

## JUST WHAT IS A 'RESIDENCE' FOR GST PURPOSES?

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### I INTRODUCTION

It is difficult to imagine an area of Goods and Services Tax (GST) where mistakes are more costly than those involving supplies of real property. Dealings in real property typically involve very large sums of money coupled with relatively low margins, so the GST component may well be greater than the margin in most (if not all) real property transactions. Treating a taxable supply as non-taxable or accounting for GST in a tax period later than the one in which attribution actually occurred is likely to prove disastrous for the supplier, since it is entirely possible that the penalty alone could exceed the profit made on the sale.

The situation is complicated by the fact that supplies of real property, unlike most other assets types, may be “taxable supplies”, “GST-free supplies”, “input taxed supplies” or supplies that fall outside the GST legislation altogether. No less troubling has been the apparent confusion about how to treat supplies of *residential* real estate. This is of significance because sales of residential properties comprise a significant proportion of all real estate sold in Australia.<sup>1</sup> The GST treatment of residential property would be of considerable concern to a purchaser because GST on residential property will not ordinarily give rise to input tax credits. This means that any GST would simply raise the price of the property, since it is only in a small number of cases that a purchaser of residential property might be entitled to an input tax credit for any GST included in the price.<sup>2</sup>

Problems with the GST treatment of residential property have arisen because of two main factors. The first is the absence of a clear and unambiguous definition of the term “residential premises” in s 195-1 of *A New Tax System (Goods and Services Tax) Act* 1999 (GST Act). Despite two attempts by the Commissioner to explain what he thinks the term means,<sup>3</sup> courts have yet to deal satisfactorily with the issue. The second is the use of the phrase “to be used predominantly for residential accommodation” in s 40-35(2) and s 40-65(1).

Following a recent Full Federal Court decision,<sup>4</sup> the government released legislation to change the definition of residential premises. The effect of the court’s interpretation of the old definition was that strata-titled units and other types of short-term accommodation would fall outside the definition of residential premises. Accordingly, sales of these types of accommodation might attract GST and, more importantly, might give rise to input tax credits for purchasers. The amendments were designed to prevent this outcome, while at the same time preserving the result of the Full Federal Court

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<sup>1</sup> Australian Bureau of Statistics 8752.0 - Building Activity, Australia, Jun 2007

<sup>2</sup> Residential property would generally be used as an individual’s private residence (in which case input tax credits are denied under s 11-15(2)(b)) or let as an investment property (in which case input tax credits are denied under s 11-15(2)(a)). It is only where the purchaser intends to use the property predominantly as a place of business that input tax credits might be available.

<sup>3</sup> Rulings GSTR 2000/20 and GSTR 2003/3.

<sup>4</sup> *Marana Holdings Pty Ltd v Commissioner of Taxation* (2004) 214 ALR 190.

decision.

The intention behind the amendments was to make it clear that leases of individual units for short-term stays to individuals or on longer-term leases to hotel operators would not be taxable supplies.<sup>5</sup>

This article suggests that the amendments fail to address some of the more fundamental difficulties present in the treatment of residential premises. In particular, it suggests the definition of "residential premises" is still flawed in its treatment of vacant land and that problems will remain despite the changes.

To explain the impact of the Full Federal Court decision and the motivation behind the change to the definition, it will be necessary to explain the former definitions of "new residential premises" and "commercial residential premises". These definitions are discussed under **Meaning of the term "residence"** below, but they are relevant here because sales of both "new residential premises" and "commercial residential premises" will be subject to GST if the other elements of s 9-5 of the GST Act are met. On the other hand, sales of "residential premises" that are neither "new residential premises" nor "commercial residential premises" will not.<sup>6</sup> Sales made by unregistered entities would fall outside the scope of the GST altogether and will not be discussed in this article.

## II SALES OF RESIDENTIAL PROPERTY

Sales of "residential premises" by registered entities will generally be input taxed<sup>7</sup> – that is to say GST does not apply to the sale, and the seller is barred from claiming any input tax credits on acquisitions that relate to that sale.<sup>8</sup> This rule does not apply where the residential premises are "new residential premises" or "commercial residential premises". Sales of "new residential premises" and "commercial residential premises" are generally subject to GST if the other elements of s 9-5 of the GST Act are present. The term "residential premises" was previously defined in s 195-1 of the GST Act 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; and includes a floating home.*

The former definition of "residential premises" is analysed at length under **Meaning of the term "residence"**, but for the sake of clarity, "new residential premises" are "residential premises" that have:

- (a) *not previously been sold as residential premises and have not previously been the subject of a long-term lease; or*
- (b) *been created through substantial renovations of a building; or*
- (c) *been built, or contain a building that has been built, to replace demolished premises on the same land.*<sup>9</sup>

The term "commercial residential premises" was defined to include:

- (a) *a hotel, motel, inn, hostel or boarding house; or*
- (b) *premises used to provide accommodation in connection with a school; or*

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<sup>5</sup> Explanatory Memorandum to *the Tax Laws Amendment (2006 Measures No. 3) Act 2006*

<sup>6</sup> Sales of "residential premises" that are not "new residential premises" are input taxed supplies under s 40-65.

<sup>7</sup> Section 40-65.

<sup>8</sup> Section 11-15(2)(a).

<sup>9</sup> Section 40-75.

- (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 paragraphs (a) to (e).*<sup>10</sup>

It is unfortunate that Parliament chose the term “commercial residential premises” rather than a term that did not contain the words “residential premises”, since the potential for confusion is clear. The interrelationship between “residential premises” and “commercial residential premises” was discussed in the *Marana Holdings case*.<sup>11</sup>

The appellants in that case attempted unsuccessfully to argue that “commercial residential premises” were merely a subset of “residential premises”. Their argument was that premises needed to be “residential premises” before they could be “commercial residential premises”.<sup>12</sup> Based simply on the language of the two terms, this argument is an appealing one. It is only when the relevant definitions are examined that the argument breaks down. The issue could perhaps have been more easily resolved if Parliament had instead used a term that did not contain the words “residential premises”.

