GSTR 2002/D7 - Goods and Services Tax: inducements to enter into a lease of commercial premises

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There is an Erratum notice for this document.
This document has been finalised.

Draft Goods and Services Tax Ruling

Goods and Services Tax: inducements to enter into a lease of commercial premises

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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 practitioners. When officially released as a final Ruling it will be a public ruling for the purposes of section 37 of the Taxation Administration Act 1953 and may be relied upon by any entity to whom it applies.

What this Ruling is about

1. This Ruling explains how inducements provided by a landlord (lessor) or a tenant (lessee) to enter into a lease of commercial premises should be treated under the *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). Such inducements are referred to in the Ruling as **lease inducements** and include **lease incentives** and **lease premiums**.

2. Certain terms used in this Ruling are defined or explained in the Definitions section of this Ruling. These terms, when first mentioned, appear in **bold** type.

3. In the examples used in this Ruling, all parties are registered for GST unless otherwise specified.

4. All legislative references in this Ruling are to the GST Act unless otherwise specified.

Date of effect

5. This draft Ruling represents the preliminary, though considered, views of the Australian Taxation Office. This draft may not be relied on by taxation officers, taxpayers or practitioners. When the final Ruling is officially released, it will explain our view of the law as it applied from 1 July 2000. The final Ruling will be a public ruling for the purposes of section 37 of the *Taxation Administration Act 1953* and may be relied upon, after it is issued, by any entity to whom it applies. Goods and Services Tax Ruling GSTR 1999/1

explains the GST rulings system and our view of when you can rely on our interpretation of the law in GST public and private rulings.

Background

6. An inducement provided by a landlord for a tenant to agree to enter into a lease is commonly referred to as a 'lease incentive'. A landlord may offer this form of inducement for a variety of reasons including recognition that the market requires that some inducement be offered to attract key tenants, maintaining the **face rent** for the property, and improving occupancy rates.

7. A tenant may provide an inducement for the agreement of the landlord to enter into a lease. This consideration may be provided by a tenant for a number of reasons, such as a shortage of desirable premises, or as an inducement to obtain priority treatment. For the purposes of this Ruling we refer to these payments as lease premiums.

8. Inducements may be in the form of monetary consideration, non-monetary consideration or a combination of both.

9. Cash inducements may include a reimbursement of expenses, or a payment made for a particular purpose, for example:

- a contribution to the whole or part of the tenant's costs of fitting out the premises;
- a payment for removal expenses.

10. Non-monetary inducements may include:

- building works (e.g., fit-outs) to adapt the premises to the particular requirements of the tenant;
- income guarantees;
- the provision of plant, computer equipment, motor vehicles, holidays, art work, etc;
- landlord agreeing to pay a tenant's rental under an existing lease.

11. In addition to the above inducements this Ruling considers rent-free (rent holiday) and rent discount periods.

12. In some cases, where one party provides a non-monetary inducement to another party, both the landlord and tenant may be liable for GST on the value of their supply.

13. For there to be a separate GST consequence in relation to an inducement it is necessary for:

- there to be a supply of an agreement to enter into a lease which is separate from the supply of the premises; and
- the inducement to be the consideration for the agreement to enter into the lease.

14. Many lease transactions involve exchanging various rights and obligations between the parties to the transaction. It is sometimes necessary to offer consideration to induce a party to enter into a lease. Whether this inducement is consideration for the supply of the premises, or is consideration for a separate supply of agreeing to enter into the lease, will depend on the facts and terms of the individual arrangement.

15. It is not appropriate to regard every obligation of benefit or economic value, that arises under a lease as consideration for a separate supply. For example, where the terms of a lease include an obligation by the tenant to repair any damage done and return the premises to their condition at the commencement of the lease (i.e., 'make good' provisions), the entry into the obligation will not be a supply by the tenant nor is it part of the consideration for a supply. It is merely part of the terms and conditions of the lease.[1]

16. However, where the tenant undertakes to carry out work on the premises to obtain the agreement of the landlord to lease the premises, there is a separate supply by the landlord. In this case, the consideration (that is the work carried out by the tenant) is for the separate supply of the agreement by the landlord. It is a separate supply rather than merely a condition of the lease, and it is also consideration for the agreement of the landlord.

17. In circumstances where it is concluded that the inducement is provided to a party to agree to enter into the lease, there may be a taxable supply. This agreement stands apart from the supply of the premises.

18. Where the inducement is consideration for the separate supply of agreeing to enter into the lease, that supply may, in certain circumstances have a different GST consequence to the supply of the premises. This Ruling considers these separate supplies.

[1] See also New Zealand case *Iona Farm Ltd v Commissioner of Inland Revenue* 19 NZTC 15,261 where Young J rejected a literal focus on the concept of consideration which would have meant all obligations entered into under a lease should be taken into account separately in determining the value of a supply.

