part of an entity's enterprise. The reference to 'exchange' is repeated in paragraphs 47, 48 and 51 of the draft Ruling without any apparent explanation. The Commissioner is asked to explain this in the draft Ruling.	The reference to 'exchange' has been removed from the Ruling. The phrase 'sale or exchange' was derived from the case law referred to in the draft Ruling in relation to trade. However, the Tax Office agrees that holding premises for the purpose of 'exchange' is not of direct relevance to the issues discussed in the Ruling.
12	**Evidence of holding premises for sale – would a developer be able to satisfy this test for all apartments where they hold back one apartment as a display apartment?** A developer has 6 almost identical strata titled apartments for sale. None are able to be sold at an acceptable price and tenants are put into 5 of the apartments. All 6 of the apartments remain available for sale, but inspections are carried out of the untenanted apartment. Would such a developer be able to satisfy the 'active marketing' test in relation to the 5 tenanted apartments?	In each case it will be a question of fact whether the particular premises are being held for the purpose of sale. All of the relevant facts and circumstances would need to be taken into account. The fact that some premises were not available for inspection would not necessarily, by itself, mean that the premises are not being held for the purpose of sale. It is considered that the application of the principles in the Ruling to this example is sufficiently covered by the guidance in the Ruling on the types of facts and circumstances that may be relevant. The Ruling notes that any one factor may not be sufficient on its own. See paragraphs 44 to 47 of the Ruling.

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13	**A more realistic example is needed to reflect a commercial approach to leasing** Paragraphs 56 to 59 – Example 3 Dee Veloper apparently signs 6 month lease agreements with tenants which allow for early termination in the event of a sale. The example also suggests that Dee Veloper has notified the tenants of their intention to sell when entering into the leases. This example would not arise in practise because to do so would ordinarily be contrary to Dee Veloper's commercial interests. We recommend that the draft Ruling be amended to contain a more commercially realistic example.	This example has been altered such that the right to terminate the lease early is not specified as a fact. An additional fact has been included such that the lease agreements allow for access to the property upon reasonable notice so that potential purchasers can inspect the premises.
14	**More guidance required on types of acquisitions subject to change in creditable purpose** Paragraphs 69 to 74 of the draft Ruling. The guidance provided by the Commissioner as to how to identify acquisitions that are subject to a change in creditable purpose and how to determine the extent to which an acquisition is applied for a creditable purpose is fairly elementary. In this regard, it is considered that additional work needs to be done with respect to identifying a wider sample of acquisitions in constructing new residential premises, particularly acquisitions of services and explain the relevant principles as to whether they are subject to a change in creditable purpose (for example are services of architects and surveyors subject to a change in creditable purpose?).	Further guidance has been provided in paragraphs 67 to 80 of the Ruling on this issue. It is considered that Division 129 extends to all acquisitions of goods and services made in constructing new residential premises which provide an enduring benefit in the form of the completed premises. It also includes consumable type acquisitions such as electricity used during the construction of the premises where such costs are absorbed into the completed premises. It is therefore considered that Division 129 can apply in relation to acquisitions of architects and surveyors services. It is also considered that repairs and improvements may be subject to adjustments under Division 129 if the premises are applied differently to the way that was intended when the repairs or improvements were acquired.

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14 cont	It is queried whether all acquisitions are capable of adjustments under Division 129. In this regard, paragraph 63 of the draft Ruling states that it provides guidance on *'identifying the types of different acquisitions that may be subject to adjustments under Division 129 (paragraphs 69 to 74 of this draft Ruling)'*. In paragraph 70, it is stated that *'[m]any relevant acquisitions will relate to the construction of particular premises'* and later, *'[i]f the constructed premises are applied differently to the intended or former application … a Division 129 adjustment can arise in relation to this type of acquisition'.* In respect of acquisitions of services, it is said that the services of an electrician, plumber, bricklayer or an entire construction contract can arise in relation to construction and be subject to Division 129 adjustments. In paragraph 71, it is further stated that 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 are directly related to the sale. It is suggested that there are several other acquisitions that may be said to directly relate to the sale of the new residential premises, for example, the services of surveyors and architects and seek the Commissioner's expansion of the list of relevant acquisitions, in particular, acquisitions of services that either relate to the sale of the new residential premises or the leasing of the premises for residential accommodation.	