### III THE DEFINITION OF “RESIDENTIAL PREMISES”

Supplies of real property that meet the definition of “residential premises” will be input taxed supplies.<sup>13</sup> Supplies of any other real property will not be input taxed, and if the other elements of s 9-5 are met, will be subject to GST. It is therefore vital that this definition be clear and unambiguous, but sadly just about every part of the definition harbours interpretational difficulties. Some of the more urgent issues include sales of vacant land, the meaning of the term “residence” and the distinction between “residential premises” and “commercial residential premises”.

#### *A Sales of vacant land*

A sale of vacant land potentially meets the definition of “residential premises” where the land is zoned for residential development. The definition refers to “land **or** a building”, so arguably *land* on its own or a *building* on its own could qualify. This is an argument dismissed outright by the Commissioner. He has made it clear that he does not consider vacant land as being capable of being occupied as a residence.

The definition requires that land must have a building affixed to it and that the building must have the physical characteristics that enable it to be occupied or be capable of occupation as a residence. Vacant land of itself can never have sufficient physical characteristics to mark it out as being able to be or intended to be occupied as a residence.<sup>14</sup>

The Commissioner’s view renders the wording of the definition somewhat troubling, since it is difficult to reconcile the construction of the definition that states “land ... that

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<sup>10</sup> Section 195-1.

<sup>11</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068.

<sup>12</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068 at 5077.

<sup>13</sup> Section 40-65.

<sup>14</sup> Ruling GSTR 2000/20 at paragraph 25.

is ... intended to be occupied and is capable of being occupied as a residence ...” with the Commissioner’s statement that “... land of itself can never have sufficient physical characteristics to mark it out as being able to be or intended to be occupied as a residence”.

The Commissioner’s interpretation presumably relies on the premise that the ability to occupy land as a residence must be present at the time of purchase – a premise not explicitly supported by the wording of the definition. The trouble is that his interpretation makes nonsense of the use of the word “or” in the phrase “land *or* a building”. This is not an appealing approach, since an assumption that Parliament would put meaningless words into a statute is not lightly made – for example, in *Commonwealth v Baume*<sup>15</sup> Griffith CJ referred with approval to comments made in *The King v Berchet*, a case decided in 1688, where the court said:

It was said to be a known rule in the interpretation of Statutes that such a sense is to be made upon the whole as that no clause, sentence, or word shall prove superfluous, void or insignificant, if by any other construction they may all be made useful and pertinent.<sup>16</sup>

So how do practitioners go about making all of the words of the definition useful and pertinent? While it may be accepted that vacant land cannot without more, be occupied as a residence, a suggested interpretation which would allow the phrase “land *or* a building” to be made “useful and pertinent” is that land be treated as meeting the definition of “residential premises” if it is intended to be occupied as a residence and is capable (at some stage) of being occupied as a residence. In other words, vacant land should be treated as residential premises provided the land has the attributes necessary to enable a dwelling to be built upon it, such as appropriate zoning, local Council consents and so on.

This problem arose primarily because the original definition of “residential premises” did not include a requirement that the premises be capable of being occupied as a residence. In its original form, the definition read “land or a building occupied or intended to be occupied as a residence, and includes a floating home”. In this form, the definition made perfect sense, and allowed for land that was *intended to be occupied as a residence* to meet the requirements of the definition. The later addition of the words that the premises be *capable of being occupied as a residence* is what has created the confusion.<sup>17</sup>

The Explanatory Memorandum to this amendment suggested that this additional requirement was inserted to ensure that sales of vacant residential land will not be input taxed under s 40-65 unless it was permissible to use the land for residential purposes and the land had some facilities ordinarily associated with residences (ie water and sewerage).<sup>18</sup> This suggests that land with the necessary plumbing would be capable of being occupied as a residence and so should be treated as “residential premises”.

This interpretation is later implicitly contradicted where the Explanatory Memorandum states that:

The amendment ensures that sales of vacant residential land will not be input taxed under section 40-65. The supply of land is not input taxed where it is:

- vacant residential land;
- commercial land; or

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<sup>15</sup> *Commonwealth v Baume* (1905) 2 CLR 405.

<sup>16</sup> *Commonwealth v Baume* (1905) 2 CLR 405 at 414.

<sup>17</sup> Substituted by No 176 of 1999, s 3 and Sch 1 item 157, effective 1 July 2000.

<sup>18</sup> Explanatory Memorandum to *A New Tax System (Indirect Tax and Consequential Amendments) Act 1999* paragraph 1.167.

- new residential premises.<sup>19</sup>

This wording suggests that supplies of vacant residential land will not be input taxed even if the land had *those facilities ordinarily associated with residences*.

In any event, it is doubtful whether the amended definition met this stated objective because it still suggested that land on its own could qualify as “residential premises”. As pointed out above, it is difficult to reconcile the part of the definition which states that “residential premises means land ... that ... is ... capable of being occupied as a residence” with the stated policy intent behind the amendment, namely that sales of vacant residential land will not be input taxed under s 40-65.

If, as the Explanatory Memorandum suggests, the intention was to disqualify vacant land from meeting the definition of “residential premises”, a more effective way to have done it might have been to replace the phrase “land or a building” with the phrase “land and a building, or a building on its own”. It is suggested that wording the definition in this way would have meant that land by itself would not meet the requirements to be “residential premises”. On the current wording, it is entirely possible that land on its own could meet the definition of “residential premises” despite the stated intention in the Explanatory Memorandum.