Ruling with explanation

19. A lease inducement is consideration provided to induce a party to agree to enter into a lease. The agreement for which the inducement is provided is a separate supply to the supply of the premises.

Separate supply

20. The concept that a lease inducement is consideration for something different to the lease of premises was discussed by Beaumont J in *Selleck v FC of T*.[2] Beaumont J stated:

> In my opinion, a lease incentive payment should be treated, in principle, as prima facie on capital account by reason of its character, that is, a payment made, in the nature of a premium, in consideration of a prospective lessee agreeing to accept the burdens (along with the benefits) of the proposed lease. The payment is an inducement to a prospective tenant to enter into the leasing transaction. As a separate and collateral arrangement, the agreement to pay this premium or incentive stands apart from, and necessarily precedes, the operation of the lease itself. In conveyancing terms, the incentive payment is an incident of the agreement for lease, rather than of the lease instrument itself … the amount is, I think, paid as a 'price' for the grant of the lease; it is a premium in that sense (see *Chelsea Investments Pty Ltd v FCT* (1966) 115 CLR 1 per Windeyer J at 8). It is the "purchase money which the [prospective lessee or prospective lessor] pays for the benefit which he gets under the lease" (see *King v Earl Cadogan* [1915] 3 KB 485 per Warrington LJ at 493; *Nixon v Doney* (1961) SR (NSW) 311 at 316).[3]

21. Where a landlord provides consideration as an inducement for the tenant's agreement to enter into a lease, the application of the GST Act does not permit the consideration for the supply of the premises by the landlord to be reduced by the amount provided as inducement for the tenant. Each transaction must be considered separately.[4]

22. This is consistent with the High Court decision in *FC of T v Montgomery*.[5] In that case, a majority of the High Court concluded that cash payments to induce a firm of solicitors to enter into a lease should not be offset against the rent prescribed in the lease to determine the real or market value rent:

> 86. In these circumstances, it is not accurate, at least for our purposes, to speak of some 'market rent' (calculated by reducing the

[2] (1997) 36 ATR 558; 97 ATC 4856
[3] (1997) 36 ATR 558 at 582; 97 ATC 4856 at 4877
[4] See also GSTR 2001/6, paragraph 125.
[5] (1999) 42 ATR 475; 99 ATC 4749

> face rent by the worth of the incentive that was paid) as if that represented the 'true' or 'real' market rent for the premises with which the face rent should be compared. The argument is one that depends upon an assumption or hypothesis that is artificial, if not positively contrary to the facts. The market produced a more complicated arrangement than the simple agreement to pay rent for the lease of premises; it produced an arrangement under which the lessee agreed to pay rent and the lessor agreed to pay an incentive. To speak in these circumstances of a 'market rent' calculated in the way suggested is to speak of an artificial construct. That is not to say that the product of the calculation may not have been of great utility to valuers. It may also have been a very useful tool in the hands of the business community when making business judgments. But it is not the rent for which the parties stipulated by the lease (or, in this case, their agreement for lease) and it is not the rent struck in the marketplace.
>
> 87. Further, because the agreements that were made represent the result of arm's length bargaining it must follow that the bargain struck represented what each party thought to be an acceptable set of terms. It is not useful to note that one party to the bargain would have preferred to undertake some less onerous obligation. Almost every party to a commercial transaction would prefer to have less onerous obligations. But in the absence of some choice about what level of rent would be paid, it cannot be said that the sums paid under the inducement agreement were received in return for an agreement to pay a higher rent.[6]

23. In rejecting the treatment of a lease incentive (inducement) as having the nature of a repayment of rent, the Court stated that the market had 'produced an arrangement under which the lessee agreed to pay rent and the lessor agreed to pay an incentive'.[7]

24. The issue of whether an inducement is consideration for a separate supply has been considered in several overseas cases. For example, the decisions in the UK case of *Customs and Excise Commissioners v Mirror Group plc*[8] and the New Zealand case *Wattie and Anor v Commissioner of Inland Revenue*.[9] These cases support the view that a lease inducement may be consideration for a separate supply.

25. An inducement will most commonly be provided for in the agreement to lease. However, whether the inducement is provided for in the agreement for lease, the lease or an addendum or variation to the lease, will not be determinative of its characterisation for the purposes of GST. The provision for the inducement in the lease rather

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[6] (1999) 42 ATR 475 at page 495; 99 ATC 4749 at pages 4764-4765
[7] (1999) 42 ATR 475 at page 495; 99 ATC 4749 at page 4764
[8] [1998] BVC 2188
[9] 18 NZTC 13297

than in a separate document will not necessarily result in a genuine inducement being treated as part of the consideration for the supply of the premises (i.e. rent) or a reduction in the consideration.

26. Lease inducements can be made by or received from any party to the lease as well as their associates or third parties.

