

GST Alert

Volume 2008, Issue No 1, 18 March 2008

Legal Alert

Volume 2008, Issue No 3, 18 March 2008

Special Edition: **Federal Court Decision** **Throws Doubt** on Property Developers Using **Margin Scheme**

The case of Brady King v. Commissioner of Taxation

has raised the possibility that property developers who acquire land whole and later subdivide it before reselling it may not be able to use the margin scheme. The ATO has issued a decision impact statement stating that it disagrees with the view of the Federal Court and indicating that it will accept taxpayers assessing themselves for GST on the basis that the margin scheme can apply to these developments, at least for the moment.

Facts

Brady King purchased an office building in King Street Melbourne on 22 May 2000 for \$9.25 million. Settlement was after 30 June 2000 (start of GST) but Brady King commenced works on a residential unit development on the site prior to 30 June, and obtained a planning permit on 26 June 2000. Brady King subsequently redeveloped the building into 124 stratum units and sold them off the plan in 2001, apart from 4, which remained unsold. In January 2002, Colliers Jardine valued the units at \$23.23 million.

Basis of dispute

Brady King lodged returns on the basis that GST should be calculated on the margin between the valuations made by Colliers Jardine and the sale price, under section 75-10(3) of the GST Act. The Commissioner contended that the margin should be calculated under section 75-10(2), as Brady King did not hold a legal interest in the parent title prior to 1 July 2000.

The formula in section 75-10(2) is the normal way of calculating the margin for the purchase price: the difference between the consideration for the ultimate supply made and the cost of the interest in question to the supplier.

Section 75-10(3) permits the margin to be calculated between the value at 1 July 2000 and the consideration for the ultimate supply, if the real estate in question was purchased prior to the start of GST, provided certain other conditions were fulfilled, namely:

- Item 3 - the supplier was registered/required to be registered on 1 July 2000, and there were improvements on the land or premises as at 1 July 2000; or
- Item 1 - the supplier acquired

the interest prior to 1 July 2000 if no other item applied.

The Commissioner made a legislative determination on the method of valuation under section 75-10(3), and Colliers Jardine made its valuation pursuant to that determination.

The issues before the Court were:

1. Whether Brady King was entitled to determine the margin using the valuation method under section 75-10(3); and
2. If so, whether the valuation it relied on complied with section 75-10(3).

Decision of Middleton J

His Honour noted that Brady King had acquired an equitable interest in land prior to 1 July 2002, and later acquired the legal title, and then converted the latter after the start of GST to a series of stratum units as defined in the GST Act, and then sold them off.

In the earlier case of *Sterling Guardian*, Stone J held that where the property was subdivided after the purchase, the acquisition cost of each unit for the purposes of s. 75-10(2) was the cost of the corresponding portion of the "parent" title and it was

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irrelevant that the individual stratum units did not exist at the time of acquisition.

The Commissioner argued that the valuation method under section 75-10(3) was not applicable because Brady King did not hold the parent freehold title prior to 1 July 2000, and that the margin was the difference between their proportionate cost of acquisition in accordance with Sterling Guardian and the consideration for their supply to third parties.

His Honour agreed with the Commissioner:

29 The property . . . that was sold by way of the Supply Contracts was not the same property that was acquired or held (no matter what meaning is given to those terms). Accordingly, s 75-10(3) does not apply; the applicant did not on any view acquire or hold before 1 July 2000 the Stratum Unit which it sold, and the requirements specified in the second column of the table were therefore not met.

In the view of the Court, the table in section 75-10(3) (see items 1 and 3 referred to above) refers to and requires a valuation of a corresponding type of property, namely the stratum unit.

His Honour went on to comment generally on the approach taken to the operation of the margin scheme in section 75-10(2), the provision which applies where the interest was not held prior to 1 July 2000. His Honour considered that in every case it was necessary to compare like with like:

The margin scheme envisages the comparison between the same

units and, for that matter, between the same interests or leases. One would readily expect this to occur so that the calculation of the margin can be determined, putting aside the identification of a date, on the basis of the acquisition and supply of the same unit, interest or lease.

