The Tax Institute

The Tax Summit

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Do you really have the right documentation to support your tax position?

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1. Overview

When Chris Wallis asks me to present a paper, he always provides me a draft title that sometimes leaves me amused, sometimes confused or a combination of the two. When I asked about the wordy title…. "You'll know what to do, make it what you will" and menu of widely spread bullet points emerged.

Per the brochure, with bullet points 3 & 4 flipped to make more sense, but in reality, I will cover the "what happens" if you don't get a certificate/approval against each of FIRB, GST withholding and CGT withholding:

> *This session will provide tips and traps in relation to assembling the revenue law related documentation required for land transactions including valuations, Tax Certificates, withholding and non-resident transactions including:*

- *A refresher of provisions dealing with the margin scheme and new residential premises*
- *FIRB timelines – how and when*
- *GST and CGT withholding*
- *What happens when there is a failure to obtain or adjust the certificate/s*
- *Build to rent, retirement villages; and*
- *Distressed sale situations and a court appointed statutory trustees that have no automatic relief from obtaining certificates.*

The paper & presentation broadly follows the above order and I have attempted to draw links between the issues for coherence.

I hope I do matters justice and seek to provide comments and focus that is meaningful and of use to practitioners. As always, I welcome questions & robust discussion throughout the presentation.

2. Refresher on *margin scheme* and *new residential premises*

The *margin scheme*[1] provisions and provisions that deal with *new residential premises*[2] are very separate and do not always intersect with each other. But they can and it is important to understand when and how this occurs and what the best approach might be.

I have not expended much text on the fundamentals below but will talk more to that and the key issues and tips I have noted in presentation.

2.1 *Margin scheme*

One fundamental to understand is that you do not need to be dealing with *residential premises*[3] or *new residential premises* to access the *margin scheme* and there are certainly occasions where you will want to go outside that. It only needs to be a *taxable supply*[4] of *real property*[5], which encompasses a:

- Freehold interest in land
- A stratum unit,
- Granting or selling a *long-term lease*[6]

2.1.1 Fundamentals

Access

The key requirements to access the margin scheme are:

(i) A *taxable supply* over a land interest as noted above.

Practical note: it is clear from the decision in *Sunchen*[7] that you cannot call something a *taxable supply* when it is not.

(ii) The land interest in question being eligible – essentially that it was acquired by "you" as something other than a fully taxed supply – i.e.

- An *input taxed supply*
- *Supply* by an unregistered vendor
- *GST-free supply*

Noting that in regard to the latter, there is a look through to the vendors *consideration* for the *acquisition* in calculating the margin as well as restrictions on related party/partnership/joint venture and intra GST group supplies.

[1] Division 75 – *A New Tax System (Goods & Services Tax) Act 1999* (**GST Act**)
[2] Section 40-75 – GST Act
[3] Section 195-1 Definitions – GST Act
[4] Section 9-5 – GST Act
[5] Section 195-1 Definitions – GST Act
[6] Section 195-1 Definitions – GST Act
[7] *Sunchen Pty Ltd v Commissioner of Taxation* [2010] FCAFC 138; 190 FCR 38

(iii) The parties agree in writing before the date of supply that the margin scheme applies.

Typically, this is done in the contract and is accordingly in place by the time of *supply.* The “tick boxes” and standard contracts deal with it adequately and can be amended by mutual agreement after signing, provided this or some other form of written agreement is in place prior to completion or settlement.

The Commissioner can extend the period past settlement but does not have to. That can be difficult – get it right on the contract before settlement.

Calculation + (no) GST Credits

GST liability = 1/11th x (GST inclusive selling price less *consideration* for the acquisition. Noting:

(i) Consideration for the acquisition is the original purchase price from 1 July 2000 or proportion of the purchase if subdivided or divided into strata or other title.

(ii) Where acquired before 1 July 2000 a valuation as set out in the table[8] may be used.

It is worth studying and understanding this table, as some beneficial outcomes can arise as noted in practice notes below.

The price should always be GST inclusive to apply the *margin scheme* and it should be noted that the purchaser is unable to claim the embedded GST even where there is the requisite registration and creditable purpose.

2.1.2 Practice Notes

Valuation Matters

I have noted above that it is worth understanding the table to s75-10(3)(b), which will generally substitute the 1 July 2000 valuation for consideration of the acquisition where the interest existed prior. This of course must be an approved valuation; however the following exceptions are worth examining further:

- Item 2A – where you acquired the land interest after 1 July 2000, but as a *GST-free supply.*

  To maintain integrity with the look through rules, that require you to use the vendors consideration for the acquisition, where this is prior to 1 July 2000, you get the value at that date.

