

Lowering Litigation Risk: Recent Rulings and Case Law Affecting Property Taxes

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**William Calokerinos, Barrister - Wentworth Chambers
2/180 PHILLIP STREET, SYDNEY NSW 2000**

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Synopsis

1. Since the introduction of the GST in 2000, there has been a number of decisions by State Courts and Tribunals dealing with disputes as to the treatment of GST under real estate contracts between parties to the contract and the Commissioner is not involved.
2. The paper proposes practical strategies when advising clients relating to the issue of GST for real property. The strategies are important and the high probability of ATO scrutiny may be, by itself, sufficient reason to ensure compliance with the provisions of the relevant GST law, being the following:
 - a. *A New Tax System (Goods and Services Tax) Act 1999 (Cth)* (“**GST Act**”)
 - b. *A New Tax System (Goods and Services Tax) Regulations 1999 (Cth)* (“**GST Regulations**”)
 - c. *Taxation Administration Act 1953 (Cth)*.
 - d. *Acts Interpretation Act 1901 (Cth)*.

(“**the relevant GST law**”).
3. The law stated is the current law in the state New South of Wales.

About the Speaker

- **William P Calokerinos** is a barrister at the NSW Bar practising from 2 Wentworth Chambers. For more information about William and his practice areas, please refer to two websites below:

NSW Bar Association Website:

<http://find-a-barrister.nswbar.asn.au/profile/william-calokerinos-8280>

Floor Website: www.2wentworth.com.au

- William is a member of the following professional bodies:

- Member, New South Wales Bar Association (Barrister Member)
- Member, Chartered Accountant, CAANZ Australia (CA)
- Member, Tax Institute (CTA Designation)
- Member, Master Builders Association –Cert IV in Building and currently completing a Diploma of Building
- Member, Environmental Planning Association
- Mediator accreditation – NSW Bar Association NMAS.

Part A - GST DISPUTES

1. Under the GST Act, it is the vendor (as the supplier) who incurs the liability to pay the GST. The vendor has no statutory right to pass on any part of its GST liability to the purchaser, although the presumption is that the GST will generally be passed on by the supplier to the recipient as part of their contractual relationship. Accordingly, how GST is dealt with in the contractual relationship between vendor and purchaser is critical.
2. Disputes on which party to the contract is to bear the cost of GST does arise and in two contexts, each of the parties to contract have different considerations, different motivations due to differing drivers to cause dispute. There are several reasons for this:

Firstly, transactions involving purchasers who are registered for GST and can claim input tax credits with respect to the transaction.

In these types of transactions, the GST is not intended to be a cost to either party because the purchaser is entitled to an input tax credit equal to the GST payable by the vendor.

Though, if the contract does not provide for the GST to be added to the Price, the vendor will still be liable to pay GST and will be out of pocket 1/11th of the Price. Further, the purchaser will receive a windfall gain of 1/11th of the Price. This is illustrated by the following examples:

- **Example 1 – GST gross up:**

A sells land to B for a stated price of \$2,000,000 plus GST. At settlement a total price of \$2,200,000 is paid and A pays GST of \$200,000 (1/11th) and B claims an input tax credit of \$200,000.

The net price paid by B is \$2,000,000.

- **Example 2 - No GST-gross up**

A sells land to B for a stated price of \$2,000,000 and the contract is silent on GST – thereby being GST inclusive. At settlement, a total price of \$2,000,000 is paid and A pays GST of \$181,818 and B claims an input tax credit of \$181,818. The net price paid by B is \$1,818,182, thereby giving B a windfall gain and leaving A out of pocket.

3. The main driver for contractual disputes is clear – if the purchaser can establish that the price was inclusive of GST, it can claim an input tax credit whilst being under no obligation to pay a dollar more to the vendor. Another driver is the NSW stamp duty, which is payable on the GST-inclusive price. As you can observe from Example 2 above, B would pay stamp duty on \$2,000,000 rather than \$2,200,000 – leading to a reduced stamp duty bill!

Secondly, transactions involving purchasers who are not registered for GST or purchasers who are registered for GST but cannot claim input tax credits. In these transactions, the liability for GST will be a cost to either the vendor or purchaser, depending upon the terms of the contract. This is illustrated by the following two examples:

- **Example 3 – GST gross up**

A sells land to B for a stated price of \$2,000,000 plus GST. At settlement a total price of \$2,200,000 is paid and A pays GST of \$200,000 (1/11th). The net price paid by B is \$2,200,000.

- **Example 4 – No GST-gross up:**

A sells land to B for a stated price of \$2,000,000 and the contract is silent on GST – thereby being GST inclusive. At settlement, a total price of \$2,000,000 is paid and A pays GST of \$181,818. The net price paid by B is \$2,000,000, leaving A out of pocket by \$181,818.

4. As can be seen above, the main driver for GST disputes comes from the vendor, who can recover an additional amount from the purchaser if it can establish that the price was exclusive of GST. This would pass the GST cost to the purchaser, who would also then be subject to an increased liability for stamp duty.
5. There are numerous case law involving GST disputes about interpretation of contracts and what was the true contracting intention of the parties to contract. Disputes arise over who effectively bears the liability for GST under a contract and the relevant case law is discussed below.

Relevant Case Law

6. In *A & A Property Developers Pty Ltd v MCCA Asset Management Ltd* [2016] VSC 653 the Supreme Court of Victoria found that GST was not to be added to the purchase price payable under a contract of sale. The decision is a further example of the difficulties that can arise when documenting the contractual position with regards to GST and the sale of real property.
 - a. In this case the parties entered into the standard form LIV contract of sale which provides for a “tick the box” process with regards to GST. The particulars of sale state that “The price includes GST (if any) unless the words “plus GST” appear in this box”. Clause 13.1 of the General Conditions provided that “*The purchaser does not have to pay the vendor any GST payable by the vendor in respect of a taxable supply made under this contract in addition to the price unless the particulars of sale specify that the price is ‘plus GST’.*”

- b. The difficulty in this case appears to have arisen because of the way the particulars of sale were completed. The price was \$2,900,000 with a deposit of \$290,000 but the word "GST" was included in the box dealing with GST, not the words "plus GST".
- c. Ginnane J opined the following by way of analysis of the GST dispute:

25 *I accept the defendants' construction of the relevant provisions of the contract. A court should not add words into a written instrument unless it is clear that words have been omitted and what those omitted words were. Here the presence of the letters 'GST' is capable of a number of interpretations. One is that proposed by the plaintiff. Another, is that some thought was given as to who should be liable to pay any GST that was payable, but a decision was not reached. A third interpretation is that the letters 'GST' were inserted erroneously and were intended to be deleted, but that the deletion was overlooked.*

26 *The plain meaning of the contract is that the obligation to pay the GST lay with the vendor. To repeat the clear words of General Condition 13.1:*

The purchaser does not have to pay the vendor any GST payable by the vendor in respect of a taxable supply made under this contract in addition to the price unless the particulars of sale specify that the price is 'plus GST'.

