GSTR 2006/6 - Goods and services tax: improvements on the land for the purposes of Subdivision 38-N and Division 75

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Goods and Services Tax Ruling

Goods and services tax: improvements on the land for the purposes of Subdivision 38-N and Division 75

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Preamble

*This document is a ruling for the purposes of section 37 of the **Taxation Administration Act 1953**. You can rely on the information presented in this document which provides advice on the operation of the GST system.*

What this Ruling is about

1. This Ruling discusses the meaning of the phrase 'improvements on the land' in the context of the phrases 'improvements on the land' or 'no improvements on the land' or equivalent phrases in Subdivision 38-N and Division 75 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act).

2. These phrases appear in Subdivision 38-N and Division 75:

- 'land on which there are no improvements' in subsection 38-445(1) and section 38-450;
- 'no improvements on the land' in paragraph 38-445(1A)(c);
- 'no improvements on the land or premises' in item 4 of the table contained in subsection 75-10(3) and subsection 75-10(3A); and
- 'improvements on the land or premises' in item 3 of the table contained in subsection 75-10(3) and in paragraph 75-10(3A)(b).

3. Unless otherwise stated, all references in this Ruling are to the GST Act.

Date of effect

4. This Ruling explains our view of the law as it applied from 1 July 2000. You can rely upon this Ruling on and from its date of issue for the purposes of section 37 of the *Taxation Administration Act 1953*. 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.

5. If this Ruling conflicts with a previous private ruling that you have obtained, this public ruling prevails. However, if you have relied on a private ruling, you are protected in respect of what you have done up to the date of issue of this public ruling.

6. If this Ruling conflicts with an earlier public ruling (for example, the Property and Construction Industry Issues Log item dealing with improvements to real property) this public ruling prevails. If you have relied on an earlier public ruling, you are protected in respect of what you have done up to the date of issue of this public ruling.

7. This means that if you have underpaid an amount of GST, you are not liable for the shortfall prior to the date of issue of this later ruling. Similarly, you are not liable to repay an amount overpaid by the Commissioner as a refund.

8. If you have relied on an earlier ruling dealing with improvements to real property and this Ruling contains an interpretation which would result in a more favourable valuation under subsection 75-10(3), you may revise your valuation to reflect this interpretation.

Ruling with Explanation

Supplies under section 38-445 or 38-450

9. Whether there are improvements on the land is relevant in establishing whether a supply made by the Commonwealth, a State or Territory[1] is GST-free under sections 38-445 and 38-450 of the GST Act.

10. Under subsection 38-445(1), if the Commonwealth, a State or a Territory makes a supply of land on which there are no improvements and the supply is of a freehold interest or long-term lease, it is GST-free unless the land has been previously supplied as a GST-free supply under section 38-445.

11. Under subsection 38-450(1), a supply by the Commonwealth, a State or a Territory of land on which there are no improvements is GST-free if the supply is by way of a lease other than a long-term lease and the lease is subject to conditions that when satisfied entitle the recipient to the grant of a freehold interest in or long-term lease of the land.

12. When the Commonwealth, a State or Territory subsequently supplies the freehold interest or long-term lease, it is GST-free under subsection 38-445(1A), unless the land has previously been supplied as a GST-free supply under section 38-445.

[1] Goods and Services Tax Ruling GSTR 2006/5 Goods and services tax: the meaning of Commonwealth, a State or a Territory discusses the Commonwealth, a State or a Territory.

Surrender of a lease under subsection 38-450(2)

13. Under subsection 38-450(2) the surrender of a lease to the Commonwealth, a State or Territory is GST-free if:

- the supply of the lease was GST-free under subsection 38-450(1), or would have been GST-free under that subsection if it had not been made before 1 July 2000; and
- solely or partly in return for the surrender of the lease, the Commonwealth, State or Territory makes a supply of the land to the lessee that is GST-free under section 38-445.

Paragraph 75-10(3)(b)

14. Whether there are improvements on the land is also relevant if a taxable supply of real property is made under the margin scheme and the margin for the supply is calculated under subsection 75-10(3).

15. If subsection 75-10(3) applies, the margin for the supply is the difference between the consideration for the supply and an approved valuation of the real property at the relevant date specified in the table in paragraph 75-10(3)(b). Whether there are improvements on the land may determine which item in the table applies to the supply. The item in the table then establishes the valuation date.

