

## Uncertain Times Ahead - GST & the Sale of Leased Premises

### Tax and Litigation Update

Late last year, the Full Federal Court handed down its decision in *MBI Properties Pty Ltd v Commissioner of Taxation* [2013] FCAFC 112 (*MBI Case*). The decision was somewhat controversial and has caused confusion for vendors and purchasers alike who are involved in property development and leasing enterprises.

Pending the Commissioner's application for special leave and the outcome of any High Court decision, the *MBI Case* marks a change in what has previously been understood as the GST treatment of commercial and residential properties sold subject to an existing lease arrangement.

#### Decision Summary

The case was concerned with whether MBI Properties Pty Ltd (*MBI*) had an "increasing adjustment" under Div 135 of the *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (*Act*) arising as a result of *MBI's* purchase of three tenanted residential apartments on a GST-free basis as the supply of a going-concern.

The apartments were purchased subject to an existing lease between the vendor and a third party. In an earlier decision, the Federal Court held that in respect of each lease, there was no ongoing supply of the premises to the relevant lessee under each lease by *MBI* following the purchase of the apartments because the ongoing nature of the lease did not constitute a further supply. The initial grant of the lease by the vendor to the lessee under each lease was a supply but once granted there was no further supply of the premises under each lease.

Following that decision, the Commissioner issued *MBI* with a GST assessment which included an increasing adjustment. The Commissioner

#### Who does this affect?

- Vendors and purchasers selling and acquiring commercial and residential properties subject to leases.
- Lessees of commercial and residential properties.

#### Article Highlights

- The Full Federal Court has rejected the Commissioner's arguments that a purchaser is subject to an increasing adjustment following the purchase of a property which was subject to an existing lease on the basis that a lease is a one-off supply and not an ongoing supply.
- The Commissioner has sought leave to appeal the decision.



argued that, despite the fact it was accepted that MBI itself did not make an ongoing supply of the premises to the relevant lessee under each lease, an increasing adjustment arose for MBI because:

- a. the vendor was treated as continuing to make input taxed supplies of the premises to the lessees under each lease after the sale; and
- b. for the purposes of section 135-5(1)(b) of the Act, a third party that acquired the properties could have the intention of making input taxed supplies through the newly acquired leasing enterprise.

The Full Federal Court unanimously rejected those arguments and found that there was no new or continuing supply of the premises by either the vendor or MBI under each lease.

### Issues Arising From Decision

The Commissioner's views about the sale of leased residential and leased commercial premises are set out in:

- GSTD 2012/1; and
- GSTD 2012/2.

As a result of the decision in the MBI Case, these views may no longer be correct and the ATO may be required to withdraw these and other rulings and restate their position.

Meanwhile, for many vendors, purchasers and lessees there are now more questions than answers. The decision raises a number of issues including whether:

- an entity that grants a lease over property will continue to be liable for GST in respect of that lease after the property is sold;
- purchasers of land, the subject of a lease are liable for GST in respect of amounts payable by the lessee under the lease following completion of a sale.
- the lessee of leased commercial premises remains entitled to input tax credits in relation to rental payments after the sale of the premises by the landlord;
- a purchaser of leased residential premises can claim input tax credits for costs associated with rental of the premises; and
- sale agreements for the sale of leased property can be structured as a GST-free sale of a going concern and whether it will provide a pricing benefit to vendors.

### Contact



**Peter Walton**  
PARTNER

t: +61 8 9426 6758  
e: pwalton@jacmac.com.au



**Jemal Zagami**  
PARTNER

t: +61 8 9426 6612  
e: jzagami@jacmac.com.au

**Fleur Lewis**  
SOLICITOR

t: +61 8 9426 6824  
e: flewis@jacmac.com.au



### What Now?

The Commissioner filed an application for special leave to appeal the Full Federal Court's decision on 15 November 2013. The application is pending and will be determined shortly.

In the meantime, the Interim Decision Impact Statement provides taxpayers with some guidance on the administrative treatment the Commissioner intends to adopt. The Commissioner has stated that for now, the Full Federal Court's decision means that purchasers of leased residential premises as a GST-free going concern may not be liable for an increasing adjustment.

Until the outcome of the application for special leave has been decided (and where relevant, any resulting appeal), the ATO does not intend to revise its current published views about the sale of leased residential premises and leased commercial premises.

Taxpayers can continue to lodge returns on the basis of those published views and will be protected from having to pay any underpaid tax, penalty or interest if those views are later determined not to be correct.

Taxpayers who rely on the MBI Case may wish to seek refunds for GST historically paid. To preserve any entitlement to refunds for pre 1 July 2012 transactions, taxpayers will need to notify the ATO. However, if the decision in the MBI Case is reversed, the Commissioner may seek to recover refunds paid to taxpayers.

A final decision impact statement will be released once the outcome of the application for special leave (and any resulting appeal) is known.

*Disclaimer: This publication is intended to provide general information only and should not be relied upon as legal advice. If you require legal advice on a matter please contact us.*

### Contact Us

t +61 8 9426 6611 f +61 8 9321 2002 e [jacmac@jacmac.com.au](mailto:jacmac@jacmac.com.au)

a Level 25, 140 St Georges Terrace, Perth, Western Australia 6000  
GPO Box M971, Perth, Western Australia 6843

[www.jacmac.com.au](http://www.jacmac.com.au)