27 *The reasoning in Duoedge Pty Ltd v Leong, contained in the passage previously quoted, is applicable even though the details of the particulars of sale in the two contracts differ.*

28 *The contract of sale appears to have been, in part, in the form of contract published by the Law Institute of Victoria and the Real Estate Institute of Victoria Ltd. The general conditions are in the form contained in the Estate Agents (Contracts) Regulations 2008. The contract provides a mechanism to oblige the purchaser to pay the vendor GST on the purchase price, but it was not used in this instance.*

29 *In construing a contract, the court can correct obvious errors in the contract's language and grammar. Such correction is usually limited to obvious mistakes in the expression of the contract, including spelling and grammar, mistakes in names, omissions or obvious words or the obvious use of the wrong word. The intention of the parties is to be determined objectively from the contract in admissible intrinsic evidence. In Fitzgerald v Masters Dixon CJ and Fullagar J stated:*

Words may generally be supplied, omitted or corrected, in an instrument, where it is clearly necessary in order to avoid absurdity or inconsistency.

30 *I do not consider that this case attracts the principle discussed in Fitzgerald v Masters. There is no absurd result or inconsistency in the construction of the contract that I have adopted.*

31 *The plaintiff did not seek an order for rectification of the contract and, in any event, the evidence suggests that the parties did not have a common intention about their agreement concerning the liability to pay GST.*

32 *A further rule of construction is that when a clause in a contract contains a blank space, which was intended to be filled in, that part of the contract will usually be held void for uncertainty, unless the parties' unexpressed intention can be discerned from the context and background or one party was authorised to fill in the blanks'.^[11] In some cases, a blank in a document may be dealt with simply by ignoring it, and reading the contract as if it was not there.^[12]*

33 *I do not consider that this case falls within those principles.*

34 *In my opinion, the contract provided a clear mechanism for the parties to give effect to an agreement that the purchaser must pay GST on the purchase price, but it was not employed in this instance. The inclusion of the letters 'GST' in the box did not shift the burden of the payment of GST to the purchaser.*

35 *The words of commercial contracts are to be interpreted in accordance with their commercial purpose. While words should ordinarily be given some role to play in the operation of the contract, sometimes words are included or are left in the contract in error.*

36 *There was no ambiguity in this contract justifying reference to surrounding circumstances.*

- d. The Court accepted the defendant's construction of the contract – that the language of clause 13.1 was clear and the purchaser was not required to pay GST unless the Particulars of Sale specified that the price was “plus GST”. The Court found that it should not add words into a written instrument unless it was clear that the words had been omitted and what those omitted words were. The Court observed that the presence of the letters “GST” was capable of a number of interpretations.
 - e. The Court observed that the plain meaning of the contract was that the obligation to pay GST lay with the vendor and that the contract provided a clear mechanism for the parties to give effect to an agreement that the purchaser must pay GST on the purchase price – but that it was not employed in this instance.
 - f. The Court also observed that the plaintiff did not seek an order for rectification of the contract – and in any event, the evidence suggested that the parties did not have a common intention about their agreement concerning the liability to pay GST.
7. This decision can be compared with the decision of the New South Wales Supreme Court in *SSE Corp Pty Ltd v Toongabbie Investments Pty Ltd as Trustee for the Toongabbie Investments Unit Trust* [2016] NSWSC 1235 where the plaintiff unsuccessfully applied for rectification of two contracts of sale by inserting the words “plus GST” after the purchase price.
 8. In *SSE Corp Pty Ltd v Toongabbie Investments Pty Ltd as Trustee for the Toongabbie Investments Unit Trust* [2016] NSWSC 1235, the plaintiff unsuccessfully

applied for rectification of two contracts of sale by inserting the words “*plus GST*” after the purchase price.

- a. In this case the plaintiff contended that by mistake the words “*plus GST*” had not been added to the statement of the price in each of the contracts before the contracts were exchanged.
- b. Robb J opined the following by way of analysis of the GST dispute:

Legal principles

23. *It will be convenient at this stage to set out the legal principles that apply to the issue of whether on the evidence that is before the court, SSE is entitled to the orders for rectification of the two contracts that it seeks in its summons. There was no real issue between the parties concerning the content of those principles.*

24. *The principles that govern the application of the equitable doctrine of rectification have been considered at length in a number of recent decisions of the Court of Appeal. It will be sufficient for the purposes of the present case to note, with respect, the following statement of those principles by Gleeson JA (with whom Meagher JA and Sackville AJA agreed) in Mayo v W & K Holdings (NSW) Pty Ltd (in liq) (No 2)[2015] NSWCA 119:*

[55] ...The authorities were considered by the court in Franklins Pty Ltd v Metcash Trading Ltd [2009] NSWCA 407; 76 NSWLR 603(Franklins v Metcash) and in Ryledar (see also Newey v Westpac Banking Corporation [2014] NSWCA 319). It is sufficient to refer to the following principles.

[56] First, a written document that has been executed is presumed to be the true record of the parties' agreement: Equuscop Pty Lt v Glengallan Investments Pty Ltd [2004] HCA 55; 218 CLR 471 at [33]. However if there is clear evidence of a mistake in the recording of their agreement the equitable remedy of rectification is available to reform the

parties' document, but not to reform the parties' bargain: Maralinga Pty Ltd v Major Enterprises Pty Ltd [1973] HCA 23; 128 CLR 336 (Maralinga) at 350 (Mason J); J W Carter, Contract Law in Australia, (6th ed 2013, LexisNexis Butterworths) at [21-02].

[57] Secondly, the rationale of rectification of a written document in equity is that it is unconscionable for a party to the contract to seek to apply the contract inconsistently with what that party knows to be the common intention of the parties at the time the written contract was entered into: Ryledar at [315] (Campbell JA; Mason P agreeing).