Vacant land sold to a purchaser who bought it for the future construction of a residence (or several residences) would arguably meet the requirement of being capable of being occupied as a residence unless the phrase “capable of being occupied” meant at the time of sale. It was open to Parliament to have added the words “at the time of sale” after the words “capable of being occupied as a residence”, which would have precluded this interpretation, but it did not. Accordingly, applying the rule outlined in *The King v Berchet*,<sup>20</sup> one way to make all the words of the definition “useful and pertinent” would be to allow for the requirement (of being capable of being occupied as a residence) to be met at a time later than the time of sale.

A possible scenario that would allow the definition to make sense in its current form is where a person built a residence on land owned by someone else. If that land was subsequently sold to the owner of the residence, the land would then meet the definition of “residential premises”, since it would be capable of occupation as a residence at the time of sale. It is suggested that this situation is rare, and probably not one contemplated by the drafters of the legislation at least insofar as the Explanatory Memorandum sets out the drafters’ understanding of the scope of the law.

### *B Meaning of the term “residence”*

The term “residence” is an essential feature of the definition “residential premises”. To be residential premises, the premises must be occupied as a residence or be capable of being occupied as a residence. Given the importance of this term, it is curious that Parliament chose not to define it. Since the term is not defined, it must take its ordinary meaning.

In common with other words in statutes that are meant to “take their ordinary meaning”, the meaning of the term “residence” and the phrase “... occupied as a residence ...” have both proved difficult to interpret. This is particularly true in relation to the treatment of strata-titled units offering short-term accommodation as so-called “serviced apartments”. The issue came to prominence recently in the *Marana Holdings*

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<sup>19</sup> Explanatory Memorandum to *A New Tax System (Indirect Tax and Consequential Amendments) Act 1999* paragraph 1.168.

<sup>20</sup> Referred to in *Commonwealth v Baume* (1905) 2 CLR 405.

case<sup>21</sup> where the court was asked to decide whether the sale of a converted motel unit was input taxed under s 40-65 as a supply of “residential premises”. The case involved the purchase of motel units by a developer who intended to convert them into strata-titled units and sell them as apartments to private buyers. Following the sale of one of the units, which had been converted from a motel room with an adjoining car space, Marana Holdings sought declaratory orders that the sale was input taxed.

Since it was agreed by the parties that the conversions of the motel units into apartments did not amount to “substantial renovations”,<sup>22</sup> the central issue in the case was whether the motel units were “residential premises” when they were purchased in the first instance by the developer. Had that been the case, any subsequent sale of the units after they had been converted into strata-titled units would have been input taxed under s 40-65 as a sale of “residential premises” that were not “new residential premises”.

Resolution of the issue turned on the definition of “new residential premises”. The term “new residential premises” is defined, among other things, as premises that have not previously been *sold* as residential premises.<sup>23</sup> If the motel units had been “residential premises” as defined when the developers acquired them, that sale would have counted as a previous sale of residential premises. Any subsequent sale of the units by the developer could not then have been a supply of “new residential premises” because they would previously have been sold as residential premises.

In concluding that the motel units were not “residential premises” when they were first sold to the developers, the court considered that the word “residence” as it appears in the definition of “residential premises” required a degree of permanence or continuity of occupation – a quality not ordinarily present in motel units.

Central to this argument was the notion that for accommodation to be “residential premises”, it needed to be “**occupied** as a residence”, which, the court concluded, meant that there needed to be an element of long-term occupation. The court referred with approval to the comments of Mr Lightman in *Urdd Gobaith Cymru v Commissioner of Customs and Excise*.<sup>24</sup>

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.<sup>25</sup>

Adopting this approach, it was the court’s view that to “occupy” a place as a residence required more than merely occupying rooms as motel guests. Accordingly, the motel units were not “residential premises” when they were sold to the developer. Thus, when the developer sold the converted strata-titled units to the public as “residential premises”, it was a first sale of residential premises so the units were “new residential premises”. Accordingly, the court found that the sale was subject to GST as a taxable supply.

The developers appealed the decision, but were unsuccessful.<sup>26</sup> In the decision handed down by the Full Federal Court, the terms “residence” and “reside” were exhaustively

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<sup>21</sup> *Marana Holdings Pty Ltd v Commissioner of Taxation* 2004 ATC 4256.

<sup>22</sup> Had the conversions amounted to “substantial renovations”, the units thus created would have been treated as new residential premises under s 40-75(1)(b) anyway.

<sup>23</sup> Section 40-75(1)(a).

<sup>24</sup> *Urdd Gobaith Cymru v Commissioner of Customs and Excise* [1997] V & DR 273.

<sup>25</sup> *Urdd Gobaith Cymru v Commissioner of Customs and Excise* [1997] V & DR 273 at 279.

<sup>26</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068.



examined, with reference to the dictionary definitions of those terms in the *Macquarie Dictionary* <sup>27</sup>, the *Oxford English Dictionary* <sup>28</sup> and the *Shorter Oxford Dictionary*.<sup>29</sup> Common to all the dictionary definitions was the suggestion that to constitute a “residence”, the premises needed to have an element of permanent or long-term occupation. Clearly, both “reside” and “residence” have the connotation of permanent, or at least long-term commitment to dwelling in a particular place.<sup>30</sup>

Support for this interpretation is to be found in the Explanatory Memorandum that accompanied the legislation. Explaining the reason for treating a supply of residential premises as input taxed, page 15 of the executive summary stated that this was done to ensure comparable treatment for renters with owner-occupiers. On this analysis, the Full Federal Court found that:

The references to “residential rents” and “owner-occupiers” suggest the intention that a person renting a house (including a home unit) be put on the same footing as a person who owns his or her own home — neither is to pay GST in connection with such occupation. Similarly, the reference to the supply of a new “house” would not normally include an hotel or motel, suggesting that the expression “residential premises” is not intended to do so.<sup>31</sup>

So while it may be accepted that “residential premises” unlike “commercial residential premises” require a degree of permanence and continuity, the implication of this decision went well beyond the case itself and carried implications for all styles of accommodation that cater for short-term occupancy.

