GSTR 2000/D3 - Goods and Services Tax: transitional valuation of work-in-progress for head contractors in the building or civil engineering industries

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Draft Goods and Services Tax Ruling
Goods and Services Tax: transitional valuation of work-in-progress for head contractors in the building or civil engineering industries

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Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers and practioners, as it is not a ruling or advice in terms of section 37 of the ***Taxation Administration Act 1953****. When officially released it will be a public ruling for the purposes of section 37 and may be relied upon by any person to whom it applies.*

What this Ruling is about

1. This Ruling explains how a head contractor should value work and materials permanently incorporated into or affixed to the site of a building or civil engineering work at 1 July 2000. This Ruling applies to building or civil engineering work which is incomplete (that is, work-in-progress) at 1 July 2000.

2. The valuation should be determined in a manner specified by the Commissioner, as required by section 19 of *A New Tax System (Goods and Services Tax Transition) Act 1999* (the 'Transition Act'). Section 19 applies to a supply of goods or real property to the extent that the supply is the construction, major reconstruction, manufacture or extension of a building or civil engineering work.

3. This Ruling outlines three alternative methods for determining the value of 1 July 2000 work and materials.

4. This Ruling does not apply to:

   (i) a supply you make as a subcontractor, unless it is of the kind referred to in paragraph 18; or

   (ii) the supply of professional services, e.g., design services, where the supply is made under a separate agreement from the construction agreement; or

   (iii) a construction being undertaken by a builder on his own real property (see Draft Goods and Services Tax

Ruling GSTR 1999/D9, titled 'The margin scheme for supplies of real property held prior to 1 July 2000').

5. Bulletin GSTB 1999/2, titled 'How to determine the value of construction work-in-progress', explains the Commissioner's preferred valuation methodology. When we issue this Ruling in its final form, we will withdraw GSTB 1999/2.

6. All legislative references in this Ruling are to the Transition Act.

Date of effect

7. This Ruling, when finalised, will apply on and from 8 July 1999 (the date of commencement of the Transition Act).

Background

8. The 'time of supply' rules contained in section 6 determine when a supply is made under an agreement which spans 1 July 2000. Under subsection 6(3), a supply or acquisition of real property is made when the property is made available to the recipient. With a building or civil engineering work, this would normally occur when the building or work is completed.

9. Because of this, where completion is on or after 1 July 2000, the entire supply would (without a special transitional rule) be subject to GST, even if most of the work and materials were provided before 1 July 2000.

10. To prevent this outcome, subsection 19(3) provides that Goods and Services Tax ('GST') is calculated only on the excess of the value of the total supply over the value of work and materials permanently incorporated or affixed on the construction site at the start of 1 July 2000.

11. The value of work and materials as at the start of 1 July 2000 will be excluded from GST only to the extent that the value is determined in a manner specified by the Commissioner.[1]

Construction Project

12. Section 19 applies to a supply that is the construction, major reconstruction, manufacture or extension of a building or civil

[1] Subsection 19(4).

engineering work. A supply of this kind is referred to in this Ruling as a 'construction project'.

13. A construction project includes:

(i) the building of a house, apartment block, warehouse, factory or office block;

(ii) extending a house to add an extra bedroom, or extending a hospital by adding a new wing;

(iii) the construction of a road, a tunnel, a dam or a bridge.

Head contractor

14. For the purposes of this Ruling, a head contractor is a contractor who supplies a construction project on or after 1 July 2000, under a written agreement entered into before 1 July 2000.

Ruling

15. A head contractor may value the work and materials permanently incorporated in or affixed to the site of a building or civil engineering work under one of three methodologies (Options A-C). These are:

(A) total of approved progress claims to 1 July 2000 see paragraphs 26 to 35);

(B) uniform increase between approved progress claims (see paragraphs 36 to 38); and

(C) independent valuation by a 'recognised person (see paragrpahs 39 to 52)'.

Explanations (this forms part of the ruling)

Contractors and section 19

16. The supply referred to in section 19 is the supply of the entire construction project. This intention is made clear in the Explanatory Memorandum to *A New Tax System (Goods and Services Tax Transition) Bill 1998* at paragraph 2.76:

> Particular points to note about this provision include:
>
> The supply is the supply of the total construction project itself as provided for in the agreement, not the components in its creation;

17. Section 19 generally does not apply to an agreement involving a subcontractor, as a supply under such an agreement is typically not a supply of a complete construction project. A subcontractor is typically engaged by a head contractor to supply components of the complete construction project.

18. However, section 19 will apply to an agreement between a subcontractor and a head contractor if the agreement is for the supply of a complete construction project.

19. For example, section 19 will apply to a subcontract agreement for the construction of a complete bridge, where that bridge forms part of the supply by a head contractor of several kilometres of roadway.

What is the 'operative date'

20. Under subsection 19(2), the value of work and materials must be determined 'as at the start of 1 July 2000'. This is in line with the general premise of the Transition Act that GST is only payable on a supply to the extent it is made on or after that date.[2]

21. However, under section 13, supply under a written agreement made before 8 July 1999 may remain GST-free beyond 1 July 2000, depending on the date and terms of the agreement.