15	**Separate acquisitions for Division 129** The draft Ruling now also needs to take into account the approach adopted by Stone J in *South Steyne Hotels* case (albeit on appeal to the Full Federal Court) in identifying each lease agreement as a separate supply for GST purposes. The logical corollary of this is that each of the acquisitions would be a separate acquisition which is taken into account for Division 129 purposes.	The Ruling notes that 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 (subject to the operation of section 156-20 in relation to progressive or periodic supplies) – see paragraph 64 of the Ruling.

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16(a)	**Alternative apportionment methods** Paragraphs 75 to 105 of the draft Ruling ***Apportionment methodology based on effective life of a building.*** Another possible fair and reasonable method of apportionment would be to look at the estimated or effective lifespan of the premises rather than the estimated revenue from the premises. This is already a recognised concept for income tax purposes in the context of depreciating assets and would be relatively simple to apply. In these circumstances, the extent to which new residential premises are applied for a non-creditable purpose would be: Period of time the premises is leased / Estimated effective life of the premises Therefore, under this apportionment method, if the estimated effective life of the asset is 40 years, and the property is leased for a period of 1 year before it is sold, the developer will be required to make an increasing adjustment equal to 1/40th of the input tax credits claimed on construction acquisitions. If the property is leased for a period of 2 years before it is sold, the developer will be required to make increasing adjustments over two adjustment periods equalling 2/40th of the input tax credits claimed on construction acquisitions.	It is not considered that an effective life method based, for example, on a 40 year effective life of a building is an appropriate fair and reasonable method of apportionment of an entity's dual concurrent application of a thing in the context discussed in the Ruling. Division 129 requires an entity to look back over the relevant period and apportion the application of the premises during that period between creditable and non-creditable purposes. Contrary to this, an apportionment method based on the effective life of the premises contemplates the entire life span of the premises rather than the actual use of the premises by the entity in the relevant period. Furthermore, residential premises include the land on which the relevant building is constructed. Land is generally an appreciating asset, and the effective life of the relevant building is considered too remote and arbitrary to reasonably reflect the application of the residential premises, comprising both the land and buildings, during the relevant period. The Commissioner would reject this method notwithstanding that the estimated effective life may be based upon the statutory rates provided for the purpose of calculating capital works deductions under Division 43 of the *Income Tax Assessment Act 1997.*
16(b)	***Comparison of the selling price of the property after the letting activity with the selling price of the property prior to the letting activity*** Many developers will be leasing completed residential properties at this time solely to defray holding costs until such time as the market improves and prices increase. Their only other option is to sell the property at 'fire sale' prices.	It is considered that an approach which compares estimated selling prices before and after the letting activity does not provide an appropriate basis of apportionment. The change in value of residential premises over time will be driven by many factors that are not related to the use of the premises to make supplies by way of lease. Therefore, changes in the estimated sale price of the premises do not provide an appropriate reflection of the use of the premises over the relevant period.

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16(b) cont	The problems currently confronting developers may be illustrated by reference to a simple example. Consider the scenario where a developer could sell a residential apartment for say $550,000 in February 2009, but the property is expected to sell for say $770,000 in August 2010 based on the prevailing market prices before the current downturn. To meet their holding costs, the developer leases the property for the next 18 months. The end result is that while the developer may have derived some rental income, their purpose (objectively considered) has been to maximise the sale price of the apartment upon which GST is levied. The outcome is that the developer remits GST of $70,000 instead of $50,000 (ignoring the margin scheme for present purposes).In the example set out the Commissioner may well take the view that it is appropriate to compare the income from the letting of the premises with the income from the ultimate sale of the premises and deny input tax credits according to the formula in paragraph 77 of the Draft Ruling. However, this approach ignores the fact that the letting activity is a means to an end – it is the means by which the developer is able to realise a much greater sale price for the property upon which GST is being remitted. The Commissioner should consider including in the draft Ruling a formula which compares the expected sale price of the property prior to the letting activity with the sale price of the property after the letting activity. It is counterintuitive to deny input tax credits (other than in respect of those costs which relate to the letting activity alone) when the purpose or objective of that letting activity is to generate a greater sale price upon which GST must be remitted. In other words, it is appropriate to have a formula which takes into account the fact that the effluxion of time arising during the period of letting has been productive in generating additional GST liabilities on sale.	

