

# TAX BULLETIN

*An update publication for our clients*

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## ATO Ruling Targets GST Payable on Sale of Retirement Villages

On 27 April 2011 the Australian Taxation Office (“ATO”) issued Taxation Ruling GSTR 2011/1, *Goods and services tax: development, lease and disposal of a retirement village tenanted under a ‘loan-lease’ arrangement*. The impact of the ruling will be to significantly increase the GST cost of some retirement village developments in the future. It may also result in the loan/lease or loan/licence model of retirement village no longer being an economically viable option in certain situations.

The ruling considers the impact of interest-free loans received from residents of a retirement village in the following contexts:

- Whether a purchaser’s assumption of the obligation to repay the loans is consideration received by the developer on a sale of the retirement village;
- The impact of the future assumption of the obligation to repay the loans on the input tax credit entitlements of the developer during the construction of the retirement village; and
- The transitional arrangements that apply to developers who were committed to projects before the issue of the ruling.

### Background

The ruling applies to arrangements that have the following features:

- A developer acquires land on which it develops a retirement village.
- The developer enters into a residence contract (lease) with incoming residents in relation to the occupation of a residential unit.
- An ongoing contribution is paid by the resident to secure the right to reside in the village. The ongoing contribution is in the form of an interest-free loan to the developer. That loan is repayable in full when the lease terminates.
- The village is sold as a taxable supply or a GST-free supply of a going concern to a purchaser as ‘new residential premises’.
- The sale arrangement contemplates either expressly or by implication that the purchaser will be responsible for the repayment of the loan when the lease is terminated.
- There are contractual and/or statutory requirements relating to the repayment of the ongoing contributions.
- Repayment of the ongoing contributions is funded at least in part by money received by the operator of the village as the ongoing contribution from a new resident.
- Under the residence contract, the operator of the village may be entitled to receive certain amounts from the resident when the lease is terminated (usually referred to as deferred management fees and/or an agreed percentage of market value changes) and the developer is entitled to set off these amounts against the payment due to the resident.

## **Whether a purchaser's assumption of the obligation to repay the loans is consideration received by the developer on a sale of the retirement village**

The ATO takes the view that the vendor of the retirement village is provided with an effective benefit (repayment benefit) when a purchaser assumes the obligation to repay the ingoing contributions of residents whose leases terminate after the date the village is sold. The repayment benefit forms part of the consideration that is received by the vendor for the sale.

The ATO has highlighted the following points in reaching this decision:

- The repayment benefit is a known and intended outcome of the arrangement;
- There is a contractual connection between the repayment benefit and the sale;
- There is a substantial relationship in a practical business sense between the sale and the repayment benefit; and
- The repayment benefit has an independent value and identity and is not merely an incidental aspect of the thing sold.

The repayment benefit is consideration that is expressed as an amount of money and the amount of the consideration is the face value of the ingoing contributions received by the developer that are assumed by the purchaser. The ATO will not permit the face value of the ingoing contributions to be discounted for any deferred management fees that might have accrued to the vendor prior to the sale.

## **The impact of the future assumption of the obligation to repay the loans on the input tax credit entitlements of the developer during the construction of the retirement village**

In the arrangements considered in the ruling, the developer makes input taxed supplies of leased residential premises and a taxable supply or a GST-free supply on the sale of the retirement village. It is therefore necessary to establish the extent of the consideration applicable to the input taxed supplies to determine the extent to which acquisitions have a creditable purpose (i.e. the extent to which the developer is entitled to claim a credit for the GST paid on its construction costs).

The ATO will allow the extent of a developer's creditable purpose for acquisitions that relate to the construction of a retirement village to be calculated on the following basis (expressed as a percentage):

$$1 - \frac{\text{Total value of economic benefits reasonably expected to be obtained from making input taxed supplies}}{\text{Total value of economic benefits reasonably expected to be obtained in respect of the arrangement}} \times 100\%$$

The value of economic benefits to be obtained from input taxed supplies will be a reasonable estimate of the value of all benefits that the developer will obtain from the input taxed leasing of the retirement village units prior to the sale of the village. This includes the benefit from having interest-free access to the ingoing contribution amounts. That benefit can be valued by using a reasonable estimate of the additional financing costs the developer would incur if it had borrowed an amount equal to the ingoing contributions under an arm's length interest bearing loan from a commercial lender. For this purpose the ATO will accept a calculation that relies on the base interest rate used by the ATO to calculate the general interest charge. The economic benefit will also include all consideration received directly (rent) or indirectly (deferred management fees) for the lease of the units to the residents.

The value of all economic benefits to be obtained in respect of the arrangement will include the value of benefits to be obtained from input taxed supplies PLUS the face value of all ingoing contributions included in the consideration for the sale of the village PLUS the actual consideration received on the sale.

### **The transitional arrangements that apply to developers who were committed to projects before the issue of the ruling**

The ATO concedes that the view that is expressed in the ruling about bringing to account the benefits associated with the ingoing contributions is arguably different from view that was expressed in a general way by the ATO in Goods and Services Taxation Ruling GSTR 2004/9, *Goods and services tax: GST consequences of the assumption of vendor liabilities by the purchaser of an enterprise*. In that ruling the ATO had expressed the view that where some or all of a vendor's liabilities are imposed on or are effectively assumed by a purchaser pursuant to the operation of law, the assumption will not amount to the receipt of consideration by the vendor.

Therefore, because the relevant legislation in all States and the Northern Territory effectively requires the purchaser of a retirement village to assume the obligation to repay ingoing contributions received by the vendor, the ATO concedes that prior to the issue of GSTR 2011/1 a reasonable interpretation of GSTR 2004/9 would not have included any benefit from the assumption of the obligation to repay the contributions into the consideration received for the sale of the village.

Accordingly, developers of retirement villages will be entitled to exclude the value of the benefit from the calculation of the consideration for the sale of a village (and from the calculation of the consideration received for input taxed supplies) where it can be objectively determined that before the date of issue of the ruling (27 April 2011) the developer was commercially committed to construct and develop a retirement village for sale. Such commercial commitment could include where the developer has contracted to purchase land for the objective purpose of developing and constructing the village. However, the transitional arrangements will not apply where a developer has merely incurred costs before deciding to construct and develop a village.

### **Pitcher Partners' Comment**

The approach taken by the ATO in GSTR 2011/1 and the GST liability of a developer of a retirement village pursuant to that approach is a fundamental change from the previous position. A developer selling a retirement village as new residential premises in the future will have a much greater GST liability than the liability that has applied to date (subject to the application of the transitional rules).

The ruling could also turn the loan/lease or loan/licence model of retirement village developments into an economically unviable option in circumstances where the developer intends that the village will be held as a short term investment and will be sold while it still constitutes new residential premises for GST purposes. Developers in this situation may view the strata title model as providing a more tax effective structure in the future.

Clients involved in retirement village developments are encouraged to contact their Pitcher Partners tax advisor to discuss how this ruling might impact on their current and future operations.

## Further Information

Please ask either your regular Pitcher Partners tax contact or any of the contacts in the Pitcher Partners firms below for further details on the issues raised in this Tax Bulletin:

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