  This may occur for example when commercial premises are acquired a GST-free going concern, but then redeveloped into *new residential premises.* Worth noting here, that if that look through value is higher than what you paid, you get to use the higher value and reduce the GST liability.

- Item 2 – Where the interest was held prior to 1 July by the supplier is not registered until a later point.

  This allows the adoption of a value for the margin scheme at the time or registration or requirement to be registered. This is very valuable and careful planning can mitigate GST liability substantially.

[8] Table to Section 75-10(3)(b) – GST Act

This may occur where a land interest is to be redeveloped into *new residential premises* for sale, but the owner had never been registered. Careful management of when registration for GST is affected or the requirement for registration arises is of value here.

It is noted that the requirement to register arises where turnover of taxable supplies is expected to exceed the $75,000 threshold, which at its best would be 12 months prior to the first sale of *new residential premises.*

- Item 4 – where:

  The supplier is the Commonwealth, a State or a 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.

  In which case the valuation date is the date of the actual *supply* effectively making this nil. External parties have sought to exploit this in conjunction with those bodies for obvious reasons.

Ensure you know who is making the supply!

The GST legalisation typically refers to "you" in regard to acquisitions and supplies being made, and also in the margin scheme provisions to the supplier, which for the purposes of that provision is also "you". I note "you is defined[9]:

> ***"you"****: if a provision of this Act uses the expression* ***you****, it applies to entities generally, unless its application is expressly limited.*

"Entity"[10] is also defined to include:

> ***Entity*** means any of the following:
>
> (a) an individual;
>
> (b) a body corporate;
>
> (c) a corporation sole;
>
> (d) a body politic;
>
> (e) a * partnership;
>
> (f) any other unincorporated association or body of persons;
>
> (g) a trust;
>
> (h) a * superannuation fund.

Why I this relevant? Simply put, the taxing provisions of the GST act apply to the particular entity, as well as access to various concessions such as the *margin scheme.*

It is not uncommon for GST registered businesses to use relate party property and sometimes the line gets blurred as to who "you" is in the transaction.

[9] Section 195-1 Definitions – GST Act
[10] Section 184-1(1) – GST Act

For property transactions always check the title! An example that demonstrates this is:

- Farming business run by John & Jane Smith 50/50 for many, many years – registered as a partnership for GST and does all the trading.
- The underlying land is considered theirs and the assumption is that the Partnership of John & Jane is the supplier if any part sold.
- On review of the title before sale. The solicitor notices that a very minor % of the title is held is held by John's mother Clare with 48% held by John and 49% by Jane.

The GST registered partnership of John and Jane is NOT the supplier or "you" on any dealing on the land.

The Partnership of Jane, John & Clare is the supplier and "you" for GST if required to register. This provides the potential if not registered that:

1. The sale could be treated as a *supply* of a capital asset and excluded from projected turnover and the requirement to register and pay GST on the sale, or
2. Sale under the margin scheme based on a value (per Item 2 above) when that partnership is required to register.

2.2 New residential premises

The supply of *residential premises* by way of lease or sale is generally *input taxed* unless they are *new residential premises* or *commercial residential premises*[11]

New residential premises at its simplest are defined as follows[12]:

(1) * Residential premises are ***new residential premises*** if they:

(a) have not previously been sold as residential premises (other than * commercial residential premises) and have not previously been the subject of a * long - term lease; or

(b) have been created through * substantial renovations of a building; or

(c) have been built, or contain a building that has been built, to replace demolished premises on the same land.

I do not intend to explore the complications and wider matters that emerge from this and the balance of the provisions other than to note:

- It is normally quite clear when premises are *new residential premises.*
- There is no simple guide on what constitutes *substantial renovations* although the somewhat ambiguous Australian Taxation Office (**ATO**) GST ruling[13] will guide you toward having to use your own logic and sense of fairness to build a case.

Most importantly however you should be aware of this provisions that premises crease to be *new residential premises* and taxable after at least 5 years of only being using for *input taxed* purposes.

Specifically:

[11] Section 195-1 Definitions – GST Act
[12] Section 40-75(1) – GST Act
[13] GSTR 2003/3 - Goods and services tax: when is a sale of real property a sale of new residential premises?