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16(c)	***The effect of the letting activity on the depreciation of the building*** The Commissioner makes no reference in the draft Ruling to the comparable position adopted in other jurisdictions, such as in New Zealand. In particular, there is now leading case law authority (the *Lundy Family Trust* case) supporting the use of a 'depreciation' style method in calculating the extent of input tax credit denial, or increasing adjustments under Division 129. These approaches compare the extent to which the leasing of the property has depreciated or diminished the value of the property and, to that extent, input tax credits should be denied. Given the acceptance of that approach by the courts, the Commissioner is asked to specifically refer to this approach in the draft Ruling.	In relation to the approach of looking at the effect of the letting on the depreciation of a building, it is considered that the different legislative approach in New Zealand involving a self supply deemed to be at the cost of the goods to the supplier limits the relevance of the *Lundy Family Trust* case to the issue of apportionment of extent of creditable purpose for the purposes of Division 129. Also, at a broader level this methodology of considering the depreciation of a building while it is being used for making input taxed supplies is similar to the effective life methodology. Therefore, for similar reasons to those set out above in relation to the effective life methodology it is not considered that this methodology provides a fair and reasonable basis of apportionment.
16(d)	***Loan/lease agreements commonly used in the retirement village industry not covered in the draft Ruling.*** In the retirement village industry it is quite common for developers to enter into loan / lease arrangements with residents as a means of securing a sale of the residual freehold interest in the property. The business model of the developers undertaking these activities is not to lease the property per se. Rather, the leasing of the property to residents is being undertaken to secure an income stream for an operator which enhances the value of the property upon sale. In many cases, the developer will not even have the expertise to operate the retirement village. The particular problems (not addressed) by the draft Ruling are: • The reasonable methods of apportionment set out in the draft Ruling do not deal with the situation where the leasing activity is simply a means to an end. That is, the developer's ability to sell the premises and the price payable for the premises upon sale is dependent upon the entry into lease agreements with the residents.	The Ruling does not specifically address the application of Division 129 to the retirement village industry. It is considered that the general principles discussed in the Ruling apply equally to the construction of retirement villages for sale or for use to make input taxed supplies followed by sale. However, it is acknowledged that the specific facts of each case, particularly in the retirement village sector, need to be considered in applying the Ruling. In particular, different considerations may need to be taken into account in determining a fair and reasonable basis of apportionment. While an output based indirect method may still be appropriate, different things may need to be taken into account in the numerator and denominator of the formula. The issues peculiar to the supplies made in the retirement village sector are outside the scope of this Ruling. Guidance on specific circumstances can be sought by writing to the Tax Office for a private ruling.

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16(d) cont	• The residents do not typically pay 'rent' for the premises. Instead, they may pay recurrent charges, and make an ingoing contribution (which is refundable upon termination, together with a share of any capital gain). The suggested apportionment methods in the draft Ruling do not readily apply to this industry.	As noted above, even though leasing activities may be thought of as a means to an end, it is considered necessary to recognise the fact that during the relevant period the entity has applied the premises to two purposes – one creditable and one non-creditable. Division 129 is concerned with identifying the difference between actual application of a thing and intended application of a thing. It is considered that the use of the premises to make input taxed supplies should be recognised as an application of the premises.
17	**Can a de minimis rule be applied in relation to an adjustment?** Paragraphs 75 to 105 of the draft Ruling. Questioned whether a de minimis rule could be applied in relation to adjustments. Provided an example of new residential premises being sold for $3 million but it had been rented for a short period bringing in $2,000 rent. The example results in essentially a 99.94% creditable purpose.	The Tax Office notes the compliance costs related to making such small adjustments but the legislative requirements for adjustments under Division 129 do not provide scope for a de minimis rule.
18	**What is the consequence of a change in the consideration for the taxable supply of the premises?** Paragraph 77 of the draft Ruling. As most of the examples are over a number of adjustment periods, what is the consequence of a change in the value of the 'Consideration for the taxable supply of the premises' (that is, the sale price of the property) if the value increases, for example from the $500,000 initial value to a revised $550,000, then 12 months later $600,000 as this will influence the final percentage?	Further guidance has been provided on determining the estimated sales consideration for the purposes of the apportionment methodology discussed in the Ruling – see paragraphs 90 to 91 of the Ruling. It is considered that the estimated sales consideration should be reassessed for each relevant adjustment period. Example 19 in the Ruling has also been amended to provide an example of the effect of a change in the estimated sales consideration on the apportionment methodology.