The Commissioner has been at pains to point out that a lease of residential units to managing agents was an input taxed supply, so purchases of apartment developments were not creditable acquisitions. The reasoning of the Commissioner was that these units were “residential premises” and not “commercial residential premises”, and they only became “commercial residential premises when aggregated with others and operated as a whole by the managing agents.

As explained above, a supply of both “new residential premises” and “commercial residential premises” would carry GST in the price, so the characterization of these units would determine whether the purchasers would be entitled to input tax credits on the acquisition. If the units were “commercial residential premises”, then the purchasers would be entitled to input tax credits as long as they were purchasing the units to carry on an enterprise. On the other hand, if the units were “residential premises”, purchasers would be denied input tax credits under s 11-15(2)(a).<sup>32</sup>

The Commissioner’s view was that the apartments were “residential premises” at the time of purchase and would retain their character as “residential premises” if and when they were later sold or leased.<sup>33</sup> An individual unit, so the argument goes, could only take on the character of “commercial residential premises” when aggregated with others and operated in the same manner as a hotel, motel, inn or hostel. A graphic illustration of a typical investor/manager arrangement is shown below.<sup>34</sup>

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<sup>27</sup> Fourth Edition 2005

<sup>28</sup> Second Edition 1989

<sup>29</sup> Fifth Edition 2002

<sup>30</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068 at 5073.

<sup>31</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068 at 5074.

<sup>32</sup> Paragraph 11-15(2)(a) states that you do not acquire a thing for a *creditable purpose* to the extent that you acquire it in making supplies that would be input taxed.

<sup>33</sup> Ruling GSTR 2000/20 paragraph 51–54.

<sup>34</sup> Taken from Ruling GSTR 2000/20.



Based on the Commissioner's view, the letting of the apartment to the manager would be an input taxed supply under s 40-35 since investors would be leasing "residential premises". The unit owners accordingly would not account for GST on the supply and would be unable to claim input tax credits either for the cost of acquiring their units or for the ongoing costs of ownership.

As things stood before the *Marana Holdings* decision, Treasury was reaping the benefit of GST paid by the developers of these apartment complexes. As explained, sales of these apartments were subject to GST because they are "new residential premises", so 1/11<sup>th</sup> of the price (or margin in the case of developers using the margin scheme<sup>35</sup>) was being paid on every sale. By treating the apartments as "residential premises" even GST-registered purchasers were unable to claim input tax credits for the GST included in the price.

If under the *Marana Holdings* decision strata-titled units such as serviced apartments that provided short-term accommodation would no longer be treated as "residential premises", the leasing of these units to managing agents would potentially become subject to GST if the other elements of s 9-5 were present and (more importantly) the owners would be entitled to input tax credits on the purchase of those units, provided they were registered for GST at the time of acquisition and acquired the units in carrying on an enterprise. The revenue costs of refunding these input tax credits to the large number of owners renting their units in this way would have been significant.

Soon after the Full Federal Court handed down its decision in *Marana Holdings*, the Minister for Revenue and Assistant Treasurer, Hon Peter Dutton, announced that the GST Act would be amended, (allegedly) to remove uncertainty in relation to the treatment of certain types of real property.<sup>36</sup> In reality, the move probably had more to do with protecting the revenue from a potentially disastrous landslide of input tax credit claims based on the *Marana Holdings* decision than any desire to remove uncertainty from the definition.

On 10 April 2006, Treasury released an Exposure Draft<sup>37</sup> of legislation to amend the definition of "residential premises". The amendments are to apply retrospectively from 1 July 2000. At the core of the amendment is the addition of the words "regardless of the term of occupation" after the words "residential accommodation" in ss 40-35(2)(a), 40-65(1), 40-65(2)(b), 40-70(1)(a) and 40-70(2)(b). References to "premises to be used predominantly for residential accommodation" are now read as "premises to be used predominantly for residential accommodation irrespective of the term of occupation".

In an apparent move to prevent the amendments from applying to establishments such as hotels, motels, boarding houses or inns, s 40-75(1)(a) was amended by the addition of the words "other than commercial residential premises" after the words "residential premises". The provision now defines "new residential premises" as "residential premises that have not previously been sold as residential premises, *other than commercial residential premises*, and have not previously been the subject of a long-term lease".

The definition of "floating home" in s 195-1 has also been amended by the proposed

<sup>35</sup> Section 75-5.

<sup>36</sup> Minister for Revenue and Assistant Treasurer Press Release No 006, 27 February 2006.

<sup>37</sup> Exposure Draft on the GST Treatment of Residential Premises, released 10 April 2006.



addition of the words “regardless of the term of occupation” after the term “occupied”. The definition now defines a floating home as “... a structure that is composed of a floating platform and a building designed to be occupied (*regardless of the term of occupation*) as a residence that is permanently affixed to the platform, but does not include any structure that has means of, or is capable of being readily adapted for, self-propulsion”. This was presumably done to ensure that floating homes would not be classified as “commercial residential premises” either.

Finally, the definition of the term “residential premises” was replaced altogether. The new provision defines “residential premises” as:

*land or a building that:*

- (a) *is occupied as a residence or for residential accommodation; or*
- (b) *is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation; (regardless of the term of the occupation or intended occupation)*

*and includes a floating home.*

The Explanatory Memorandum cites potential difficulties in distinguishing between supplies of premises that are “residential premises” from supplies of premises that do not constitute “residential premises” as the prime reason for the amendment. In particular, Treasury was concerned that the court’s reasoning was likely to lead taxpayers to treat certain supplies of real property as taxable rather than input taxed, specifically:

- letting of strata-titled units such as serviced apartments by owners to guests on a short term basis;
- leasing of strata-titled units to hotel operators or similar operators; and
- leasing of display homes and provision of certain short-term employee accommodation.<sup>38</sup>

The intention behind the amendments would be to ensure that these supplies would all be input taxed supplies under s 40-35.

