

GSTD 2014/3 - Goods and services tax: do payments made by a vendor to a purchaser of real property when the rent received falls below a rental yield guaranteed by the vendor give rise to an adjustment event for the purposes of Division 19 of the A New Tax System (Goods and Services Tax) Act 1999?

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Goods and Services Tax Determination

Goods and services tax: do payments made by a vendor to a purchaser of real property when the rent received falls below a rental yield guaranteed by the vendor give rise to an adjustment event for the purposes of Division 19 of the *A New Tax System (Goods and Services Tax) Act 1999*?

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Ruling

1. Yes, payments¹ made to a purchaser of real property by the vendor when the rent received falls below the rental yield guaranteed by the vendor of the real property for a specified period, give rise to an adjustment event for the purposes of Division 19 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) when:

- the payments are made by the vendor, pursuant to a bilateral agreement between the vendor and the purchaser of the real property, and

¹ The relevant payment may consist of one or more payments made during, or at the end of, the rental guarantee period.

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- the guaranteed rental yield is a bona fide and reasonable representation of the rental return that the real property may achieve, and of how the property is expected to perform in the market place,² at the time that the vendor and the purchaser enter into the agreement under which the rental guarantee payments are required to be made
- the agreement between the vendor and the purchaser of the real property is integral to the contractual arrangement under which the parties have agreed to the terms and set the price for the sale of the property
- the vendor and purchaser agree, as part of the terms of their agreement, that the vendor is responsible for securing a tenant, and the vendor may act as the purchaser's letting agent or may appoint an external letting agent for the real property acquired under the contract of sale, and
- the terms of the agreement between the vendor and the purchaser of the real property include:
 - i. the real property is to be leased to a tenant pursuant to a lease agreement between the purchaser of the real property and the tenant
 - ii. the vendor is required to make a payment or payments to the purchaser which are based on the difference between the rent received from the real property (or relevant part of the real property) and the amount of the return that the property (or relevant part of the property) is expected to achieve in the market place (that is, the guaranteed rental yield)
 - iii. the vendor guarantees the rental amount or the rental yield of the real property for a set period of time subsequent to its sale to the purchaser, and
 - iv. the consideration provided by the purchaser is limited to the agreed sale price for the real property, and the purchaser does not provide any separate or additional consideration for the rental guarantee.

2. If the vendor's supply of the property is a taxable supply, the vendor will have a decreasing adjustment to the extent that the GST liability applicable to its supply of the real property with a guaranteed rental yield was attributable to a prior tax period.³

3. If the purchaser's acquisition of the property is a creditable acquisition, the purchaser will have an increasing adjustment to the extent that its entitlement to an input tax credit was attributable to a previous tax period.

² We do not consider it necessary for the vendor or the purchaser to obtain a formal market valuation to demonstrate that the guaranteed rental yield is a bona fide and reasonable representation of the expected rental return for the property. Rather, relevant objective evidence such as the rental yield achieved by, or the advertised rental for, similar premises in surrounding areas or an independent real estate agent's estimate of the expected rental yield, may be used to demonstrate that a guaranteed rental yield is a bona fide and reasonable representation of the expected rental return for the real property.

³ See paragraph 15 of Goods and Services Tax Ruling GSTR 2000/19 *Goods and services tax: making adjustments under Division 19 for adjustment events*. See paragraph 30 of Goods and Services Tax Ruling GSTR 2000/29 *Goods and services tax: attributing GST payable, input tax credits and adjustments and particular attribution rules made under section 29-25*.

4. For the purposes of the margin scheme in Division 75,⁴ the consideration that the purchaser provides for its acquisition for the property, is reduced by the amount of the payment received from the vendor.

5. Rental guarantees that are not covered by the circumstances set out in paragraph 1 are outside the scope of this Determination. Whether payments made under such rental guarantees give rise to adjustments would require consideration of all the relevant facts and circumstances.

