

## JOINT SUBMISSION BY

The Institute of Chartered Accountants in Australia, The Taxation Institute of Australia, the National Institute of Accountants, CPA Australia and Taxpayers Australia

### *Draft Goods 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?***

**Date: 12 February 2010**

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The Professional Bodies welcome the opportunity to comment on Draft Goods and Services Tax Determination GSTD 2009/D2 ("the Draft Determination").

#### **GENERAL COMMENTS**

The Draft Determination addresses in more details the circumstances highlighted in Taxpayer Alert 2009/5 where an *associate* is engaged by an *entity* to arrange construction of residential premises and claims GST credits where the *entity* would not otherwise be able to claim credits and an extended non-commercial arrangement exists in respect of payment to the *associate* for the value of construction.

This may effectively achieve significant deferral of the GST liability of the *associate/s* and/or GST cost to the *entity*. The full circumstances of the type of arrangement are set out in paragraphs 1 to 3 of the Draft Determination.

#### **The ATO View**

The ATO have expressed that one or more of the following may apply:

- That the *associate*<sup>1</sup> is not carrying on an *enterprise*<sup>2</sup>, is not entitled to register for GST and is accordingly not able to claim input tax credits on acquisitions in respect of building/construction.
- That if the *associate* is already registered for other reasons, the building/construction/arrangement activity is not part of that *enterprise* and they are accordingly not entitled to claim input tax credits on acquisitions in respect of building/construction.
- Any other act or payment by the landholder *entity* may be construed as *consideration*<sup>3</sup> for the supply of building/construction services, attributable to the period that this occurs. Bona fide loan agreements are excluded from this.
- Division 72<sup>4</sup> may apply to deem *consideration* if there is no consideration, or deem greater consideration if there is inadequate consideration at GST inclusive market value attributable to the period of supply.

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<sup>1</sup> A New Tax System (Goods & Services Tax) Act 1999 ('GST Act') – Section 195  
Income Tax Assessment Act 1936 ('1936 Act') – Section 318

<sup>2</sup> GST Act – Section 9-20

<sup>3</sup> GST Act – Section 9-15

- Otherwise Division 165<sup>5</sup> may apply to the arrangement in respect of the deferral of the GST liability of the *associate*.

### **The Professional Bodies View**

The Professional Bodies welcome any approach by the ATO that restricts arrangements or the application of practices that clearly constitute abuse and provide an unusual and uncommercial outcome within the property industry.

It is noted however that the fundamentals of the arrangements outlined are fairly common practice within the property industry and the key issue is correct identification of those arrangements that constitute abuse and are outside the spirit of the GST legislation.

It is noted that the following characteristics are common to the arrangements that are subject of the Draft Determination:

- The parties are associates for the purposes of Division 72.
- There is little or no *consideration* for the building/construction that is proximate to the supply of the building/construction.
- The terms are not commercial.
- It is implicit that there is either:
  - Single intention/application by the landowner to rent (*input taxed*<sup>6</sup>) the premises for at least 5 years before sale, or
  - Dual intention of rent (*input taxed*) and sale (*taxable*) within 5 years.

### **SPECIFIC COMMENTS**

The Professional Bodies consider that the ATO approach to the existence of an *enterprise* or the exclusion of certain activities from an existing *enterprise* in the circumstances outlined is both inconsistent with the legislation and at odds with the spirit of the legislation and current practice. It may also have broader unintended impact in creating a principle that would apply to circumstances where an *enterprise* should be recognised.

Support should be included as to the broad definition of the term “enterprise” – e.g. Explanatory Memorandum to the GST Act, as follows:

*Enterprise is defined widely because the GST is intended to have a broad base. Certain things are included as enterprises so that input tax credits are available to them.*

Given the broad definition, the activities conducted by the associate would likely constitute “an adventure or concern in the nature of trade”. This would generally equate to there being a profit making intention or isolated transaction (as outlined in paragraph 12).

The comments made at paragraph 7-10 of the determination assume a specific set of circumstances which would give rise to the associate not carrying on an “enterprise”. Namely, the specific characteristics include:

- The services are provided by the associate solely to land holder and nobody else.
- There does not appear to be any contractual arrangements allowing the associate to sue for payment.
- The lack of commercial substance.

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<sup>4</sup> GST Act

<sup>5</sup> GST Act

<sup>6</sup> GST Act – Division 40-75

These characteristics do not reflect the broad features contemplated at paragraph 3 of the Determination.

It would be prudent for the Tax Office to acknowledge that an enterprise (in the nature of trade) would generally arise and that certain specific circumstances may prevent the undertakings from being classified as an enterprise (as opposed to noting that it is not an enterprise from the outset).

In particular, the funds made to the associate to fund the building and services may be considered to be consideration and therefore, may be of a profit making nature.

Therefore, in their current form, the comments at paragraph 7-10 may cause confusion to users. This approach is considered unnecessary where the parties are associates as application of the provisions of Division 72 is more appropriate.

The Professional Bodies concur that any other *act payment or forbearance* may be appropriately treated as *consideration* in respect of the supply of building/construction services where no other explanation exists. The Professional Bodies agree with the ATO's comments in respect of *bona fide* loans which would not otherwise constitute consideration. The Commissioner should however outline circumstances/indicia where the provision of funds would be considered to be a bona fide loan (ie. presence of loan agreement, etc).

Given that in all circumstances the parties will be associates (as defined for GST purposes), the most appropriate approach by the ATO is considered to be the application of Division 72 to impute market value *consideration* in the appropriate period.

It is requested however that the ATO make it clearer that the Draft Determination will only apply in circumstances where the parties are associates or at the very least are not dealing at *arms-length*.

Even in such circumstances however, there may be *bona fide* arrangements involving associates where a delayed payment arrangement occurs, yet this is done on commercial and *arms-length* terms with appropriate loan agreements in place.

The Professional Bodies consider that such arrangements done on a commercial basis between associates should not be impacted by the provisions of Division 72, and the difficulty will be finding appropriate guidance on what the ATO may or may not consider appropriate for differential treatment.

For this reason the Professional Bodies request that the Draft Determination include a number of examples that would and would not be impacted in the ATO view to provide clarity to taxpayers and advisors.

The Professional Bodies accept, for example that a deferral of 5 years, based on a sole application of the premises by the landowner to *input taxed* use would produce an unacceptable result and should be the subject of alternate action by the ATO (section 40-75 of the GST Act).

Where the period is less than 5 years and/or there is a dual application, and the premises remain taxable as *new residential* on sale by the landowner, the position is less clear and will depend very much on the terms and commerciality of the arrangement. Appropriate examples of this would be most helpful and the Professional Bodies are prepared to provide drafts of same if required.

The Professional Bodies consider that Division 165 ought not to have any application to circumstances addressed in the Draft Determination – specifically that the parties are *associates* - as a number of other provisions (such as Division 72) have application and should be applied in the first instance.

We also suggest that a comment should be inserted after paragraph 34 noting that the application of Division 165 may differ to the extent that the scheme described in paragraph 34 changes.

In our view, the application of Division 165 should be one of last resort and perhaps is more applicable to non-arms length transactions between non-associates.

**Date of effect**

There is no guidance by the Commissioner with respect to the date of effect to the Determination and that such a date would be included in the final determination (refer para. 42). Arguably, to prevent taxpayers from undertaking such arrangements, the date of effect for the Determination would have retrospective and prospective application.

A comment should be inserted requesting confirmation of the date of effect.