Would the amendments make a difference to cases like *Marana Holdings*? It is suggested not – at least not in relation to the outcome. If the *Marana Holdings* case was decided in the context of the new amendments, the outcome would be the same but the reasoning might differ. The *Marana Holdings* decision essentially said that motel units could not be “residential premises” because they were not occupied for long enough. Under the proposed amendments, motel units might be “residential premises” because the length of stay would no longer be relevant.

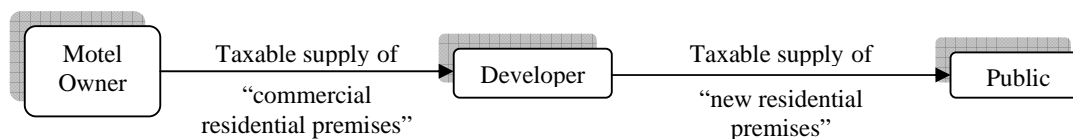
So even though the motel units might be “residential premises”, a developer who bought them to convert and sell as strata-titled units would still not be required to treat the sale as an input taxed supply. This is because under the proposed new definition the units would remain “new residential premises” despite their earlier sale as “residential premises”. The proposed new definition states that premises are “new residential premises” if they have not previously been sold as residential premises *other than as commercial residential premises*. This would effectively mean that the earlier sale of the units (even as residential premises) would not count.

Thus under these changes, the sale of the converted strata-titled units by the developer would be treated as the first sale of residential premises. This would mean that the converted strata-titled units would be “new residential premises” because they would not be treated as having previously been sold as residential premises. Therefore, the

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<sup>38</sup> Goods and Services Tax Treatment of Residential Premises Explanatory Material paragraph 1.3.

sale would be a taxable supply and the developer would need to account for GST on the sale. The sequence of transactions is explained in the diagram below.



Accordingly, the sale from the developer to the public would remain a taxable supply, so the amendments would achieve their aim of preserving the result in the *Marana Holdings* decision.

### *C The distinction between “residential premises” and “commercial residential premises”*

The distinction between “residential premises” and “commercial residential premises” is an important one since a supply of “commercial residential premises” by way of sale or rent is potentially a taxable supply, whereas the supply of “residential premises” by way of sale or rent is an input taxed supply (unless it is a sale of “new residential premises”). The distinction is also important in the proposed definition of “new residential premises” because a sale of residential premises would not be counted as a sale if they were sold as “commercial residential premises”. Accordingly, a subsequent sale of those premises would be treated as the first sale, so they would be considered “new residential premises” despite the earlier sale.

So how does one distinguish between “residential premises” and “commercial residential premises”? As suggested above, the language implicitly supports the argument that premises cannot be “commercial residential premises” unless they are themselves “residential premises” – in other words “commercial residential premises” are merely a subset of “residential premises”. Unfortunate use of language aside, the definitions of the two terms have nothing in common.

“Residential premises” is supposed to refer to dwellings while “commercial residential premises” is supposed to refer to commercial establishments. The main problem with the definition of “commercial residential premises” is paragraph (f). The inclusion of the words “anything similar” in the paragraph is an example of perhaps one of the most annoying practices of legislative draftspersons. It is sometimes referred to as the “just in case” strategy and occurs frequently in legal definitions. Something is defined by including those things that the drafter considers necessary, but just in case there may be something he or she has not thought about, they include “anything similar” just in case. Unfortunately, the use of this strategy broadens the scope of the definition so much as to render it virtually useless. Because of this inclusion, one could conceivably have premises that are both “residential premises” as defined and “commercial residential premises” as defined. This is a highly unsatisfactory outcome because if premises are both residential premises and commercial residential premises, which takes precedence? This difficulty was acknowledged by the Full Federal Court in the *Marana Holdings* appeal.<sup>39</sup>

Clearly, [paragraph (f)] is intended to extend the definition beyond the premises identified in pars (a) to (e). The problem lies in identifying the features which will

<sup>39</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068 at 5075.

lead to particular premises, not otherwise within the definition, being so included. Given the difficulties with pars (c) and (d) to which we have referred, and the apparent exclusion of accommodation in some educational establishments which accommodation might conceivably be residential premises, we doubt whether it was intended that all premises within the definition of “commercial residential premises” also be “residential premises” as defined. Of course that does not exclude the possibility of some overlap. Premises used as a private residence might also be used to provide accommodation to paying guests. Whether such premises are described as an “hotel” a “motel” or a “boarding house” may depend upon many factors, including size of the premises, proportions used for private and rental accommodation, liquor licensing requirements, arrangements for meals and other services and questions of public relations.<sup>40</sup>

The Commissioner has attempted to differentiate “commercial residential premises” from “residential premises” in GST Ruling GSTR 2000/20. At paragraph 83 he outlined a number of factors he considers relevant in determining whether premises were “similar” to residential premises described in paragraph (a) of the definition of “commercial residential premises”. Since the premises described in paragraphs (b) to (e) of the definition would not ordinarily be seen as “residential premises” as that term appears in paragraph (f) of the definition, he confined his analysis to paragraph (a).

The relevant factors are:

- commercial intention;
- multiple occupancy;
- holding out to the public;
- accommodation is the main purpose;
- central management;
- management offers accommodation in its own right;
- services offered; and
- status of guests.<sup>41</sup>

It should be noted that these factors are the characteristics commonly used to identify establishments such as hotels, motels, inns, hostels or boarding houses; so arguably, premises exhibiting some or most of these characteristics should qualify as “anything similar to residential premises described in paragraph (a)”.