16. For example, item 4 of the table applies where the supplier is the Commonwealth, a State or Territory and has held the interest, unit or lease since before 1 July 2000, and there were no improvements on the land or premises in question as at 1 July 2000. Under item 4, the valuation must reflect the value of the real property on the day on which the taxable supply takes place. In addition, if item 4 of the table applies, then the valuation excludes any improvements on the land or premises at the valuation date.[2]

Legislative context of the term 'improvements on the land'

17. The Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998 in respect of subsection 75-10(3), and the House of Representatives Supplementary Explanatory Memorandum to the Indirect Tax and Consequential Amendments Bill (No 2) 1999 in respect of subsection 75-10(3A), refer to unimproved land held by the Commonwealth, a State or a Territory as at 1 July 2000, which is subsequently improved before the supply.

18. The Explanatory Memoranda confirm that GST is intended to be applied to the difference between the sale price and the value of the land component at the date of sale. The effect is that the value of the land is not subject to GST and that only the value of improvements is taxed.

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[2] Subsection 75-10(3A).

19. The Explanatory Memoranda also state that this outcome is intended to be consistent with the operation of Subdivision 38-N of the GST Act which provides that grants of freehold interests in unimproved land by governments are GST-free. Accordingly, the treatment of improvements is the same for subsections 75-10(3) and 75-10(3A) as it is for Subdivision 38-N.

20. Unimproved land is taken to be land in its natural state. Thus, to establish whether there are improvements on the land for the purpose of these provisions, the land is compared with land in its natural state.

The meaning of 'improvements on the land'

21. The meaning of 'improvements' in the context of land tax has been held by the High Court in *Morrison v. Federal Commissioner of Land Tax* (1914) 17 CLR 498 at 503 to be:

> Any operation of man on land which has the effect of enhancing its value comes within the definition of 'improvement'.

22. Applying this principle means that, for there to be 'improvements on the land':

- there must have been some human intervention;
- the human intervention must have been physically located on the land; and
- that human intervention must enhance the value of the land at the relevant date[3] for ascertaining whether there are improvements on land.

23. Where there has been a number of human interventions on the land it is necessary to establish whether any of the human interventions enhance the value of the land. If any of the human interventions located on the land enhance its value at the relevant date, then there are improvements on the land. This is regardless of whether the net value of the human interventions enhances the overall value of the land.

24. Determining whether a human intervention enhances the value of the land entails an objective test. This means that whether an intervention enhances the value should not be determined by reference to use or intended use by either the supplier or the recipient.

[3] Paragraph 34 discusses the relevant day for ascertaining whether there are improvements on the land.

Human interventions

25. The following are examples of human interventions that may enhance the value of land:

- houses, town-houses, stratum units, separate garages, sheds and other out-buildings;
- commercial and industrial premises;
- farm houses, farm outbuildings, internal fencing, stockyards, wells and bores, excavated tanks, dams, surface drains, culverts, bridges, sown pasture, formed internal roads, and irrigation layouts;
- formed driveways, swimming pools, tennis courts, and walls;
- any other similar buildings or structures;
- fencing – internal or boundary fencing;
- utilities, for example, water, electricity, gas, sewerage connected or available for connection;
- clearing of timber, scrub or other vegetation;
- excavation, grading or levelling of land;
- drainage of land;
- building up of soil fertility;
- removal of animal pests, rabbit burrows etc;
- removal of rocks, stones or soil; and
- filling of land.

Enhancing the value of the land

26. A human intervention is not necessarily an improvement. To be an improvement, the human intervention must enhance the value of the land.

27. In some circumstances, a human intervention on land neither enhances nor decreases the value of land. For example, fire breaks, solely to allow access to fire equipment and reduce the spread of a fire, may not enhance the value of the particular land.

28. In other circumstances, human interventions that were once improvements but that have deteriorated over time or have contributed to land degradation, may no longer enhance the value of the land and are not improvements. For example, clearing is a human intervention which ordinarily enhances the value of the land. However, clearing may deteriorate over time with the regrowth of the same type of vegetation or even different vegetation (for example, lantana, blackberry or other noxious weeds). Clearing also may degrade the land by later causing erosion or salinity problems.

29. Similarly, a building that initially enhanced the value of the land may have deteriorated over time to such an extent that it is a detriment as it is uninhabitable and has been condemned by order of the local council is not considered to be an improvement.

30. In some situations, improvements may have been on the land but no longer exist as improvements on the relevant day specified in the table below. For example, bushland owned by the Commonwealth, a State or a Territory may have originally been fenced, but due to deterioration, no valuable fencing exists on the relevant day.

31. The following High Court cases provide support for considering the impacts of deterioration or degradation:

- *Morrison v. Federal Commissioner of Land Tax* (1914) 17 CLR 498 at 504:

  > While improvements or the consequent operations of nature are still going on, the value of improvements may, of course, increase from year to year, just as, in the case of some improvements, *it may be exhausted* [emphasis added].

