

GSTR 2010/1 - Goods and services tax: application of Division 165 of A New Tax System (Goods and Services Tax) Act 1999 where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5

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Goods and Services Tax Ruling

Goods and services tax: application of Division 165 of *A New Tax System (Goods and Services Tax) Act 1999* where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling considers whether the general anti-avoidance provisions in Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act)¹ may apply to an associate in relation to arrangements of the type referred to in Taxpayer Alert TA 2009/5 (TA 2009/5): Use of an associate to obtain Goods and Services Tax (GST) benefits on construction of residential premises for lease.

¹ All legislative references in this Ruling are to the GST Act unless otherwise stated.

2. This Ruling does not consider whether an associate is carrying on an enterprise under section 9-20 or would otherwise be entitled to input tax credits under Division 11 for the acquisitions it makes in constructing or arranging the construction of the residential premises for a land owner.²

3. This Ruling does not consider whether any payment or act by a land owner that involves an associate prior to the sale of the residential premises may be taken to be 'consideration' within the meaning of section 9-15. This Ruling does not consider whether Division 72 may apply to these arrangements.

4. Whether the provisions in paragraphs 2 and 3 of this Ruling apply will depend on the circumstances of the particular case under consideration.

5. The application of Division 165 will be considered in this Ruling on the basis that the core provisions would operate to provide a GST benefit in the particular case.

6. This Ruling was previously issued as draft Good and Services Tax Determination GSTD 2009/D2 Goods and services tax: are there GST consequences where a land owner engages the services of an associate to arrange construction of residential premises for lease under an arrangement described in Taxpayer Alert TA 2009/5?.

Background

7. TA 2009/5 issued on 17 February 2009, and describes arrangements where a land owner (B) engages an associate (A) to construct residential premises which are to be used for making input taxed supplies by way of lease.

8. TA 2009/5 describes arrangements which have the following features:

- B, who may or may not be registered for GST, plans to construct residential premises to lease to third parties.
- B engages A, a registered entity and an associate of B, to construct the residential premises.
- A either undertakes the construction or engages an arm's length builder, and claims input tax credits on its acquisitions.
- Under the terms of the contract or agreement, A cannot seek any payment from, nor issue an invoice to B until the premises are sold. B leases the completed residential premises to third parties (an input taxed supply).

² In determining whether an associate is carrying on an enterprise, the Commissioner will have regard to MT 2006/1 The New Tax System: the meaning of entity carrying on an enterprise for the purpose of entitlement to an Australian Business Number.

9. This Ruling only applies to associates that have entered into arrangements which include all of the features listed in paragraphs 7 and 8 of this Ruling. For example, if B engages A to construct, or arrange for the construction of premises, but does not use the premises to make input taxed supplies by way of lease, then such an arrangement is outside the scope of this Ruling. Similarly, if, under the terms of the contract or agreement, A can receive progress payments, or issue an invoice to B for the supply of the construction services prior to the sale of the premises by B, then such an arrangement is also outside the scope of this Ruling.

10. Under the arrangements described in paragraphs 7 and 8 of this Ruling, A claims input tax credits in relation to the construction of the residential premises (which are ultimately leased out by B – an input taxed supply) and its corresponding GST liability is deferred, in some cases indefinitely.

11. In some cases B may undertake an act or make a payment involving A prior to the sale of the premises.³ For example, B may provide funds to A to assist it to meet its financial obligations in relation to the costs of constructing the residential premises.

Ruling

12. The general anti-avoidance provisions in Division 165 may apply to arrangements of the type referred to in TA 2009/5 where an associate is carrying on an enterprise and would otherwise be entitled to input tax credits under Division 11, where that associate's GST is not attributable in accordance with section 29-5 to a tax period at a point earlier than the sale of the residential premises, and where Division 72 does not apply.

13. The application of Division 165 to any particular arrangement depends on a careful weighing of all the relevant circumstances of the arrangement and the relative weight that should be attached to each of those circumstances. Therefore, in the absence of all relevant information, it is not possible to state definitively whether a particular arrangement will attract the application of Division 165.

³ Under these circumstances A would normally remit GST upon the sale of the residential premises by B.

