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Vendor guide on GST treatment of residential premises

It is typical for people to consider stamp duty, land tax and income tax implications when they sell a property, but remember that it is equally important to consider whether the transaction will be subject to goods and services tax (GST). One important thing to remember is that there is now a single test that looks at the physical characteristics of a property to determine its suitability for residential accommodation, and as a result, its GST treatment.

Let us run through how the sale of your property may fall under one of these three categories:

- taxable supply – the seller is liable for GST on the sale and can claim GST credits for anything purchased or imported to make the sale
  (e.g. GST paid on real estate agent fees)
- GST-free supply – the seller is not liable for GST, but can still claim GST credits for anything purchased to make the sale, or
- input taxed supply – the seller is not liable for GST on the sale and also cannot claim any GST credits.

The sales of properties are input taxed, and not subject to GST, if they are used predominantly for residential accommodation. We address various issues below that determine whether residential premises can be considered residential accommodation or not. After that, we outline what happens when you sell commercial residential and new residential premises.

1. Buyer's intention not relevant to the Tax Office's assessment

The requirement for residential premises to be used predominantly for residential accommodation does not require an examination of the intention, or use by, any particular person. Premises that display physical characteristics evidencing their suitability and capability to provide "living accommodation" are residential premises – even if they are not used for accommodation on an extended basis or they are used for a purpose other than to provide accommodation, such as when premises are used as a business office.

The case study below, adapted from a Tax Office ruling, is an example of how a buyer's intention is irrelevant.

Case study: *Edward operates an enterprise which involves leasing a house on land which he owns. Subsequently, a developer approaches Edward and offers to purchase his property. The developer intends to demolish the house, redevelop the property into a new apartment building, and sell the apartments.*

However, the fact that the developer does not intend to use the house to provide residential accommodation is not a relevant factor in determining the character of the premises. Based on its physical characteristics, the house is residential premises to be used predominantly for residential accommodation. The buyer's plans do not change the characteristics of the premises in the hands of the supplier. As a result, the sale of the house is input taxed.

2. Fit for human habitation

Residential premises are not fit for human habitation when they are in a dilapidated condition, which prevents them from being considered residential accommodation. They must also provide shelter and basic living facilities to be considered residential accommodation.

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3. Sale of other facilities together with a residential unit

A supply of a residential apartment in a building may include a garage, car-parking space or storage area within the building complex. If these are supplied together within the residential unit, then the supply of these lots will be input taxed. If however they are sold separately, then they are not a sale of residential premises to be used predominantly for residential accommodation and will therefore be subject to GST.

4. Premises used both for residential accommodation and for business purposes

The supply of premises needs to be apportioned if part of it is not being used predominantly for residential accommodation. This is important for people running a business at home. For instance, if a residential premise is modified so that part of it is used as a business premise, the taxpayer will need to apportion the value of the supply of the premise between the taxable portion (that used for business) and the input taxed portion (the residential accommodation portion).

However, bear in mind that apportionment does not have to take place if merely one room of a residence is used for business purposes. For instance, if a room of a residential premise is used for office purposes without significant physical modification – like putting in furniture, shelving or communication lines – then this is not sufficient to require an apportionment. The whole of the sale or lease of these premises would be input taxed.

The case study that follows, again adapted from a Tax Office ruling, illustrates when a residential premise should be apportioned.

Case study: *Sharon decides to partly modify her house to use in her line of work as a doctor. She modifies an area of the house to provide office and consulting room space, an operating theatre, a waiting room and storage space for the business.*

The modifications result in the part of the premises consisting of the office, consulting room, operating theatre and car park no longer being residential premises used predominantly for residential accommodation.

Alternatively, part of the premises is still designed predominantly for residential accommodation – comprising bedrooms, bathroom, kitchen, living room, lounge room and gardens.

If Sharon later sells or leases the premises, she will need to apportion the value of the supply between the taxable and input taxed parts of the supply.

5. Land included with building used for residential purposes

There is no restriction on the area of land that can be included with a building to be considered residential premises. It differs according to circumstances. Taxpayers will need to look at the extent to which the physical characteristics of the land and building as a whole indicate that the land is part of the building for residential purposes.

However, vacant land cannot be residential premises because it is not capable of being occupied for residential accommodation as it does not provide shelter and basic living facilities.

As mentioned earlier, the sale of premises are input taxed to the extent that they are used predominantly for residential accommodation. However, sale of commercial residential premises and new residential premises – other than those used for residential accommodation before December 2, 1998 – are not input taxed and are therefore subject to GST.

