

A Comparative Study of the GST Implications on Real Property Transactions in Australia and New Zealand

Dr Sue Yong

Maggie Ma

Auckland University of
Technology

Introduction

1. Widespread adoption of this broad based indirect tax based on consumption (valued added) since 1960s. 140 countries have introduced GST c. f. 10 in 1960s
2. GST can account for up to 20% of total tax revenues for some countries.
3. GST is charged on all taxable supplies and payable by the final consumer.
4. Introduction of GST:
 1. Australia: 1st July 2000, NZ: 1st Oct 1986
 2. Main reasons: To reduce reliance on direct taxes such as income taxes and capital gains, reduce marginal tax rates, and to broaden the tax base.
 3. Very similar GST models but with some variations
 4. Heavier reliance on GST by NZ (27.6% c.f. 14.3%)

Background

- NZ: GST is applied comprehensively at 15% for almost all goods and services in NZ and with limited exceptions
- Australia: GST is imposed at 10% upon the consumption of goods and services in Australia with few exceptions. Applies zero rating to a wide range of life necessities and merit goods.

Background

- Real property transactions are significant due to:
 - the high value per item and economic significance (and therefore high tax revenues and tax credits involved)
 - Design complexities
 - Difficulty in implementing solutions that satisfy the canons of taxation
 - Gave rise to a large number of disputes, litigations and court cases

Research Questions and Aims

- What are the main issues pertaining to real property transactions in Australia and New Zealand that has given rise to tax litigations?
- Compare and contrast the differences in GST treatment for real property transactions relating to:
 - Sale of residential properties
 - Consideration in the sale of properties (different from the original abstract)

Approach Adopted for this Study

- Comparative study from the perspective of the taxation canons in interpreting the GST legislations and cases.
- Theoretical approach used.

Adam Smith's (1776) The Wealth of Nations: Canons of Taxation

- Equity (Fairness): necessity to warrant widespread support from taxpayers
- Certainty: making it clear to fulfil tax obligations in terms of timing, manner and quantum of payment. See the NZ GSTA 1985 and the Australian A New Tax System (GSTA 1999).
- Convenience: Relates to the timing of tax payable which is at the convenience of the taxpayer.
- Efficiency: Relates to the cost of imposing a tax on the taxpayers and the tax authority. Linked to simplicity and neutrality.

Comparative Studies Approach

- “Reading information about the other legal systems has been worthy of praise because of the difficulties associated with its acquisition” (Wilson, 2007).
- Used to highlight and discuss **similarities and differences** in taxation systems between countries (Cassidy, Cheng and Yong, 2014; Arnold and Edgar, 1995; Abdul Hamid 2013; Evans, 2012) and provide **lessons to be learned** by countries that are considering introducing a new tax (e.g. NZ considering CGT and Malaysia considering GST).

Importance and Relevance of this Study

- **Importance:**
 - High value of Trans-Tasman ownership of Foreign Direct Investment (FDI) (which includes real properties)
 - NZD 304 billion (2012) by Australian
 - Australia is the most attractive offshore investments for NZ:
 - 27.8% of total offshore investments (2012) c.f. 14.2% and 7.9% for US and UK respectively.
- **Relevance of this study:** The tax implications of GST on individuals, businesses and trusts who own or are considering trading in real properties in Australia and NZ. Also for academics, tax authorities and tax practitioners

GST Treatment on Real Property Transactions

Real Property Transactions:

- Many and Varied
- Includes the sale and lease of existing and new residential and commercial premises
- Determining the implications of GST on premises can be challenging for taxpayers and their advisers due to:
 - Mix of residential and commercial premises
 - The distinction between commercial and residential premises
 - Long term accommodation in commercial residential premises
- Generally, the sale of premises is:
 - Input-taxed in Australia
 - GST-exempt in NZ

GST on Real Property: Australia (1)

1. Sale of New Residential Premises or sale of premises converted for residential use:
 - a) Subject to GST and is not input taxed
 - b) Sale of new residential houses by registered businesses (including builders and developers) and sale of premises that have been converted for residential use (such as warehouses or CBD office blocks) will be treated as taxable supplies and subject to GST.
 - c) Will not be fully taxable unless the margin scheme concession or going concern exemption can be applied.

2. Tax Avoidance Issues:
 - a) Circumvent the GST laws to avoid GST payments and/or:
 - b) Claim GST input credit

GST on Real Property: Australia (2)

3. Sale of commercial residential premises (hotels):

- Input tax does not apply i.e. GST will be charged if the seller is registered for GST
- Can attract the normal GST rate at 10% of the value of the sale or;
- At the GST margin system calculated at $1/11^{\text{th}}$ of the registered business' gross margin on the sale of the property which is usually the difference between the tax-inclusive sale price and the original purchase price.