22. If section 13 applies to an agreement under this Ruling, the date for valuation becomes the earlier of 1 July 2005 and the date the first review opportunity under the agreement arises.[3]

23. The date valuation is required under a particular agreement is referred to in this Ruling as its 'operative date'. The operative date cannot occur before 1 July 2000.

24. For the purposes of this Ruling, we will assume the operative date is 1 July 2000 although readers should be aware that it may be a later date.

25. We explain section 13 in greater detail in Draft Goods and Services Tax Ruling GSTR 1999/D11 ('Transitional arrangements – GST-free supplies under existing agreements').

The valuation methodologies

Option A - Total of approved progress claims to 1 July 2000

26. Under this option, the 1 July 2000 valuation of work and materials will be the sum total of all approved progress claims made for the construction project prior to 1 July 2000. This total will

[2] Section 7.
[3] Subsection 19(5).

include claims approved on or after 1 July 2000 in respect of progress achieved before that date.

27. For Option A to apply, payments under the construction agreement must be approved by a suitably qualified person designated under the agreement. Typically this would be a quantity surveyor or an architect.

28. The designated person should certify either the progress made during a period (e.g., monthly progress claim for work done in that period) or that a particular stage of construction, as specified in the construction agreement, has been completed.

Residential houses

29. An agreement for the construction of a residential house may not have a suitably qualified person designated to certify progress claims. In cases where a financial institution is funding the construction of a residential house, the financial institution may approve the progress claim itself.

30. The release of funds by a financial institution financing the construction of a residential house will be taken to be an approved progress claim for the purposes of Option A, provided:

(i) funding of the construction of the residential house has been made available by the financial institution on a draw-down basis as specified stages of completion are reached; and

(ii) the financial institution satisfies itself that the claimed stage of completion has been reached prior to releasing the funds.

Retentions

31. Construction agreements generally provide for a percentage (e.g., 5%) to be retained from each progress payment to the head contractor. These funds may not be released until some time after the project has been completed to ensure work of a satisfactory standard.

32. For the purposes of determining the valuation under Option A, the total of approved pre-1 July 2000 progress claims should include all deductions made under retention arrangements.

Example 1

33. Buildsmall Pty Ltd ('Buildsmall') has been contracted by Joe Big Bucks to build a warehouse on industrial land. The building work is commenced on 1 March 2000 and it is estimated that the job will take 12 months to complete. Under the agreement, Buildsmall lodges

monthly progress claims, which are reviewed by an architect, as the designated person under the agreement.

The following table sets out Buildsmall's payment details for progress claims lodged before 1 July 2000.

Date progress claim is lodged	Date approved	Amount approved (including retention amount)	Amount paid net of retention amount (5%)
23 March	10 April	$102,000	$96,900
23 April	10 May	$70,000	$66,500
23 May	10 June	$55,000	$52,250
23 June	10 July	$73,000	$69,350
Total		$300,000	$285,000

If Buildsmall adopts Option A, the value of work and materials at the start of 1 July 2000 will be $300,000.

Note that in this example, Option A would not reflect the value of the work and materials affixed on site on or after 23 June.

Materials must be permanently incorporated or affixed

34. Some construction agreements allow for the head contractor to be paid for unfixed materials stored on site, or for manufactured work fabricated off-site. Subsection 19(2) does not allow the inclusion of these items in the valuation.

35. For the Option A valuation, where approved progress claims have included an amount for materials not permanently incorporated in or affixed to the construction project, the claim total must be reduced to reflect the extent to which those materials have not been incorporated or affixed as at the start of 1 July 2000.

Option B - Uniform increase between approved progress claims

36. Option B, like Option A, is based on the total of approved progress claims. The same requirements regarding approval of progress claims apply, as do the treatment of retention amounts and unaffixed materials.

37. However, Option B differs in that it will reflect work done on site up to the start of 1 July 2000. Option B treats the increase in the total approved progress claims from the last claim date before 1 July 2000 to the first claim date afterwards as having occurred uniformly on a daily basis.

Example 2

38. Mario is a builder who is constructing a house for Gustav on Gustav's land, under a written agreement made in March 2000. In accordance with the agreement, Mario can make progress claims only as the house reaches certain stages of completion specified in the agreement. Gustav's bank has approved a loan for the construction of the house and will release funds on a draw-down basis as the stages of completion are reached.

The construction reachs a specified stage on 10 June and Mario duly makes a claim. The claim is approved, making the total of claims approved to that date $90,000.

Further significant progress is made before 30 June, but the next specified stage is not reached until 10 July. Mario's claim on reaching that stage is $30,000, which is duly approved by the bank. There are 30 days from 11 June to 10 July inclusive. Option B treats the $30,000 as having occurred evenly on a daily basis, that is $1,000 a day.

Mario chooses Option B for his valuation. The valuation is $110,000 ($90,000 plus $20,000 for progress from 10 June to 30 June).