Example 1

Guaranteed rental yield – residential premises

6. *Apartment Builders, a property developer, is selling individual apartments in a newly constructed residential apartment complex.*

7. *Lillian, a property investor, purchases an apartment from Apartment Builders for \$750,000. The \$750,000 sale price is struck and agreed to by the parties on the basis that, as part of the terms of the sale, Apartment Builders agrees to guarantee a rental yield of 5% per annum for 24 months (amounting to a total guaranteed rental of \$75,000 for the 24 month period). The 5% rental yield guaranteed by Apartment Builders is reflective of the rental yield that has been achieved by comparable apartments in the same suburban area.*

8. *Immediately following the sale of the apartment to Lillian, Apartment Builders arranges for the apartment to be leased to an arm's length third party tenant, Vincent. Under the terms of the lease agreement executed between Lillian and Vincent, the rental is \$3,000 per month for 12 months. At the end of the 12 month lease term, Vincent agrees to rent the apartment for another twelve months. Under the terms of the renewed lease, the rental is increased to \$3,100 per month. Therefore, the total rent received by Lillian for the 24 month 'rental guarantee' period is \$73,200.*

9. *Because the total rental payments received by Lillian over the 24 month 'rental guarantee' period is less than the guaranteed amount of \$75,000 (that is, \$3,125 per month for 24 months), pursuant to the agreement made between Apartment Builders and Lillian, Apartment Builders makes a payment of \$1,800 to Lillian.*

10. *The \$1,800 payment made by Apartment Builders has the effect of reducing the consideration for the supply of the apartment by Apartment Builders to Lillian. The \$1,800 payment is an adjustment event under paragraph 19-10(1)(b) of the GST Act.*

Example 2

Guaranteed rental yield – commercial premises

11. *Legis Properties (Legis) sold the Wonder Mart shopping centre to Lature Developments (Lature). At the time of the sale of the shopping centre to Lature, it was 75% leased to retail and commercial businesses under terms covering at least the next two years. The remaining 25% of the shopping, comprising 5 individual shops, was untenanted.*

⁴ See subsection 75-10(2) and sections 75-12, 75-14 and 75-16 of the GST Act. See also Goods and Services Tax Ruling GSTR 2006/8 *Goods and services tax: the margin scheme for supplies of real property acquired on or after 1 July 2000*.

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12. *The price for Legis' sale of the shopping centre to Lature was struck and agreed to by the parties on the basis that Legis agreed to guarantee the rental yield of 5 untenanted shops for a period of two years.*

13. *Consistent with the amount of rent being paid by the tenants of other similar shops in the shopping centre, under the agreement between Legis and Lature, the guaranteed rental yield of the five untenanted shops totalled \$30,000 per month. If any month during the two year period that Legis has guaranteed the rental yield for the five shops, the total monthly rental received by Lature for those five shops falls below \$30,000, Legis is required to pay the amount of shortfall to Lature.*

14. *Immediately following the sale, Legis arranged for the vacant area to be leased by Lature to a third party. Three of the five vacant shops were leased after the sale and the total monthly rent received by Lature for those three shops was \$18,000. After 12 months, the remaining 2 untenanted shops were leased and the total monthly rent for the five shops was \$29,000.*

15. *Pursuant to the terms of the agreement between Legis and Lature and the rental yield guaranteed by Legis for the five shops, Legis paid Lature \$12,000 per month in the following month for the first 12 months of the two year guarantee period and \$1,000 per month for the remaining 12 months of the two year guarantee period.*

16. *The above mentioned monthly payments made by Legis during the two year rental guarantee period in accordance with the terms of the agreement between Legis and Lature had the effect of reducing the consideration for the sale of the Wonder Mart shopping centre and is an adjustment event under paragraph 19-10(1)(b) of the GST Act.*

Date of effect

17. 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

30 July 2014

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.*

Guarantee of rental yield by a vendor of real property

18. As part of the arrangement for the sale of commercial and residential premises and the negotiation of the sale terms and the purchase price agreed to by the vendor and the purchaser, a vendor may guarantee a rental amount or yield for the acquired premises for a specified period. That is, the vendor may, as part of the terms of sale, guarantee the return that the property is expected to achieve in the market place. For example, based on the rental yield of comparable premises in surrounding locations and the property market, a vendor of real property may provide a purchaser with a guaranteed rental yield of 5% per annum for 2 years from the date of completion of the purchase.

19. Either as part of the terms of the sale contract, or in a collateral written agreement, a common type of rental guarantee arrangement involves the vendor and purchaser agreeing that the vendor is responsible for securing a tenant and letting the apartment. If the apartment is not leased, or if the rent received falls below the guaranteed yield for the return period, then the vendor is obligated to make a payment to the purchaser to ensure that the purchaser has received the guaranteed rental yield for the total period for which the rental yield is guaranteed by the vendor.