(2) However, the * residential premises are not ***new residential premises*** if, for the period of at least 5 years since:

(a) if paragraph (1)(a) applies (and neither paragraph (1)(b) nor paragraph (1)(c) applies)--the premises first became residential premises; or

(b) if paragraph (1)(b) applies--the premises were last * substantially renovated; or

(c) if paragraph (1)(c) applies--the premises were last built; the premises have only been used for making supplies that are * input taxed because of paragraph 40 - 35(1)(a).

2.2.1 Practice notes

I will discuss the practical issues in session as to:

(i) When the 5-year period commences – generally when first let on a bona fide basis.

(ii) Per title to be supplied – multiple strata v multiple dwelling on a single title such as BTR or retirement village premises.

(iii) Selling the property before and after the 5 years. Selling toward but before 5 years can be quite a negative result:

a. Full liability on sale – whether *margin scheme* or fully taxable
b. Recovery on GST input credits likely to be limited.

(iv) Where you maintain the intention to sell as a *taxable supply* the ATO considers the 5 years never expires as wholly for input taxed supplies.

3. FIRB re-cap & timelines

3.1 The framework

The *Foreign Acquisitions & Takeovers Act 1975* requires foreign investors to notify – or essentially seek approval – from the Treasurer, who has the authority to prohibit the investment, place certain conditions on it or simply let it through.

There is a presumption that investments should proceed unless found to be contrary to the national interest or national security.

This function is largely delegated to the Foreign Investment Review Board (FIRB) who advises the Treasurer and there are a number of guidelines and thresholds in place to assist applicants and smooth that process.

The cost of this is intended to be met by application fees required under the *Foreign Acquisitions & Takeovers Fees Impositions Act 2015.*

3.1.1 Foreign investors

Taken direct from the online guidance https://foreigninvestment.gov.au/guidance/general/key-concepts#foreign-investors:

Foreign Investors

- a person not ordinarily resident in Australia
- a corporation, where a person not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest
- a corporation in which two or more people, each of whom is not ordinarily resident in Australia, a foreign corporation or a foreign government hold an aggregate substantial interest
- the trustee of a trust in which a person not ordinarily resident in Australia, a foreign corporation or a foreign government holds a substantial interest
- the trustee of a trust in which two or more people, each of whom is not ordinarily resident in Australia, a foreign corporation or a foreign government hold an aggregate substantial interest
- a foreign government
- a person not ordinarily resident in Australia, a foreign corporation or a foreign government that holds at least 20 per cent in a limited partnership
- two or more people each of whom is not ordinarily resident in Australia, a foreign corporation or a foreign government, that hold an interest of at least 40 per cent in a limited partnership
- any other person that meets the conditions, prescribed by the regulations.

Foreign Government Investors

- a foreign government or separate government entity
- a corporation, the trustee of a trust, or a general partner of a limited partnership, in which:
    - a foreign government or separate government entity holds a substantial interest of at least 20 per cent, including with associates
    - foreign governments or separate government entities of more than one foreign country (or parts of more than one foreign country) hold a substantial interest of at least 40 per cent, including with associates.

All of the above extend to associates, indirect interest etc.

3.2 Australian land investments

Guidance is provided on acquisitions where you might be expected to submit an investment proposal.

Paraphrased direct from the online guidance https://foreigninvestment.gov.au/getting-started/investment-information/land:

National security land

- *any national security land - the monetary threshold is:*
    - *$0 for all investors, **regardless of its value***

Agricultural land

- *agricultural land – the monetary threshold is:*
    - *$15 million if you meet certain conditions. This may differ for certain investors.*
    - *$0 for foreign government investors, regardless of its value and whether the land is sensitive or vacant.*

Commercial land

- *commercial land – the monetary threshold is:*
    - *$0 for vacant commercial land for all investors*
    - *$310 million for developed commercial land*
    - *$67 million for developed commercial land that is considered sensitive (an operational mine is considered to be sensitive developed commercial land as are properties near Defence land or land that has communication infrastructure)*
    - *$1,339 million for free trade agreement partners, regardless of whether the land is sensitive*

- *$0 for foreign government investors, regardless of its value and whether the land is sensitive or vacant.*

A no objection notification for vacant commercial land will generally be conditional on the land being put to productive use within a reasonable timeframe.

Residential land

- *$0 for all investors,* ***regardless of its value***

Exemption certificates

You may be able to apply for an exemption certificate for your investment proposal.

Typically, these are given for lower-risk, non-sensitive investments where you are seeking to make several investments over a specified time.