- *Lewis Kiddle and another v. Deputy Federal Commissioner of Land Tax 27 CLR 316 at 320:*

  > Presumably, a purchaser of land, if he considered this question at all, would determine that the amount to be attributed to value of improvements would be equal to the amount which he gained or saved by reason of the improvements having been made, he being thereby relieved from the necessity of making them. This amount would be found by ascertaining the amount which it would cost to make the improvements in question at the relevant date, including a proper allowance for loss of interest on all outlay during the period which must elapse before such outlay became fully productive, and *by deducting from the sum so ascertained a proper allowance for depreciation or partial exhaustion of the improvements* [emphasis added].

Multiple human interventions on the land

32. Where there are a number of human interventions on the land, it is not appropriate to take a holistic approach to establishing whether there are improvements on the land. Instead, it is necessary to determine whether any of the human interventions enhance the value of the land. If any of the human interventions enhance the value of the land there are improvements on the land.

33. For example, a building that is uninhabitable because it is derelict and condemned by order of the local council does not enhance the value of the land. The building in these circumstances is a detriment rather than an improvement. However, if the land on which the building is located is cleared and the clearing has not deteriorated or has not degraded the land, there are improvements on the land. The clearing still enhances the value of the land.

When you ascertain whether there are improvements on the land

34. The following table describes the relevant day for ascertaining whether there are improvements on land.

Section	***Relevant day for ascertaining whether there are improvements on the land***
Subsection 38-445(1)	When the supply is made.
Subsection 38-445(1A)	When the land was previously supplied by the Commonwealth, a State or a Territory by way of a lease to the recipient of the supply.
Subsection 38-450(1)	When the supply is made.
Item 2A of the table in subsection 75-10(3)	When the land was previously supplied by the Commonwealth, a State or a Territory by way of a lease to the recipient of the supply.
Item 3 of the table in subsection 75-10(3) .	1 July 2000.
Item 4 of the table in subsection 75-10(3).	1 July 2000.
Subsection 75-10(3A)	The day on which the taxable supply takes place.

Who establishes whether there are improvements on the land

35. Determining whether a human intervention enhances the value of the land is an objective test. This means that whether an intervention enhances the value of the land should not be determined by reference to use or intended use by either the supplier or the recipient. For example, real property with a building on it that is not condemned, enhances the value of the land even though the recipient may intend to demolish the building and construct some other building in its place.

36. As the issue of whether there are improvements on the land is a question of fact, it may be prudent to engage a professional valuer to establish this.

Meaning of 'on the land'

37. The term 'improvements on the land' refers to any human intervention on the land which has the effect of enhancing its value. It is not limited to visible structural improvements and includes improvements below the surface of the land, such as underground drainage or other facilities.

38. Support for this view is found in the decision in *Commonwealth of Australia of Australia v. Oldfield* (1976) 133 CLR 612; (1976) 10 ALR 243 where the High Court described the meaning of 'improvements on the land' in the following manner:

> We are concerned with the value at the relevant date of the physical consequences which enure to the land of the acts whereby the land attained a quality and usefulness additional to that which it had in its virgin state.
>
> …
>
> Improvements to land result in improvements on that land in the relevant sense. The preposition 'on' does not here mean 'on the surface of the land' or the like unless the word improvement is limited to physical objects placed or constructed in or in the soil and for the reasons which I have given I do not think that the word has that meaning.[4]

Alternative view

39. There is an alternative view that the expression 'improvements on the land' is limited to visible structural improvements such as buildings and does not extend to things such as clearing and draining.

40. This view does not accept the principles adopted in the land tax cases as these cases considered a broader expression, being 'improvements thereon or appertaining to' the land.' The expression is broader, on this view, because the words 'appertaining to the land' extend the phrase to improvements that are not necessarily on the land'.

41. However, in *Brisbane City Council v. Valuer-General (Queensland)* [1978] HCA 40, Gibbs J, with whom the four other members of the Court agreed, when considering the meaning of the phrase 'thereon or appertaining thereto', noted at 47 that:

> [t]his means that the improvements, if not on the land, must be 'such as are in the strict legal sense 'appurtenant' to the property and incident to its ownership' (*McDonald v. Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231, at pp 234-235).

42. From the above it can be seen that the words 'appertaining to' only extend the meaning of the phrase to a limited extent. Given this, it seems that the conclusions in the rating and land tax cases are more likely based on the expression 'improvements thereon' rather than the improvements 'appertaining to' the land.

43. As the phrase 'improvements thereon' is analogous to 'improvements on the land', it is the Commissioner's view that the principles in the rating and land tax cases apply when ascertaining the meaning of 'improvements on the land'.