Supply for consideration

27. The definition of taxable supply requires, amongst other things, that you make a supply for consideration.[10] Section 9-15 states that consideration includes any payment or any act or forbearance for a supply if the payment is "in connection with", "in response to or for the inducement" of a supply.

28. There needs to be a relationship or connection (nexus) between the supply and the payment, act or forbearance. Justice Graham Hill in his article, *Flagging for the Courts the problems of the GST*[11], said:

> …'consideration' means that even where the word is used in its ordinary sense, it has rather the meaning of 'what moved the supply' rather than the meaning it has in the law of contract.[12]

29. In deciding whether a sufficient nexus exists between a supply and consideration, regard must be given to the true character of the transaction. An arrangement between parties will be characterised not merely by the description that parties give to the arrangement, but by looking at all of the transactions entered into and the circumstances in which the transactions are made.[13]

Consideration

30. Where the landlord or tenant is making a supply, the consideration (inducement) for that supply may be monetary, non-monetary, or a combination of both.

31. Where the lease inducement is solely monetary consideration, the entity providing the inducement is not making a supply. Subsection 9-10(4) excludes from a 'supply' a supply of money unless the money is provided as consideration for a supply that is a supply of money.

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[10] Paragraph 9-5(a)
[11] The Tax Specialist Volume 3 No 6 June 2000 page 304 ff.
[12] Cf in the context of stamp duty where the word "consideration" has been held to be used not in its contractual sense, but rather in the sense of that which moves the conveyance or transfer: per Dixon J in *Archibald Howie Pty Ltd v Commissioner of Stamp Duties* (1948) 77 CLR 143 at 152.
[13] See GSTR 2001/6, paragraph 71

32. Where the lease inducement wholly or partly consists of non-monetary consideration, there are two separate transactions, each of which may give rise to a taxable supply. The provision of a thing that forms non-monetary consideration will itself be a taxable supply if all of the requirements of paragraphs 9-5(a) to (d) are met.

33. Where all or part of the consideration for a supply is non-monetary consideration, the GST inclusive market value of that consideration is used to work out the price and value of the supply. In most circumstances where parties are dealing at arm's length, we are of the view that the goods, services or other things exchanged are of equal GST inclusive value. However, other reasonable methods can be adopted to determine the GST inclusive market value of the consideration.[14]

Example 1 - non-monetary consideration and separate supplies

34. *A landlord provides a motor vehicle to the tenant as consideration for the tenant agreeing to enter into the lease, and the landlord supplies commercial premises to the tenant (see Appendix A for diagram which demonstrates the supplies in this case).*

35. *The tenant makes a taxable supply by agreeing to enter into the lease (paragraph 9-10(2)(g)).*

36. *The landlord is making two supplies, being the supply of the premises and the supply of the vehicle. The consideration for the supply of the premises is the rental payments received, and the consideration for the supply of the vehicle is the agreement to enter into the lease by the tenant. We accept in this case that the GST inclusive market value of the agreement to enter into the lease would be the same as the GST inclusive market value of the vehicle. However, other reasonable methods can be adopted to determine the GST inclusive market value of the consideration.*[15]

37. *The GST payable and input tax credits arising from the above described transactions are:-*

(a) Supply of agreement to enter into lease by tenant

Consideration provided by landlord is motor vehicle (GST inclusive market value $33,000)

GST payable by tenant $3,000

Input tax credit to landlord $3,000

(b) Supply of motor vehicle by landlord

[14] Paragraph 9-75(1)(b). See also GSTR 2001/6, paragraphs 138 to 158.
[15] See also GSTR 2001/6, paragraphs 138 to 158.

Consideration provided by tenant is agreement to enter into lease (GST inclusive market value $33,000)

GST payable by landlord $3,000

Input tax credit to tenant $3,000

(c) Supply of premises by landlord

Consideration provided by tenant is lease payments ($1,100 per month)

GST payable by landlord $100 per month

Input tax credit to tenant $100 per month

Supply made in course or furtherance of an enterprise

38. A supply by a landlord or a tenant in agreeing to enter into a lease will not be a taxable supply unless 'the supply is made in the course or furtherance of an enterprise' that the supplier carries on.[16]

39. In the context of a lease of commercial premises, such as in the example in paragraph 34, the supply made by a tenant (the agreement to enter into the lease) in return for a lease inducement (motor vehicle) will ordinarily be made in course of the tenant's enterprise.

40. Similarly, the leasing of premises by a landlord is of itself an enterprise. Therefore the supply of the car by the landlord in return for the tenant's agreement to enter into the lease will be made in course of that enterprise.

