

# EXPOSURE DRAFT

EXPOSURE DRAFT (10/04/2006)  
(as amended at 12/04/2006, see page 6)

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## GOODS AND SERVICES TAX TREATMENT OF RESIDENTIAL PREMISES

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## EXPLANATORY MATERIAL



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# ***Goods and services tax treatment of residential premises***

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## **Outline**

1.1 The proposed amendments will amend the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) to ensure that following the decision of the Full Federal Court of Australia in *Marana Holdings Pty Ltd v Commissioner of Taxation* [2004] FCAFC 307 (the *Marana* decision) supplies of certain types of real property are input taxed. This is consistent with the Government's policy intent.

## **Context of amendments**

1.2 In the *Marana* decision, the Court:

- decided that the sale of a unit, which was previously a room in a motel, was 'new residential premises' and therefore subject to GST; and
- considered that the terms 'reside' and 'residence' connoted a permanent, or at least long-term, commitment to dwelling in a particular place.

1.3 The Court's reasoning has resulted in potential difficulties in distinguishing between supplies of premises that are residential premises and therefore input taxed, and supplies that are taxable. In particular, the Court's reasoning is likely to lead taxpayers to seek to treat certain supplies of real property as taxable rather than input taxed, with effect from 1 July 2000 when the GST system was introduced. These include:

- short-term letting of strata titled units such as serviced apartments by owners to guests;
- leasing of strata titled units to hotel operators or similar operators; and
- leasing of display homes and provision of certain short-term employee accommodation.

1.4 The interpretation of the GST Act arising from the *Marana* decision represents a significant change in the GST treatment of affected premises. As such it would create uncertainty as well as advantaging some taxpayers while disadvantaging others. Further, the new view could add to complexity and the compliance burden for taxpayers. In particular:

- Uncertainty would be created in respect of the GST treatment of other forms of accommodation (for example, holiday homes).
- Investors who have purchased affected premises since the introduction of the GST and who were previously denied input tax credits would be advantaged by the change in view. If these investors are registered for GST, they would be entitled to claim input tax credits for the earlier acquisition costs. However, they would need to remit GST on supplies of premises (including on a subsequent sale of the premises) unless past transactions have been protected by the reliance on an ATO ruling.
- GST registered owners of units who purchased premises before the introduction of the GST would be disadvantaged by the change in view. They would not be able to claim input tax credits for acquisition costs incurred before 1 July 2000 but would need to remit GST on supplies of premises (including on a subsequent sale of the premises) unless past transactions have been protected by the reliance on an ATO ruling.
- Complexity and compliance costs would increase. The GST treatment of given premises would need to be determined on the basis of a range of factors rather than mainly on premises' physical characteristics. There would be flow-on consequences for income tax as the capital allowances and capital gains tax rules depend on the GST treatment of transactions.
- Small scale investors who, since the introduction of the GST, have purchased (or will purchase) units and may be encouraged to enter the GST system to claim input tax credits, may be disadvantaged. These investors may be required to deal with a significant compliance burden as the tax treatment could change from time to time depending on lease arrangements.

1.5 The proposed amendments will restore the policy intent. The continuation of input taxed treatment of supplies of the affected premises represents a sound balance between taxing (and crediting) business inputs and ensuring that owners of residential premises need not concern themselves with the compliance difficulties arising from the GST treatment of such premises.

## Summary of new law

1.6 The proposed amendments will ensure that:

- supplies of certain types of real property are input taxed to maintain the policy intent that the words ‘residential’ and ‘residence’ are not limited to extended or permanent occupation; and
- as a consequence of the above proposed amendment to overcome the implication of the *Marana* decision – residential premises which have only previously been sold as commercial residential premises or part of commercial residential premises are still regarded as new residential premises.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p><i>Residential premises and residential accommodation</i></p> <p>Premises may qualify as residential premises regardless of the term of occupation. Accommodation may qualify as residential accommodation on a similar basis.</p>	<p><i>Residential premises and residential accommodation</i></p> <p>It is arguable following the <i>Marana</i> decision that the terms residential premises and residential accommodation refer only to long-term occupation.</p>
<p><i>New residential premises</i></p> <p>No change. The amendment confirms the current treatment of these premises.</p>	<p><i>New residential premises</i></p> <p>A supply of residential premises is not precluded from being a supply of new residential premises merely because the premises have previously been sold as commercial residential premises or part of commercial residential premises.</p>

