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Intentions Irrelevant

This article appeared in this month's edition of the Law Society Journal (NSW).

David and Daisy are physiotherapist clients of yours. They come to see you about buying a house and converting it to a new physiotherapy and gymnasium complex. The agreed purchase price is \$800,000. You discuss how soon the development will commence, though David and Daisy are not sure, they indicate that they would like to start sooner rather than later.

You talk to them about what entity to purchase the property in. After discussion with their accountant, they decide to use their family trust, which owns some other property which can be used as additional security. The accountant tells you that the trust is registered for GST.

As David and Daisy intend to demolish the property and develop it for a commercial purpose you tell them that the sale will not be for residential premises but that they will be able to claim back any GST in the price as an input tax credit.

On reviewing the contract from the vendor's solicitor you note that it is marked as being input taxed residential property and that it is tenanted in accordance with a residential tenancy agreement, for a further three months.

You write to the vendor's solicitor informing them of your client's intention and that the sale will not be input-taxed due to your clients intention.

The vendor's solicitor tells you that his clients are registered for GST and that provided they get \$800,000 in their hand they are happy for it to be a taxable supply.

The contract is amended to increase the price to \$880,000, insert \$80,000 as the GST Amount and put an "X" in the taxable supply box.

The GST status of the sale isn't discussed further, the sale completes without a hitch and the vendor gives David and Daisy a tax invoice.

The sting

David and Daisy's trust cannot claim an input-tax credit on the purchase price. As a result a purchase they thought would cost them \$800,000 (\$880,000 less the GST of \$80,000) could, subject to their rights under the contract, cost them \$880,000.

The purchaser's intention alone is usually insufficient to determine the GST status of a transaction.

The fact that the contract says it is a taxable supply does not help. Section 9-5 makes it clear that a supply is not a taxable supply if it is input-taxed. The supply of residential premises is input-taxed.

The Federal Court, in *Sunchen Pty Ltd v Commissioner of Taxation*, confirmed the view that the purchaser's future intention does not stop a property being "residential premises" if the property satisfies the requirements of s.40-65 at the time the supply is made.

In this case, as the property was being used as a residence when it was purchased and will continue to be used as a residence until the lease expires. The fact that the purchaser then intends to develop the property in the future is not relevant to assessing whether it is residential premises when the supply occurs.

In a Decision Impact Statement released on 21 February 2011 the Tax Office confirmed that it shares the Federal Court's view.

As the supply is input-taxed, the vendor has no obligation to pay \$80,000 in GST to the Tax Office.

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Clause 13.8 and 13.8.1 of the standard contract requires the vendor to pay the purchaser one eleventh of the price on completion of the contract if the contracts says it is a taxable supply and it is not.

Let's hope for David and Daisy's sake that the vendor has not moved to Majorca and still has \$80,000 to pay back.

When acting for buyers, and sellers, of property, it is very important to consider all aspects of the transaction from a GST perspective.

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