An exhaustive analysis of each of these factors is beyond the scope of this article, but it may be useful to examine one of the more contentious of them - namely the issue of multiple occupancy - since the Commissioner relies on this factor more than any of the others to deny input tax credit claims to purchasers of strata-titled units.<sup>42</sup>

The Commissioner believes that it is only when strata-titled units are aggregated with others under a management arrangement that they take on the characteristics of “commercial residential premises”. Based on this view, a strata-titled unit operated by an individual investor alone would not be considered “commercial residential premises” even if its sole purpose was to provide short-term accommodation to the public and all the other factors outlined above were met.

It is suggested that this is a specious argument because it ignores the fact that what is required to satisfy the terms of paragraph (f) of the definition is that the premises be “similar” to residential premises described in paragraph (a). The *Macquarie Dictionary* defines the term “similar” as “having likeness or resemblance, especially in a general way”. To suggest that all of the factors outlined above (in particular the multiple

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<sup>40</sup> *Marana Holdings v Commissioner of Taxation* 2004 ATC 5068 at 5078.

<sup>41</sup> GST Ruling GSTR 2000/20 at paragraph 83.

<sup>42</sup> GST Ruling GSTR 2000/20 at paragraph 52.

occupancy factor) must be present before premises have the likeness or resemblance of hotels, motels, inns, hostels or boarding houses, especially in a general way, is an argument that cannot be sustained. Premises that possess all of these characteristics would be *identical* rather than *similar* to hotels, motels, inns, hostels or boarding houses, and the paragraph only requires that they be *similar*.

In addition, it should be pointed out that GST Rulings are neither binding on the Commissioner nor on taxpayers. This is because, unlike Taxation Rulings, they are not covered by either Division 358 or 359 of Schedule 1 to the *Tax Administration Act* 1953. As such, they do no more than explain how the Commissioner interprets the legislation. Accordingly, until the issue is clarified, either through amending legislation or judicial interpretation, it remains open to purchasers of strata-titled units to challenge the Commissioner's interpretation of what is meant by "anything similar to residential premises described in paragraphs (a) to (e)". Again, the amendments to the definition of "residential premises" would do nothing to address this issue nor to resolve the position for investors. Certainly, investors who purchase strata-titled units to let on a commercial basis would be no less likely to succeed in claiming input tax credits than they would have been without the amendments.

#### *D Premises intended to be occupied as a residence*

Another difficulty with the definition of "residential premises" is the use of the phrase "intended to be occupied as a residence". At first blush, this would appear to refer to the intention of the purchaser, an interpretation implicitly supported by the Supreme Court in *Toyama Pty Ltd v Landmark Building Developments Pty Ltd*.<sup>43</sup> The court was examining the meaning of the phrase "to be used predominantly for residential accommodation" in s 40-35(2)(a) and s 40-65(1).

The construction of both provisions should be approached in the same way. They require a prediction as to the future use of the premises. The most important factor in such a prediction is the intention of the future owner or lessee of the property. In the case of a lease, the question of how the property is to be used in the future will usually be determined by the terms of the lease. In the case of a sale, the likely future use of the property will probably depend on the purchaser's intentions, to be assessed having regard to objective circumstances such as the physical condition of the premises, the zoning or any restrictive covenants.<sup>44</sup>

It should be noted that the court was reluctant to apply this reasoning directly to the phrase "... intended to be occupied as a residence ..." in the definition of "residential premises". This reluctance was apparently influenced by the comments of the Full Federal Court in the *Marana Holdings* appeal. The Full Federal Court said:

The appellants' [purchasers'] argument assumes that the relevant intention is that of the appellants [purchasers] at the time of acquisition. We disagree. If Parliament intended that a subjective intention be the relevant consideration for the purposes of s 40-75(1)(a), one might reasonably have expected it to have indicated whose intention was relevant for that purpose — the vendor's or the purchaser's. In any event, it is difficult to see why such intention would be of any significance in this context.

In our view the word "intended" in the definition is used in a different sense. The relevant meaning of the verb "intend" is, according to Shorter Oxford, "[h]ave as one's purpose (an action etc)". The verb may also be used in the passive form to describe the object of an intention. In the present case, the passive verbal form "is intended" has as its grammatical subject the connective "that", standing in place of the

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<sup>43</sup> *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* [2006] NSWSC 83.

<sup>44</sup> *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* [2006] NSWSC 83 at [92].

words “land or a building”. The person having the relevant intention is not identified. This sentence structure is commonly used to describe characteristics of the subject of the sentence, which subject is the object of the relevant intention. To say that a building is “intended” to be occupied as a residence implicitly describes the intention with which it was designed, built or modified, which intention will be reflected, to greater or lesser extent, in its suitability for that purpose.<sup>45</sup>

It is curious that while the court in the *Toyama* case was reluctant to accept the proposition that the subjective intention of the purchaser did not apply in the case of the definition of “residential premises”, it was prepared to apply the subjective test in determining whether the premises were to be used predominantly for residential accommodation. It is respectfully suggested that this is an inconsistent approach. One cannot on the one hand say that the subjective intention of the purchaser is not to be taken into account in determining whether the premises are “intended to be used as a residence” while on the other hand saying that the subjective intention of the purchaser is the determining factor in deciding whether premises are to be used “predominantly for residential accommodation”.

While accepting that a distinction may be valid given the different wording of the two provisions, it is suggested that if the subjective intention of the purchaser was relevant at all in determining the status of the premises, that intention should be relevant in both contexts.

On the other hand, if the legislative intent was to enable parties to determine the status of the premises without reference to the subjective intention of either party (a preferred outcome), that subjective intention should have been excluded from both the definition of “residential premises” and the construction of ss 40-35(2)(a) and 40-65(1). Had this been done, it would have eliminated the need for complex covenants in leases and sales of residential property. These covenants are essential to protect the seller in the event that the nature of the supply is afterwards affected by the subjective intention of the purchaser – an intention that might remain unknown to the seller until after the transaction has been settled.

