

Temporary leasing before sale of residential premises - GST treatment

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If a property developer actively markets residential premises for sale, while at the same time temporarily leasing them, they may no longer be required to repay all the GST credits earlier claimed on construction costs. This is because the ATO has recently clarified its view that while a property is simultaneously leased and being actively marketed for sale, **at that time**, it will be viewed as applied in **part** for a creditable purpose, rather than being applied wholly for a non-creditable purpose.

The ATO's view is expressed in *Interpretative Decision* ID 2008/114, rather than a public ruling. This means that while the view is indicative of the ATO's position on the issue, it is not actually binding on the Commissioner and cannot be relied upon by taxpayers.

Adopting the ATO's position, however, is likely to provide a significant cash flow benefit to property developers that ultimately sell properties as new residential premises. In addition, depending on the size of the costs incurred by a property developer, the active marketing of properties, whilst at the same time leasing them, may provide a real GST benefit, as the need for adjusting the claiming of GST may end before the actual sale of the new premises.

Background

Property developers can claim GST on construction costs incurred if they intend to make sales of "new residential premises".

However, if it turns out that the developed premises are rented out temporarily, then part of the GST previously claimed may need to be repaid back to the ATO (by way of an increasing adjustment).

The percentage of GST that needs to be repaid to the ATO depends on whether or not the developer's properties are being actively marketed.

Temporary leasing & no active marketing

In simplified terms, for residential properties that during a period are temporarily rented, but **not** actively marketed, the entitlement to GST on acquisitions made (eg construction costs incurred) is as follows:

	Time 1 - intended sale	Time 2 - rented & no active marketing	Time 3 - sold as new residential premises
% of GST claimable on costs	100%	0%	Actual sale price / Actual sale price + Actual rent

This means that all of the GST claimed on acquisitions by a developer in time 1 will need to be entirely repaid back to the ATO in time 2. However, if after the temporary leasing of the property, the property is sold as new residential premises, in time 3, part of the GST repaid in time 2 will again be claimable by the developer. The proportion claimable may be determined by reference to the **actual** sale price of the property and the **actual** rent derived from the property during the period it was rented.

The ATO expressed its view on properties that are not actively marketed, during a period that they are temporarily leased, in paragraphs 25 and 26 of the *Property and Construction Industry Partnership Issues Register* Section 04 (see section 4.1.2).

The ATO's view on properties that are simultaneously actively marketed, while being temporarily leased, however, was previously unclear (see *Property and Construction Industry Partnership Issues Register* Section 04, section 4.1.2, paragraph 8).

Temporary leasing & active marketing

For residential properties that during a temporary period are rented, but at the same time actively marketed, the position of the developer regarding their entitlement to GST on acquisitions is as follows:

	Time 1 - intended sale	Time 2 - rented & active marketing	Time 3 - sold as new residential premises
% of GST claimable on costs	100%	Estimated sale price / Estimated sale price + Estimated rent	Actual sale price / Actual sale price + Actual rent

This means that the extent of change in the percentage of GST claimable where a property is actively marketed, is likely to be significantly less where a property continues to be actively marketed, while it is at the same time being temporarily leased. That is, the percentage difference between time 2 and time 3 is likely to be smaller than that between time 1 and time 3.

In effect, therefore, property developers are provided with a cash flow or deferral benefit in time 2, as they are not required to repay all of the GST claimed in time 1. The extent to which the developer is required to repay GST in time 2 is based on an **estimate** of the sale price and an **estimate** of the rent to be derived during the temporary leasing.

A further adjustment to the GST repayable may then arise in time 3, being the time of the eventual sale of the property as new residential premises, based on the **actual** sale price of the property and the **actual** rent derived from the property.

Due to the operation of the adjustment period methodology, in the GST legislation, the time lapse may be such that for certain of the costs of the developer there will be no need to make any further adjustment of the GST credits repaid in time 2. Therefore, in addition to deferral benefit noted above, a real GST benefit may

result for those developers that whilst seeking to sell properties, temporarily lease them (for example, due to poor real estate market conditions).

Active marketing

The issue, therefore, arises as to what a developer needs to do to ensure that their properties are being actively marketed, whilst being temporarily leased.

According to the ATO, a property is being actively marketed if, for instance:

- it is listed for sale with a real estate agent or agents
- it is advertised for sale in property publications or via Internet advertising websites
- where arrangements are made for 'open for inspection' times and/or showing prospective buyers through the premises.

In addition, in the context of strata developments, actual third party sales of other strata units will be considered evidence of active marketing.

Listing premises for sale at a price that is significantly above market value may be an indicator that the premises are not being actively marketed.

Conclusion

The ATO has just clarified its view on the GST treatment of claiming credits on construction costs for the development of residential premises that are actively marketed and temporarily leased, before being sold within 5 years of construction.

The ATO's view provides both a cash flow benefit and a real GST benefit. The cash flow or deferral benefit may result from the delay in the developer being required to repay GST to the ATO, as a result of the temporary leasing. The real GST benefit may result from certain adjustment periods for construction costs ending prior to the developer being required to repay GST based on the actual sale price and the actual rent derived from their properties.