Commercial residential premises

Commercial residential premises include the below:

a) a hotel, motel, inn, hostel or boarding house

b) premises used to provide accommodation in connection with a school

c) a ship that is mainly let out on hire

d) a ship that is mainly used for entertainment or transport or a marine at which one or more of the berths are occupied by ships used as residences

e) a caravan park or a camping ground, or

f) anything similar to the residential premises described in paragraphs (a) to (e).

Consult this office to find out more about the specific characteristics of the commercial residential premises. There are also variations on the places outlined that are still considered commercial residential premises, so be sure to seek advice.

New residential premises

A new residential premise is one that:

- has not been sold as a residential premise previously
- has been created through substantial renovations (consult this office to find out what constitutes "substantial renovation"), or
- is a new dwelling that has replaced an existing dwelling on the same land.

"Off the plan" sales and newly built homes are considered sales of new residential premises. Once

the property has been continuously rented for five years however, it ceases to be a new residential premise.

Consult this office before selling a property, be it commercial or residential, to find out what the GST implications of the sale will be.

Car expenses – a very popular deduction, but you've got to get it right

Each year, the Tax Office reports that work-related expenses are the most common type of tax deduction claimed, and it also reports that one of the most popular of work-related claims is for vehicle expenses.

Vehicle expenses are a very regulated area for claiming deductions, so good guidance on making car expense claims is essential to stay on the right side of the taxman. It is not generally allowed, for example, to claim the cost of trips between home and work, even if you do minor work-related tasks on the way (such as for example picking up the mail from your employer's post office box).

This is also the case where you may be called into work while otherwise at home (if you were "on call" for example), or if you worked shifts that are outside usual work hours. The fact that there happens to be no public transport near where you work also generally doesn't make a difference.

Allowable claims

The rules do allow a claim however if you need to drive in order to carry bulky items (like an extension ladder, for example) that can't be left at the workplace, or you have multiple sites that you travel between as part of your employment.

Claims can also be made if your home is a "base" of work (and you travelled from there to another site, such as a client's premises, to continue that work). You can also make a claim if you have a second job and travel directly from one workplace to another.

Car expenses are costs resulting from using your car for work (that is, to produce assessable income). But these deductions are only for "cars" and are not for other vehicles such as motorcycles, utes or vans (with a one-tonne capacity, or any vehicle with a nine or more passenger capacity).

Expenses for these vehicles are treated as "travel" expenses, as are costs for short-term car hire, bridge and road tolls, parking fees and such (but you must be eligible to make such claims — check with this office).

The methods

To claim legitimate car expenses, the first step is to work out (and record) how many of the kilometres travelled are business kilometres. After that, there are four methods to choose from, and you can take up whichever of these methods give you the largest deduction – provided you have the back-up evidence if the Tax Office asks for it.

The four options to determine car expense deductions are:

- cents per kilometre
- 12% of original value
- one-third of actual expenses, and
- the logbook method.

1. The cents per kilometre method

The cents per kilometre method can be used to claim up to a maximum of 5,000 business kilometres per year (but no more than 5,000). You do not need written evidence, but you may need to be able to show how you worked out your business kilometres.

The number of kilometres is multiplied by a cents per kilometre rate based on the engine size of the vehicle used. This ranges from 63 cents for a 1.6 litre or less engine to 75 cents for a 2.601 litre or more engine. Hybrid cars are still based on the petrol driven cylinder volume. The resulting figure is divided by 100 to arrive at the amount you can claim in dollars.

2. The 12% of original value method

The 12% of original value method takes that portion of your car's original value as the claimable amount and you can travel more than 5,000 business kilometres in the claim period. If you bought the car, then 12% of the cost is used. If it is leased, a market value from the time you leased it is used.

But this method has a limitation applied for "luxury" cars, where a maximum cost is set and is indexed each year. It is $57,466 for the 2013-14 financial year.

3. The one third of actual expenses method

The one third of actual expenses method is just as it sounds (and does not take in purchase price or include capital costs such as improvements to the vehicle). But you will need to have receipts for fuel and oil costs, or use the odometer records to calculate a reasonable estimate.

All other car expenses need to be recorded, as will the make and model, engine capacity and registration number. You can travel more than 5,000 kilometres, but may need to show how you worked

these business kilometres out. The limit of $57,466 also applies (which does not include GST by the way).

4. The logbook method

The logbook method requires that you record each car expense (in a logbook, naturally – you can get a blank one at most newsagents). The logbook needs to be kept for at least 12 weeks.

Your claim is worked out on the business use percentage for each expense (and again, not the purchase price or improvements). You will need to keep odometer readings and records of all other car expenses, and use the logbook to work out the percentages.