## Detailed explanation of new law

### Short-term occupation

1.7 The proposed amendments will amend the definition of residential premises to confirm that the period of occupation or intended occupation of land or a building is not relevant in determining whether premises are considered to be residential premises. The amendments will amend the definition to ensure that the use or intended use of property for residential accommodation means that it is residential premises and therefore subject to input tax treatment upon sale or rental. A similar change is made to the definition of a floating home. *[Item 7, section 195-1 – definition of floating home and item 8, section 195-1 – definition of residential premises]*

1.8 Without these changes, the *Marana* decision would otherwise suggest that the term residential premises refers only to premises occupied or intended to be occupied for long-term occupation.

1.9 The proposed amendments will also qualify ‘residential accommodation’ to ensure that it does not solely refer to long-term accommodation but may include short-term accommodation (that is, it may apply regardless of the term of occupation). *[Items 1 to 5, paragraphs 40-35(2)(a), 40-65(2)(b), 40-70(1)(a), 40-70(2)(b), subsection 40-65(1)]*

#### **Example 1.1 Serviced apartment for short-term stays**

Marek leases a strata titled unit in a serviced apartment complex to Phil. Permitted use of the apartment is restricted to short stays. The lease of the unit is input taxed because it is a lease of residential premises. The prohibition on long-term occupation of the apartment does not prevent the premises being characterised as residential premises. Under the proposed amendment, residential premises are not limited to those occupied or intended to be occupied permanently or for an extended period.

#### **Example 1.2 Employee accommodation**

Coalmer Enterprises Ltd provides accommodation for its employees in residential barracks. The employees’ occupation of the barracks is not subject to conditions relating to their terms of employment, such as limitations on personal possessions or a requirement to vacate at the end of a period of duty or a set quota of work. Nevertheless, the barracks are occupied on a short term basis. The proposed amendments ensure that the supply of the accommodation to the employees remains input taxed.

## **Interaction between commercial residential premises and residential premises**

1.10 Broadly, the above proposed amendments will ensure that a sale of residential premises (other than new residential premises) comprising a strata titled unit in commercial residential premises, such as a hotel or motel, will be input taxed.

1.11 For example, a supply of one or several units in a complex will not constitute a supply of commercial residential premises. This is because the supply of a single unit or several units in, for example, a hotel or motel is not a supply of a hotel or motel.

## **Application and transitional provisions**

1.12 The proposed amendments will apply to net amounts for tax periods that commence on or after 1 July 2000. *[Item 9]*

1.13 The proposed amendments will apply from the first tax period in which the GST applies because the GST law has been administered on the basis that residential premises and accommodation include premises/accommodation for both short and long-term occupation. This view was set out in Australian Taxation Office Goods and Services Tax Ruling GSTR 2000/20 which was released on 21 June 2000.

## **Consequential amendment**

1.14 The proposed amendments will make a consequential change to the definition of new residential premises. The proposed amendment will ensure that premises will not be precluded from being new residential premises merely because they have previously been sold as commercial residential premises. *[Item 6, paragraph 40-75(1)(a)]*

1.15 This will ensure that in accordance with the policy intent, any value added upon conversion of commercial residential premises to residential premises is subject to GST.

### **Example 1.3**

Camille Enterprises purchases a motel in August 1996 and operates it for ten years as a motel. In August 2006, Camille Enterprises ceases operation of the motel, strata titles the motel and sells one of the strata titled units as residential premises to Sebastien.

*[Click here and insert the name of the Bill]*

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Although the motel was sold as commercial residential premises in August 1996, the sale of the strata titled unit to Sebastien in August 2006 is a sale of new residential premises. This reflects that the premises have not previously been sold as residential premises and that a prior sale as commercial residential premises does not<sup>1</sup> preclude a later sale of residential premises from being a sale of new residential premises. The sale is subject to GST.

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<sup>1</sup> 'not' inserted on 12 April 2006