14. Division 165 must be considered on a case by case basis. However, the existence of some or all of the following additional features in an arrangement of the type referred to in TA 2009/5 points towards it being reasonable to conclude that the dominant purpose or principal effect of the arrangement would be for the associate to get a GST benefit:

- the parties agreeing that the associate will not seek payment nor issue an invoice until sale of the premises, without nominating a specific date or period within which the premises will be sold;
- a land owner being under no obligation to sell the premises;
- the absence of a clause requiring a land owner to pay interest to compensate an associate for the indefinite delay in payment;
- the absence of a default clause in the event of non-payment by a landowner for an associate's services.

Date of effect

15. This Ruling applies to tax periods commencing both before and after its date of issue. However, this Ruling 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 Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Appendix 1 – Explanation

① *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.*

Whether Division 165 applies to the arrangement

Do the general anti-avoidance provisions apply?

16. The application of Division 165 has been considered by the Administrative Appeals Tribunal,⁴ and the Commissioner has set out his views on the application of Division 165 in a number of public rulings, taxation determinations and a practice statement.⁵

17. The application of Division 165, which contains the general anti-avoidance provisions, requires a careful weighing of the individual circumstances of each case. For the Division to apply, the following four elements need to be satisfied:

- (1) One or more of the steps in the arrangement is a 'scheme' as defined in subsection 165-10(2);
- (2) A 'GST benefit', as defined in subsection 165-10(1), arises under the scheme;
- (3) An entity gets a GST benefit from the scheme; and
- (4) It is reasonable to conclude, taking account of the matters in section 165-15, that the dominant purpose or principal effect of entering into or carrying out the scheme was to get a GST benefit.

⁴ *Re VCE and Federal Commissioner of Taxation* [2006] AATA 821; 2006 ATC 187; (2006) 63 ATR 1249; *Case 3/2010* [2010] AATA 497; 2010 ATC 1-022.

⁵ PS LA 2005/24 Application of General Anti-Avoidance Rules; GSTR 2004/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/2: Avoidance of GST on the sale of new residential premises; GSTR 2005/3 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/9 - exploitation of the second-hand goods provisions to obtain input tax credits; GSTR 2005/4 Goods and services tax: arrangements of the kind described in Taxpayer Alerts TA 2004/6 and TA 2004/7 – use of the Grouping or Margin Scheme provisions of the GST Act to avoid or reduce the Goods and Services Tax on the sale of new residential premises; GSTR 2005/5 Goods and services tax: arrangements of the kind described in Taxpayer Alert TA 2004/8: use of the Going Concern provisions and the Margin Scheme to avoid or reduce the Goods and Services Tax on the sale of new residential premises; GSTD 2006/5 Goods and services tax: what are the results for GST purposes of barter exchanges engaging in the arrangement described in Taxpayer Alert TA 2005/4?; and GSTD 2007/2 Goods and services tax: what are the results for GST purposes of a charitable institution engaging with an associated endorsed charitable institution in an arrangement described in Taxpayer Alert TA 2007/1?

Element 1: Scheme

18. It is considered that all or only some of the elements comprising the arrangement described in paragraphs 7 and 8 of this Ruling would constitute a scheme under the broad definition in subsection 165-10(2): see the observations of the High Court in *Federal Commissioner of Taxation v. Hart* (2004) 217 CLR 216 at 234 to 238 and 260 to 261 in relation to the virtually identical definition of 'scheme' for the purposes of Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936).

19. The 'scheme' includes:

- a land owner engaging an associate to undertake construction of residential premises;
- an associate being interposed between a land owner and a third party builder *or* an associate undertaking the construction itself;
- an agreement or understanding resulting in neither payment nor invoicing for an associate's services until such time as the premises are sold; and
- a land owner leasing the premises for an indefinite period of time.⁶

Element 2: GST benefit

20. Further, it is considered that the arrangement constitutes a scheme which gives rise to a GST benefit under paragraphs 165-10(1)(b) or 165-10(1)(c).

GST benefit paragraph 165-10(1)(b) – engaging a third party builder

21. An entity obtains a tax benefit in connection with a scheme for the purposes of paragraph 165-10(1)(b) if an amount that is payable to that entity is or could reasonably be expected to be larger than it would have been had the scheme not been entered into or carried out. The application of the test involves a prediction as to events that would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable. Thus the enquiry directed by Division 165 requires comparison between the scheme in question and an alternative postulate (the 'counterfactual'): see the comments of the High Court in *Federal Commissioner of Taxation v. Peabody*⁷ on the reasonable expectation test in the context of the definition of 'tax benefit' for the purposes of Part IVA of the ITAA 1936.

