

Is a motel “a residence”?

Beaumont J answers “no”!

Inconsistently with a Commissioner’s ruling on the issue, a single judge of the Federal Court has held that a sale of a motel is not a sale of a residence. For redeveloped motels, this means that the subsequent sale of a unit previously sold as part of a motel is liable to GST.

INTRODUCTION

The Commissioner has successfully argued his case in what has been heralded as Australia’s first substantive GST decision.

Delivered on 15 March 2004, the first GST judgment is found in *Marana Holdings Pty Limited v Commissioner of Taxation* [2004] FCA 233.

Decided by a single judge of the Federal Court, Beaumont J holds that the sale of a single renovated unit, earlier sold as a part of an existing motel, involved a sale of “new residential premises”. In so holding, Beaumont J takes a strictly literal approach to the meaning of the term “residence”. According to his Honour, “a residence”, in its noun sense, can only be a residence if a person occupies it for a significant period of time. In other words, premises used for temporary stays, lodging, sleeping or overnight accommodation should not be referred to as residences.

In so holding, Beaumont J dismisses the declaratory orders sought by the taxpayer that the sale of the individual renovated unit was “input taxed” under s 40-65 of the GST Act.

THE FACTS

In simple terms, the case involved 2 sales of property.

- The first sale happened in September 2002 and involved the sale of an existing motel by a vendor to the taxpayers – referred to here as sale 1; and

“

a residence requires a significant degree of
permanence of occupation...

”

- The second sale happened in October 2003 and involved the sale of a single renovated unit by the taxpayers to an individual – referred to here as sale 2.

In between sales 1 and 2, the taxpayer:

- obtained approval from a Local Council for developing the motel;
- renovated the motel to permit registration of a strata plan and sale of strata units;
- undertook building works to the motel; and
- converted a room (and a car space) in the motel into a lot in a strata plan.

Under the GST Act, the tax treatment of sale 2 is linked to the character of the premises sold in sale 1. In particular, whether sale 2 results in an “input taxed” supply, as opposed to a “taxable supply”, depends on whether sale 1 involves a sale of “a residence” and therefore of “residential premises”.

THE GST ACT

The case deals with a number of provisions in the GST Act. To begin with, however, the provision to focus on is s 40-65(1) which provides that: "A sale of real property is input taxed, but only to the extent that the property is *residential premises* to be used predominantly for residential accommodation."

The definition of the phrase "residential premises" is found in s 195-1 where it is defined as "land or a building that:

- (a) is occupied as a residence; or
- (b) is intended to be occupied, and is capable of being occupied, as a residence."

However, under s 40-65(1) a sale is not input taxed to the extent that "the residential premises are:

- (a) commercial residential premises; [which correctly, in my view, the Commissioner did not argue in this case] or
- (b) new residential premises other than those used for residential accommodation before 2 December 1998." [which the Commissioner did argue.]

The phrase "commercial residential premises" is defined in s 195-1 to include, amongst other things, a "motel" (See para (a)). The phrase "new residential premises" is defined in s 40-75(1) as follows:

"(1) Residential premises are new residential premises if they:

- (a) have not previously been sold as residential premises ... ; or
- (b) have been created through substantial renovations of a building;" [The Commissioner did not argue this provision.]"

THE ARGUMENTS AND DECISION

Was the motel "a residence"?

Taxpayers' argument

According to the taxpayer, at the time of sale 1 the existing motel was "residential premises" and so sale 2 did not involve a sale of "new residential premises". In other words, sale 2 involved a sale of premises previously sold as residential premises.

In particular, the taxpayers relied on *Goods and Services Tax Ruling* GSTR 2003/3, para 43, to argue that the process of strata titling an apartment block does

not, of itself, make premises new. According to GSTR 2003/3, when newly strata titled units are sold, the sale of those units are not sales of new residential premises, if the land and the building have together previously been sold as "residential premises".

In the taxpayer's view, when the motel that existed before was sold, it was sold "as residential premises", because it was premises "occupied as a residence". That is, the premises were used as a motel for the provision of residential accommodation.