His Honour then went on to say that the margin scheme could only apply to the same property being acquired and subsequently sold. In this, he went further than the Commissioner.

His Honour noted the provisions of section 75-10(15), which contained a provision specifically covering subdivided land:

For the purposes of section 75-10, if the freehold interest, stratum unit or long-term lease you supply relates only to part of land or premises that you acquired, the consideration for your acquisition of that part is the corresponding proportion of the consideration for the land or premises that you acquired.

His Honour held that section 75-10(15) did not apply because it related to a situation where part of the land had been sold, and related to land in its physical rather than in its juridical sense. This is a surprising conclusion, given the fact that the acquisition, subdivision and sale of a series of units as occurred in this case amounts to the successive sales of a number of parcels of land each originally forming part of the land acquired. While His Honour may be correct in asserting that the subsection provides no assistance in applying the valuation method,

it is difficult to see that it does not apply with respect to section 75-10(2) - otherwise what does it apply to?

His Honour then went on to decide that the references to freehold interests in land, stratum unit and long-term use as used in Division 75 applied only to legal interests in land and not equitable ones:

Whilst the definition of 'real property' is wide, s 75-5(1) restricts the application of the margin scheme to specific sub-sets of real property, namely the juridical concepts of the three forms set out, 'freehold interest in land', 'stratum unit' and 'long-term lease'.

45 In my view, looking at the context of the phrases used, they refer only to legal interests. The phrases are normally employed, although not always, to refer to legal interests. The reference to stratum unit (as defined) would ordinarily be confined to a registrable interest created by statute. The three sub-sets are presumably referred to because each of the estates or interests have accepted and well known meanings, and are to be distinguished from each other.

This conclusion sits oddly with the fact that the definitions of property in the GST Act generally cover every conceivable form of property, whether legal or equitable, and with the absence of express limiting words in the sections concerned.

Finally, His Honour declined to consider whether the valuation complied with section 75-10(3),

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because the conclusion he reached on the first matter made it unnecessary to do so.

ATO Decision Impact Statement

The Commissioner issued a Decision Impact Statement on the case on 20 February 2008. In it, he notes that the views expressed suggest that "developers would be precluded from using the margin scheme at all for unit developments". He does not agree with this.

The Commissioner's arguments before the Court were based on Brady King not holding a legal interest in the property prior to 1 July 2000, not on not holding stratum units. The Commissioner considers that a developer who held a legal interest in the parent title prior to 1 July 2000 can use the valuation method.

The Commissioner's own rulings on the subject do not accord with the tenor of the decision.

The Commissioner noted that, as he had won the case he was unable to appeal it. Our checks with the Federal Court registry confirm that an appeal has been lodged.

The Commissioner is "considering the implications of the decision". While it is doing this, the ATO does not intend to revise its current ruling. He makes the following critical statement:

This means that developers and others who rely upon the current rulings to self assess their GST liabilities under the margin scheme will be protected from retrospective adjustments where the terms of section 105-60 of Schedule 1 to the Taxation Administration Act 1953 are satisfied. In particular, this means that, subject to compliance with all requirements set out in the rulings, developers will be able to continue to self assess GST during this period on the basis that the margin scheme is available for unit developments, and the valuation method may be used, notwithstanding that the strata titles have not issued at the valuation date. The same principle applies in respect of other subdivisions, such as flat land subdivisions, where the title to the lots supplied may not have issued at the valuation date.

Practical Implications

For the moment, developers are protected only by administrative treatment afforded by the decision impact statement. However, that protection will probably apply to supplies of stratum units during current tax periods, not to future sales of stratum units in developments the property for which is being purchased now.

From a legal point of view, the position is now unclear, because we have two conflicting decisions of single judges of the federal Court: this case and Stone J. in *Sterling Guardian*, because the two decisions do conflict in substance, despite Middleton J.'s careful attempts to distinguish them. It is to be hoped that the issue will be clarified on appeal.

Developers should be seeking expert GST advice before completing the relevant BAS statements if developments are underway. For new developments, it may be appropriate to factor in the worst case scenario of no margin scheme applying. Having said that, given the housing crisis, it is difficult to see the Government not supporting changes to the Act to ensure that the margin scheme applies as intended.

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