[58] Thirdly, the "intention" that is relevant to rectification of the contract is the subjective intention of the parties, sometimes called the actual intention: Ryledar at [267]. Before rectification of the contract is granted, the actual intention needs to exist in circumstances where it can be seen that there is a common intention of all those entering into the contract: Ryledar at [279].

[59] In Ryledar at [281], Campbell JA emphasised that when that intention relates to the terms upon which the parties will contract with each other, it is still necessary for them to know enough of each other's intentions for it to be said that there is a common intention. His Honour explained that the parties might come to know each other's intentions where those intentions are directly stated, or through the various other means by which one person's intentions can become known to another person. Those means sometimes involve a process of conscious and deliberate inference and could also involve simply perceiving a gestalt in a series of events. His Honour also noted that negotiation of any contract takes place in a context in which various facts are known or assumed by the negotiating parties. Thus, for example, if a contract is negotiated in a context where there are well understood business practices and conventions, and nothing is said about those practices and conventions not applying, it can be legitimate to conclude that both parties to the contract intended to act in accordance with those practices and conventions,

even if they did not expressly communicate to each other that they intended to act in accordance with those practices and conventions.

25. *It is also necessary to consider the following observation made by McClelland J (as his Honour then was), when in Johnson Matthey v AC Rochester Overseas Corp (1990) 23 NSWLR 190, his Honour said, at 195, that the entitlement to rectification of a written contract requires “clear and convincing proof of a common intention of the parties not reflected in the written document”. The reference by Gleeson JA to “clear evidence” in par [56] in Mayo is to the same effect.*

26. *I have not lost sight of the fact that SSE submitted in the alternative, to its claim that the parties exchanged contracts for the sale of the two properties under a common mistake as to its terms, that there was a unilateral mistake under which SSE was mistaken, but Toongabbie Investments was aware that SSE was acting under a material mistake. I do not propose to consider the principles that may apply where a unilateral mistake of this nature is established in fact, as I do not think it is arguable on the evidence that Toongabbie Investments was actually aware that SSE was acting under a material mistake when it exchange the contracts.*

27. *SSE strongly put a submission contrary to the conclusion that I have expressed in the preceding paragraph, based on an email exchange that took place between Ms Azar and Mr Elachi on 19 August 2015. I will explain below in chronological context why I have not accepted that submission.*

- c. The Court undertook a detailed review of the evidence and concluded that the parties did not make a common mistake in the recording of the agreement, and that the purchaser entered into the contracts with a definite and clear understanding that the prices were to be inclusive of GST, whatever the subjective understanding of the vendor may have been. The principals of the purchaser were not aware, when the contracts were exchanged, that the contracts did not reflect the vendor’s understanding of the prices to be paid –

so this was not a case where the vendor entered into the contracts under a unilateral mistake that was known to the purchaser.

- d. This decision can be compared with the decision of the New South Wales Supreme Court in *AFC Holdings Pty Ltd v Shiprock Holdings Pty Ltd* [2010] NSWSC 985, which involved the use of put and call options in a Deed arrangement.
9. In an earlier matter, in the case of *AFC Holdings Pty Ltd v Shiprock Holdings Pty Ltd* [2010] NSWSC 985, the NSW Supreme Court of NSW considered the matter of the vendor/defendant entered into an option deed by which an option was granted to the purchaser/plaintiff to purchase the vendor's properties.
10. The price stated in the option deed was \$4m and clause 5 of the deed stated that "*if the Grantor incurs a liability to pay GST in connection with this Deed, the Grantee must pay to the Grantor on demand in addition to the Option Fee and any Extension Fee(s) the amount of the GST*".
- a. The purchaser exercised the option and a contract of sale was entered into, in the standard form of the NSW Law Society – 2005 edition. Towards the bottom of the first page of the contract, under the heading "Tax information", against the statement "GST: taxable supply" the box "yes in full" was marked with a cross. Special condition 4 provided that "The sale is a taxable supply and the purchaser will pay to the vendor on completion the amount of Goods and Services Tax for which the vendor is liable".
 - b. The purchaser contended that special condition 4 simply recorded that the amount payable by the purchaser included an amount payable by the defendant in respect of GST.
 - c. The vendor contended that the effect of the clause was that the purchaser was required to pay an additional amount on the account of GST. The Court preferred the vendor's construction. In doing so, the Court observed that the difficulty with the purchaser's construction was that the clause would have no practical effect – why would the parties have included special condition 4 if it were simply stating the obvious.

Part B - 2018 GST Law Update

11. Given the constant changing landscape of property transactions and GST, with this in mind, it is appropriate and timely to remind ourselves of property taxes and how the current GST regime affects our clients.
12. Taxpayer self-assessment is the basis of the Australian taxation system. This means the responsibility is placed on taxpayers to accurately complete their Business Activity Statements by the specified time (which is usually accepted as an honest lodgment by the Commissioner).
13. To assist taxpayers with their self-assessment, the ATO primarily offers both public and private binding rulings which taxpayers can use to guide them when they self-assess. In particular, private rulings provide taxpayers with an opportunity to ascertain the Commissioner's opinion on the application of certain tax laws to their specific circumstances before they lodge a return. State and territory revenue offices also provide revenue rulings to assist taxpayers in lodging their returns in relation to state and territory tax laws.
14. It is important to be aware of the ATO private ruling process. Useful information is provided on the following ATO website below:
 - a. [https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-\(rulings\)/Private-rulings/](https://www.ato.gov.au/General/ATO-advice-and-guidance/ATO-advice-products-(rulings)/Private-rulings/)
15. In addition to utilising the ATO private ruling process, it is also important to stay up to date with GST law. On 7 February 2018, legislation was introduced into Parliament to require purchasers of new residential premises and "*potential residential land*" to withhold an amount from vendors and to pay the amount directly to the ATO at or before settlement. The legislation takes effect from 1 July 2018.
16. Tax reform and specifically GST has once again become prominent in the political arena during the period 2017/2018, and the mainstream media has taken up the tax debate with vigour and provided tax advisers with some significant issues to consider.

