GSTD 2012/1 - Goods and services tax: what are the goods and services tax consequences following the sale of residential premises that are subject to a lease?

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Goods and Services Tax Determination

Goods and services tax: what are the goods and services tax consequences following the sale of residential premises that are subject to a lease?

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[Note: This is a consolidated version of this document.]

Background

1. This Determination concerns the following goods and services tax (GST) issues:

   (a) whether a supply of residential premises by way of lease remains an input taxed supply under section 40-35 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)[1] following the sale of a reversion;

   (b) whether the purchaser of the reversion is entitled to input tax credits in connection with their acquisition of the reversion and other acquisitions; and

   (c) whether the purchaser of a reversion has an increasing adjustment under Division 135 if the sale of residential premises is, or is part of, the sale of a going concern.[2]

[1] All legislative references are to the GST Act unless otherwise indicated.
[2] The GST consequences for the purchaser of a reversion in commercial premises are addressed in Goods and Service Tax Determination GSTD 2012/2 *Goods and services tax: what are the goods and services tax consequences following the sale of commercial premises that are subject to a lease?*

2. In this Determination, when we refer to 'residential premises' we mean residential premises as defined in section 195-1 to be used predominantly for residential accommodation and that are not commercial residential premises. That is, premises the supply of which may be input taxed under sections 40-35 or 40-65.

3. In this Determination, the term 'reversion' refers to the freehold interest acquired when residential premises are sold subject to a lease. It also refers to the interest acquired when a leasehold estate is assigned subject to a sub-lease of residential premises. Both of these interests are a form of real property as defined in section 195-1.

4. [Omitted.][3]

Ruling

5. Following a sale of residential premises that are subject to a lease, the purchaser makes a supply of the premises by way of lease, which is an input taxed supply under section 40-35.

6. The purchaser of residential premises is not entitled to an input tax credit under section 11-20 in respect of the purchase of the premises if and to the extent that it is intended that the lease will continue following the completion of the sale.

7. The purchaser is not entitled to input tax credits for acquisitions relating to the ongoing lease of the residential premises.

8. The purchaser has an increasing adjustment under Division 135, where residential premises subject to a lease are acquired through a supply of a going concern under section 38-325, or a GST-free supply of farm land under section 38-480, and the purchaser intends that the lease will continue. When determining the proportion of non-creditable use in calculating the amount of any Division 135 adjustment, the price of the purchaser's intended supply of the residential premises by way of lease includes the rent to be paid under the lease.

9. In the following example, all of the entities are registered for GST.

Example – Sale of residential premises subject to a lease

10. *Property Ltd, as owner of all of the lots in a residential apartment complex in which each apartment is individually strata titled, leases the apartments to Management Pty Ltd under individual leases. Young Pty Ltd then purchases the lots from Property Ltd subject to the existing leases to Management Pty Ltd.*

11. *No GST is payable by Young Pty Ltd in relation to the leases because Young Pty Ltd does not make taxable supplies of the leases. Young Pty Ltd is not entitled to input tax credits in respect of the purchases of the apartments because it makes an input taxed supply of the apartments by way of lease after the sale. Additionally, Young Pty Ltd is not entitled to input tax credits for acquisitions associated with the purchases of the apartments, such as legal services, or for any acquisitions concerning the supply of the apartments by way of lease, such as management services, insurance and maintenance.*

[3] [Omitted.]

12. *The fact that Young Pty Ltd acquired the apartments subject to the existing leases indicates an intention at the time of the acquisition for the leases to continue. In the absence of evidence to the contrary, Young Pty Ltd would therefore have an increasing adjustment under Division 135 if it acquired the apartments as part of a GST-free supply of a going concern.*

12A. *When determining the proportion of non-creditable use as part of calculating any Division 135 adjustment, the price of the input taxed supplies of residential premises that Young Pty Ltd intends to make by way of lease includes the rent to be paid under the existing leases. If Young Pty Ltd only intends to make input taxed supplies of residential premises by way of lease through the enterprise it acquired, the amount of any Division 135 adjustment it has would be one tenth of the price of the supply of the going concern.*

Date of effect

13. This Determination applies both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
22 February 2012

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Continuing supply of leased premises

14. Where real property is sold subject to a lease, the purchaser acquires the 'reversion' in that real property.[4] Under common law and real property legislation operating in each State and Territory,[5] the rights and benefits under the lease continue to exist and are enforceable between the purchaser and the lessee following the sale.[6]

15. Consequently, the lessee maintains the right to possession of the property and has the obligation to pay rent. The purchaser acquires the benefit of the right to the rent payable by the lessee and is bound to permit their continued enjoyment of the leased property.