41. In recent years lease inducements, received as part of a business enterprise, have been considered by the Courts on a number of occasions.[17] In *FC of T v Cooling*, Hill J stated:

> Where a taxpayer operates from leased premises, the move from one premises to another and the leasing of the premises occupied are acts of the taxpayer in the course of its business activity just as much as the trading activities that give rise more directly to the taxpayer's assessable income.[18]

42. Furthermore, when considering the nature of a lease incentive in *FC of T v Montgomery*, the High Court concluded that it was received in the course of carrying on a business.[19]

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[16] Paragraph 9-5(b)
[17] See *FC of T v. Cooling* (1990) 22 FCR 42; 21 ATR 13; 90 ATC 4472; *Selleck v. FC of T* (1997) 36 ATR 558; 97 ATC 4856; *Lees & Leech Pty Ltd v FC of T* (1997) 36 ATR 127; 97 ATC 4407 and *FC of T v. Montgomery* (1999) 42 ATR 475; 99 ATC 4749; *O'Connell v Commissioner of Taxation* (2002) FCA 904.
[18] (1990) 21 ATR 13 at 26; 90 ATC 4472 at 4484
[19] (1999) 42 ATR 475 at page 503; 99 ATC 4749 at page 4769

43. The 'carrying on' of an enterprise 'includes doing anything in the course of commencement or termination of the enterprise'.[20] Therefore, for example, where a tenant in establishing a business receives an inducement from a landlord for agreeing to enter into a lease, the agreement may constitute a taxable supply.

Inducement provided to or paid by an associate

44. Where the inducement is provided to an associate of a party agreeing to enter into a lease, the inducement can still be consideration for the supply by that party. The payment is made in connection with the supply of that agreement. For example, a service company for a professional firm may agree to enter into a lease and the landlord pays the partners of the firm a lease incentive. The payment is consideration for the supply by the service company even though the company itself does not receive the payment.

45. In the New Zealand case *S41, TRA No 31/95,*[21] the lease agreement provided that the lessor pay the partners (associates) an inducement of $137,000 in return for the taxpayer (the partnership) entering into the lease agreement. The Taxation Review Authority held that there was a supply of services by the taxpayer (partnership) and that supply was made in the course or furtherance of the taxable activity carried on by the taxpayer.

46. The obtaining of business premises was fundamentally part of the taxpayer's business activity. Although the taxpayer was not in the business of entering into leases, the leasing of suitable premises from which to conduct a taxable activity was part and parcel of the carrying on of the taxable activity. When the partners signed the Deed of Lease, they were acting as partners of the taxpayer firm: 'It was artificial to try to separate the inducement payments to the partners from the taxpayer's leasing transaction.'[22]

47. It would not alter the analysis of the transaction if an associate of the landlord provided the consideration for the supply by the tenant of the tenant's agreement to enter into a lease.

48. Similarly, where a landlord provides consideration to induce a holding company to procure one of its subsidiaries to enter into a lease with the landlord, the holding company will be making a supply to the landlord.

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[20] Section 195-1: definition of 'carrying on'
[21] 17 NZTC 7280
[22] 17 NZTC 7280 at page 7280

Inducements for leases of premises

Types of lease inducements

49. A number of types of lease inducements commonly provided by landlords are considered in the following paragraphs. Each lease inducement is examined for the purpose of determining whether there has been a taxable supply and the method of calculating the GST on the supply. In each case, it is assumed that the tenant as the party making the supply:

- is registered or required to be registered;
- agrees to enter into the lease in the course or furtherance of the tenant's enterprise;
- agrees to enter into the lease in Australia; and
- does so for consideration.

Cash incentives

50. Where a cash payment is paid to the tenant as an inducement to agree to enter into a lease, the payment of cash by the landlord to the tenant is consideration for the tenant agreeing to enter into the lease. The agreement to enter into the lease is a supply by the tenant that is subject to GST. The supply by the landlord of the premises is separate from the agreement to enter into the lease.

51. Where the landlord provides cash payments to the tenant, any requirement for the tenant to expend those payments on a particular item, or for a particular purpose, will not alter the GST payable on the supply by the tenant. However, where the payment is made because the tenant is acting as agent of the landlord in fitting out the premises, the payment will not be treated as consideration for the tenant's agreement to enter into the lease. In this case, the landlord is merely expending funds on the premises, rather than providing an inducement to the tenant.

52. If the supply by the tenant is a taxable supply then the tenant will be liable for GST equal to one-eleventh of the consideration received. Where a condition of the cash inducement is that it is repaid in part or full if the lease is terminated before a certain date, the termination will give rise to an adjustment event under Division 19.

Fit-out incentives

53. In some circumstances the landlord may agree to provide a fit-out of the premises as an inducement to the tenant. The terms of the fit-out agreement may take a number of forms.

54. Where the landlord provides a fit-out of the premises as an inducement to the tenant to enter into the lease, and retains ownership of the fit-out, this is not consideration for the agreement to enter into the lease by the tenant. The landlord will only be providing a supply of premises for rental consideration. The supply of the fit-out is part and parcel of the supply of the leased premises.