Commissioner's argument

Contrary to his own ruling on the subject matter, the Commissioner argued that sale 1 did not involve a sale of "residential premises" as defined.

Beaumont J's decision

In finding for the Commissioner, Beaumont J held that the motel was not "a residence" and therefore not "residential premises". Beaumont J approached the issue literally, looking to the ordinary meaning of the word "residence" – that is: "the place, especially the house, in which one resides; dwelling place; dwelling."

According to his Honour, the statutory definition of "residential premises" in s 195-1 of the GST Act like its ordinary meaning includes an element of occupation. Ordinarily, to occupy a place you need to live in a place, and not simply lodge in the place temporarily.

The question posed by the definition in s 195-1 is – can a room in a motel be occupied as a residence?

In response to that question, Beaumont J agreed with the observation made in *Urdd Gobaith Cymru v Commissioner of Customs and Excise* [1997] V & DR 273 (at 279):

"I agree that "a residence" clearly implies a building with a significant degree of permanence of occupation. However the word loses that clear meaning when used as an adjective. In ordinary English "residential accommodation" merely signifies lodging, sleeping or overnight accommodation. It does not suggest the need for such accommodation to be for any fixed or minimum period."

Following the approach in that case, Beaumont J rejected the taxpayers' argument.

While the motel could, in loose terms, have been described as residential accommodation, that is not the test in s 195-1. The test in s 195-1 is whether something is a "residence", in its noun form, and before something can be described as "a residence" a person must occupy the premises for a significant period of time. In its noun form, it cannot be said that a residence exists where a person temporarily stays in premises for the purpose of sleeping overnight or for a short period of time. According to Beaumont J, from a grammatical perspective, this is the crucial difference between the noun "residence" and the adjective "residential". In short, premises can be residential, without being a residence.

This is a rather literal construction of the wording of the definition of residential premises. While the view is, strictly speaking, correct, and consistent with case law in the income tax context (see for example *FCT v Applegate* (1979) 9 ATR 899), there is much to be said for the contrary view. In particular, when one considers the terms of the GST legislation as a whole and its purpose as a simple and easy to understand tax for business.

Was the motel "intended to be occupied as a residence"?

As an alternative argument, the taxpayers submitted that when sale 1 happened the motel was "intended to be occupied ... as a residence".

In response, Beaumont J holds that in its reference to premises which "have not previously been sold ...", it is clear that "previously" refers to a sale before the one which is being considered. Beaumont J notes that the Commissioner accepted that sale 2 was a sale of premises intended to be occupied as a residence. However, as the Commissioner argued, and his Honour agreed, sale 1 did not have that character, for the same reason – ie the motel while residential in nature, was not a residence. Therefore, Beaumont J again rejects the taxpayer's argument.

Was the motel "residential premises"?

As another alternative argument, the taxpayer contended that the motel was sold as "residential premises" and thus as "commercial residential premises". In

particular, the taxpayers referred to the definition of “commercial residential premises” in s 195-1 as follows:

“commercial residential premises means:

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

(b) premises used to provide accommodation in connection with a *school; or

(c) a *ship that is mainly let out on hire in the ordinary course of a *business of letting ships out on hire; or

(d) a ship that is mainly used for *entertainment or transport in the ordinary course of a *business of providing ships for entertainment or transport; or

(da) a marina at which one or more of the berths are occupied, or are to be occupied, by *ships used as residences; or

(e) a caravan park or a camping ground; or

(f) anything similar to *residential premises described in paras (a) to (e).’

The taxpayers pointed out to Beaumont J that the definition in para (f), in particular, supports the view that the preceding paragraphs refer to things that are residential premises. This point is also made in a Commissioner’s ruling (GSTR 2000/20, para 18).

Accordingly, the taxpayers submitted that the structure of the GST Act contemplates that a motel can be both “commercial residential premises” and “residential premises”. In other words, under the GST Act, the categories of commercial residential premises and residential premises are overlapping, rather than mutually exclusive. Or better still, in the author’s view, that “commercial residential premises” are simply a subcategory of “residential premises”. With the main difference being the business-like manner with which such premises are run. Support for this view is found in s 40-35(1)(a) on residential rent where it is stated that “a supply of premises that is by way of lease, hire or licence ... is input taxed if the supply

is of residential premises (other than commercial residential premises) ...”