16. No separate or new lease need be entered into between the purchaser of the reversion (as new owner of the real property) and the existing lessee to ensure the continued operation of the lease.

17. In *Commissioner of Taxation v. MBI Properties Pty Ltd* (*MBI*)[7] the High Court found that, in addition to a supply arising when a lease is granted, on purchasing leased residential premises the purchaser assumed the vendor's obligation under the lease to provide the lessee with use and occupation of the premises.[8] The High Court concluded that as a result of assuming and observing this obligation, the purchaser made an input taxed supply of the residential premises by way of lease to the lessee progressively during the remaining lease term.[9]

GST consequences

Input taxed treatment following the sale of leased residential premises

18. The *MBI* decision confirms that, following the sale of leased residential premises, the purchaser makes a supply of the residential premises by way of lease to the lessee, which is input taxed under section 40-35.

19. Accordingly, the purchaser of a reversion in residential premises is not liable for GST in respect of the rent it receives.

20. [Omitted.] [10][11][12]

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[4] Butt, P 2010, *Land law*, 6th edn, Thomson Reuters, Sydney, p. 276.
[5] For example, see sections 117 and 118 of the *Conveyancing Act 1919* (NSW). Similar provisions are contained in real property legislation in the other States and the Australian Capital Territory and the Northern Territory.
[6] For example, see *Westley Nominees Pty Ltd v. Coles Supermarkets Australia Pty Ltd* [2006] FCAFC 115 at [13]. See also Butt, P 2010, *Land law*, 6th edn, Thomson Reuters, Sydney, pp. 375-8 and Bradbrook, AJ MacCallum, SV Moore AP and Grattan S 2011, *Australian Real Property Law*, 5th edn, Thomson Reuters, Sydney, pp. 643-644.
[7] [2014] HCA 49; 2014 ATC 20-474; (2014) 92 ATR 241.
[8] *MBI* at [40].
[9] *MBI* at [36] and [40].
[10] [Omitted.]
[11] [Omitted.]
[12] [Omitted.]

21. [Omitted.]

22. [Omitted.]

23. [Omitted.]

24. [Omitted.][13]

25. [Omitted.]

Input tax credits

26. Under section 11-20, a taxpayer is entitled to input tax credits for any 'creditable acquisition' they make. Section 11-5 contains the requirements for an acquisition to be a creditable acquisition.

27. Paragraph 11-5(a) requires that, for an acquisition to be a creditable acquisition, the acquisition must be solely or partly for a 'creditable purpose'. Paragraph 11-5(b) requires that the supply of the thing, for which an input taxed credit is claimed, be a taxable supply. The supply to a purchaser of residential premises that are not 'new residential premises' as defined in section 40-75 at the time of sale, is not a taxable supply.[14]

28. Paragraph 11-15(2)(a) provides that an acquisition is not for a creditable purpose to the extent that the acquisition relates to making supplies that would be input taxed.[15] A supply of residential premises by way of lease is an input taxed supply under section 40-35.

29. As decided in *MBI,* the purchaser of leased residential premises makes an input taxed supply of the premises by way of lease. Acquisition of the leased residential premises and acquisitions relating to the continuing lease of the premises, - like management services, repairs and maintenance,- have a sufficient relationship with the making of a supply that is input taxed for the purposes of paragraph 11-15(2)(a).[16]

30. Consequently, the purchaser of the reversion in residential premises is not entitled to input tax credits for acquisition of the reversion or acquisitions relating to the continuing supply of the residential premises by way of lease.

31. [Omitted.]

32. [Omitted.]

Division 135

33. The supply of a going concern is GST-free where the requirements of subsection 38-325(1) are satisfied. Additionally, section 38-480 makes the supply of land on which a farming business has been carried on GST-free in certain circumstances.

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[13] [Omitted.]

[14] This is because the supply of the premises is input taxed under section 40-65.

[15] Goods and Services Tax Ruling GSTR 2006/4 *Goods and services tax: determining the extent of creditable purpose for claiming input tax credits and for making adjustments for changes in extent of creditable purpose*, sets out the Commissioner's view on section 11-15 in more detail.

[16] *HP Mercantile Pty Ltd v. Commissioner of Taxation* [2005] FCAFC 126; (2005) 143 FCR 553; 2005 ATC 4571; (2005) 60 ATR 106; per Hill at [35]-[39] and [73]. See also *Rio Tinto Services Ltd v. Commissioner of Taxation* [2105] FCA 94; 2015 ATC 20-489 at [26].

34. Under subsection 135-5(1) the recipient of a supply of a going concern or a supply of farm land to which section 38-480 applies has an increasing adjustment if the condition in paragraph 135-5(1)(b) is satisfied.