17. There have been recent amendments in 2018 to the GST law, and the amendments are to apply to supplies on which any of the consideration (other than the deposit) is first provided on or after 1 July 2018, regardless of the date of the contract of the sale. However, if the contract was entered into before 1 July 2018, the amendments do not apply if consideration (other than the deposit) is first provided before 1 July 2020. Transitional provisions also apply to existing “property development arrangements”.
18. The intention of the amendments is that the changes will prevent tax evasion by unscrupulous property developers that fail to remit the GST on sales of new residential premises and new subdivisions, despite having claimed GST on construction costs.

Exposure Draft of the new GST legislation

19. An Exposure Draft of the legislation was introduced on 6 November 2017 and the summary of the amendments are below:

b. The withholding regime – s 14-250 of Schedule 1 to the Taxation Administration Act

- The amendments are to be introduced into Schedule 1 of the Taxation Administration Act 1953 as an extension of the withholding provisions in Division 14. These provisions require a payer to withhold part of monies payable to another person in certain circumstances and to pay those amounts to the ATO – for example PAYG withholding.
- S 14-250(1) and (2) – The withholding obligations will apply to the supply of:
 - “new residential premises” – other than premises have been created through substantial renovations of a building and commercial residential premises; and

- “potential residential land” which is defined as “land that it is permissible to use for residential purposes, but does not contain any buildings that are *residential premises” – other than land which contains any building that is in use for a commercial purpose.
 - For the sale of “potential residential land”, the withholding obligation only arises if the purchaser is not registered for GST or does not acquire it for a creditable purpose.
 - S 14-250(6)-(7) – The purchaser must pay to the Commissioner an amount equal to 1/11th of the “price” for the supply, but where the margin scheme applies 7% of the “price” must be withheld – although the Minister may determine a higher percentage but not exceeding 9%. Where the contract of sale specifies an amount as the “contract price”, that is the price to be used.
 - S 14-250(4) – The amount must be paid on or before the day on which any of the consideration for the supply (other than as a deposit) is first provided. This will usually be at settlement, but for a contract payable by instalments, the obligation will be triggered at the time of payment of the first instalment (not being the deposit).
 - S 14-250(11) – Where there are multiple purchasers, the supply will be treated as separate supplies to each purchaser and each purchaser will be required to withhold the appropriate portion of the price. Purchasers who are joint tenancy are treated as single recipients.
 - Where the purchaser pays the amount to the Commissioner, the supplier will be entitled to a credit equal to that amount.
- c. Disclosure obligations on the vendor – s 14-255
- S 14-255(1) – A supplier must not make a taxable supply of “residential premises” or “potential residential land” to another entity

unless, before making the supply, the supplier gives to the other entity a written notice including:

- Whether the other entity will be required to make a payment under s 14-250 in relation to the supply.
 - If so, particular information including the amount required to be paid and when the amount is required to be paid.
 - A notice will need to be given each time residential premises are supplied as a taxable supply – not just where the supply falls within the amendments. This is to assist purchasers to comply with the legislation.
- S 14-255(2) – The notification obligation does not apply to the sale of commercial residential premises or to “potential residential land” to a purchaser who is registered or acquires the land for a creditable purpose.
 - S 14-255(6) – If the supplier does not give the notice, it is liable to an administrative penalty of 100 penalty units (a penalty unit is currently \$210).
 - S 14-255(3) – The failure of the vendor to comply with the notification obligation under (1) does not affect the purchaser’s obligation to withhold and to pay the Commissioner.

d. Penalties

- If the purchaser does not pay the amount to the Commissioner the purchaser will be liable to a penalty equal to the amount payable – s16-30 of Schedule 1 to the TAA. However, no penalty will be applied where:

- the amount related to the taxable supply of new residential premises and the purchaser reasonably believed the premises not to be new residential premises, the purchaser received a notification stating that the premises were not new residential premises or the notification indicated that no amount was required to be paid to the Commissioner, and at the time consideration was first provided for the supply there was nothing in the contract or any other circumstances that made it unreasonable for the purchaser to believe that the notification was incorrect.
- the purchaser gave to the vendor a bank cheque for the amount and made payable to the Commissioner on or before the day consideration was first provided (usually settlement).

Part C - Strategies to Mitigate GST Disputes

20. The imposition of GST on real property transactions continues to test owners and developers and their legal advisers and attract the examination of the ATO and State and Territory Revenue Offices (SROs).

There are several reasons for this:

- i. there is a general belief that whatever GST the supplier charges can be claimed back by the recipient of the supply as an input tax credit;
- ii. there is a general belief that the margin scheme is always an option for residential developers;
- iii. transactions are high value and can be fully taxable, partly taxable, taxable under the margin scheme, GST-free, input taxed or out-of scope (non-taxable and not subject to GST law application);
- iv. the GST treatment can impact the contract price;
- v. property developers are often inexperienced;
- vi. property developments are often underpinned by complex arrangements; and
- vii. property developments usually involve the claiming of substantial input tax credits upfront, thereby placing the developer on the ATO's radar.

21. There are other, equally valid reasons, for ensuring compliance with the GST Act, namely; to make savings and also increase profitability of the enterprise when the opportunity arises; and to avoid costly party to party disputes in litigation.
22. If there was a difference of view between the parties as to how the GST law may apply, the contract could provide a mechanism for resolving the difference of view (for example, by obtaining a binding ruling from the Commissioner).
23. Where litigation does not involve the Commissioner as a party, there is a danger that the potential GST issues may not be completely understood and the litigation may, therefore, not provide a satisfactory outcome. The problems where the Commissioner is not a party to litigation has also raised problems where ordinary income tax or CGT issues are involved (see Appendix One for these issues).
24. It is clear as a matter of principle that a decision of a court case, in which the Commissioner is not a party, involves the determination to the effect of a taxation provision that does not bind the Commissioner: See for example the case of *Groves v FCT [2011] FCA 222*.
25. Practitioners to limit any risks of tax litigation may apply a GST checklist to limit the risk of dispute. Below is one such checklist.
26. Taking a little time with a GST checklist is a handy tip. Try to implement the checklist in your advisory dealings. Preferably, before a property contract is signed, a checklist will assist the solicitor to keep themselves and their property developer client out of trouble.