What appears to have become a more common practice according to an article published by the RBA[14] is the acquisition of lower value commercial premises, particularly around CBD's where rents have lagged and the conversion or rebuilding of these sites as residential premises.

The article is 10 years old and as yet I have not determined that this practice is or is not still permitted, however I have just been referred a matter where this is relevant and I may have the answer by the time of the presentation!

3.3 Process & time frames

3.3.1 Residential land

You may apply for the approval of residential premises online through the ATO website[15]. In doing so, you are required to apply for approval **before** you "acquire an interest" in the property. This raises certain practical issues noting:

- The decision maker has a statutory period of 30 Days to make the decision.
- "Acquire an interest" is noted to include signing an unconditional contract to purchase amongst other interests (including security and leasehold interests greater than 5 years).

Here is a tension for buyers, particularly in the current market, where sellers may not be willing to be patient on either exchange or settlement. To be strictly within the guidelines, the contract would clearly need to be subject to FIRB approval.

All of this may of course be manageable for the right buyer with the right seller, however:

- Where approval is gained subsequent to the commitment or settlement, on a practical level there are no consequences,

[14] *Foreign Investment in Australian Commercial Property* by Kevin Lane, Adam Sinclair & David Orsmond - Reserve Bank of Australia Bulletin September Quarter 2021

[15] https://www.ato.gov.au/online-services/foreign-investors/residential-application#Howtoapply

- Where approval is not obtained, and the property been acquired there is a breach which may at the very least result in fines and also require disposal of the property (see note below).

For these reasons applying for an Exemption Certificate where you are able to provide the required details including State, property type, details of ownership and expected purchase price covering you for 12 months may be more practical where the purchase is of something reasonably “vanilla”.

In addition to this there is an Exemption Certificate available to property developers and other vendors provided certain conditions are met:

- The development consists of 50 or more dwellings
- Multi storey projects - not house and land packages
- These are marketed for sale and to be sold (not retained as investments)
- No more than 50% is to be sold to foreign persons and they have FIRB approval
- The project has development approval – certificate will not be issued before this is in place.

Compliance & penalties

Valuable and practical guidance is provided in the FIRB’s *Guidance 14*, the most recent update I could locate being 3 January 2023. Critically it notes the possibly severe penalties for:

- Failing to notify the Treasurer before acquiring an interest in residential land
- Acquiring an interest in residential land, after notifying the Treasurer, but before receiving foreign investment approval (per the example above)
- Providing the Treasurer with false or misleading information in an application for foreign investment approval for residential land
- Engaging in conduct that contravenes an order made by the Treasurer under Part 3 of the Act (e.g. an order prohibiting the acquisition of residential land, or an order requiring the disposal of a residential property) Failing to comply with a national security call-in notice from the Treasurer relating to residential land (e.g. prohibiting an acquisition of residential land while a national security review is completed)
- Failing to comply with a notice, given by the Treasurer, to provide information relating to residential land
- Failing to lodge a vacancy fee return on-time
- Failing to make and keep records relating to residential land

Key take outs worth noting are however:

(i) Self-disclosure will generally get a better result that allowing the ATO/FIRB to find out.
(ii) A number of the penalties fall under criminal provisions as well as having fines and civil penalties
(iii) It is possible to obtain retrospective approvals, logically this will require self-disclosure

The Treasurer via the ATO and FIRB have been very active in seeking out those in breach in a crackdown that has run since at least 2015 and resulted in a number headlines in the press:

- “More foreign buyers forced to sell their homes in FIRB crackdown”[16]

[16] Australian Financial Review (AFR) 19 February 2019

- "'Illegally held': Foreign buyers forced to sell 630 Aussie homes"[17]

Land investments – not residential

Encompassing vacant land, commercial & industrial sites. Note the various thresholds above that may streamline the process, which is by way of submission to the FIRB application portal rather than online with the ATO.

Exploring all aspects & types is not feasible in the context of this presentation, suffice to say the requirements may be substantially similar, as are the timelines and penalties for not obtaining approval or incorrectly obtaining same, however one may observe that the information requirements for submissions appear substantially more detailed and onerous. Particularly on specific assets.

[17] The Daily Telegraph 25 July 2023

4. GST and CGT withholding

The GST & CGT withholding provisions may have a common purpose of limiting leakage of Commonwealth revenue in circumstances where taxpayers are unwilling or unable to meet their obligations and occur similarly around the disposal of certain property interest however, they have a completely separate different operation in practice.

Where both are required in regard to a particular sale, there is no priority of one over the other at settlement.