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19	**The calculations in examples 7 and 9 require clarification** We submit that paragraphs 89-99 of the draft Ruling represent an overly complicated application of Division 129 within the period when it should be recognised as a timing provision. The application of a further time based apportionment methodology to an already complicated formula is unwarranted when, for most developments, the increasing adjustment will be partly or fully reversed when the property is sold. We seek clarification of the calculations in some of the examples in the draft Ruling. In Example 8, a time-based apportionment is applied to ascertain the extent of creditable purpose for the period until the first adjustment period, where the application changed from solely for sale to solely for lease. However, in Example 7 where there was also a change in application no time-based apportionment was applied. It is submitted that for consistency the actual application in Example 7 should be 95.02% (that is 6/21 x 100 + 15/21 x 93.02). In addition, Example 9 only partially applies the time-based apportionment. While we do not accept the need for the further time based apportionment method, if it must be included, it is submitted that the actual application in Example 9 should be 68.44% (that is 6/21 x 100 + 9/21 x 93.02 + 6/21 x 0).	It is considered that an additional time based apportionment step in the methodology is appropriate where the premises have not been held for the purpose of sale for the whole of the relevant period of time. This is because otherwise, if an entity held the premises for the purpose of sale for only a short period of time (for example, one day as an extreme example) the entity is likely to be entitled to retain the majority of its credits under the output based indirect method. It is not considered that this provides a fair and reasonable basis of apportionment. In relation to the comment on Example 7 of the draft Ruling, it is the Tax Office view that also using a time based apportionment in such a scenario effectively results in a double counting of the creditable application. This is because the fact that the premises were only leased for part of the period is already reflected in the amount of rent the entity receives. In relation to the comment on Example 9 of the draft Ruling, the same reasoning as in relation to Example 7 applies to explain why the time based apportionment is applied in the way that it is.
20	**Clarification of example 8 needed** Paragraph 89 and Example 8 of the draft Ruling. Having made a clear change in creditable purpose, would John in Example 8 need to make subsequent adjustments over the ensuing periods until the apportionment % of input credits initially claimed reaches/approaches a value of 0.00%, and at that point would the subsequent sale of the property incur a GST liability?	John would be required to make subsequent adjustments based on his continued application of the premises. The sale of the premises may be a taxable supply of new residential premises subject to the operation of subsection 40-75(2), which is discussed in paragraphs 132 to 144 of the Ruling. Footnote 51 in the Ruling has been added at the end of Example 12 in the Ruling to identify these issues.

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Issue No.	Issue raised	Tax Office Response/Action taken
21	**What are the implications of the developer choosing to live in the residential premises before selling them?** Paragraphs 101 to 103 – Example 10 of the draft Ruling. The example should be expanded or extended to cover the full issues when the developer chooses to live in the premises. For example, what is the Commissioner's view of the implications for later adjustment periods? Have such premises left the GST net, such that all credits claimed are clawed back in the next adjustment period? Further, is any subsequent sale of the property outside of the course or furtherance of an enterprise or is it subject to the five year rule.	It is considered that the principles discussed in the Ruling will apply equally where the developer chooses to live in the premises. This is demonstrated through Example 16 of the Ruling (Example 10 of the draft Ruling). Also, footnote 42 in the Ruling has been added at paragraph 49 to highlight that the principles regarding dual applications apply equally to applications of new residential premises to a private or domestic purpose. However, specifically, each case will depend on its facts. If an entity is continuing to hold the premises for the purpose of sale, there will continue to be a dual concurrent application of the premises and further adjustments in later adjustment periods will be required. If the entity commences applying the premises only to a private or domestic purpose, the entity will have to continue making adjustments in relevant adjustment periods based on a fair and reasonable method of apportionment. Guidance on the issue of 'course or furtherance of' an enterprise is provided in the context of *in specie* distributions from a trust in Goods and Services Tax Determination GSTD 2009/1 Goods and services tax: is a supply by way of an *in specie* distribution of an asset that is applied in an enterprise carried on by a discretionary trust to a beneficiary of the trust made 'in the course or furtherance of' the trust's enterprise? The issue is also discussed in the context of partnerships in paragraphs 85B to 85G of Goods and Services Tax Ruling GSTR 2003/13 Goods and services tax: general law partnerships.