GST Checklist

The following is a suggested GST checklist:

- Confirm the description and proposed GST treatment of the target property
- Check the identity and GST status of the vendor/supplier and purchaser/recipient on ABN lookup - use the website <http://abr.business.gov.au/>

- Compare the supplier's identity with the named proprietor on title
- Consider what happens if the Commissioner challenges the treatment to be adopted by the parties or if something else goes wrong – such as the purchaser is not in fact registered for GST.
- If cancellation of GST Registration is an option, will that cancellation result in an increasing adjustment?
- Confirm that the purchaser of a going concern is correctly identified and registered for GST and that the requisite agreement has been made and documented.
- Confirm that the “going concern” is “going” at settlement and that all things necessary for the purchaser to continue to carry on that enterprise have been supplied?
- Discuss the opportunities and risks with the vendor/purchaser
- Consider funding a private ruling application – get advice from Counsel if required.
- If purchasing a property as a going concern or farm land, can the margin scheme be used later and, if so, how will the margin be calculated?
- Is there a risk to the purchaser of an increasing adjustment under Div 135 of the GST Act?
- If conducting a residential development correctly determine the developer's registration date (commencement of enterprise), input tax credit on purchases and any subsequent change of use adjustments
- Understand the significant difference between dual concurrent use (property leased and, on the market) and taking a property off the market (sole use as leased premises) – see (GSTR 2009/4).
- If the acquisition is a fully taxable supply, consider getting the GST paid into trust, to be released once the purchaser gets the GST refund from the ATO
- With contentious purchases, consider obtaining the contractual right to have involvement in any dispute with the Commissioner.
- Consider putting the developer on a monthly reporting cycle during the development phase – after 12 months the developer may be able to change to quarterly

- Lodge credit BAS as early as possible – even before the end of the month in order to receive the refund.

Application of the checklist

EXAMPLE 1

Treeview Pty Limited (**Treeview**) owns a two-storey property in rural NSW and in the outskirts of the country CBD. Treeview is registered for GST. It reports its GST position to the ATO annually and sells the property with vacant possession to Mac Developments Pty Limited (**Mac**) for \$6 million plus GST and gives the purchaser what appears to be a valid tax invoice. It takes Mac six months to recover its \$600,000 GST. The reason for the delay is that the ground floor of the building was commercial and first floor was a residential apartment. The GST had to be recovered in part from the ATO and in part from the vendor.

Apply the checklist above to the factual scenario to identify issues, aid compliance and securing the savings and the avoidance of the disputes with parties and the ATO.

Secondly, in this scenario, assume that Treeview, with early planning, the purchaser (Mac) could have invited the vendor to cancel its registration and make the supply without GST.

If the cancellation had been available to the vendor (without any increasing adjustment), the purchaser would have been able to purchase the entire property without GST and use the margin scheme on resale. What would have been the savings in GST?

EXAMPLE 2

XYZ Family Trust (Trust) has owned a large property in a Perth suburb since the 1970s. The land is presently very valuable. The Trust has never been registered for GST or required to be registered for GST due to it never charging market rent to its associated family business company XYZ Bricks Pty Limited (Bricks). Bricks moved to new premises several years ago, leaving the suburban property vacant. The Trust

is enjoying the appreciation in value, but is struggling with the ongoing costs of holding the property.

A property developer, Big Gain Pty Limited (Big Gain), approaches the trustee with an offer to purchase the land for \$10 million plus GST.

The trustee approaches his tax agent for GST advice. The tax agent provides the following advice:

- The land has been used commercially
- Failing to account for GST could be a \$1 million mistake
- Applying for a private ruling or seeking Counsel's opinion will cost money
- The Trust has never been registered for GST
- Registering for GST will allow the Trust to give Big Gain a tax invoice of \$11 million, including the GST of \$1.0 million.
- Big Gain will presumably (although the agent is not advising this entity) recover the GST from the ATO as an input tax credit, thereby achieving a revenue neutral outcome; and
- Reporting and paying the GST to the ATO is a risk neutral position for the Trust to adopt and the Trust is happy to achieve a low risk revenue neutral outcome.

You are advising Big Gain. You are briefed that to consider and advise on the following issues:

- Consider section 188-25(a) of the GST Act and calculate Trust's prospective GST turnover at the time of signing the contract of sale – is the turnover below or above \$75,000?
- Consider the following - does the land qualify as a capital asset?
- What would the Commissioner say about this hypothetical transaction? (see the ATO's GST Advice GSTA TPP 070 - *Goods and services tax: Is a party to a contract for the sale of a commercial property who deregisters for GST before settlement required to pay GST?*).

If the Commissioner is satisfied that Trust's projected turnover is below the threshold, the Commissioner would cancel the registration.

What is the relevance of Trust's GST Registration for Big Gain?

- The outcome of the matter would give the purchaser (Big Gain) a significant advantage in terms of access to the margin scheme upon the sale of the town houses and the entitlement to use the full purchase price to calculate the margin, instead of some other amount.
 - See GSTR 2000/28 - Goods and services tax: attributing GST payable or an input tax credit arising from a sale of land under a standard land contract.
- What are the possible adjustment on cancellation of Trust's GST registration under section 138-5 of the GST Act?
- Big Gain may wish to fund a joint application for a private ruling to confirm that Trust can either not register for GST or cancel its registration and treat the sale of the property as a non-taxable supply.
- Big Gain cannot use the margin scheme if, when the company first purchased the property from Trust, the sale to Big Gain was fully taxable and the margin scheme was not used. Accordingly, if such ruling is obtained, Big Gain can use the margin scheme when it sells developed properties, thereby saving around \$900k (\$10 million / 11).

Part D - Issues from using or misusing general GST clauses in contracts

27. Below is an extract of a standard contract in NSW for the sale of land. It is widely used in NSW. Its inclusion in this paper does not suggest it is a bad clause. On the contrary, it has been a useful tool for many years. The most recent version of the contract is the Contract for the Sale and Purchase of Land 2017 Edition and below is the extract of the GST Standard clause.

28. As an aside, the Contract for the Sale and Purchase of Land 2017 Edition takes into account changes made in the Conveyancing (Sale of Land) Regulation 2017 (“Regulation”), which commences on 1 September 2017. The 2017 edition also includes other legislative updates e.g. strata legislation.