Worth recapping both at a high level and perhaps discussing the issues that arise

4.1 GST withholding

This integrity measure has been in place since 1 July 2018 and places the obligation on the purchaser to withhold and remit the given rate of GST to the ATO. The purchaser is not required to register for GST.

The key provisions are set out in Subdivision 14-E of Schedule 1 to the *Tax Administration Act 1953* (**TAA**) – Sections 14-250 to 14-255.

The types of properties impacted are:

- *New residential premises* as defined, but **not** *new residential premises* created by *substantial renovations* and not *commercial residential premises,* and
- Land that could be used to build new residential premises.

Where:

- There is a *taxable supply.*
- The recipient is not registered for GST and does not acquire the property for a *creditable purpose*[18]*.*

The rates at which an amount should be withheld are:

- For a *supply* under the *margin scheme* 7% of the contract price or otherwise the *price*[19] of the *supply.*
- Otherwise, 1/11th of the contract price or otherwise the *price* of the *supply.*

There are a series of steps and notifications that form part of this process, all of which should be carried our and in place to effect settlement of the property:

Step 1: Supplier must notify purchaser

Step 2: Purchaser or representative lodges Form one

Step 3: Form one email confirmation

Step 4: Purchaser or representative lodges Form two

Step 5: Purchaser makes the payment

Step 6: Payment email confirmation

Step 7: Supplier credit and email confirmation

[18] Section 11-15 – GST Act
[19] Section 9-75(1) – GST Act

Step 8: Supplier lodges business activity statement

If all goes well, the GST is withheld – which is clearly not a final tax – and paid to the credit of the vendor with the ATO and this is washed up on lodgement of the vendor BAS. See comments under issues in practice.

I do not intend to work through these steps in detail but note that there are penalties for the vendor if they fail to provide the notification and penalties for the purchaser where GST is not withheld and remitted to the ATO.

4.1.1 Issues in practice

Where the supplier issues his notice correctly and in a timely manner you may reasonably rely on that as purchaser/recipient and be guided on the withholding obligations with may be:

- Nil
- 7% of the tax inclusive *price*
- 1/11th of the tax inclusive *price*

Unless you have knowledge or suspect that the vendors notification is incorrect. This may occur where for example the contract states the sale is under the margin scheme, whereas indicating that no withholding is required.

Purchasers may not always have the tax knowledge to determine errors, so it is important that you as recipient are properly advised as the penalty for non-compliance falls on you. This is particularly where the nature of the property and vendors status is more complicated as may be the case in regard to:

- Purchase of a lot from a broadacre subdivision where the vendor is indicating the supply is not taxable.
- Purchase of land that may or may not be capable and/or intended to be used to build new residential premises.
- Where the vendor does not provide the purchaser with notification yet wishes to proceed with settlement.
- Where the vendor notification includes details of an entity that is not apparent from the title.

The lawyers acting on the transaction should provide guidance on these matters and/or engage specialist advice, however conveyancers are not generally able to provide GST advice and obtaining specialist advice would be recommended to ensure that the purchaser is not unduly penalised.

Logically the contract for sale may not proceed to settlement without resolving these matters, however this can be messy and where you wish the purchase to complete, the liability rests with the purchaser/recipient if correct withholding is not made. The solution may be to simply withhold the maximum amount of 1/11th and proceed with the balance of forms and payment to the ATO, where the vendor details are reasonably known.

This highlights the fundamental practical risk of what might happen if the incorrect amount and/or incorrect ABN of the vendor is used? It can be resolved with both the vendor and the recipient being able to apply for a refund of monies as may be applicable, but its messy and certainly not preferred.

4.2 Capital gains withholding

Foreign resident capital gains withholding (**FRCGW**) has applied to contracts after 1 July 2016, initially at the rate of 10% of the purchase price, increased to 12.5% for contracts after 1 July 2017.

The key provisions are set out in Subdivision 14-D of Schedule 1 to TAA – Sections 14-200 to 14-235.

This is an integrity measure to ensure that the CGT liability of sales of *taxable Australian property* (**TAP**) by *foreign residents* is met. As for GST withholding it is not a final tax, and impacted parties are still required to lodge an income tax return for the period to which credits for the withholding tax may be applied and/or refunded.

It applies to:

(i) Real property interests (broad, including ordinary land interest, quarrying & prospecting rights with a market value of $750,000 or more, or
(ii) Indirect real property interests of 10% or more, or options to acquire same, in property rich entities (more than 50%) – including company title arrangements.