55. Where the tenant is acting in the capacity of agent of the landlord in fitting out the premises, and the landlord retains ownership of the fit-out, the cash payment by the landlord will not be consideration for the tenant's agreement to enter into the lease.

56. Similarly, a cash reimbursement of all or part of the tenant's expenditure on the fit-out will be treated in the same way as a payment to undertake the fit-out where the tenant is acting as the landlord's agent and the landlord retains ownership of the fit-out. The reimbursement will not be consideration for the tenant's agreement to enter into the lease.

57. However, where a landlord contributes an amount equivalent to the amount expended by the tenant on a fit-out owned by the tenant, this will be treated in the same way as other cash inducements paid by the landlord. The agreement to enter into the lease is a supply by the tenant. The supply is subject to GST and the consideration is the cash payment. What the tenant uses the cash for is not relevant.

Example 2 - fit-out incentives

58. Grant agrees to enter into a lease of Tracey's commercial premises by the beach. To induce Grant to agree to enter into the lease, Tracey agreed to contribute to the cost of Grant's partitioning of the premises. Grant does not act as Tracey's agent in commissioning the fit-out. The fit-out is owned by Grant.

59. The fit-out of the leased premises is completed and Grant pays $10,000 to the contractor. Tracey pays Grant for the cost of the fit-out.

60. Grant makes a supply to Tracey by agreeing to enter into the lease. The contribution by Tracey to the cost of the fit-out is consideration for Grant's agreement to enter into the lease. Therefore, the supply made by Grant will be a taxable supply. Grant is liable for GST calculated as one-eleventh of the consideration.

61. Where the tenant agrees to enter into a lease in consideration of the fit-out being completed by the landlord, and ownership of the fit-out passes on completion to the tenant, this will be separate consideration for the agreement to enter into the lease by the tenant. The tenant is liable for the GST of one-eleventh of the GST inclusive

market value of consideration for the supply.[23] The market value of the fit-out should be determined by the value of the fit-out at the time ownership of the fit-out passes. The landlord is also making a supply of the fit-out for non-monetary consideration, that being the agreement to enter into the lease.

62. Example 2 assumes that the fit-out comprises chattels and ownership passes to the tenant immediately. The same principles would apply to the extent that the chattels comprising the fit-out become fixtures if the tenant has a right to remove the fixtures on expiry of the lease. Although the tenant does not have legal title to the fixtures, the tenant nevertheless obtains a valuable interest in them.

Income guarantees

63. A landlord may agree to guarantee a tenant's income from the business operated from the premises if the tenant agrees to enter into a lease. The supply by the tenant is the entry into the agreement and the consideration is the GST inclusive value of the guarantee at the time of entry into the guarantee.

64. The tenant is liable for GST of one-eleventh of the GST inclusive market value of the consideration for the supply (i.e., the guarantee).[24]

65. The landlord also makes a taxable supply of the guarantee. Arrangements of this nature, although described as guarantees, are neither guarantees nor indemnities for the purposes of regulation 40. A guarantee for the purpose of regulation 40 is an arrangement under which a third party agrees to be liable for the debt, default or miscarriage of another (in this instance, the tenant). An indemnity is a contractual obligation under which a person assumes primary responsibility for the debt or undertaking of another. The income guarantee does not have the character of either of these arrangements, and consequently is not a financial supply for the purposes of regulation 40. The consideration for the supply of the guarantee is the GST inclusive market value of the tenant's agreement to enter into the lease.[25]

Plant

66. Where the landlord provides plant as an inducement for the tenant's agreement to enter into the lease and that plant becomes owned by the tenant, the tenant makes a taxable supply of the

[23] See paragraph 33 and GSTR 2001/6, paragraphs 138 and 158
[24] See paragraph 33 and GSTR 2001/6, paragraphs 138 and 151
[25] See GSTR 2002/2 for further discussion.

agreement to enter into the lease and the consideration is the plant provided by the landlord.

67. The tenant is liable for GST of one-eleventh of the GST inclusive market value of the plant. The landlord will also make a taxable supply of the plant, in addition to the supply of the premises. As the consideration for the landlord's supply is not expressed in money, the GST payable by the landlord is one-eleventh of the GST inclusive market value of the agreement to enter into the lease.[26]

Example 3 - inducement to enter into a lease

68. *Liz, a landlord, provides computer equipment to Tom as an inducement for Tom to enter an agreement to lease premises. Tom makes a taxable supply by agreeing to enter into the lease, the consideration for which is the supply of the computer equipment. Tom pays GST on the GST inclusive market value of the computer equipment. Liz makes a taxable supply of computer equipment, the consideration for which is Tom's agreement to enter into the lease. Liz also makes a taxable supply of the premises under the lease the consideration for which is the rent. Liz pays GST on both supplies.*

Landlord agrees to pay the tenant's rent under an existing lease

69. A tenant may have an existing lease, and a new landlord may agree to pay the tenant's rental under the existing lease if the tenant will agree to enter into a new lease. Payments by the new landlord under such an arrangement are consideration for a taxable supply by the tenant but are not a supply by the new landlord.[27]

70. The tenant is liable for GST of one-eleventh of the amount paid by the new landlord to the tenant's previous landlord.