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(a)	**Interaction between Division 129 and the '5 year rule' in subsection 40-75(2)** Paragraphs 106 to 112 of the draft Ruling. ***GST as a tax on final private consumption – Division 129 should be applied as a timing provision until the 5 years has passed*** GST is intended to be a tax on final private consumption. The interpretation and application of difficult GST issues needs to reflect that underlying purpose. The input taxing of residential rent and sales of existing residential property reflects a treatment of them as consumption with a denial or clawback of credits for the supplier being a means of taxing the consumption. The application of Division 129 to residential property developments needs to particularly ensure that the tax is restricted to final private consumption and not to business entities or transactions. It needs to be remembered that, for most residential property developers, Division 129 is essentially a timing provision rather than substantially determining the underlying liability. Most residential property that enters the realm of operation of Division 129 will be sold within five years. Thus in most cases, the bulk of the GST paid on acquisitions by the developer will be ultimately creditable, either up front or by way of reversal of most of the Division 129 increasing adjustments. It is only for a minority of developments where the property remains leased and unsold after five years that Division 129 should act as the trigger for the final GST liability. It is submitted that Division 129 should be applied as a simple timing provision until the five year period has passed. Its application should not be overly complicated. Once the five year mark has passed, Division 129 and the five year rule should be applied on a consistent basis, that is: • Input tax credits on acquisitions should be denied; and • The sale of the residential property should be input taxed (see below).	See Tax Office response to 22(b) of this Compendium.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(b)	***Disagree with the Commissioner's view as it will lead to impractical outcomes*** In relation to the interaction of Division 129 and the 5 year rule for leasing new premises, we do not agree with the Commissioner's view that the premises will still be 'new residential premises' after they are rented out for 5 years if they are also held out for sale in that period. We consider, as noted by the Commissioner, that this interpretation is contrary to the legislative intent. Whilst we do not consider the words 'used' and 'applied' to be the same, we recognise that various interpretations to align them, (or not align them), will lead to impractical outcomes. For example: 1. premises being taxed as new premises when only a minor percentage of input tax credits were allowable (eg where there was a single, but active, marketing attempt for a very short period, or a single opportunity to sell), or 2. premises being taxed as new premises where credits were almost fully claimed, but division 129 does not claw them back because the 5 years for division 40 is reached after division 129 ceases to apply, or 3. There are also matters such as which 5 year period is relevant and how do you calculate the period, (for example, first, any, last or cumulative?) One outcome is that 50 year old premises may be taxed as new because there is an attempt to sell the premises some time in that 50 year period. These issues are not simply resolved through the Commissioner's view and need considerable work. It is considered that more consultation is needed, and potentially legislative amendments are necessary to clarify the interaction of provisions. Otherwise, there are likely to be extraordinarily counter-policy outcomes and considerable uncertainty.	The concern regarding the possibility for impractical outcomes to arise is noted. However, it is not considered likely that any impractical outcomes will necessarily arise from the approach taken to the interaction of the 5 year rule and Division 129 in the Ruling. The approach taken is considered to result in the following outcomes: • If premises are rented for over 5 years and until the relevant adjustment periods have ended and the premises have been held for the purpose of sale for the entire period and the premises are then sold, the sale will be a taxable supply of new residential premises but the entity would have been entitled to retain a large percentage of credits. • If premises are rented for over 5 years and until the relevant adjustment periods have ended and the premises have only been used for making input taxed supplies for the entire period and the premises are then sold, the sale will be an input taxed supply of residential premises but the entity would have been required to make increasing adjustments for the majority of credits. In the first example referred to, if the premises started being held for sale before the end of 5 years of use for making input taxed supplies by way of lease, then this may result in the requirements of the 5 year rule not being met. However, depending on whether relevant adjustment periods still apply the entity may be entitled to a decreasing adjustment entitling the entity to some of the relevant input tax credits. The second example is considered to be consistent with the policy of allowing most of the credits where a taxable supply of new residential premises by way of sale is made. In the third example, any continuous 5 year period of use only for making input taxed supplies by way of lease would mean that there was an input taxed supply of residential premises when they are sold.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(c)	***'Used' and 'applied' have no strong similarity and the Commissioner's approach contradicts the policy intent*** The Commissioner's approach to this issue in the draft Ruling confuses the 'use' to which the premises are put (which is the test under subsection 40-75(2)) with the language of Division 129 which focuses upon the way that the premises are 'applied'. With respect, there is no 'strong similarity' between the meanings of those terms and, furthermore, the Commissioner's approach contradicts the underlying policy of the provisions.	As noted in the Ruling, it is considered that the relevant meanings of 'used' and 'applied' are largely synonymous. Furthermore, as noted in the Ruling, it is considered that the approach taken is consistent with the policy intent in relation to subsection 40-75(2) that is expressed in the Revised Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 8) 2000.