Input tax credit claims

If you are registered for GST you will need all the car-related invoices to claim back the right amount of input tax credits. You will again need to know the business kilometres to work out the percentage. Only expenses made for a "creditable purpose" are eligible for input tax credit claims.

One interesting, and perhaps unintended, benefit for employers is that where a car is supplied to an employee, and that employee uses the vehicle for part-private uses, the employer can still claim input tax credit entitlements at the full amounts, unaffected by this employee private use. This is because the Tax Office views the use of the car by the employer (giving the employee the benefit of using it) as still qualifying as a "creditable purpose", and therefore entitling the employer to claim full input tax credits.

For the one third of actual expenses and the 12% of original value methods, you can make a claim of one third of the input tax credits included in the cost. With the logbook method, the percentage of business use determines the extent of input tax credit claim.

Since car expenses are the most claimed work-related expense, be sure to consult this office on what constitutes an allowable claim adn which if the four claiming methods will work out best for your circumstances.

FBT – fears, cheers and changes

The current FBT year is just wrapping up, and it has been a period of potential turmoil with the proposal to scrap the statutory formula method for calculating car benefits. However not long after this landed on the legislative table it was swept off it again by the current government. So the status quo remains in this area of FBT law. But it may have served as a distraction from some other important adjustments, one of which is that the FBT rate is increasing come April 1.

The increase to the FBT rate (and gross-up rates) comes about due to the Medicare levy increasing from 1.5% to 2% of taxable income from July 1, 2014. The boost to the levy is to be directed to the DisabilityCare Australia Fund. Consequently, the FBT rate will increase from its present 46.5% to 47%, but comes into force earlier (for the FBT year commencing April 1, 2014).

Type 1 and type 2 gross-up rates are also affected, and ultimately the grossed-up taxable value of fringe benefits provided. The rate for type 1 benefits increases from 2.0647 to 2.0802, and type 2 from 1.8692 to 1.8868, both from April 1. For employers, the additional FBT payable due to the increase (in percentage terms for each dollar of benefit provided) is 1.83% for type 1 benefits and 2.03% for type 2 benefits.

Note that the higher gross-up formula was introduced to avoid allowing employers the benefit of claiming GST input tax credits for items bought for the private use of employees. The higher gross-up effectively recovers the input tax credit that an employer can obtain in providing a fringe benefit.

Also the Tax Office recently changed the lodgement due date for 2014 FBT returns that are lodged electronically through this office. This deadline is now June 25, 2014. Payment of any outstanding FBT is still due by May 28.

The Tax Office also revealed in its compliance program for 2013-14 that it will be actively pursuing non-lodgement of FBT returns. It will be focusing on employers that may have FBT obligations but that are not in the FBT system, indicating that this will be achieved through the use of third-party information — for example, where motor vehicles are registered in the business name, but no FBT return has been lodged or employee contributions disclosed.

In July 2013, the Tax Office issued 10,000 letters to employers that may have an FBT obligation in respect of a motor vehicle registered in the business name. It will not be surprising to see such campaigns continue for 2013-14 given that car fringe benefits accounts for a significant slice of FBT revenue. This will be the case given that the statutory formula method remains as an option for valuing car fringe benefits, as mentioned above.

Tax and FBT issues in relation to the Living Away From Home Allowance (LAFHA) continue to test both employers and employees, with some of the central concerns emanating from amendments made to the LAHFA provisions that limit the FBT concession available when providing such benefits to certain

employees.

Apart from fly-in fly-out or drive-in drive-out workers, the concessional treatment is limited to employees who:

- maintain a home in Australia (at which they usually reside) for their immediate use at all times while required to live away from that home for employment purposes
- will resume living at that home when no longer away from it for employment purposes
- incur expenses for accommodation, food and drink for a maximum of 12 months while at a particular work location, and
- have provided their employer with a declaration that they are living away from their home.

There are some further substantiation requirements, depending on employee circumstances. In working out an employer's FBT liability, the taxable value of LAFHA fringe benefits provided to eligible employees can be reduced by:

- the amount of the employee's actual substantiated accommodation expenditure while living away from home for employment
- the amounts incurred for food and drink costs, less a statutory amount if applicable (note that "reasonable amounts" for food and drink costs have been determined by the Tax Office — ask this office for these).

The tax treatment of expenditure incurred under LAHFA arrangements can be quite complex, and it is advisable to seek advice on this matter. The Tax Office says it will embark on an educational campaign over the 2013-14 FBT year relating to these and other LAFHA sticking points. It has also made available several forms and declarations that may be relevant, depending on the circumstances of an employee. The relevant forms and declarations are available from this office.