[4] 133 CLR 612 at 620.

44. The alternative view also argues that the construction adopted in the rating and land tax cases may have been influenced by the perceived policy of that legislation, and consequently the decisions do not have application in the GST context.

45. In *McGeogh v. Federal Commissioner of Land Tax* (1929) 43 CLR 277, per Knox CJ and Dixon J at 290, the policy intent of the relevant legislation was articulated in the decision, in which the purpose of land tax was described as a policy of taxing the 'unearned increment'. That is, without regard to improvements effected by the owner or the owner's predecessors, but having regard to extrinsic circumstances, such as public roads or railways, increased settlement in the neighbourhood and other benefits not brought about by the operations on the land of successive operators. However, this reference to the apparent policy of land tax was not the primary basis for the decision.

46. For the above reasons, and having regard to the High Court decision in *Commonwealth of Australia of Australia v. Oldfield* 10 ALR 243, the Commissioner considers the better view to be that improvements on the land, in the GST context, are not limited to visible structural improvements. This view is consistent with the Explanatory Memorandum which refers to the provisions requiring that the land is 'unimproved' or land that 'has not been improved'.[5]

Improvements that are not on the land

47. While the term 'improvements on the land' is not limited to visible improvements, it should be noted that 'improvements on the land' does not include interventions that are not upon the land, such as amenities in the surrounding area, even though they may enhance the value of the land.

Subdivided land and item 4 of the table in subsection 75-10(3)

48. In this part of the Ruling, the Commissioner considers whether a supply of a particular subdivided lot is ineligible for consideration under item 4 of subsection 75-10(3) because the larger area (englobo land) from which it was subdivided had improvements on it at 1 July 2000, even though the physical area of the particular subdivided lot had no improvements.

49. The issue is whether it is necessary to consider whether any part of the englobo land had improvements on it or whether regard should be had only to that part of the englobo land that forms the subdivided lot.

50. It is the Commissioner's view that the words 'land or premises in question' in item 4 qualify the application of the improvements test to land that is supplied and not the larger area from which it is subdivided.

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[5] Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998, paragraph 5.132.

51. These words can be contrasted with the expression 'interest, unit or lease' which are used elsewhere in the item to refer to the legal interest being supplied under the margin scheme. This distinction supports the view that it is the physical land rather than the legal interest that is considered when determining whether there were improvements on the land at the relevant date.[6]

Detailed contents list

52. Below is a detailed contents list for this draft Goods and Services Tax Ruling:

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Commissioner of Taxation
26 April 2006

[6] This interpretation is also considered to be consistent with the practical approach to the interpretation of Division 75 adopted by Stone J in *Sterling Guardian Pty Limited v. Commissioner of Taxation* [2006] FCAFC 12.

Previous drafts:

GSTR 2005/D5

Related Rulings/Determinations:

GSTR 1999/1; GSTR 2006/5

Subject references:

- Commonwealth
- freehold interest
- improvements
- long-term lease
- margin
- margin scheme
- real property
- State
- Territory

Legislative references:

- ANTS(GST)A 1999 Subdiv 38-N
- ANTS(GST)A 1999 38-445
- ANTS(GST)A 1999 38-445(1)
- ANTS(GST)A 1999 38-445(1A)
- ANTS(GST)A 1999 38-445(1A)(c)
- ANTS(GST)A 1999 38-450
- ANTS(GST)A 1999 38-450(1)
- ANTS(GST)A 1999 38-450(2)
- ANTS(GST)A 1999 Div 75
- ANTS(GST)A 1999 75-10(3)
- ANTS(GST)A 1999 75-10(3)(b)
- ANTS(GST)A 1999 75-10(3A)
- ANTS(GST)A 1999 75-10(3A)(b)
- TAA 1953 37

Case references:

- Brisbane City Council v. Valuer-General (Queensland) [1978] HCA 40; (1978) 140 CLR 41
- Commonwealth of Australia of Australia v. Oldfield (1976) 133 CLR 612; (1976) 10 ALR 243
- Lewis Kiddle and another v. Deputy Federal Commissioner of Land Tax 27 CLR 316
- McDonald v. Deputy Federal Commissioner of Land Tax (NSW) (1915) 20 CLR 231
- McGeogh v. Federal Commissioner of Land Tax (1929) 43 CLR 277
- Morrison v. Federal Commissioner of Land Tax (1914) 17 CLR 498
- Sterling Guardian Pty Ltd v. Commissioner of Taxation [2006] FCAFC 12

Other references:

- Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998
- House of Representatives Supplementary Explanatory Memorandum to the Indirect Tax and Consequential Amendments Bill (No 2) 1999

ATO references

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