Landlord accepts the assignment of the tenant's existing lease

71. Where a landlord accepts the assignment of a tenant's lease with another landlord as an inducement for a tenant to agree to enter into a new lease, the tenant makes a taxable supply of the agreement to enter into the lease. The landlord's acceptance of the obligations under the lease by way of the assignment is the non-monetary consideration for this supply. The tenant is liable for GST of one-eleventh of the value of the obligations accepted under the assignment.

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[26] See paragraph 33 and GSTR 2001/6, paragraphs 138 and 151.
[27] Subsection 9-10(4).

72. There is also a supply by the landlord, which is the acceptance of the obligations of the lease under the assignment. The non-monetary consideration for this supply is the agreement by the tenant to enter into the new lease. As neither the consideration for the landlord's supply nor the tenant's supply is expressed in money, we will accept that the goods, services or things exchanged are of equal GST inclusive value. However, other reasonable methods can be adopted to determine the GST inclusive market value of the consideration.[28]

Other supplies as consideration

73. Where the landlord provides a holiday package or other kinds of non-monetary consideration to the tenant as an inducement to agree to enter into a lease, the tenant makes a taxable supply. The holiday package or other supply is separate consideration for that agreement.

74. The tenant is liable for GST of one-eleventh of the GST inclusive market value of the holiday package or other non-monetary consideration. The landlord will also make a taxable supply of the holiday package or other non-monetary consideration, in addition to the supply of the premises. As the consideration for the landlord's supply (e.g., holiday package) is not expressed in money, the GST payable by the landlord is one eleventh of the GST inclusive market value of the agreement to enter into the lease.[29]

Rent-free or rent discounted period – no separate supply

75. In some circumstances, a landlord may offer a rent-free or rent discount period at the start of a lease.

76. However, in this situation there is only one taxable supply being the supply of the premises for the rental. Ordinarily, the GST will be attributed to tax periods progressively as the rent is received (in the case of a landlord who accounts on a cash basis) or in accordance with Division 156. This means that in respect of the rent-free periods no GST will be attributable.

Example 4 - rent-free period – no separate supply

77. *Seaside Property Co constructs a new shopping centre in a popular beachside community and is seeking appropriate tenants to give the centre the desired mix of businesses for that location. Max operates his business from a shop in a nearby shopping centre. Max's existing lease for his current business premises expires in 12 months.*

[28] Paragraph 9-75(1)(b). See also GSTR 2001/6, paragraphs 138 to 158.
[29] See paragraph 33 and GSTR 2001/6, paragraphs 138 and 151.

78. *Seaside Property Co approaches Max and offers him premises in the new centre rent-free until his existing lease expires in twelve months time, if he moves his business to the new premises. Max agrees and enters into a five-year lease. Seaside Property Co has made one supply being the supply of the leased premises. No GST will be attributable during the rent-free period. Following the end of the rent-free period, GST will be attributable in accordance with Division 156.*

79. Where a rent discount (reduced rent) is applicable for a specified period, GST is only payable on the reduced rent for the supply of the premises during this reduced rent period. During the reduced rent period there is a reduction in the consideration for the supply of the premises. There is only one supply being the supply of the premises. The granting of the rent discount is not a supply or consideration for a supply.

Rent-free or rent discount period in exchange for service

80. In some circumstances a landlord may offer a rent-free period or rent discounted period at the start of a lease in exchange for something which the tenant agrees to do (e.g., carrying out repairs which benefit the landlord). Where this occurs there is a supply of the premises by the landlord, the consideration for which is a combination of monetary (the rents received) and non-monetary (the thing the tenant agrees to do). By providing the non-monetary consideration the tenant is also making a supply of the thing that the tenant does (e.g., carry out the repairs).

81. The consideration for the tenant's supply of services is non-monetary consideration, being the supply of the premises during the rent-free period or at the discounted rent. In the case of a rent-free period, the consideration for the tenant's supply is the GST inclusive value of the supply of the premises for that period.

82. In the case of a rent-discounted period, the consideration for the tenant's supply is the difference between the GST inclusive market value of the supply of the premises during that period and the discounted rent for the period.

83. The supply by the tenant forms part of the consideration for the supply of the premises by the landlord. That is, the consideration for the supply of the premises is the rental and the GST inclusive market value of the thing the tenant agreed to do (e.g., the repairs).