⁶ The Commissioner considers that there would also be a 'scheme' where the residential premises are used for private purposes rather than leased.

⁷ (1994) 181 CLR 359 at 385.

22. It is reasonable to expect that in those cases where the scheme involves an associate engaging a third party builder, a land owner would otherwise have contracted directly with that builder on normal commercial terms. Accordingly, under the counterfactual an associate has no input tax credit entitlement and no GST liability. Under the scheme that associate claims input tax credits on its acquisitions in providing its construction services, and does not remit GST. The scheme therefore gives rise to a GST benefit to that associate under paragraph 165-10(1)(b) as it could reasonably be expected that a larger amount would be payable to that associate under the provisions of the GST Act (apart from Division 165) than would have been the case but for the scheme.

GST benefit paragraph 165-10(1)(c) – associate undertakes construction

23. An entity obtains a tax benefit in connection with a scheme for the purposes of paragraph 165-10(1)(c) if an amount that is payable by that entity is or could reasonably be expected to be payable later than it would have been had the scheme not been entered into or carried out.

24. It is reasonable to expect that in those cases where the scheme involves an associate undertaking the construction of the premises itself, a land owner would otherwise have engaged that associate on normal commercial terms. Accordingly, under the counterfactual that associate would have an input tax credit entitlement and a corresponding GST liability. Under the scheme that associate claims input tax credits on its acquisitions in providing its construction services, and defers remitting GST. The scheme therefore gives rise to a GST benefit to that associate under paragraph 165-10(1)(c) as it could reasonably be expected that an amount payable by that associate is payable later under the provisions of the GST Act (apart from Division 165) than it would have been but for the scheme.

Element 3: entity gets GST benefit

25. An associate gets the GST benefit described at paragraphs 23 to 24 of this Ruling.

Element 4: Tax avoidance conclusion

26. Division 165 must be considered on a case by case basis to determine whether it would be concluded that the dominant purpose or principal effect of the scheme would be to get a GST benefit. This requires an objective assessment of the scheme against the twelve matters set out in subsection 165-15(1). The references to the particular matters in this Ruling should not be regarded as exhaustive or limiting the Commissioner in the application of Division 165 in other cases.

27. Consideration of some of the matters in subsection 165-15(1) may point in the direction of a tax avoidance purpose or effect, others may point in the opposite direction, and some may be neutral. It is the evaluation of these matters, alone or in combination, some for, some against, that section 165-15 requires in order to reach the conclusion to which section 165-5 refers.⁸

Application of Division 165 to the arrangement

Paragraph 165-15(1)(a) – the manner in which the scheme was entered into or carried out

28. Manner involves consideration of the ways, methods, and/or procedures by which, the particular scheme was carried out in comparison to the counterfactual, to enable contrivance and artificiality to be identified, such as by the presence of additional steps or complications.⁹

29. Where an associate engages a third party builder or where an associate undertakes construction itself, the manner in which the scheme is entered into or carried out involves a land owner, who plans to lease the constructed premises,¹⁰ contracting with an associated entity on terms that require neither that land owner to make payment nor that associate to issue an invoice until such time as the premises are sold.¹¹ The feature of linking payment for that associate's services to sale of the premises, the occurrence of which is controlled by that land owner, is not indicative of an arm's length dealing.

30. An associate claims input tax credits during the construction phase on the acquisitions it makes to supply the construction services, whilst the absence of progress payments and an invoice allows it to delay payment of GST on the supply of those services indefinitely.

31. The presence of some or all of the following features in an arrangement or agreement would point to a dominant purpose or principal effect of obtaining a GST benefit:

- the parties agreeing that the associate will not seek payment nor issue an invoice until sale of the premises, without nominating a specific date or period within which the premises will be sold;

⁸ Cases concerning Part IVA of the ITAA 1936, such as *Commissioner of Taxation v. Hart and Anor* [2004] HCA 26; 2004 ATC 4599; 55 ATR 712, *Federal Commissioner of Taxation v. Consolidated Press Holdings Ltd (No. 1)* [1999] FCA 1199; (1999) 91 FCR 524; 99 ATC 4945; (1999) 42 ATR 575 and *Federal Commissioner of Taxation v. Spotless Services Ltd* [1996] HCA 34; (1996) 186 CLR 404; 96 ATC 5201; (1996) 34 ATR 183, provide guidance to the Commissioner in considering the [Division 165](#) matters.