GST on Real Property: Australia (3)

3. Supply of residential premises (leases, hire or licence):

- a) Is input taxed and therefore landlords are not allowed to claim input tax credits for GST paid on their business expenditures. The supply of residential premises is input taxed only to the extent that the premises are used predominantly for residential accommodation. Apportion needed if any part of the residential premises are used for commercial purposes.
- b) LT Lease: the supply is input taxed and not GST is payable and no GST credits can be claimed.
- c) But supply of new residential or commercial residential premises in terms of long term lease attracts GST and are not input taxed.
- d) Rents on commercial premises are subject to GST and are not input taxed. Therefore tenants who are registered for GST will be able to claim GST credits if they are in business. Landlords of commercial premises will be able to claim input tax credits on any GST paid on purchases relating to the operation of the commercial premises.

GST on Real Property: Australia (4)

4. Sale of a “going concern”:

- Sale of existing homes are input taxed and would not attract GST as home owners are not GST registered.
- The sale of new houses would be subject to GST as well as the sale of commercial residential premises applying normal rules or the margin rules

GST on Real Property: NZ (1)

1. The supply of land and property is subject to GST except for the sale of family homes.
2. Homeowners are not registered for GST which means they cannot charge GST on the sale and therefore not allowed to claim any GST input tax for any expenditure incurred relating to the land and property.
3. Land sold by a private person to a registered person is treated as being a “second hand good” with a claimable input credit available to the GST registered purchaser.

GST on Real Property: NZ (2)

4. Tax Avoidance issues:

- a) Timing of supply and the cash and invoice basis:
The use of invoice basis to claim GST credits when the settlement date for the sale of premise is delayed for a long time:
- *Ch'elle Properties (NZ) Ltd v CIR*
 - *Glenharrow Holdings Ltd v CIR*

Courts ruled against their abusive GST schemes that manipulated the operation of the GST to affect the timing and receipt of deductions and the payment of GST

Aims of the Study

Aims:

1. The meaning of supply for consideration
2. The sale of premises

The meaning of supply (Australia): Section 9-5 of the GSTA 1999: Makes, Consideration, course of enterprise, Australia, registered.

- a) A supply is not a taxable supply to the extent that it is GST-free supply or an input taxed supply
- b) Definition of supply: Section 9-10 of the GSTA 1999:
 - a) Supply of goods, services, provision of advice or information, grant (assignment, surrender of any right), financial, an entry into, or release from an obligation to do anything, to refrain from an act or to tolerate an act of situation

Supply and Consideration-GST: Australia (1)

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- c) **Consideration:** S 9-15 GSTA: any payment, or any act or forbearance, in connection with a supply of anything (\$ or barter)

Supply and Consideration-GST: Australia (2)

Given wide interpretation by the Australian courts:

- ***FCT v Reliance Carpet Co Pty Ltd (2008)***
- ***FCT v Qantas Airways Ltd (2012)***

Supply and Consideration-GST: Australia (3)

Reliance Carpet: Deposits received as security for the sale of a real property transaction attracts GST even though there was a forfeiture of contract by the purchaser. HC viewed the deposit received was consideration for supply under s 99-10 of the GSTA 1999. Different from NZ.

Qantas Airways: FC and HC claimed that GST was payable as supply was made by Qantas when customers booked and paid for their flights and it did not matter whether the customers did not travel on the booked flights.

Supply and Consideration-GST: NZ (1)

The meaning of taxable supply (NZ): Section 8 of the GSTA 1985: Supply of g and s, not an exempt supply, NZ, registered person, furtherance of a taxable activity.

- a) A taxable supply is a supply of g and s including zero rated supplies. Exempt supplies are not charged with GST. All forms of supply. Goods – all kinds of personal or real property, except choses in action and money. Services – anything which is not goods or money and therefore includes choses in action and products transmitted electronically (similar to Aust, supply includes everything other than money).