Standard Clause – Extract taken from the NSW 2017 – Contract for the sale and purchase of land 2017 edition

Front Page of the contract

Vendor Signature

<p>GST AMOUNT (optional)</p> <p>The price includes</p> <p>GST of \$</p>

Purchaser Signature

Page 2 of the contract:

Tax information (the parties promise this is correct as far as each party is aware)

land tax is adjustable NO yes

GST: Taxable supply NO yes in full yes to an extent

margin scheme will be used in making the taxable supply NO yes

This sale is not a taxable supply because (one or more of the following may apply) the sale is:

- not made in the course or furtherance of an enterprise that the vendor carries on (section 9-5(b))
- by a vendor who is neither registered nor required to be registered for GST (section 9-5(d))
- GST-free because the sale is the supply of a going concern under section 38-325

- GST-free because the sale is subdivided farm land or farm land supplied for farming under Subdivision 38-O
- input taxed because the sale is of eligible residential premises (sections 40-65, 40-75(2) and 195-1)

Below is an extract from the relevant standard GST terms and conditions:

(Page 9 - Extract taken from the NSW 2017 – Contract for the sale and purchase of land 2017 edition)

13 Goods and services tax (GST) – Standard Clause – Extract taken from the NSW 2017 – Contract for the sale and purchase of land 2017 edition

13.1 Terms used in this clause which are not defined elsewhere in this contract and have a defined meaning in the GST Act have the same meaning in this clause.

13.2 Normally, if a party must pay the price or any other amount to the other party under this contract, GST is not to be added to the price or amount.

13.3 If under this contract a party must make an adjustment or payment for an expense of another party or pay an expense payable by or to a third party (for example, under clauses 14 or 20.7) – 13.3.1 the party must adjust or pay on completion any GST added to or included in the expense; but 13.3.2 the amount of the expense must be reduced to the extent the party receiving the adjustment or payment (or the representative member of a GST group of which that party is a member) is entitled to an input tax credit for the expense; and 13.3.3 if the adjustment or payment under this contract is consideration for a taxable supply, an amount for GST must be added at the GST rate.

13.4 If this contract says this sale is the supply of a going concern – 13.4.1 the parties agree the supply of the property is a supply of a going concern; 13.4.2 the vendor must, between the contract date and completion, carry on the enterprise conducted on the land in a proper and business-like way; 13.4.3 if

the purchaser is not registered by the date for completion, the parties must complete and the purchaser must pay on completion, in addition to the price, an amount being the price multiplied by the GST rate ("the retention sum"). The retention sum is to be held by the depositholder and dealt with as follows – • if within 3 months of completion the purchaser serves a letter from the Australian Taxation Office stating the purchaser is registered with a date of effect of registration on or before completion, the depositholder is to pay the retention sum to the purchaser; but • if the purchaser does not serve that letter within 3 months of completion, the depositholder is to pay the retention sum to the vendor; and 13.4.4 if the vendor, despite clause 13.4.1, serves a letter from the Australian Taxation Office stating the vendor has to pay GST on the supply, the purchaser must pay to the vendor on demand the amount of GST assessed.

13.5 Normally, the vendor promises the margin scheme will not apply to the supply of the property.

13.6 If this contract says the margin scheme is to apply in making the taxable supply, the parties agree that the margin scheme is to apply to the sale of the property.

13.7 If this contract says the sale is not a taxable supply – 13.7.1 the purchaser promises that the property will not be used and represents that the purchaser does not intend the property (or any part of the property) to be used in a way that could make the sale a taxable supply to any extent; and 13.7.2 the purchaser must pay the vendor on completion in addition to the price an amount calculated by multiplying the price by the GST rate if this sale is a taxable supply to any extent because of – • a breach of clause 13.7.1; or • something else known to the purchaser but not the vendor

13.8 If this contract says this sale is a taxable supply in full and does not say the margin scheme applies to the property, the vendor must pay the purchaser on completion an amount of one-eleventh of the price if – 13.8.1 this sale is not a taxable supply in full; or 13.8.2 the margin scheme applies to the property (or any part of the property).

13.9 If this contract says this sale is a taxable supply to an extent – 13.9.1 clause 13.7.1 does not apply to any part of the property which is identified as being a taxable supply; and 13.9.2 the payments mentioned in clauses 13.7 and 13.8 are to be recalculated by multiplying the relevant payment by the proportion of the price which represents the value of that part of the property to which the clause applies (the proportion to be expressed as a number between 0 and 1). Any evidence of value must be obtained at the expense of the vendor.

13.10 Normally, on completion the vendor must give the recipient of the supply a tax invoice for any taxable supply by the vendor by or under this contract.

13.11 The vendor does not have to give the purchaser a tax invoice if the margin scheme applies to a taxable supply.

13.12 If the vendor is liable for GST on rents or profits due to issuing an invoice or receiving consideration before completion, any adjustment of those amounts must exclude an amount equal to the vendor's GST liability.

29. With perusal of the standard GST clause above, the cause for litigation on GST issues that does not involve the Commissioner could, in some instances, have been avoided if the parties to the contract have obtained adequate professional advice and the contract was prepared on the basis of the advice.

CONCLUSION

30. Thank you for your attention.

Follow up questions are welcome at the following contact at 2 Wentworth Chambers:

Email: wcalokerinos@wentworthchambers.com.au.

APPENDIX – OTHER TAXES:

From the outset, attendees need to appreciate that the distinction between the following two terms: ***‘property development’*** and ***‘property investment’***.

- (i) ***‘Property development’*** is used to mean the development of property for the purpose of sale (including subdividing the family’s ½ acre block, broad acre subdivision and high-density strata developments).
- (ii) ***‘Property investment’*** is used to mean the development of property for the purpose of retention and use to derive assessable income (including as premises of a trading business and to derive rental).

Inevitably, disputes between the taxpayer and the Commissioner will arise where the primary or substantive issue cannot be settled. This is not uncommon and invariably ends up in litigation, but increasingly, the Commissioner, to his credit, has focused his office’s efforts towards resolving disputes at an earlier stage through alternative methods of dispute resolution.

Advisers can assist our clients. We need to have an awareness of taxation law in Australia.

Income taxation matters

The income taxation of a property project is complex as up to three taxation regimes may apply to levy tax. Broadly speaking, the transfer of land may be taxable:

1. as a disposal of trading stock of a property development business;¹
2. as a profit-making scheme;² or
3. as a taxable gain on the disposal of a CGT asset.³

Income Tax Issue Checklist

Consider the following matters:

- The fact that land may be **trading stock** for tax purposes - trading stock is considered to be objects acquired for the purpose of manufacture, sale or exchange

¹ Div. 70 ITAA 1997.

² Sec. 6-5 ITAA 1997.