For the same reasons as before, however, Beaumont J rejects the taxpayers’ argument. According to Beaumont J, the use in the s 195-1 definition of the noun “residence”, rather than the adjective “residential”, dispensed with the argument.

An additional flaw in the taxpayers’ argument is not actually identified in Beaumont J’s judgment. Contrary to the taxpayers’ assertion, not all of the paragraphs in the definition of commercial residential premises are, in fact, residential premises. Specifically, paras (c) and (d) of the definition refer to things that are not strictly speaking residential premises. This is highlighted in a footnote in GSTR 2000/20. Accordingly, this would seem to support a view different to that put forward by the taxpayers’ – namely, that the categories of residential premises and commercial residential premises overlap in some instances, but in other instances they are completely exclusive.

Was the motel used for residential accommodation?

The taxpayers’ final argument before Beaumont J was that if the strata unit was “new residential premises” within s 40-75, they “were used for residential accommodation before 2 December 1998” within s 40-65(2)(b). Therefore, the exclusion in para 2(b) applied and the sale of the strata unit was “input taxed” under s 40-65(1).

The taxpayers submitted that the relevant use as residential accommodation before December 1998 arose from use as a motel prior to that date; and the circumstance that the residential use by customers was of a temporary nature did not, as was decided in *Urdd Gobaith* (and, to the same effect in the AAT Case 10,476 (1995) 31 ATR 1264 (at 1271)), prevent the conclusion that the strata unit was then used for “residential accommodation”.

Beaumont J again rejects the taxpayers’ argument. As with all of the taxpayers’

other arguments, this argument was conditional on the motel being “a residence”. Section 40-65(2)(b) begins with the words “new residential premises” and that phrase, according to Beaumont J is tied to the already discussed definition of “residential premises”. According to his Honour, the definition of “new residential premises” was not satisfied in the case before him, as prior to sale 2 happening, no “occupation as a residence” existed.

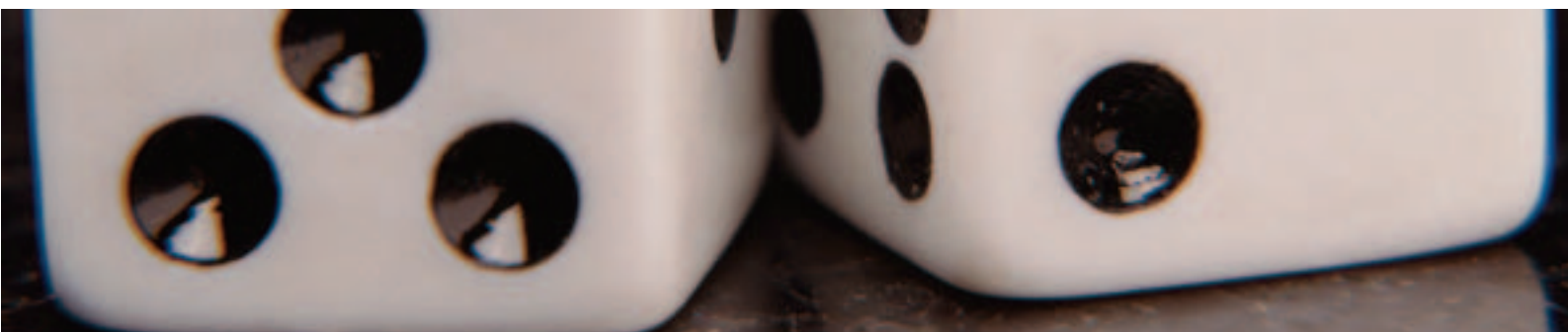
An unexplored difficulty with the taxpayers’ arguments

Another difficulty with the taxpayers’ arguments is that as a matter of fact, under sale 1, only the motel was sold and not the separate room (as different premises). As noted at para 51 of GSTR 2000/20, one of the fundamental characteristics of commercial residential premises is multiple occupancy and this characteristic emphasises the difference between a single room for hire, and a hotel. Therefore, even if the motel were viewed as “residential premises”, arguably, it could still be said the premises were not previously sold as residential premises. In particular, the premises were only sold as multiple occupancy premises and not as single rooms.