20. Depending upon the terms of the rental guarantee agreement, the vendor may be required to pay the purchaser the payment periodically (for example, weekly or monthly) for the specified period, or make one single payment at the end of the specified period. .

Supply for consideration

21. Section 9-15 of the GST Act provides that a payment is consideration for a supply if the payment is 'in connection with', 'in response to' or 'for the inducement' of a supply. Thus, there must be a sufficient nexus between a particular payment and a particular supply for the payment to be consideration for that supply.⁵

Payment of purchase price by the purchaser to the vendor

22. The payment of the purchase price by the purchaser to a vendor of real property with a guaranteed rental yield is 'in connection with' a supply and is consideration for the supply of that real property with the guaranteed rental yield to the purchaser. That is, the vendor makes a supply for consideration of the real property with the guaranteed rental yield to the purchaser.

⁵ See paragraph 50 of Goods and Services Tax Ruling GSTR 2001/6 *Goods and services tax: non-monetary consideration*.

No supply made by the purchaser

23. Payments made by the vendor of real property under an arrangement whereby the vendor has guaranteed the rental yield of the property for a specified period are not consideration for a supply⁶ made by the purchaser.

24. It is acknowledged that under the terms of the rental guarantee agreement between the vendor and the purchaser, the purchaser's entitlement to the payments may be conditional upon the purchaser's agreement to terms including that the vendor is responsible for letting the property to tenants. However, it is considered that the payments are made because the rent received falls below the guaranteed rental yield for the specified period. The purchaser receives these payments, and the vendor is obliged to make the payments, only when the rent received falls below the guaranteed yield for the specified period. The payments are not made 'in connection with', 'in response to', or 'for the inducement' of the purchaser's agreement to allow the vendor to manage the letting of the property.

25. Moreover, payments made to the purchaser are not third party consideration for the supply of the real property by way of lease to the tenant. Under the terms of the rental guarantee agreements that are the subject of this Determination, the vendor is required to make the payments even if the real property is not tenanted for all or part of the period of the guaranteed rental yield and the payments are only made if the rent received from the lease of premises falls below the guaranteed rental yield. That is, the supply by way of lease of the property to a tenant does not trigger the payment of the relevant amounts to the purchaser under the terms of the rental guarantee agreement.⁷

Adjustment events

26. Subsection 19-10(1) of the GST Act provides that:

- (1) an **adjustment event** is any event which has the effect of:
 - (a) cancelling a supply or acquisition; or
 - (b) changing the consideration for a supply or acquisition; or
 - (c) causing a supply or acquisition to become, or stop being, a taxable supply or creditable acquisition.

27. The expression 'which has the effect of' in subsection 19-10(1) of the GST Act is considered to broaden the terms of the provision enabling regard to be had to the practical effect of what occurs to ascertain whether or not a particular payment gives rise to an adjustment event.⁸

⁶ See paragraph 9-5(a) of the GST Act.

⁷ See *AP Group Pty Ltd. v. Federal Commissioner of Taxation* [2013] FCAFC 105 at [43] and [44].

⁸ See Goods and Services Tax Ruling GSTR 2000/19 *Goods and services tax: making adjustments under Division 19 for adjustment events* at paragraph 18 where it is stated that the substance of the arrangement or an event will determine whether a payment or allowance changes the consideration for a supply and is an adjustment event.

28. The Tribunal, in *Electrical Goods Importer v. Commissioner of Taxation* when considering whether or not a cash back payment by an importer of electrical goods to a domestic retail customer changed the consideration for GST purposes for any supply made by the importer, held that the words 'in connection with' in the definition of 'consideration' must be construed by reference to a supply and moreover a supply that is made for consideration.⁹ Payments made under the kind of rental guarantee arrangements addressed in this determination, and which exhibit the particular features referred to in paragraph 1 of this Determination, are made by a vendor to the purchaser under a rental guarantee arrangement that is contemporaneous with the sale of the property. The rental guarantee arrangement forms part of the contractual bargain struck between the parties for the supply of real property. Therefore, it is considered that the making of the payments is made 'in connection with' the vendor's earlier supply of the real property.