In operation it treats everyone as *foreign resident* unless they can show otherwise and provide a:

- Clearance certificate for real property interests
- Vendor declaration for other included assets (stating that they are Australian resident).

Foreign residents may also apply for a variation certificate to withhold something less than the 12.5%. Most commonly this involves preparing submissions to set out that the withholding will be excessive as there is insufficient gain or there are losses to offset the gain. It can however extend to certain creditors/security interests being compromised[20].

4.2.1 Issues in practice

Most common issue that arises is that the clearance certificate is not obtained in time for settlement and as a consequence the vendor is treated as *foreign resident* the purchaser will withhold the 12.5%.

Where the appropriate certificate is not in place this is required, and the FRCGW will not be withheld in error.

The vendor must then lodge a tax return and claim the credit in their next tax return, which may of course be some time away, creating a potential cash deficiency. The benefit is of course that some level of any final CGT liability is provided for.

In my experience, failure to apply for the clearance or variation certificate in time is most commonly why these matters occur, then compounded by vendors keen to complete and not willing to delay or risk the sale by delays.

A word of warning – where FRCGW is withheld and lodgement of the return results in a material refund, particularly for foreign residents, my experience is that this refund will be queried by the ATO.

Further to this, where all the information to support and substantiate the position taken in the return – cost base evidence etc – is not readily available, the reviewer will have little patience and amend the gain, requiring the matter to be taken to Objection. Currently there are further material delays expected in resolving matters at that level.

Best practice? Get your clients clearance or variation certificates well ahead of time – ideally before the contract is executed.

[20] Section 14-235(1) – Schedule 1 to TAA

5. Build to rent, retirement villages etc

The purchase of land to develop BTR or a retirement village will be subject to FRCGW under the rules noted above unless clearance or variation certificates are obtained and may also be subject to GST withholding as land to be used to develop new residential premises as both will be considered such for the first 5 years of letting.

Similarly, the disposal of a BTR interest or a retirement village with be subject to the normal requirements of FRCGW. From a GST perspective, these developments will remain *new residential premises* and subject to GST withholding for at least a period of 5 years from letting – longer where there is a dual intention to rent and sell.

5.1 Income tax perspective – relatively simple

Build to rent (**BTR**) and retirement village independent living units (**ILUs*)*** on typical loan/ease or loan/licence arrangements are relatively straightforward from an income tax perspective, noting typically:

- Capital cost of acquisition and/or construction
- Typically, not strata title accommodation units
- Entitlement to capital allowances on eligible construction costs 2.5% - 4%
- Emerging rental is income when received or recognised
- Deductions for finance and other revenue expenses
- Subject to CGT on disposal

There are some nuances on how rental income is recognised on retirement village ILU's which typically have a large "ingoing contribution" that approximates the value of the ILU as a separate property but is ordinarily split to be treated as an upfront lease fee of say $10,000 with the balance treated as a loan from residents. When the resident leaves, there is an exit fee or deferred management fee (**DMF**).

Only the upfront fee and the exit fee/DMF is treated as income, both on an entitlement/receipts basis. Many resident contracts on ILU's will include a "share of the capital gain" being brought to account on exit – being the difference between their ingoing contribution and the next residents ingoing contribution. This is however <u>not</u> a capital gain under the *Income Tax Assessment Act 1997* (**ITAA97**) but rather simply an adjustment mechanism on the exit fee/DMF.

Thos wishing to know more should refer to the specific income tax ruling dealing with ILU's in retirement villages[21].

5.2 GST – a bit more complex

The GST treatment of BTR in particular more recently as well as ILU's in retirement villages is the subject of ongoing robust discussions, however the simple answer is as *residential premises* for lease:

(i) The lease/licence or rental income is *input taxed* and as a consequence;
(ii) There is no recovery of GST input tax credits on underlying acquisitions in regard to making that *supply* as there is not the requisite *creditable purpose.*

From an overall GST imposition on projects such as these, this should in theory provide a lower net GST impost over time where the rental is ultimately sufficient to cover the construction and operation costs, ignoring

[21] TR 2002/14 - Income tax: taxation of retirement village operators

the time value of money. This however may take many years or even decades to do so, substantially diluting that benefit.

Both industry participants & bodies together with professional bodies have been actively pushing for concessions that would mitigate the high capital cost and long payback periods as a barrier to constructing both BTR and retirement village ILU facilities.