22(d)	***The 5 year period is vague and ambiguous where the period is interrupted by periods where the premises are marketed for sale*** Basing the 5 year rule on the period or periods of letting the premises (unaffected by attempts at selling the premises) is an objective test that is clearly identifiable and calculable in practise. By contrast, if the 5 year period is interrupted by periods over which the premises are being marketed for sale (while still being leased), there is then a propensity to lead to vague and ambiguous outcomes.	A finding that the premises have been held for the purpose of sale requires an objective assessment of all the relevant facts and circumstances. It is considered that such an approach still requires more than a subjective intention to sell the premises.

Issue No.	Issue raised	Tax Office Response/Action taken
22(e)	***Alternative view that after 5 years leasing any sale is an input taxed supply and the taxpayer will have to make adjustments for any ITCs it may have retained for construction costs*** The Commissioner's approach points to the underlying policy of the 5 year rule as set out in the Explanatory Memorandum. What seems to concern the Commissioner is that a taxpayer will be allowed to claim input tax credits and sell the premises without GST. This misunderstands the position and does not arise. If a taxpayer holds premises for the purposes of selling it, while also letting the premises for 5 years, then at the cessation of the 5 year period of letting the taxpayer will only be able to supply the premises in such a way as to make an input taxed supply. As such, an increasing adjustment arises such that the input tax credits that may have been claimed while the premises have been held for sale are effectively repaid under Division 129. In short, there is no 'double dipping'. The correct policy outcome arises in that the taxpayer is not liable to pay GST on the sale, and is not entitled to retain input tax credits for its construction costs.	A number of issues are considered to arise with respect to this alternative view. Firstly, assuming that adjustment periods still apply to the entity for the relevant acquisitions once the premises have been used for making input taxed supplies by way of lease for a continuous period of 5 years, adjustments under Division 129 are based on the actual application of a thing compared with its intended or former application. Division 129 does not operate by re-assessing intended use of a thing at the end of each adjustment period. Therefore, it is arguable that the actual application of the thing will remain predominantly as holding the premises for the purpose of making a taxable supply by way of a sale of new residential premises. Consequently, only a relatively small increasing adjustment would be required and the entity would retain a large percentage of input tax credits despite only ever making input taxed supplies. This is arguably contrary to the policy intention. To arrive at the outcome suggested in the alternative view of a 100% increasing adjustment it would be necessary at the relevant adjustment period to classify the entire past actual application of the thing as relating to making the input taxed sale of residential premises despite the fact that at the time of previous adjustment periods the entity would have been holding the premises for a creditable purpose of selling new residential premises. It is difficult to see that the nature of past application of a thing could change based on a future event. This seems contrary to the approach in Division 129 which is to compare the actual application of a thing with the intended use of the thing when it was acquired.

Issue No.	Issue raised	Tax Office Response/Action taken
22(e) cont		Secondly, another difficulty with the proposed alternative view is that the 5 year continuous period of rental is likely to be reached outside the final adjustment period for many of the acquisitions. This will arise because many acquisitions could have only two or five adjustment periods and may be made some time before the premises actually commence being rented. Therefore, in many cases the increasing adjustment which the alternative view suggests will not be made.
22(f)	***There may be a taxable supply of new residential premises after a long period of letting*** The Commissioner's position in the draft Ruling becomes even more problematic given his view that the 5 year period must be 'continuous' – see GST Ruling 2003/3. In particular, if the approach in the draft Ruling is applied, a taxpayer may still make a taxable supply of new residential premises after say 9 years of letting the premises, where the premises are being held for sale in conjunction with, or substitution for, that letting activity.	It is agreed that this outcome is possible. However, it is considered that in most cases the entity would have also been entitled to retain a large proportion of its input tax credits on the relevant acquisitions.
22(g)	***It is improbable that a developer could prove that they were holding the premises for sale for a period in excess of 5 years*** The Commissioner's approach is also, to some extent, highly theoretical. If a taxpayer is intending to lease premises for a period in excess of 5 years, then it would be a rare case where they could also be demonstrating that they are holding the premises for sale.	It is agreed that this issue is likely to arise in only rare circumstances.