The liberal approach – commercial residential premises as residential premises

The taxpayers’ arguments for a broader and more purposive interpretation of the phrase “residential premises” as encompassing “commercial residential premises” are not unique. In fact, the taxpayers’ arguments mirror statements made by the Commissioner in his own ruling.

The arguments in favour of a more liberal approach are stated clearly in GSTR 2000/20. In para 18 of that ruling, the Commissioner notes that to understand the use of terms such as the noun “residence” and the adjectives “residential premises” and “residential accommodation” it is necessary to view those terms in the context of the structure of the GST Act.



In particular, the Commissioner refers to the argument based on the definition of "commercial residential premises" which Beaumont J dismisses. According to the Commissioner para (f) of the "commercial residential premises definition" "clearly indicates" that the preceding paragraphs refer to things that are residential premises. In its ruling, the Commissioner states that this suggests the definition of residential premises and the use of residence in that definition have a broader meaning than those words would ordinarily have.

Later in para 20, the Commissioner states that to be used for "residential accommodation" or to be "occupied as a residence", premises do not have to be a home or a permanent place of abode. Based on the Commissioner's ruling, to be residential premises as defined, a place need only provide sleeping accommodation and the basic facilities for daily living, even if for a short term.

Although this approach may be the preferable one to take in the GST context, particularly if it is intended to be a simple tax and one that can be understood by business, the approach was not taken by Beaumont J in the case before him. Instead, Beaumont J preferred the strictly literal approach to interpretation.

Accordingly, if his Honour's decision is not appealed, the Commissioner may need to revise his rulings on the subject matter to ensure that they accord with the true legal position.

In addition, the Commissioner's approach in arguing his case casts doubt on the

reliance taxpayer's can place on GST Rulings. In this regard, it should be emphasised that unlike income tax counterparts, GST Rulings are only administratively binding, as opposed to legally binding, on the Commissioner: contrast s 37 of the TAA.

General application of case

Property developments usually involve substantial renovations

A case such as the one before the single judge of the Federal Court is unlikely to be the situation most commonly encountered in property developments. Most commonly, before premises are converted from their commercial state into their residential state there will need to be substantial renovations undertaken to the premises before they are suitable for sale for residential purposes.

Accordingly, in most property developments, a sale of residential premises will be a supply of new residential premises and therefore taxable because it will come within para (b) of the s 40-75 definition, rather than para (a). The paragraphs are separated by a disjunctive "or", so that only one of the paragraphs needs to be satisfied before "new residential premises" exist. In other words, most situations are caught by that para (b) and not para (a). Thus, the general application of the decision should not be overstated. Even in the context of a strata titling, it will generally be necessary for the developer to perform substantial renovations to the premises before units are sold as residences.

Residential and commercial rental

Further, it is unlikely that the case will have any impact on residential rental and rental of commercial residential premises. Section 40-35 is clear in its wording. Under that section, rent from residential premises (other than commercial residential premises) is input taxed and thus rent from commercial residential premises is not input taxed. The section clearly differentiates between the two categories of premises.

CONCLUSION

With the continuing changes to people's permanent and temporary living arrangements, it is a shame that such a literal interpretation has been taken to the "residence" terminology used in the GST Act. GST as a tax was intended to be simple. It was intended as a tax that could be easily understood by business people.

When lawyers and judges alike focus on nuances in language and grammar to distinguish situations that in reality are commercially similar or identical, it makes it difficult for others to believe the tax is fulfilling its intended purpose. As a result of such stringent approaches to language, the GST runs the risk of becoming a tax like every other – that is, it becomes a tax that just needs to be complied with, but not quite understood. Often more liberal interpretations, while not strictly correct, lend credibility to taxation and its purposes. ♦

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