In essence to mitigate the upfront capital cost and meet GST liabilities over time. Examples such as:

(a) Provide operators who develop facilities 100% of GST input credits on development & construction costs, with these to be paid back over a 10-year period, or earlier if sold.

(b) Treatment of such facilities as *commercial residential premises.* If this were the case, the result would be:

- 100% recovery on all relevant GST input tax credits
- Liability for GST on accommodation charges – essentially upfront lease fee and exit fees/DMF, noting:
    - Where these qualify as being *predominantly for long term accommodation*[22] the GST liability will be half the normal rate.
    - Where the entire facility it will be subject to GST on ordinary principles.
    - The operator may elect to be *input taxed* at a later point, which may result in an *adjustment event*[23] although where the GST adjustment periods have expired (maximum 10, or about 11 years) no adjustment will arise.

There are strong arguments that retirement village ILU's may already fit in the definition of *commercial residential premises* and that both BTR and retirement villages should do from a policy perspective, however it is unlikely in the current political and financial climate that these ideas will make much progress in the short to medium term.

5.2.1 Issues in Practice

On the assumption that the facilities are constructed for lease as *input taxed residential premises* and no GST is sought to be claimed on construction (apart from minor commercial parts etc) care has to be taken on sale of the facility noting that they will remain *new residential premises* for a period of at least 5 years from when leased. It is further noted that the Commissioner has some views[24]:

(i) Where you hold the "dual intention" to both lease (input taxed) and sell (taxable) at a later point then you may claim a portion of your GST input tax credits on a fair and reasonable basis – typically $ numbers as they relate to these supplies, however:

- The Commissioner's view remains that the 5-year period for *new residential premises does not expire, and*
- You are required to make annual *adjustments* based on expected sale prices – not very practical when there is only a single title - and input taxed supplies made.

[22] Section 87-10 GST Act
[23] Division 129 – GST Act
[24] GSTR 2009/4 - Goods and services tax: new residential premises and adjustments for changes in extent of creditable purpose

(ii) Sale of the entire facility within 5 years, or such further period as extended per above, will result in a full GST liability on same, as against only a partial recovery of GST credit on construction. This may be observed as a worsening situation the longer you lease.

(iii) The Commissioner's view on retirement villages[25] further complicates matters, in that he considers that the *consideration*[26] on sale of the village encompassing ILU's is the sum of the contract price plus the value of resident loans.

It would not be uncommon to have resident loans in place – which the industry & most advisors consider have no value and are not *consideration* – that are many multiples of the contract price. Where the contract price was say $30m and the resident loans $60m on a land purchase price of say $5m then the GST liability would be 1/11 x (90m - $5m) or $9,090,909 on a contract price and cash received of $30m.

[25] GSTR 2011/1 - Goods and services tax: development, lease and disposal of a retirement village tenanted under a 'loan-lease' arrangement
[26] Section 9-15 – GST Act

6. Distressed sale situations and a court appointed statutory trustees that have no automatic relief from obtaining certificates

Both the CGT withholding and GST withholding regimes place the responsibility on the purchaser with penalties for non-compliance as noted above. If withholding is applicable the purchaser does not have the capacity to vary the obligation.

Distressed sale situations may or may not involve insolvency and the external appointment insolvency practitioner or a mortgagee taking possession. Neither of which will override the withholding obligation of the purchaser, although there are some nuanced differences in regard to variations of CGT withholding and variation certificates as set out below.

Court appointed statutory trustees – generally appointed to sell property where the owners or beneficiaries are in dispute – simply stand in the shoes of the owners who are still required to meet their obligations and gain no special dispensation or variation of withholding liabilities for either GST or CGT.

There are however some differences between the provisions.

GST Withholding

The provisions are contained in is just two sections - s14-250 & s14-255 of Schedule 1 to the TAA and make it clear that “you” a recipient of a relevant *supply* have an obligation under the provisions to withhold and emit the relevant amount to the Commissioner.

Unlike the CGT withholding equivalent there is no opportunity to obtain an exemption or variation certificate and consequently no obligation on the Commissioner to have regard to protecting another creditors rights as set out below.

The provisions rely on the integrity of the vendor notification and related steps to ensure the required amount is collected. The protection against incorrect or false notifications is backed up by penalties.

This is consistent with the scheme of the GST legislation in that the GST being paid on such an acquisition – ignoring withholding – is borne by the purchaser and simply passes through the vendor “on trust” to the ATO. Its is not the vendors to deal with, nor any insolvency appointed insolvency practitioner or mortgagee in possession.