³ Pt 3.1 and 3.3 ITAA 1997.

in the ordinary course of business.⁴

- **Profit making schemes** - the ordinary income of a business operation or commercial transaction includes the 'profit' on certain isolated transactions entered into with the purpose of making a profit.
- **Capital gains tax implications** - A capital gain or loss may arise upon the occurrence of a CGT event (e.g. a transfer)⁵ in respect of a CGT asset (e.g. land),⁶ unless an exemption applies, rollover relief defers the capital gain or a provision denies the loss.

A capital gain arises where the proceeds from the CGT event exceed the adjusted acquisition costs of the CGT asset.⁷ A capital loss arises where the proceeds from the CGT event are less than the adjusted acquisition costs of the CGT event.⁸

Capital gains on assets acquired before 20 September 1985 are disregarded.⁹

A net capital gain is included in the assessable income of the taxpayer.¹⁰

- Differences in expense treatment for **development costs**.
- **Mere realisation of an asset** - where the trading stock, profit making scheme or capital gains tax regimes do not apply (e.g. pre-CGT assets), the proceeds of the project are not taxed.

Post-CGT buildings and intangible improvements to pre-CGT Assets are separate post-CGT Assets.

These improvements are subject to the CGT regime, requiring capital proceeds to be apportioned. A post-CGT building or structure is a separate asset to the pre-CGT

⁴ *FCT v St Hubert's Island P/L* 78 ATC 4104; (1978) 8 ATR 452.

⁵ Sec. 104-10 ITAA 1997 - Disposal of a CGT Asset: CGT event A1.

⁶ Sec. 108-5 ITAA 1997.

⁷ Sec. 102-5 ITAA 1997.

⁸ Sec. 102-10 ITAA 1997.

⁹ Sec. 104-10(5) ITAA 1997 - Disposal of a CGT Asset: CGT event A1; *Determination* TD 7.

¹⁰ Sec. 102-5 ITAA 1997.

land.⁶²

- Selecting the **landowner structure** for a property project is not always possible.¹¹
- Legitimate tax planning uses tax policy distinctions/disconformities to reduce the overall effective tax rate.
- Choosing the optimal business structure is an art rather than a scientific application of principles. The choice of structure will vary depending upon (amongst other matters) the insolvency protection, liquidity and financing requirements and priorities of each participant.
 - Consider a company structure
 - Consider a trust structure
 - Consider an 'unincorporated joint venture'
- Care needs to be exercised when the structuring of a property development is intended to be on capital account, because changes to the taxpayer structure (e.g. a change of shareholding or a change of purposes in a Constitution) may transform a capital account development into a property development business.
- The practice of establishing separate development entities to argue that each entity does not have a history of property development may be of little effect: *FCT v Whitfords Beach Co P/L*¹²

Attendees should consider the above issues and these issues will be critically discussed during the presentation.

- The main legislative instruments that regulate Australian income taxation laws are below:

¹¹ e.g. the land was acquired under a will or by a particular entity for commercial and other reasons without regard to the taxation and commercial issues for future development.

¹² *FCT v Whitfords Beach P/L* [1982] HCA 8.

- *Acts Interpretation Act 1901* (Cth)
- *Administrative Decisions (Judicial Review) Act 1977* (Cth)
- Commonwealth of Australia Constitution Act, s 51(ii), s 53, s 55, s 90, s 114
- *Freedom of Information Act 1982* (Cth)
- *Fringe Benefits Tax Assessment Act 1986* (Cth)
- ***Income Tax Assessment Act 1936*** (Cth)
- ***Income Tax Assessment Act 1997*** (Cth)
- *International Tax Agreements Act 1953* (Cth)
- ***Taxation Administration Act 1953*** (Cth)
- *Administrative Decisions (Judicial Review) Act 1977* (Cth)
- *Taxation Administration Regulations 1976* (Cth)

Stamp Duty – State Tax (NSW)

- In NSW, one of the more significant transaction costs associated with purchasing a property is “stamp duty”. Stamp duty is imposed on the transfer of ownership in the real property.
- Generally, an instrument or transaction may be “*dutiable*” in NSW where it affects property in the jurisdiction of NSW or the instrument is executed by a party in the jurisdiction of NSW.
- Depending on the jurisdiction and type of instrument or transaction, the applicable duty payable may be “nominal” (ie a fixed amount, generally because a concession applies) or “ad valorem” (ie imposed on a sliding scale, with higher rates of duty being payable as the value of the transaction increases).
- The sanctions for the non-payment of duty are broadly similar across the jurisdictions, with penalty tax and interest applying to unpaid duty, and unstamped instruments being unenforceable and inadmissible in evidence until the correct duty is paid.
- Stamp duty paid on the transfer of real property will generally form part of the cost base of the property for the purposes of CGT.

Stamp Duty - Recent Case Law Update

Consider the case of *Balcaskie Investments Pty Limited v Chief Commissioner of State Revenue* [2017] NSWCATAD 19 as follows:

Facts:

1. Mrs Wall was the trustee of the Shirley Wall Family Trust, which was a discretionary trust (“**the Trust**”). The Trust owned 2 parcels of real estate. A Deed was executed under which:
 - (a) Mrs Wall was removed as the trustee of the Trust and Balcaskie Investments Pty Limited was appointed the trustee of the Trust in her place; and
 - (b) The Trust Deed for the Trust was amended by inserting the following new clause 22:

“22. The Original Trustee and the New Trustee and any future and past trustees are absolutely prohibited from being a beneficiary under the Trust Deed or from otherwise directly or indirectly benefiting under the Trust Deed and this clause will not be capable of amendment or revocation”.
2. The insertion of the new Clause 22 showed that the advisers to the Trust were well aware of the potential ad valorem stamp duty that could be payable under Section 54(3) and the new clause 22 was inserted into the Trust Deed to avoid that ad valorem stamp duty.
3. The Trustee lodged for stamping 2 Applications to Record New Registered Proprietor to transfer title to the 2 parcels of real estate from the old trustee to the new trustee consequent upon the Deed appointing the new trustee.
 - The Chief Commissioner took the view that he was not satisfied that Section 54(3)(b) had been satisfied (that none of the trustees of the trust after the

appointment of the new trustee could become a beneficiary of the Trust) and imposed ad valorem duty of \$68,930 on the 2 Applications to Record New Registered Proprietor.