This issue remains a major difficulty for GST-registered lessors or sellers of residential property. If a property is let or sold and later employed for a purpose other than residential accommodation, the lease or sale would potentially change from an input taxed supply to a taxable supply. This is an entirely unsatisfactory outcome, since s 9-40 makes it clear that the “supplier” is responsible for paying the GST. Without an enforceable covenant, the lessor or seller would be disadvantaged by having to remit 1/11<sup>th</sup> of the rent or the purchase price to the ATO simply because the tenant or purchaser decided to use the property for a purpose other than residential premises – an event over which he or she might have had no control. A further difficulty is that the lessee or purchaser would be quite within their rights to demand a tax invoice to support a claim for an input tax credit – a windfall brought about by their own actions.

The intention of the purchaser is also relevant in situations involving a sale of land with a vacant house on it. If the purchaser had no intention of living in the house, preferring instead to demolish the house and replace it with another, his or her subjective intention might render the sale subject to GST. If the subjective intention of the purchaser was considered, the supply of the property could not be input taxed because on this analysis, the purchaser did not intend to use the property “predominantly for residential accommodation”. As discussed, if we accept that land by itself cannot meet the requirement of being a residence, then the land and vacant house can also not meet the definition of “residential premises”. If the other requirements of s

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<sup>45</sup> *Marana Holdings Pty Ltd v Commissioner of Taxation* (2004) 214 ALR 190 at 203–204.

9-5 were present, the sale would be a taxable supply.

This issue arose in the *Toyama* case,<sup>46</sup> which involved an application for equitable compensation for an alleged breach of trust, and arose out of the sale of a piece of real estate. The applicant, Landmark Building Development Pty Limited (Landmark), and the plaintiff in the proceedings, Toyama Pty Limited (Toyama), were the co-owners of the real estate. Landmark owned two-thirds of the land as tenant in common with Toyama, which owned one-third.

The property was sold by auction on 7 August 2003 for \$2,760,000. The contract for sale provided that the sale was a taxable supply under s 9-5 of the GST Act. A house had been built on the land that comprised two residences.

The land was marketed as a development site, since the Port Stephens Council had given approval for the erection of a 14-unit development on the land. The trustees expected, as turned out to be the case, that the land would be purchased by a developer, the house demolished, and new units built on the site.

Landmark's view was that the sale was not a taxable supply because, among other things, the supply was an input taxed supply of residential premises. Its contention was that the trustees acted in breach of trust and were therefore liable to compensate Landmark for two-thirds of the loss occasioned by that breach.

In dismissing the appeal, the court found that the trustees were correct in describing the sale as a taxable supply. The purchaser, Concrete Pty Ltd, intended to demolish the existing buildings. The fact that the existing buildings were constructed as a residence (which made them "residential premises") did not sway that court. It was variously suggested in the evidence that the house was used as a residence by the directors, leased to tenants as a residence and also used as a veterinary clinic. What was not in dispute however was that the building (although not currently used as a residence) was built as a residence and was capable of being occupied as a residence. What was also not in dispute was that the purchasers intended to erect residential units on the land.

In concluding that the property was not "residential premises", the court focused on the intention of the purchasers – that was, to demolish the existing house and erect 14 residential units on the property. Notwithstanding that the 14 residential units could only have been occupied as residences, the court focused on the building on the property at the time of sale.

Landmark did not submit that the purchaser's intention that the new units to be constructed on the land be used as residential accommodation satisfied s 40-65(1). They are not the residential premises sold.<sup>47</sup>

With respect, this misses the point. The residential premises sold was the "land **or** a building" not just the building. Since the land was purchased for the explicit purpose of erecting residential dwellings, it is suggested that this was precisely the "residential premises" sold. Moreover, had Parliament made it clear what was meant by the phrase "intended to be occupied as a residence", the confusion would not have arisen.

#### *E Premises capable of being occupied as a residence*

Premises not occupied as a residence at the time of sale may still meet the definition of "residential premises" if they are "intended to be occupied and *capable of being occupied as a residence*."

As pointed out, the original definition of "residential premises" did not include a

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<sup>46</sup> *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* [2006] NSWSC 83.

<sup>47</sup> *Toyama Pty Ltd v Landmark Building Developments Pty Ltd* [2006] NSWSC 83 at paragraph 103.



requirement that the premises be capable of being occupied as a residence.

The Commissioner's approach follows the policy intent outlined in the Explanatory Memorandum, in that he takes the phrase "capable of being occupied as a residence" to mean that the premises must possess the requirements necessary to occupy it as a residence **at the time of sale**.<sup>48</sup> As discussed, this is not explicitly stated in the legislation and makes a sensible interpretation of the definition of "residential premises" virtually impossible.

The Commissioner considers that for premises to have the requirements necessary to occupy it as a residence, it must provide the occupants with sleeping accommodation and at least some basic facilities for day-to-day living – these include such things as areas for sleeping, eating and bathing, but it is not necessary that these things be arranged in a similar manner to a conventional house or apartment.<sup>49</sup> The Commissioner believes that a residence may consist of detached buildings, semi-detached buildings, strata title apartments, single rooms or suites of rooms within larger premises. While it is difficult to see how a single room would possess the required characteristics, it is encouraging to note that the Commissioner has not dictated the style of the accommodation required and he allows for the possibility that dormitory or barrack-style accommodation could still meet the concept of a residence.

An issue that arises in the context is one of homes that have been removed from the land upon which they were originally situated and taken to a display area for sale. These homes may have their fittings intact, and the seller would usually offer a relocation and stumping service as part of the price, so purchasers would receive a completed house permanently affixed to land of their choice. These homes are popular with first home buyers since they may carry a lower per-square-metre cost than that applicable to newly built homes. The obvious question is whether the sale of these homes would be input taxed as a supply of "residential premises" or taxable as a supply of something else.