29. Having regard to the connection between the payments and the earlier supply, it is considered that the practical effect of the payments made under rental guarantee arrangements that exhibit the features referred to in paragraph 1 of this Determination, is a reduction in the consideration provided by the purchaser for the vendor's supply of the real property with a guaranteed rental yield.

30. Therefore, in these cases, the payments by the vendor to the purchaser give rise to an adjustment event under paragraph 19-10(1)(b) of the GST Act.

The guaranteed rental yield must be a genuine representation of how the property is expected to perform

31. The terms of the agreement and the broader arrangement between the vendor and the purchaser in respect of the sale of the real property may not expressly link the payments under a rental guarantee arrangement to a reduction in the consideration for the supply of the real property with rental guarantee in the contractual documentation. However, a critical factor underpinning the conclusions in this Determination is that the payments made by the vendor to the purchaser are made under a contemporaneous and bilateral agreement between the parties that is integral to the contractual arrangement under which the parties have negotiated and agreed on the purchase price for the real property.

32. It is considered that the quantum of the rental yield guaranteed by the vendor is a critical factor for determining whether or not a rental guarantee arrangement and the payments made under that arrangement, are integral to the contractual arrangement and the purchase price agreed to for the sale of the real property.

⁹ See *Electrical Goods Importer v. Commissioner of Taxation* [2009] AATA 854 at [59] about the need to consider the connection between a payment and an earlier transaction in determining whether or not the payment gives rise to an adjustment event.

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33. In circumstances where the guaranteed rental yield is not a bona fide or reasonable representation of the potential rental yield from the real property, it is considered that the relevant rental guarantee agreement is not integral to the contractual arrangement and the purchase price agreed to by the parties for the sale of the real property. For example, having regard to the features of the particular property, the current rental market conditions and the rental yield achieved by other similar properties in surrounding areas, a property's rental yield is reasonably expected to be 5% per annum. If, as part of the rental guarantee arrangement between the parties, the vendor guarantees a rental yield of 10%, then the guaranteed rental yield will not be a bona fide or reasonable representation of the rental yield from the real property. In instances where the rental yield guaranteed by the vendor is higher than what the return the real property could reasonably be expected to achieve in the market place, the purchaser will always invariably receive a payment from the vendor. This is in direct contrast to circumstances where the guaranteed rental yield is a reasonable and bona fide representation of the property's expected performance in the market place. In those cases the purchaser will only receive a payment from the vendor if the real property does not perform to an expected standard, and the purchaser has in effect got something less than what they bargained for.

34. In cases where the guaranteed rental yield is not a bona fide or reasonable representation of the potential rental yield of the real property, the purchaser obtains something more than a supply of real property that is guaranteed to perform to the expected market standard. In those cases, the purchaser is obtaining an additional and separate incentive to purchase the property, beyond the bargain struck and the arrangement under which the parties have negotiated the sale price of the real property. In these cases, the payments made by the vendor to the purchaser under the rental guarantee arrangement do not give rise to a reduction in the consideration provided by the purchaser for the vendor's supply of the real property and the conclusions reached in this Determination do not apply.

References

Previous draft:

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*Related Rulings/Determinations:*TR 2006/10; GSTR 2000/19; GSTR 2000/29;
GSTR 2001/6; GSTR 2006/8*Subject references:*

- buildings
- freehold
- real estate
- real property
- rental property
- rental property income

Legislative references:

- TAA 1953
- ANTS(GST)A 1999 9-5(a)

- ANTS(GST)A 1999 9-15
- ANTS(GST)A 1999 Div 19
- ANTS(GST)A 1999 19-10(1)
- ANTS(GST)A 1999 19-10(1)(b)
- ANTS(GST)A 1999 Div 75
- ANTS(GST)A 1999 75-10(2)
- ANTS(GST)A 1999 75-12
- ANTS(GST)A 1999 75-14
- ANTS(GST)A 1999 75-16

Case references:

- AP Group Ltd v. Federal Commissioner of Taxation [2013] FCAFC 105; (2013) 214 FCR 301; (2013) 2013 ATC 20-417
- Electrical Goods Importer v. Commissioner of Taxation [2009] AATA 854; 2009 ATC 1-018; (2009) 74 ATR 982

ATO references

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