Consideration: S 2- any payment made or any act or forbearance (voluntary or not) resulting from the supply of goods and services but does not include payment made as an unconditional gift to any non-profit body. *Turakina Maori Girls College Board of Trustees v C of IR*

Supply and Consideration-GST: NZ (2)

Sale of a going concern:

- is a taxable supply under s 5(12) but becomes a zero-rated supply by s 11(1)(c) – if both purchaser and vendor agree in writing and are registered for GST.
- Apportionment needed if the supply is partly zero-rated and partly taxable supply under s 5(14) and also in ***CIR v Smiths City Group Ltd (1992)***
- If a dwelling is included in a supply, then the supply of dwelling is deemed to be a separate supply from any other real property included in the overall supply – to prevent the purchaser from claiming an input tax deduction in relation to the dwelling (house).
- If the registered person has claimed an input tax deduction in relation to the dwelling (or a proportion of it), any subsequent supply of the dwelling is deemed to be a taxable supply (or proportion of the dwelling as taxable supply).

Supply and Consideration-GST: NZ and Australia (3)

Consideration in the GST legislation required an element of reciprocity as found in:

Taupo Ika Nui Body Corporate v CIR (1997)

Australian court took a wider interpretation of consideration for GST purposes that reciprocity is not an element to determine consideration:

Body Corporate Villa Edgewater CTS 23902 v FC of T (2004)

NZ: Supply of services by the body corporate did not amount for a supply for consideration.

Australia: The body corporate is an enterprise and the contributions made by the lot-owners are made in the course of furtherance of the enterprise

Sale of a going concern: NZ (partially tenanted)

Ordinarily the sale of a commercial building that is rented to tenants on commercial terms would qualify as a “going concern” at the time of supply.

Case 27 shows that a partially tenanted property can qualify as the supply of a taxable activity as a “going concern” with 42 % use of commercial letting

Sale of a going concern: Aust (partially tenanted)

ATO seems to apply more restrictions for an enterprise of leasing to claim as a “going concern” sale:

- Building has been leased for a number of years
- Various floors were vacant but were actively marketed
- The remaining floors were being refurbished
- ATO required that all leases, agreements and covenant must be included in the sale when the partially tenanted building is sold.

Different from NZ especially with **Case 27** – it would not have qualify as a “going concern” sale as it does not include the last item.

Mixed use of real property:

New Zealand:

Norfolk Apartments Ltd v CIR (1995)

Apartments in retirement villages providing two proposed supplies – dwelling (exempt supplies) and facilities for residents in the common areas (lease) – Courts disallowed the claims for input tax deductions for GST associated with the purchase of land and the costs of construction of the retirement village

Mixed use of real property:

Australia:

***Wynnum Holdings No 1 Pty Ltd & Anor v FC of T
(2012)***

South Steyne Hotel Pty v FC of T (2009)

Mixed use of real property: Aust

Courts have difficulty in drawing clear boundaries between when the supply of the residence is treated as:

- A home
- A home where supplier of care and medical attention are brought in
- A home provided as part of a combination package of personal care, nursing services, meals, monitoring services
- A place where you stay whilst medically treated and
- A more like hospital

Summary and conclusion (1)

- Real property transactions have posed significant problems for the current GST legislations
- No clear boundary for mixed used assets between exempt and taxable supplies
- Definition of sale of going concern, consideration differs between the two countries
- Wider and more comprehensive interpretation of the GST legislations by Australian courts c.f. NZ courts

Summary and conclusion (2)

- Outset: Australian GST rules are more complex and comprehensive. Australia also applies more restrictions and requirements on real property transactions
- Different canons of taxation being emphasised:
 - Aust: Equity over efficiency and simplicity (uncertainty and ambiguity)
 - NZ: Efficiency and simplicity over equity (create more inducements to aggressively undertake tax planning and avoidance to minimise GST liabilities)

Final note: NZ Tax Authority

- Rise in GST collection due to the implementation of a multi-year property compliance programme by IR consisting of two phases:
 - Identification of risks and examples of speculative activity in the property sector. Match external, third party property and land information with internal IR data. Aim of IR is to educate taxpayers, tax agents and legal advisers and to alert them about potential tax liabilities before transactions took place. Publications and website on tax and property transactions

Final note: NZ Tax Authority

Second phase:

- Direct contact via mail and phone with taxpayers and managing risks especially those with previous records of property transactions. Additional audits of property transactions were undertaken based on risk identification in the first phase.
- Results: Additional tax revenue (GST and income tax) of about NZD 36 million pa with NZD 33 m from audits and NZD 3 m from voluntary disclosures

Conclusions and suggestion for future studies

- Use of abusive GST schemes in the property sector led to significant tax revenues lost from GST collection.
- Comparative study on the GST treatment between the two countries in three areas, therefore not exhaustive. Other aspects to be explored further
- Australia: more comprehensive approach in their treatment of GST.
- Lessons to be learnt for Trans-Tasman real property ownership and transactions.