The practice in the industry is to treat these sales as taxable supplies, but it is suggested that this is the result of erring on the side of caution rather than any coherent analysis of the definition of "residential premises". The houses are not occupied as a residence when they are sold, so to be an input taxed supply under s 40-65 the premises must be intended to be occupied as a residence and capable of being occupied as a residence. In the majority (if not all) of the cases, the premises would be purchased as homes, so the question to be answered is whether the premises are capable of being occupied as residences. And it is the Commissioner's view that the premises should be capable of being occupied as a residence at the time of purchase.

The extent to which a structure is capable of being occupied as a residence will, according to the Commissioner, depend upon whether the structure possesses "sleeping accommodation and at least some basic facilities for day to day living". These basic facilities are said to include areas for sleeping, eating and bathing – one might even add areas for food preparation and laundry. Whether these facilities exist in a structure would be a matter of fact, and it would be tempting to dismiss this as a purely objective exercise. One cannot however ignore the subjective element – things that are basic facilities to one person may be woefully inadequate to another. It is at least arguable that these houses, once removed from their original location and stored in a display village, would still possess sufficient basic facilities to satisfy many people.

This would lead to the absurd notion that where a purchaser fell into the less

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<sup>48</sup> Ruling GSTR 2000/20 at paragraph 25.

<sup>49</sup> Ruling GSTR 2000/20 at paragraph 26.

discerning category of people who considered that the house offered adequate basic facilities, the sale should be treated as input taxed, since the structure was “residential premises” as far as they were concerned (being intended to be occupied and capable of being occupied as a residence). On the other hand a sale to the more discerning buyer should be treated as taxable, since they would not consider the facilities adequate, and therefore not capable of being occupied as a residence. This demonstrates the unsatisfactory nature of wording in legislation that requires subjective analysis.

#### IV CONCLUSION

The title of this article asks whether the amendments to the definition of “residential premises” go far enough. For the reasons outlined in the article, it is suggested not. That is not to say that attempts to clarify the definition should be dismissed merely because not all the potential problems have been ironed out – far from it. There are many other provisions in this legislation that are equally fraught with problems, and equally deserving of the legislature’s attention, so an attempt to fix them all would be a monumental task.

These suggestions are modestly offered so that there is at least an attempt to remove uncertainty from what is the very risky business of property development.

The first suggestion involves the phrase “land or a building” in the definition. The policy intent of Parliament as suggested by the Explanatory Memorandum<sup>50</sup> was to preclude vacant residential land from meeting the requirements of the definition of “residential premises”. The wording of the definition suggests that Parliament still wanted a building on its own to be able to meet the definition. These two intentions could perhaps be made clearer if the phrase “land or a building” was reworded as “land and a building; or a building on its own ...”. Moreover, if the only reason for the addition of the words “capable of being occupied as a residence” was to preclude supplies of vacant residential land, commercial land or new residential premises being input taxed, those words could be removed and thus solve many of the other anomalies in the definition.

Another suggestion involves the potential difficulty in distinguishing between “residential accommodation” and “commercial residential accommodation”. The difficulty is entirely due to the inclusion of paragraph (f) in the definition of “commercial residential premises”. The inclusion of phrases such as “anything similar” is all too common in tax legislation, particularly in definitions. Rather than allowing a single unforeseen item to escape the definition, people who draft legislation rely on these catch-all provisions that can do more harm than good.

It is suggested that paragraph (f) of the definition of “commercial residential premises” be repealed in the interests of achieving greater clarity. If this results in some premises escaping classification as “commercial residential premises”, the provision could always be amended to include it later.

The use of the phrase “intended to be occupied as a residence” is the subject of some interpretational difficulty. Whenever a provision requires an examination of *intention*, it leads to the inevitable difficulty of deciding whether it refers to the subjective intention of a party (which is notoriously difficult to prove) or some objective intention that can be determined by reference to the surrounding facts. So it is with the interaction between the definition of “residential premises” in s 195-1 on the one hand, and the provisions of s 40-35(2)(a) and s 40-65(1) on the other. Both require a determination as

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<sup>50</sup> Goods and Services Tax Treatment of Residential Premises Explanatory Material paragraph 1.3.

to whether premises are intended to be occupied as a residence, but that intention is said to be objective in the case of the definition, but subjective in the case of the two provisions.

The obvious problem with this construction is that entities may be made liable for GST through events entirely outside their control. Someone who purchases a residence and later uses it for a commercial purpose will have nothing to lose from this conduct, since the liability to pay the GST rests with the seller. Unless the seller had the foresight to insert the appropriate covenants, he or she would incur an unforeseen liability to remit 1/11<sup>th</sup> of the purchase price as GST, while the purchaser (whose conduct brought it about) would effectively enjoy a windfall of 1/11<sup>th</sup> of what he or she paid to acquire the property.

This situation might be corrected by ensuring that the intention implied by s 40-35(2)(a) and s 40-65(1) was an objective one. If for some reason it was necessary to have the intention surrounding the supply to be a subjective one (and one can scarcely imagine why), then it would be fairer for the intention of the seller to be the deciding factor. This is because, as discussed, it is the seller who bears the risk of GST being payable on the transaction.

The subjective/objective assessment again presents a problem with the part of the definition that reads “capable of being occupied as a residence”. What one person might consider “capable of being occupied as a residence” might be spurned by another. It is suggested that the Commissioner’s attempt to inject some objectivity into what can be regarded as capable of being occupied as a residence has not entirely removed this uncertainty.

The Explanatory Memorandum<sup>51</sup> suggests that the reason for the addition of this phrase was to make it clear that supplies of vacant residential land, commercial land or new residential premises would not be input taxed. It is suggested that this objective might be more effectively achieved by substituting the words “land and a building; or a building on its own” for the words “land or a building” in the definition. If this was done, the words “capable of being occupied as a residence” could be removed altogether.

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<sup>51</sup> Goods and Services Tax Treatment of Residential Premises Explanatory Material paragraph 1.3.