[GST: When are “old” premises treated as “new residential premises”?]

I was invited to write an article for Thomson Reuters Weekly Tax Bulletin recently on a topic based on one of my LinkedIn posts.
See the article below

Visit their website [here.]

GST: When are “old” premises treated as “new residential premises”?

– by Ken Fehily, Director/Principal, Fehily Advisory

There is a “5-year rule” treating new residential premises (‘NRPs”) as input taxed instead of being taxable (and so subject to GST), that continues to be regularly misunderstood – by advisers, developers and certainly the average investor.

Many incorrectly conclude that GST stops being payable on NRPs simply on the basis of them being first sold after more than 5 years. They often also simultaneously conclude that they are still entitled to the full GST input tax credits that were claimed during development.

However, that would mean the developer fully escapes GST on NRPs. That doesn’t make much sense as it’s well known that GST was designed to capture GST on NRPs at some stage, and the 5-year rule surely can’t be an accidental gaping loophole that still exists after 21 years of GST.

In the ordinary course of events, a developer of NRPs would build NRPs with an intention to sell them and:

- be entitled to claim full GST input tax credits during the development; and
- be liable to pay GST (full 10% or calculated under the margin scheme) when they are first sold.

Alternatively a developer of NRPs would build NRPs with an intention to rent them for at least 5 years and:

- not be entitled to claim any GST input tax credits during the development (ie it works out to be input taxed); and
- if sold after 5 years, will be input taxed and not subject to GST.

The 2 above straightforward scenarios result in the ATO capturing and keeping GST on the inputs (if built to rent) or keeping GST on the taxable sale (if built to sell). That is, the ATO gets GST one way or the other, as intended.

Less straightforward, but not unusual, scenarios

However, ss 9-5, 11-5, 40-65, 40-75 and Div 129 of the GST Act operate collectively to cover the less straightforward but not unusual scenarios when a developer:

- always had a “dual intention” of building the NRPs, renting them for a period of time and then

selling them;
- initially intending to build them to sell, but changed that to build to rent or to a dual intention, or
- initially intended to build them to rent, but changed that to build to sell or to a dual intention.

It is beyond the scope of this brief article to explain all of the compliance complications arising from the above less straightforward scenarios. That is because it requires continually apportioning s 11-5 input tax credits on a tax period by tax period basis, periodically making Div 129 adjustments in each tax period ending June – and that can continue to be required for a period much longer than 5 years.

However, for the developer to be able to determine if, and the extent to which, it can claim GST input tax credits and/or is required to make Div 129 adjustments, it must know if the ultimate supply of the NRP will be input taxed or taxable.

Under the 5-year rule, NRPs are treated as input taxed, and are no longer subject to 10% GST when the NRPs are eventually sold for the first time, but only if:

- the NRPs were applied/used exclusively (100%);
- for the purpose of input taxed residential leasing;
- for a continuous and unbroken period of 5 years (commencing on the date that the NRP first became residential premises – the normal proxy used is the date of the occupancy permit): and
- noting that GST input tax credits would not normally have been claimed at all during that full 5-year period.

However, if:

- there was "dual intention" of the developer at any time during that 5-year period to sell and rent the NRPs (evidenced in financial accounts, permits, finance/insurance, partnership/JV agreements); or
- at any time during that 5-year period there was an unsuccessful attempt to sell the NRPs (eg simply appointing a selling agent or advertising the NRPs for sale, whether vacant possession or tenanted),

then:

- the rule of using the NRPs exclusively for a continuous and unbroken period of 5 years for input taxed residential renting is broken, meaning the NRPs are taxable and not input taxed if then sold; and
- that 5-year period starts all over again, but only once the developer commits to applying the NRP exclusively for the purpose of input taxed residential rent only, and not having the intention and not taking any action to try to sell the NRP for at least another 5 years.

The 5-year rule would then only arise if the second attempt at a continuous 5 years of input tax renting, and not claiming GST input tax credits, is reached. That means it could remain taxable as new residential premises 5, 10 or even more years after becoming residential premises.

A common trap

Even when the developer/advisor does know the 5-year rule fairly well, a common trap is to engage a selling agent, or advertising the NRP for sale, just before completion of the 5-year period, say at 4 years and 9 months, knowing that it would take at least 3 months to sign up a buyer and settle.

Even if settlement of the sale might not occur till after the end of the 5-year period, the actions of putting the NRP on the market just prior to the completion of the 5-year period means that 5-year test is not met. This means that the NRP will be subject to GST when sold – even though it will be more than 5 years after becoming residential premises. This is a common trap.