	Paragraph 111 It was considered that it would be unlikely that an entity could demonstrate a dual purpose for 6 years. Time should be a relevant factor in evidencing whether premises are being held for the purpose of sale. Example 11 could note that being able to objectively evidence holding for sale for a period of 6 years is unlikely and an exception rather than what would ordinarily happen, however the example is intended to demonstrate the principle.	It is agreed that in many cases it would be unlikely that an entity could demonstrate it was holding the premises for the purpose of sale for greater than 5 years yet still not have sold the premises. However, the example is intended to demonstrate the possible interaction of subsection 40-75(2) and Division 129. Footnote 54 has been added at paragraph 139 to note that it would be a rare situation where an entity was able to demonstrate based on an objective assessment of the facts and circumstances that it was still holding the premises for the purpose of sale after such a long period of time.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(h)	***Conclusion regarding Example 11*** Thus, disagree with the suggested outcome in Example 11 in the draft Ruling. Given that the application of Division 129 to property developments should be seen as a timing provision until the five year period has ceased, the interpretation of Division 129 should not dictate an interpretation of subsection 40-75(2) that results in a denial of an exemption for a property leased for the five year period. It is submitted that the particular premises are input taxed when sold per subsection 40-65(1).	This comment is noted however it is considered that the alternative view set out in the Tax Office response to 22(e) of this Compendium leads to other difficulties and the approach taken in the Ruling is therefore preferred.
22(i)	***The Commissioner's view on the interaction between the provisions potentially results in double taxation*** The burden on a taxpayer applying the Commissioner's interpretation of the 5 year rule as a continuous period could also be significantly onerous and potentially result in double taxation. A taxpayer's five year 'continuous' period may not be completed until more than 10 years after the taxpayer had initially leased the premises. During that period, the taxpayer would not have been entitled to claim all input tax credits and will have paid some of its input tax credits on construction back (pursuant to the Tax Office's revised view on the application of Division 129) and yet the taxpayer is still liable for the full GST on the sale of the property. In the event that the residential premises are subsequently sold, after all Division 129 adjustment periods have passed, and the premises are still considered to be new residential premises, the taxpayer will still be making a taxable supply and liable to GST on the full price (or margin). However, in that scenario, the taxpayer will not be entitled to a decreasing adjustment as no adjustment periods will be available for the taxpayer. As such, the taxpayer will be liable to remit the full GST on the supply of the premises, but effectively will not be entitled to reclaim the relevant proportion of input tax credits for the GST on its construction. This potential double taxation cannot, we submit, be the better approach to the interaction of Division 129 and subsection 40-75(2).	See Tax Office response to Issue 22(b) of this Compendium.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(j)	***The interpretation of subsection 40-75(2)*** The better approach to the interpretation of subsection 40-75(2) is for the five year period to be determined on a cumulative basis after the premises have become new residential premises. We submit that this approach: • reflects the words of the legislation; • does not result in the taxpayer incurring 'double taxation'; and • reflects the policy intent of subsection 40-75(2). We do not consider that the ATO's revised view with respect to the application of Division 129 leads to the result that the premises have been used to make supplies other than input taxed supplies in the period. In our view, it does not follow that the active marketing of premises for sale is a relevant 'use' for the purposes of the five year rule in subsection 40-75(2). *The wording of the section* The current ATO view is that the requirement within subsection 40-75(2) is satisfied where, for a *continuous* period of 5 years, the only supplies of the residential premises are by way of lease. This view is based on the Commissioner's emphasis of the phrase 'the period' in connoting a single, continuous period. With respect, we submit this very narrow, restrictive approach is not justified by reference to 'the period'. We note that subsection 40-75(2) does not state that the 5 year period needs to be for a continuous period. We would consider that had the Parliament meant for the relevant period to be a 'continuous period' such language could have easily been inserted into the legislation. By inserting additional words into the interpretation of the legislation, the Commissioner risks interpreting the legislation in a way unintended when it was originally enacted.	The interpretation of subsection 40-75(2) is considered 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. The approach taken in this Ruling is consistent with the Commissioner's views stated in GSTR 2003/3. The Commissioner does not intend to revise the views stated in GSTR 2003/3.