⁹ See paragraph 93 of PS LA 2005/24 Application of General Anti-Avoidance Rules.

¹⁰ GSTR 2009/4 Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose at paragraph 46 details some factors which objectively determine a land owners purpose during the construction phase.

¹¹ In some cases, the agreement between the parties is not in writing, which is not reflective of an arm's length dealing.

- a land owner being under no obligation to sell the premises;
- the absence of a clause requiring a land owner to pay interest to compensate an associate for the indefinite delay in payment;
- the absence of a default clause in the event of non-payment by a landowner for an associate's services.

Paragraph 165-15(1)(b) – the form and substance of the scheme, including:

***(i) the legal rights and obligations involved in the scheme; and
(ii) the economic and commercial substance of the scheme***

32. This factor is directed to examining the scheme for discrepancies between the form of the scheme and its substance, particularly commercial or economic substance.

33. The form of the scheme involves the supply of building services by an associate to a land owner for the construction of residential premises, enabling that associate to claim input tax credits on its acquisitions.

34. In substance a land owner controls all aspects of the construction. That land owner executes and funds the scheme as the finance is received by it and it either provides those funds to an associate, or allows that associate to draw down on that land owner's loan, to enable that associate to pay for construction. That land owner also controls if and when the premises are sold and consequently if and when payment is made to that associate. The uncommercial terms stipulated by that land owner ensure that associate would not be in a position to enforce payment.

35. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraph 165-15(1)(c) – the purpose or object of the [GST] Act ... and any relevant provision of this Act ... (whether the purpose or object is stated expressly or not)

36. The purpose of Subdivision 40-B, in making supplies of residential rent input taxed is to ensure comparable treatment with owner-occupiers who cannot claim input tax credits on acquisitions.¹²

¹² See paragraph 5.164 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

37. The purpose of paragraph 11-15(2)(a) is to deny input tax credits for acquisitions that relate to making supplies that would be input taxed.¹³ In those cases where an associate engages a third party builder to undertake construction, the interposition of the associate allows it to obtain input tax credits on its acquisitions, which otherwise would not have been available to that associate or that land owner had the scheme not been entered into.

38. The purpose of Division 29 is to determine which tax period GST on taxable supplies is attributable to.¹⁴ In those cases where an associate undertakes construction of the premises itself, its agreement with a land owner that neither payment nor invoicing for its services will occur until such time as the premises are sold enables the associate to defer attribution of its GST liability indefinitely.

39. The purpose or object of Division 165 is to deter artificial or contrived schemes that give an entity a GST benefit by increasing GST refunds, reducing GST, or altering the timing of payments of GST or GST refunds.¹⁵

40. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraphs 165-15(1)(d) and 165-15(1)(e) – the timing of the scheme and the period over which the scheme was entered into or carried out

41. The scheme identified at paragraphs 7 and 8 of this Ruling commences shortly prior to the construction of the residential premises and concludes upon payment to or invoicing by an associate, which occurs upon sale of the premises, the date of which may not be stipulated in the agreement.

42. In those cases where an associate undertakes construction of the premises itself, the ability of a land owner to control when the premises are ultimately sold allows that associate to indefinitely delay payment of its GST liability.

43. The Commissioner considers that this matter points to a dominant purpose or principal effect of obtaining a GST benefit.

¹³ See paragraphs 3.23 and 3.26 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

¹⁴ See paragraphs 4.29 and 4.35 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

¹⁵ See paragraphs 6.303 and 6.304 of the Explanatory Memorandum to the A New Tax System (Goods and Services Tax) Bill 1998.

Paragraph 165-15(1)(f) – the effect that [the GST Act] would have in relation to the scheme apart from this Division

44. Where an associate engages a third party builder to undertake construction on behalf of a land owner, the associate would be entitled to input tax credits on its acquisitions under the scheme, apart from Division 165. Had that land owner contracted with that builder on normal commercial terms, its acquisitions would relate to making supplies that would be input taxed and would not be for a creditable purpose within the meaning of section 11-15.