This was the intent of the legislation and does effectively provide the Commissioner priority of a sort as noted by commentators at the time of introduction.

CGT Withholding

These provisions are more detailed, covering s14-200 through s14-235 of Schedule 1 to the TAA. The purpose of CGT withholding is different in that it is intended to provide funds to meet the liability of the vendor for any CGT that may be payable. As well as provisions that allow exemption from the requirements for Australian tax *residents,* and variations for those who can show the liability will be less, it also has a specific requirement for the Commissioner to consider other creditors[27]:

[27] Section 14-235(1) – Schedule to the TAA

14-235(1) In exercising a power under this section to vary an amount, the Commissioner must have regard to the need to protect a creditor's right to recover a debt.

How this might work in operation is quite usefully set out in the EM to the Exposure Draft for FRCGW[28]:

Foreign Resident CGT Withholding Regime

Variation for sale of secured property

1.85 A creditor of the vendor may have a security interest (for example, a mortgage) over an asset that is subject to the amendments. There may be situations where the proceeds of the sale are insufficient to cover both the amount to be paid to the Commissioner and to discharge the debt the loan secures.

1.86 The Commissioner does not have any priority over secured creditors in relation to the recovery of tax-related liabilities. It is not the intention of these amendments to undermine the security of creditors in the event of a vendor's default. The Commissioner must consider this intention when deciding whether to vary a withholding amount. ***[Exposure Draft, item 1, subsection 14-225(1) in Schedule 1 to the TAA 1953]***

1.87 To support this power, a secured creditor may apply to the Commissioner for a variation where they are exercising a power, in relation to the security, to recover the debt (for example a power of sale). ***[Exposure Draft, item 1, subsection 14-225(3) in Schedule 1 to the TAA 1953]***

Example 1.4 Power of sale

Chris, a foreign resident, owns a commercial property located in Australia. Chris owes $1 million to a bank, which is secured by a mortgage over the commercial property.

Chris' business has been performing poorly and he has missed a number of repayments on the loan. The bank decides to exercise its power of sale.

The property is sold for $950,000 net of costs. The proceeds are insufficient to pay the Commissioner and discharge Chris' mortgage.

Chris would prefer that the Commissioner is paid in preference to the bank because he would be entitled to a credit for this amount. Therefore, he does not apply for a variation (even though one may be available if he made a capital loss).

The bank is entitled to apply for a variation and does so. The Commissioner considers the circumstances and concludes that requiring an amount to be paid to the Commissioner would prevent the bank from recovering the debt from its secured interest.

The Commissioner issues a notice to the bank that varies the amount to nil. The bank provides a copy of the notice to the purchaser. The purchaser is relieved of any obligation to pay an amount to the Commissioner.

[28] https://treasury.gov.au/sites/default/files/2019-03/C2015-038_CGT_Withholding_Exposure_Draft_EM.pdf

Exposure Draft

1.88 It will not be necessary for the Commissioner to exercise this discretion other than in situations where the secured creditor is in a position to exercise a recovery power, or such a position is likely to arise.

Example 1.5 Other secured creditors

Daniel, a foreign resident, owns commercial property located in Australia. Daniel owes $950,000 to a bank, which is secured by a mortgage over the property. Daniel has been meeting all of his obligations under the loan and there is nothing to suggest Daniel will have difficulty continuing to meet his obligations.

Daniel enters into a contract to sell the property for $1 million. The purchaser knows that Daniel is a foreign resident and will be required to pay $100,000 to the Commissioner when the property settles. In these circumstances, there will be insufficient sale proceeds available at settlement to discharge the mortgage.

Daniel (rather than the bank) is entitled to apply for a variation. However, on the available information, Daniel would not be entitled to a variation. If he wishes to dispose of the property, he will need to make other commercial arrangements acceptable to the bank (because the bank has the power to prevent the sale). This is likely to require him to provide an additional $50,000 to the bank or to refinance his obligations in some way.

1.89 The outcome in Example 1.5 may be different if Daniel could point to circumstances that meant it was likely that he would soon default on his loan obligations. It is not the intention to draw a distinction between an ordinary sale and a sale by a mortgagee where the impetus for the sale is the same – the unsustainable financial position of the mortgagor. However, provided the mortgagor has other viable options to discharge the mortgage without a variation to the withholding amount, a variation is not required to protect the security of the mortgagee.

Clearly noting the difference between the right and resources of another creditor, as against the rights and resources of the owner, who is ultimately responsible for the CGT liability.