Court decision on trade incentive payments could have far-reaching GST consequences

A recent decision by the Full Federal Court dealt with the goods and services tax (GST) treatment of four types of manufacturer incentive payments made to a car dealership. However the decision, and the Tax Office's response, is likely to have an impact in the wider market, not just in the motor vehicle dealership industry.

The GST law in relation to identifying "supply" and "consideration for supply" are not industry specific. Therefore the interpretations and concepts that have been highlighted by the court case may have implications for business taxpayers in many other industries that use supplier rebate programs, incentive agreements and similar schemes.

In fact, should any business's circumstances reflect the decisions in the case and/or the Tax Office's administrative advice as offered in its "decision impact statement", that business may well be entitled to claim a refund. In fact, all business taxpayers should also take these factors into consideration before finalising any proposed future supplier rebate or incentive agreements.

The case

A business taxpayer, AP Group, ran a number of car dealerships, selling motor vehicles to end users. AP Group entered into dealership agreements with vehicle manufacturers and wholesale distributors, which included incentive payments such as the following:

- Fleet rebate — in some cases the dealer will have paid more for a car than if they were a fleet buyer, so the difference in price is paid to the dealer
- Run-out model support payment – the dealer receives payments by reference to cars earmarked from specified run-out stock (with no requirement to pass on any discount to end user)
- Retail target incentive – payments made to dealers that achieve sales volume targets
- Wholesale target incentive – orders placed within certain parameters for a qualifying period receive percentage discount on subsequent invoices, with payments not tied to sales made.

The Tax Office had taken the view that each of these attracted liability for GST, as they were "consideration for taxable supplies" under the GST rules. The taxpayer however disagreed with this, with the resulting appeals and counter-appeals landing the case before the Full Federal Court.

The outcome

The end result from the AP Group case is that the first two of the above payments have been deemed to attract GST, while the last two do not. Basically this is because the Full Federal Court was of the view that the first two constitute "consideration" for the supply of cars to AP Group's customers. Therefore GST will specifically be payable on fleet rebates and run-out model support payments that have the

characteristics of the examples in the case, however in more general terms similar incentive arrangements for businesses operating in industries other than vehicle retail may in fact also attract GST.

And a warning regarding motor vehicles that were subject to the luxury car tax (LCT) before the court decision – the LCT liability will increase as a result of the incentive payment being added to the consideration paid by the customer, or for cars that were just under the LCT threshold before may now be over it.

The Tax Office's decision impact statement (ask this office for a copy, or speak to us about it) makes it plain that the Tax Office may consider similar incentive agreements made in other industries to be "consideration for taxable supplies", but it says that this will be dependent on relevant facts and circumstances. It also says that it will prepare guidance for other industries.

The Tax Office has also announced that it is reviewing GST public rulings that discuss "supply" as well as "consideration for supply" to determine whether any revisions are necessary to these rulings. Consult this office for more if you have any concerns regarding this area of the tax law.

Loan interest can be deductible to a partnership

A general law partnership is formed when two or more people (and up to, but no more than, 20 people) go into business together. Partnerships are generally set up so that all partners are equally responsible for the management of the business, but each also has liability for the debts that business may incur.

Partnership deduction for interest expenses

A typical scenario when launching a business based on a general law partnership structure sees each partner advance some capital to start up the enterprise. As the income years come and go, each partner takes a share of the profit and counts this as part of their personal assessable income for tax purposes.

However as the business becomes established, or better yet proves to be viable and becomes a successful operation, there is likely to come a time when its working capital — which had been financed from each partner's pocket — can be refinanced through the partnership business borrowing funds.

For such partnerships, there is a "refinancing principle" under tax law that spells out some general principles governing the deductibility of loan interest in such circumstances.

As a general rule, interest expenses from a borrowing to fund repayment of money originally advanced by a partner, and used as partnership capital, will be tax deductible. This is covered in tax ruling TR 95/25 (you can ask this office for a copy).

The ruling states that to qualify for a tax deduction, the interest expense "must have sufficient connection" to the assessable income producing activities of the business, and must not be "of a capital, private or domestic nature".

However interest on borrowings will not continue to be deductible if the borrowed funds cease to be employed in the borrower's business or income producing activity. Nor will deductibility be maintained should borrowed funds be used to "preserve assessable income producing assets". There is also a limitation on deductibility of loan interest in that borrowings to repay partnership capital can never exceed the amount contributed by the partners.