Example 5 - rent-free period in exchange for services

84. *Property Holdings Ltd owns a shopping centre and is seeking appropriate tenants to give the centre the desired mix of businesses*

for that location. Wendy operates her travel business, Wendy Travel Pty Ltd (WT), from a shop in a nearby shopping centre.

85. *Property Holdings Ltd approaches WT and offers it a five year lease of the premises in the shopping centre rent-free for the first 6 months on the condition that it provide free travel services to the value of $20,000. WT agrees and enters into a five-year lease. Property Holdings Ltd has made one supply being the supply of the leased premises. This supply is a taxable supply. During the rent-free period the consideration is the GST inclusive market value of the supply made by WT, being the value of the travel provided. Following the end of the rent-free period, the consideration is the lease rentals.*

86. *WT has also made a supply, being the travel services. The consideration is the GST inclusive market value of the supply of the premises during the rent-free period. We accept that the GST inclusive value of the rent-free period would equal the GST inclusive value of the travel. However, other reasonable methods can be adopted to determine the GST inclusive market value of the consideration.*[30]

Lease premiums

87. Traditionally, a lease premium applied to a rent controlled environment and was a term used to describe a payment made by a tenant to a landlord as additional rent. The only supply was the supply of the premises and the consideration for that supply was the combination of the rent and the lease premium. However, over time commercial practices have changed and in today's commercial environment this term is also used to describe a payment made by a tenant to the landlord for something other than the supply of the premises, that is, it is for a separate supply.

88. For example, a tenant may provide consideration to a landlord to induce a landlord to enter into an agreement to grant a lease of premises. The supply by the landlord is the entry into the agreement to grant the lease, rather than the supply of the premises, and the consideration is the premium paid by the tenant.

89. This is to be contrasted with those situations where an amount is paid over and above the lease payments but is still for the one supply being the supply of the premises.

90. The Full Federal Court in *FC of T and Krakos*[31] characterised a lease premium as follows:

> A sum will be a premium where it is paid as consideration for the grant of a lease. The expression is used in contradistinction to rent,

[30] See also GSTR 2001/6, paragraphs 138 to 158.
[31] 96 ATC 4063

> which is the consideration payable under the lease for the right of use and occupation of the leased premises during the term of the lease.

91. The character of a payment may not necessarily be determined by the description given to it by the parties to a contract. In *Radaich v. Smith*[32] McTiernan J said:

> …the parties cannot by the mere words of their contract turn it into something else. Their relationship is determined by the law and not by the label they choose to put on it.

92. Further, in *Rotherwood Pty Ltd v FC of T* [33] Lee J stated:

> The description of the payment in the contract may be only part of a matrix of facts from which the character of the payment, as paid or received, is to be determined: see *Reuter v FCT* (1993) 27 ATR 256 at 261-2; 93 ATC 5030 at 5036; *FCT v Cooling* (1990) 22 FCR 42 at 53 per Hill J.

93. In *Frazier v Commissioner of Stamp Duties (NSW)* [34] the Court stated:

> …the whole of the circumstances must be looked at, for the question to be decided is whether in fact - and this involves the construction of the deed as well as other relevant evidence if any - this amount was paid as a consideration for the granting of the lease or whether it is a payment intended as rent for the supply of the premises.

94. Whether a payment to a landlord by a prospective tenant is rent or a lease premium must be determined in the light of particular facts and circumstances. There are occasions when, based on all the facts, an amount referred to as a lease premium should be characterised as a rental payment as shown in the example below. Where the true character of the transaction is that the consideration is not a genuine inducement but is part of the consideration for the supply of the premises, the payment will be treated as rent for GST purposes.[35]

Example 6 - an up front payment that is for the supply of the premises and is 'rent'

95. *Jo, a landlord, is experiencing cash flow difficulties. She offers Retail Holdings Co the lease of a building on very attractive terms if Retail Holdings Co will make an up-front payment of a premium of $50,000 in addition to a reduced monthly rental.*

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[32] (1959) 101 CLR 209, and IT 2002/14 paragraph 133
[33] 96 ATC 4203; 32 ATR 276
[34] (1985) 17 ATR 64
[35] See GSTR 2000/35, paragraph 71

96. *The payment by Retail Holdings Co is not an inducement to agree to enter into the lease. For GST purposes the payment is not consideration for the agreement to enter into the lease but is consideration for the supply of the premises.*

97. However, where the payment is clearly identifiable as being for something separate from the supply of the premises, and is provided to induce the landlord into taking on an obligation prior to the lease and separate to those obligations that normally flow from the lease, the payment will be in the nature of a lease premium.