Option C – Independent valuation by a 'recognised person'

39. Under this option, you engage the services of an independent, appropriately qualified person, or 'recognised person', to determine the 1 July 2000 valuation.

40. This may be the appropriate option for you if:

(a) you are not satisfied that Options A or B will give an accurate valuation of work and materials at 1 July 2000; or

(b) work is not being undertaken on a progress claim basis.

41. Having Options A and B available to you does not prevent you from choosing this option. If you have an in-house employee with the same qualifications or experience as a recognised person, that employee may conduct the valuation, provided you have maintained adequate records.

42. A recognised person may adopt different approaches to determining the valuation under this option. Two approaches are outlined below in paragraphs 43 and 44. It is essential that the approach to valuation used is soundly based and reasonable, taking into account the characteristics of the job being valued.

43. In Example 3, the valuation is determined by taking the cost of materials used and work undertaken until 1 July 2000 and adding a profit margin based on the profit margin estimated for the job.

44. In Example 4, the total of approved progress claims made before 1 July 2000 is taken as a base. The value of work and materials incorporated into the job between the last progress claim and the start of 1 July 2000 is then added to this.

Example 3

45. In May 2000, Complete Constructions Pty Ltd enters a contract to construct an inground swimming pool for Springbuck City Council. The project commences on 1 June 2000 and no progress claims are made until 15 July 2000. As a substantial amount of work has been completed on the swimming pool, Complete Constructions engages a quantity surveyor to value the work and materials permanently incorporated or affixed to the site as at the start of 1 July 2000. The value of work and materials is determined as follows:

Valuation component at the start of 1 July 2000	**Amount**
Cost of materials affixed to the swimming pool site	$25,000
Cost of work done re swimming pool site	$55,000
Profit margin allocated to work done as at 30 June 2000 based on the estimated profit margin (10%) for the finished swimming pool	$8,000
Total	$88,000

Complete Constructions may use $88,000 under Option C as the value of work and materials incorporated in or affixed to the swimming pool site at the start of 1 July 2000.

Example 4

46. In January 2000, DEF Ltd entered into an agreement to build a shopping complex for XYZ. The project commenced in February 2000. Trevor is an architect. As the person designated under the agreement, Trevor has previously approved progress claims totalling $750,000. The last claim date was 20 May 2000.

Trevor values the work and materials permanently incorporated or affixed to the site as at the start of 1 July 2000 at $1,000,000. Trevor's valuation is based on the total of his previous approvals plus his valuation of the further work and materials affixed, from 20 May to the start of 1 July 2000.

What is a 'recognised person'?

47. For the purposes of this Ruling, a recognised person is either:

(i) a member of a body or association listed below; or

(ii) registered as a quantity surveyor, architect, valuer, civil engineer, or land surveyor under State or Territory law.

- Australian Institute of Quantity Surveyors;
- Royal Australian Institute of Architects;
- Australian Property Institute[4];
- Institution of Engineers of Australia; or
- Association of Consulting Surveyors Australia

48. In addition, the Commissioner will accept valuations from registered persons in these professions who have full professional qualifications from New Zealand or the United Kingdom.

When is the valuation to be ascertained?

49. The valuation at the start of 1 July 2000 should be determined on or before the end of your first tax period after that date. This will generally be 31 July 2000 if you have elected a one month tax period, or 30 September 2000 for a three monthly tax period. These dates will be later if your operative date is after 1 July 2000.

50. However, subsection 19(5) gives the Commissioner a discretion to allow a later date for the valuation to be determined. A later date may be needed by suppliers using a monthly tax period where Option B is chosen, and the first specified stage of completion after 1 July 2000 is not reached by month end.

51. The Commissioner will allow you a later date for the determination of the operative date valuation provided:

(a) the agreement for the construction project allows you to make progress claims only on reaching specified stages of completion, regardless of the time between stages; and

[4] NB, a member of the Australian Property Institute must be accredited as a Certified Practising Valuer to be a recognised person.

(b) you have elected a monthly tax period;

(c) you choose to value under Option B;

(d) the first post-1 July 2000 specified stage has not been completed by the end of the first tax period.

52. If the above circumstances apply to you, the later date for the valuation will be the earlier of the end of the tax period in which the specified stage of completion is reached, or 30 September 2000.

Detailed contents list

53. Below is a detailed contents list for this Draft Ruling:

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Your comments

54. If you wish to comment on this draft Ruling, please send your comments promptly by **28 April 2000** to:

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Commissioner of Taxation
29 March 2000

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Not previously issued in draft form.

Related Rulings/Determinations:
GST Bulletin GSTB 1999/2

Subject references:
- agreements spanning 1 July 2000
- building or civil engineering work
- construction project
- head contractor
- one month period
- real property
- recognised person
- special transitional rule
- subcontractor
- three month period
- time of supply
- valuation

Legislative references:
- ANTS(GSTT)A 6(3)
- ANTS(GSTT)A 7
- ANTS(GSTT)A 19(1)
- ANTS(GSTT)A 19(2)
- ANTS(GSTT)A 19(3)
- ANTS(GSTT)A 19(4)
- ANTS(GSTT)A 19(5)

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