The ability to make these interest expense deductions under the "refinancing principle" is generally limited to general law partnerships — and not tax law partnerships such as those used to jointly purchase an investment property. This principle would also not apply to companies or individuals. (There are very prescribed conditions where, for example, a company may make such a claim, but under very specific circumstances.)

Other partnership facts and foibles

Partnerships can be less expensive to set up as a business structure than starting business as a sole trader, as there will likely be greater financial resources than if you operated on your own. On the flip side however, you and your partners are responsible for any debts the partnership owes, even if you personally did not directly cause the debt.

Each partner's private assets may still be fair game to settle serious partnership debt. This is known as "joint and several liability" – the partners are jointly liable for each other's debts entered into in the name of the business, but if any partners default on their share, then each individual partner may be severally held liable for the whole debt as well.

Other general factors to note about partnerships include:

- the business itself doesn't pay income tax. Instead, you and your partners will each need to pay tax on your own share of the partnership income (after deductions and allowable costs)
- the business still needs to lodge a tax return to show total income earned and deductions

claimed by the business. This will show each partner's share of net partnership income, on which each is personally liable for tax

- if the business makes a loss for the year, the partners can offset their share of the partnership loss against their other income
- a partnership does not account for capital gains and losses; if the partnership sells a CGT asset, then each partner calculates their own capital gain or loss on their share of that asset
- the partnership business is not liable to pay PAYG instalments, but each partner may be, depending on the levels of their personal income
- as a partner you will need to take care of your super arrangements, as you are not an employee of the business, and
- money drawn from the business by the partners are not "wages" for tax purposes.

Lastly, as with any business, the partnership will need an ABN and will need to register for GST if the business's annual turnover is more than $75,000 (before GST).

New SMSF penalty regime to kick in on July 1, 2014

Did you know you may have to fork out $10,200 if you lend money to a fellow self-managed superannuation fund (SMSF) member or a relative who is in dire need of some financial assistance? Or $1,700 for a breach as minor as failing to keep adequate records? The countdown is on, with only around four months remaining until the new SMSF administrative penalty regime kicks in on July 1.

If all this sounds familiar, it is because the SMSF penalty regime was essentially a measure that was due to be implemented by the previous federal government on July 1, 2013 but due to inadequate legislative support, the measure was held back. With the new government at the helm however, the measure has been given the nod and looks set to come into effect.

Currently, the Tax Office has a few ways in which it deals with non-complying funds. It can:

- make an SMSF non-complying for tax purposes, take away its tax concessions and effectively force it to wind-up
- accept an enforceable undertaking
- take trustees to court and seek a civil penalty, or
- disqualify SMSF trustees.

With its new regulatory powers however, the Tax Office will be able to prevent repeat breaches by:

- issuing trustees with a direction to rectify contraventions within a specified timeframe
- enforcing mandatory education for trustees where there is non-compliance with super law, so that trustees are aware of their obligations (the compulsory education course will be at their own expense), and
- imposing administrative penalties that will be payable by the trustee, not out of the assets of the SMSF (refer to table below).

It is worth remembering that the new administrative penalty regime will involve a system of penalty points for various breaches – with each penalty point worth $170. The most common penalties for breaches will carry units that range from five units to 60 units, equal to a value of $850 to $10,200. This will be a change from the current system where each penalty unit is only worth $110, meaning the highest fine an SMSF could ever be administered with was $6,600.

What the Tax Office will not do is:

- issue binding rulings in relation to SMSFs
- collect data on SMSF borrowing from credit providers (the Tax Office will instead collect data directly from SMSFs as part of its collection and publication of SMSF data)
- prohibit investment in in-house assets, and
- require SMSFs to provide information to members on an annual basis.

Do ensure your SMSF is up to speed with all its administrative and compliance obligations. Consult this office to familiarise yourself with the new administrative penalties to avoid landing in hot water with the Tax Office.

Breach	Penalty units	Amounts
Failure to comply with Tax Office education directive	5	$850
Failure to appoint an investment manager in writing when one is appointed	5	$850
Failure to provide information on approved form in prescribed time upon establishing fund	5	$850
Failure to complete a form with requested information as part of ATO's statistical program	5	$850
Failure to prepare financial statements	10	$1,700
Failure to keep trustee minutes for at least 10 years	10	$1,700
Failure to keep records of change of trustees for at least 10 years	10	$1,700
Failure to sign trustee declaration within 21 days of appointment and keep for at least 10 years	10	$1,700
Failure to keep member reports for 10 years	10	$1,700
Failure to notify the Tax Office of a change of SMSF status e.g. fund ceasing to be an SMSF	20	$3,400