35. For this to occur, paragraph 135-5(1)(b) requires that the recipient intends that some or all of the supplies, made through the enterprise to which the supply of the going concern or farm land relates, will be supplies that are neither taxable supplies nor GST-free supplies.

36. In the absence of contrary evidence, the fact that residential premises are acquired subject to an ongoing lease indicates that the purchaser intends to make a supply of the premises by way of lease.[17]

37. [Omitted.]

38. Since the supply of residential premises by way of lease is input taxed, it is neither a taxable supply nor a GST-free supply. Consequently, if the sale of residential premises subject to a lease is GST-free under section 38-325 or section 38-480, the purchaser has an increasing adjustment under Division 135 where the lease is to continue. The amount of the adjustment is calculated in accordance with subsection 135-5(2).

39. When determining the proportion of non-creditable use in calculating the amount of an adjustment under subsection 135-5(2), the price of a purchaser's intended input taxed supply of residential premises by way of lease, includes the rent to be paid under the lease.[18]

40. Where the purchaser only intends to make input taxed supplies through the enterprise related to the going concern or farm land it has acquired, the proportion of input taxed supplies expressed as a percentage calculated on the basis of the prices of those supplies (that is, the proportion of non-creditable use), is 100%. In these circumstances, the increasing adjustment under Division 135 is one tenth of the price of the supply of the going concern or farm land.

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[17] *MBI* at [40].

[18] *MBI* at [45]. The price, or, consideration within the meaning of section 9-15, for a supply of premises by way of lease will ordinarily include, and may for residential premises be limited to, the rent to be paid under the lease. However, depending on the circumstances, payments other than rent may also be consideration for the supply. See for example Goods and Services Tax Determination GSTD 2000/10 *Goods and services tax: are outgoings payable by a tenant under a commercial property lease part of the consideration for the supply of the premises?*

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

GSTD 2000/10; GSTD 2012/2; GSTR 2006/4; TR 2006/10

Subject references:

- creditable acquisition
- creditable purpose
- goods and services tax
- GST input tax credits & creditable acquisitions
- GST lease and real property
- GST sale of real property
- GST residential premises
- GST residential rents
- increasing adjustment

Legislative references:

- ANTS(GST)A 1999 9-10(2)(g)
- ANTS(GST)A 1999 11-5
- ANTS(GST)A 1999 11-5(a)
- ANTS(GST)A 1999 11-15
- ANTS(GST)A 1999 11-15(2)(a)
- ANTS(GST)A 1999 11-20
- ANTS(GST)A 1999 38-325
- ANTS(GST)A 1999 38-325(1)
- ANTS(GST)A 1999 38-480
- ANTS(GST)A 1999 40-35
- ANTS(GST)A 1999 40-65
- ANTS(GST)A 1999 40-75
- ANTS(GST)A 1999 Div 135
- ANTS(GST)A 1999 135-5(1)
- ANTS(GST)A 1999 135-5(1)(b)
- ANTS(GST)A 1999 135-5(2)
- ANTS(GST)A 1999 Div 156
- ANTS(GST)A 1999 195-1
- Conveyancing Act 1919 (NSW) 117
- Conveyancing Act 1919 (NSW) 118
- TAA 1953

Case references:

- Commissioner of Taxation v. MBI Properties Pty Ltd [2014] HCA 49; 2014 ATC 20-474; (2014) 92 ATR 241
- HP Mercantile Pty Ltd v. Commissioner of Taxation [2005] FCAFC 126; (2005) 143 FCR 553; 2005 ATC 4571; (2005) 60 ATR 106
- MBI Properties Pty Ltd v. Commissioner of Taxation [2013] FCAFC 112; 2013 ATC 20-420; (2013) 92 ATR 184
- Rio Tinto Services Ltd v. Commissioner of Taxation [2015] FCA 94; 2015 ATC 20-489
- South Steyne Hotel Pty Ltd v. Federal Commissioner of Taxation [2009] FCAFC 155; (2009) 180 FCR 409; 2009 ATC 20-145; (2009) 74 ATR 41
- Westley Nominees Pty Ltd v. Coles Supermarkets Australia Pty Ltd [2006] FCAFC 115; (2006) 152 FCR 461; 2006 ATC 4363; (2006) 62 ATR 682

Other references:

- Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998
- Bradbrook, AJ MacCallum, SV Moore AP and Grattan S 2011, Australian Real Property Law, 5th edn, Thomson Reuters, Sydney
- Butt, P 2010, Land law, 6th edn, Thomson Reuters, Sydney, p. 276
- Decision Impact Statement MBI Properties S90/2014.
- Decision Impact Statement South Steyne Hotel Pty Ltd NSD 97/2009

ATO references

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