Example 7 - lease premium that is an inducement for a separate supply

98. *Noelene, who operates Noelene's Beauty Salon, has been seeking premises in a specific locale, and with high exposure, to open a new shop. She finds premises being constructed by Property Developer Ltd that satisfies her particular requirements but knows that the premises will be in demand. Noelene approaches Property Developer Ltd offering it $10,000 to ensure her tenancy in the new building.*

99. *The payment by Noelene is an inducement for the agreement to grant the lease. Property Developer Ltd is making a taxable supply separate from the supply of the premises and GST payable will be 1/11th of $10,000, i.e., $909.09.*

Example 8 – lease premium that is an inducement for a separate supply

100. *Widget Property Co Ltd (WPC) owns a number of premises which it leases. Slew Corporation wants to operate one of its subsidiaries, Fast Ken's Fabricators Pty Ltd (FKF), at a specific location owned by WPC. Slew Corporation offers WPC $100,000 if it will lease the premises to FKF. The rent payable by FKF under the lease is the market rate.*

101. *The payment by Slew Corporation is an inducement for the agreement to grant the lease. WPC is making a taxable supply, being the agreement to grant the lease, separate from the supply of the premises and the GST payable will be 1/11th of the $100,000, i.e., $9,090.90. This is in addition to the GST payable on the rent.*

Liability for GST on a lease premium

102. Where the landlord receives a lease premium in return for agreeing to grant a lease, it is the landlord who is making the supply and the landlord who will have the liability for GST if it is a taxable supply.

103. Where the landlord receives a cash payment as a lease premium, the GST payable will be 1/11th of this amount.

104. Where the landlord receives non-monetary consideration for the agreement to grant the lease, the GST payable will be 1/11th of the GST inclusive market value of the consideration. For example, if the tenant agrees to undertake work on the premises in return for the landlord agreeing to grant the lease, the GST payable by the landlord will be 1/11th of the GST inclusive market value of the work undertaken.

105. In this example, the tenant is also making a supply, being the work undertaken, for consideration, which is the agreement to grant the lease. The GST payable by the tenant is 1/11th of the GST inclusive market value of the agreement to grant the lease. We accept this would equal the GST inclusive market value of the work undertaken.[36]

Definitions

106. **Face rent** - the rental specified in the lease without discount for any incentive.

107. **Lease inducement** - consideration provided by a party in order to persuade the other party to agree to enter into a lease.

108. **Lease incentive** - an inducement given by a lessor or a lessor's agent to entice a prospective tenant to enter into a lease of premises.[37]

109. **Lease premium** - a sum of money or other consideration given for the grant of any lease. A lease premium is an additional amount of consideration given by a lessee over and above the rent to obtain the lease of the premises.

110. The following terms used in this Ruling are defined in section 195-1 of the GST Act.

111. ***Consideration***, for a supply or acquisition, means any consideration, within the meaning given by section 9-15, in connection with the supply or acquisition.

Detailed contents list

112. Below is a detailed contents list for this draft Ruling:

[36] See GSTR 2001/6, paragraphs 138 and 151
[37] Butterworths Australian Legal Dictionary 1997

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Appendix A - Supplies where non-monetary inducement provided and premises leased

Your comments

113. If you wish to comment on this draft Ruling, please send your comments promptly by 11 December 2002 to:

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Subject references:
- Commercial premises
- Consideration
- Face rent
- Lease incentive
- Lease inducement
- Lease premium

Legislative references:
- ANTS(GST)A 1999 9-5(a)
- ANTS(GST)A 1999 9-5(b)
- ANTS(GST)A 1999 9-5(c)
- ANTS(GST)A 1999 9-5(d)
- ANTS(GST)A 1999 9-10(2)(g)
- ANTS(GST)A 1999 9-10(4)
- ANTS(GST)A 1999 9-15
- ANTS(GST)A 1999 195-1
- TAA 1953 37

Case references:
- Commissioner *of Inland Revenue v Wattie* 18 NZTC 13297
- Commissioner *of Inland Revenue v Wattie* 18 NZTC 13991
- *FC of T v. Cooling* (1990) 22 FCR 42; 21 ATR 12; 90 ATC 4472*FC of T v Krakos* 96 ATC 4063
- *FC of T v. Montgomery* (1999) 42 ATR 475; 99 ATC 4749
- *Frazier v Commissioner of Stamp Duties (NSW)* (1985) 17 ATR 64
- *Iona Farm Ltd v Commissioner of Inland Revenue* 19 NZTC 15261
- *Lees & Leech Pty Ltd v. FC of T* (1997) 36 ATR 127; 97 ATC 4407
- *Mirror Group plc* [1988] BVC 2188
- *O'Connell v Commissioner of Taxation* (2002) FCA 904
- *Radaich v Smith* 101 CLR 209
- *Rotherwood Pty Ltd v FC of T* 96 ATC 4203; 32 ATR 276

- *Selleck v FC of T* (1997) 36 ATR558;
97 ATC 4856

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Appendix A

Supplies where non-monetary inducement provided and premises leased

(see Paragraph 34 of Ruling)