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Issue No.	Issue raised	Tax Office Response/Action taken
22(j) cont	Furthermore, overemphasis on the word 'the' in these circumstances appears to be taking the literal 'textual approach' that the Courts have rejected – as was illustrated in the judiciary's approach to the word 'would' in *HP Mercantile* and the identity of property argument in *Sterling Guardian*. *Only 'used' for 'making input taxed supplies'* We submit that the view regarding 'use' fails to consider the relevant phrase holistically. The phrase is 'used for making supplies' relevant to the period. Therefore, comparing 'use' with other purposes or activities (such as marketing) which don't result in 'making supplies' in the period is inappropriate. What is necessary is to consider what other ***supplies*** in the period the relevant premises have been 'used for making' (that is taxable or GST-free supplies). On this analysis, the marketing of the premises for sale is not a relevant 'use for making' a taxable supply in the period unless the taxable supply is made in the period. If a taxable sale is not made in the period, the premises were not ***used for making*** anything other than input taxed leasing supplies in the period. This interpretation ensures that taking the apportionment approach for the application of Division 129 does not result in the consequence that the five year period never commences. On the contrary, the ATO view results in the five year rule never commencing due to any 'use' in marketing the premises from time to time. In our view, this approach does not accord with the policy of these provisions. On the ATO view, if a vendor of residential property attempts to sell the property as each residential tenancy agreement expires, say every 6 to 12 months it markets the premises for sale and leaves them vacant, there would never be a continuous period of 5 years, even if the premises were twenty years old. We do not think that that is the intended result of the legislation.	

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22(j) cont	*Policy* We submit that the better approach is that 'the period' within subsection 40-75(2) be a cumulative period of five years from the time the residential premises are considered to be new. The treatment of 'the period' in this way means that the taxpayer should, almost invariably, be entitled to some input tax credit recovery under Division 129 to the extent that the taxpayer uses the residential premises to make a taxable supply by selling within that period. This interpretation accords with the policy in the Revised Explanatory Memorandum (paragraph 1.16). This interpretation would also accord with the entitlement to an input tax credit found in section 11-20 of the GST Act. That is, if the use was known upfront, that would result in partial input tax credits for an entity intending to construct new residential premises, lease them for a period and then sell them within five years. On the other hand, if the premises are sold after the 5 year period had concluded, the taxpayer would be making an input taxed supply of residential premises. The taxpayer would be making an input taxed supply of residential premises. The taxpayer would have to repay all input tax credits on any acquisitions related to the original construction of the premises, but the taxpayer would not be required to remit any GST on the supply of the premises. We submit that this approach would be in line with the policy intention of ensuring that GST is not embedded in sales of residential premises which have initially been used to make an input taxed supply but are ultimately used to make a taxable supply. Such an approach would also be in accordance with section 11-15, which allows a taxpayer an input tax credit 'to the extent that the acquisition' does not relate to making input taxed supplies.	

Issue No.	Issue raised	Tax Office Response/Action taken
23	**Does the apportionment applied to the input tax credits also apply to the amount of GST due upon the sale of the property?** Paragraphs 113 to 151 – Example 12 of the draft Ruling. In calculating the final adjustments for the quarter following the sale you have addressed the input credits, but not the GST due as a result of the sale of the property. Can you clarify if David can apply the final apportioned % of 87.11% of the amount of GST due as a result of the sale or if David will incur the full 10% GST on the sale? For example: Incurring the full GST component: Liability = GST * Sale Price = 10% * $500,000 = $50,000 OR an apportioned amount: Liability = GST * Sale Price * Adjustment = 10% * $500,000 * 87.11% = $43,555	The requirement to make adjustments under Division 129 and the extent of any adjustments made does not affect the calculation of the GST liability on the sale of the premises. Therefore, assuming that the requirements of section 9-5 are satisfied for a taxable supply, under the basic rules the liability for GST on the sale would be 10% of the value of the taxable supply (section 9-70). However, it may be necessary to consider whether any further adjustments under Division 129 are required following the sale of the premises.
24	**Do adjustments apply to the sale price?** Paragraphs 113 to 151 – Example 12 of the draft Ruling. 1. On the sale of the unit for $500,000 is the GST payable $^1/_{11}$ of $500,000 or is it $^1/_{11}$ of $500,000 $^+$/- other adjustments? 2. If there are adjustments, what are they? 3. Depending on the answers to 1 and 2 above, would it be appropriate to comment in the draft Ruling?	On the facts of Example 19 of the Ruling (Example 12 of the draft Ruling) it is not considered that further GST adjustments are required in relation to the supply consideration. The example does not address settlement adjustments but simply assumes that the consideration remains $500,000. However, in practice it may be common to also consider any settlement adjustments which are taken into account in determining the consideration for the supply of the real property (refer to Goods and Services Tax Determination GSTD 2006/3 Goods and services tax: are settlement adjustments taken into account to determine the consideration for the supply or acquisition of real property?). Given that no specific adjustments in relation to the supply consideration arise on the facts it is not considered necessary to add any further explanation to the Ruling.