45. Where an associate undertakes construction of the premises itself, the effect of the scheme under the GST Act apart from Division 165 is that that associate's payment of its GST liability is deferred indefinitely until such time that it receives consideration from, or issues an invoice to a land owner.¹⁶

46. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraph 165-15(1)(g) – any change in the avoider's financial position that has resulted, or may reasonably be expected to result, from the scheme

47. The transactions entered into as part of the scheme have no positive economic impact on the financial position of an associate apart from the GST benefit that results from the scheme.

48. The uncommercial nature of the arrangement in which an associate is not compensated by a land owner for the indefinite delay in payment may adversely affect that associate's financial position.

49. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraph 165-15(1)(h) – any change that has resulted, or may reasonably be expected to result, from the scheme in the financial position of an entity (a connected entity) that has or had a connection or dealing with the avoider, whether the connection or dealing is or was of a family, business or other nature

50. There may be some change to the financial position of the land owner where there are savings in the overall costs of construction which accrue to the land owner on account of GST benefits obtained by its associate. However, there would otherwise be no substantive change in the overall financial position of a land owner as a result of the transactions constituting the scheme.

¹⁶ See subsection 29-5(1).

51. A land owner derives rental income from the residential premises and continues to make the regular repayments on any finance it obtained and provided to an associate to finance construction of the premises. Further, that land owner is not required to compensate the associate for any delay in payment.

52. To this end, a land owner is in a similar position to what it would have been had it not interposed an associate and contracted directly with a builder.

53. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraph 165-15(1)(i) – any other consequence for the avoider or a connected entity of the scheme having been entered into or carried out

54. A land owner obtains finance for the construction of the premises, and it, rather than an associate makes repayments to a financier. Further, the engagement of a third party builder by an associate to undertake construction services is inconsistent with the interposition of the associate to undertake the building of the premises.

55. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraph 165-15(1)(j) – the nature of the connection between the avoider and a connected entity, including the question whether the dealing is or was at arm's length

56. The parties are associates and are not dealing with each other at arm's length. The uncommercial terms are a product of this relationship and result in that associate obtaining input tax credits on its building acquisitions, and delaying payment of GST on its supply of building services for an indefinite period of time.

57. This matter points to a dominant purpose or principal effect of obtaining a GST benefit.

Paragraphs 165-15(1)(k) and 165-15(1)(l) – the circumstances surrounding the scheme and any other relevant circumstances

58. The Commissioner would consider any other circumstances surrounding the scheme.

Division 165 conclusion

59. Whether Division 165 applies depends on all the facts and circumstances of an arrangement. With respect to an arrangement of the kind described in TA 2009/5, it may be reasonable to conclude, having regard to the matters set out in subsection 165-15(1) and subject to the particular features of an arrangement, that the sole or dominant purpose of the scheme or part of the scheme, or the principal effect of the scheme or part of the scheme, was for the associate to obtain a GST benefit.

60. It follows that Division 165 may apply to the scheme and enable the Commissioner to exercise his powers under section 165-40 to negate the GST benefit obtained by an associate.

Appendix 2 – Detailed contents list

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References

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GSTD 2009/D2

Related Rulings/Determinations:

TR 2006/10; GSTR 2004/3;
 GSTR 2005/3; GSTR 2005/4;
 GSTR 2005/5; GSTD 2006/5;
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 MT 2006/1

Subject references:

- anti avoidance
- associate
- associate entity
- creditable purpose
- entity carrying on an enterprise
- input tax credit
- goods and services tax
- GST new residential premises
- GST enterprise
- GST residential premises
- property development industry
- real estate

Legislative references:

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- ANTS(GST)A 1999 9-5
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34 ATR 183
- Re VCE and Federal
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AATA 821; 2006 ATC 187; (2006)
63 ATR 1249

Other references:

- Explanatory Memorandum to
the A New Tax System (Goods
and Services Tax) Bill 1998
 - TA 2004/2
 - TA 2004/6
 - TA 2004/7
 - TA 2004/8
 - TA 2004/9
 - TA 2005/4
 - TA 2007/1
 - TA 2009/5
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