Relevant Law

4. Section 54(3) of the *NSW Duties Act* provide as follows:

“(3) *Duty of \$50 is chargeable in respect of a transfer of dutiable property to a person as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Chief Commissioner is satisfied that, as the case may be:*

(a) *none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust, and*

(b) *none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust, and*

(c) *the transfer is not part of a scheme for conferring an interest, in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person.”*

5. If the Chief Commissioner is not so satisfied then in most cases ad valorem duty will be levied on the transfer of property (usually real estate) from the old trustee to the new trustee.

6. There were a number of issues raised by the case. The case resolved around conflict of two provisions, namely, clauses 14 and 22 of the Trust Deed. The Tribunal held that clause 22 (the clause preventing the Trustee from becoming a Beneficiary) prevailed over clause 14 (the generic amendment clause) in accordance with the general contractual principle of interpretation that where a clause deals with a specific

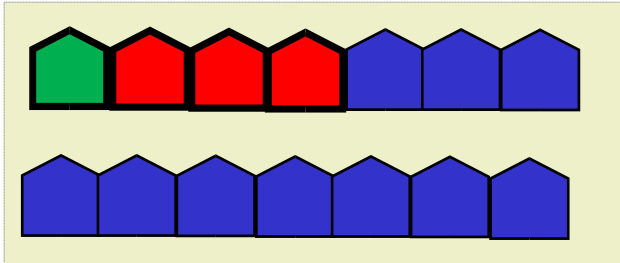
situation.

Land Tax – State Tax (NSW)

- Land tax is a state based tax that is payable in relation to property owned by an entity which is located in NSW and is not exempt from the payment of land tax.
- In New South Wales the assessment is made in relation to property which is owned as at 31 December in the year prior to the relevant land tax year. The land tax year is a calendar year.
- There are three main Acts in NSW that regulate the calculation and payment of land tax:
 - *Land Tax Act 1956* (NSW) — sets the land tax rates and thresholds;
 - *Land Tax Management Act 1956* (NSW) — deals with the fundamental issues of who has to pay land tax and when it is payable, as well as the exemptions to land tax; and
 - *Taxation Administration Act 1996* (NSW) — looks at general provisions relating to taxation such as:
 - assessment and reassessment of tax liability;
 - obtaining refunds of tax;
 - imposition of interest and penalty tax;
 - approval of special tax return arrangements; and
 - collection of tax.
- The provisions of the *Taxation Administration Act 1996* (NSW) have been held to apply to land tax.
- In addition to these main Acts, there are a number of other Acts that are relevant to the calculation and payment of land tax.

CASE STUDY - Mixed investment and sale projects

MIXED INVESTMENT/DEVELOPMENT



FACTS:

- Thomas attained a property for the purpose of subdivision, building 1 shop (Green), 3 terrace houses (Red) and 48 townhouses for lease (Blue).
- To repay the bank, Thomas estimates that the shop, the 3 terrace houses and 15 townhouses would be sold (i.e. 36% of the project).
- In fact, only the shop, 3 terrace houses and 13 townhouses were sold (32% of the project)

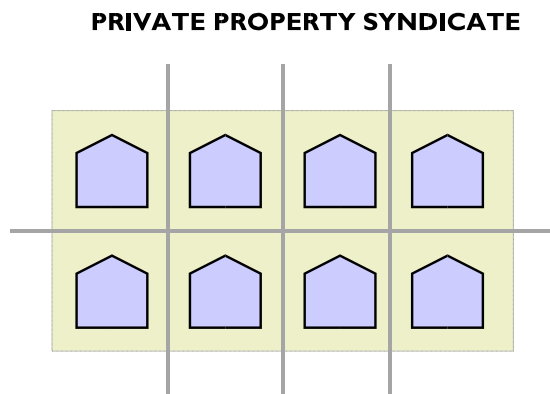
What tax issues arise?

See the case of *ARM Construction P/L v FCT* (case attached to paper):¹³

- The properties intended to be sold and in fact sold would be a profit-making scheme. The balance would retain their capital status.
- Although the taxpayer intended to sell an additional 2 townhouses, that expectation does not appear to make those 2 townhouses part of the profit-making scheme.

¹³ *ARM Construction P/L v FCT* 87 ATC 4790, 4806; (1987) 19 ATR 337.

CASE STUDY – Private property syndicate projects – Unit Trust



FACTS:

- Thomas and seven unrelated people acquired a property in a unit trust for the purpose of subdivision, building a house on each block and distributing the block in specie (in kind) to each unitholder.
- To reconcile the mixed purposes, the property should be subdivided and each block distributed in kind to the relevant unit holder.
- This will ensure the property is not trading stock and is not a profit-making scheme. This will permit the various unit holders to have different intentions.

What tax issues arise?

The terms of the unit trust will be vital.

- The unit holders of a traditional unit trust hold a tenants-in-common interest in all of the property (not any identifiable part of the property).¹⁴
- After subdivision, each unit holder owns a proportionate interest in each block.
- The partition and exchange of interests so that each unit holder owns one block absolutely represents a proportionate disposal of an interest in all other blocks.

¹⁴ *CSR (Vic) v Karingal 2 Holdings P/L* [2003] VSCA 214.

- The disposal of the various interests will, therefore, have income tax consequences.¹⁵

If a special purpose unit trust is used where each unit in the trust grants a beneficial interest in the particular block of land, then the unitholder will have an absolute entitlement to the land and there is no partition and exchange.¹⁶

- The unit holder exemption exempts an in-kind transfer of land by the principal unit trust to a unit holder who was a unit holder at the time the land was acquired.

The transfer must be a transfer in the capacity of beneficiary and not on sale. There must not be any collateral consideration.

- The beneficiary must receive the property in its capacity that it owned the units. Where the unit holder was a company there must be no change in ownership control or as a trustee there must be no change in the relevant beneficiary from the date the land was acquired by the principal unit trust.
- The unit trust is treated as a separate entity for GST purposes¹⁷ and the in-kind distribution of property will have GST consequences.¹⁸

¹⁵ Determination TD 92/148.

¹⁶ Sec. 116-30 ITAA 1997; cf TR 2004/D25; *CSR (Vic) v Victoria Gardens Developments P/L* [2000] VSCA 233.

¹⁷ Sec 23-5 & 184-1 GSTA 1999.

¹⁸ By analogy with partnerships see *Rulings* GSTR 2003/13 & GSTR 2003/D5.