

TAX BULLETIN

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COURT DECISION GIVES TAXPAYERS MORE CERTAINTY ON GST STATUS OF RESIDENTIAL PREMISES

The Full Federal Court has provided more certainty to taxpayers in determining whether GST is payable on supplies of residential premises.

The Court has handed down its long anticipated decision in the case of *Sunchen Pty Ltd v Commissioner of Taxation* [2010] FCA 21. At issue in that case was the interpretation of the provisions in the GST legislation that determine when a sale of real property should be classified as a supply of residential premises. In finding in favour of the Commissioner, the Court held that the GST status of a property sale should be determined objectively by looking at the physical characteristics of the property at the time it is sold.

The decision is welcome as it provides some much needed clarity on how the GST provisions dealing with residential premises should be applied in practice. However, as discussed below, there will continue to be issues in terms of distinguishing between residential premises and other types of property for GST purposes.

Background

The case had its origins in 2006 when Sunchen purchased a residential property consisting of a single storey house with a carport. At the time it was acquired, the property was occupied by a tenant pursuant to a residential tenancy agreement. The price was stated to be “inclusive of GST”. The property also had a development approval, the benefit of which was assigned to Sunchen by the vendor.

Sunchen argued that it intended to develop the property and claimed an input tax credit equal to one eleventh of the purchase price on the basis that the development approval and Sunchen’s intention to proceed with the development meant that the property was not residential premises to be used predominately for residential accommodation. The vendor had treated the sale as an input taxed supply of residential premises which was not subject to GST. The Commissioner disallowed the credit claimed by Sunchen on the basis that the sale of the property to Sunchen was not a taxable supply.

The legislation and the arguments

Ultimately the case revolved around the interpretation of section 40-65(1) of *the A New Tax System (Goods and Services Tax) Act 1999* (“the GST Act”). Section 40-65(1) provides that:

“A sale of real property is input taxed, but only to the extent that the property is residential premises to be used predominantly for residential accommodation (regardless of the term of occupation).”

Sunchen argued that the words “**to be used**” meant that weight should be given to the subjective intentions of the purchaser in determining the classification of the property. Sunchen argued that as it had acquired the development rights to the property, this evidenced that the property was not intended to be used for residential accommodation and the supply by the vendor was therefore not input taxed but was instead a taxable supply.



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The Commissioner argued, and the majority of the Full Federal Court agreed, that the words “to be used” required the classification of a property “to be determined objectively by reference to the physical characteristics of the property as at the date of acquisition” and not the subjective intentions of the purchaser.

In this case, the physical characteristics the property at the time of its sale to Sunchen “demonstrated that it was to be used predominantly for residential accommodation (regardless of the term of occupation)” and as such was input taxed.

The impact of the decision on future property sales

The decision is a welcome result in that it allows the GST classification of a property to be ascertained according to its physical characteristics and not the subjective intentions of the purchaser. In the course of submissions, the Commissioner argued and the Court recognised that adopting the subjective intentions of the purchaser as part of the classification process would make the provisions unworkable. The decision accords with the way in which the ATO has been applying the relevant legislative provisions in practice.

Ultimately taxpayers require certainty to enable them to meet their GST obligations. This case at least places the focus on the physical characteristics of the property as the means of achieving that certainty.

Situations will still arise, however, where the focus on the physical characteristics of a property will present its own challenges to taxpayers in determining the correct GST treatment. A typical example is where a residential property may be used over time for a number of different activities, such as an office, storage and even as a residence. It can be challenging to ascertain at any particular time the physical attributes that existed. In this respect, developers and other vendors of real property should continue to take care in determining the GST status of their property transactions.

FURTHER INFORMATION

Please ask your regular Pitcher Partners tax contact for further details on the issues raised in this Tax Bulletin.

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