Published on *The National Law Review* https://natlawreview.com

BTR Series Part 3: Indirect Tax—What Else Could Be Done and How Should Tax Regulations Align?

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The term “indirect tax” is used to describe taxes that are imposed on goods, land, or services (or transactions involving goods, land, or services). In contrast, “direct taxes” are imposed on income or profits.

The most relevant indirect taxes in a build-to-rent context are goods and services tax (GST), transfer duty and land tax. Each of these is discussed in turn below.

GST

GST is a form of “valued added tax” (commonly referred to as VAT in overseas jurisdictions). It applies to “taxable supplies” at a rate of 10% and is calculated based on the value of the supply.

Input tax credits (GST credits) are available for GST incurred on costs that relate to making taxable or GST-free supplies.

The table below sets out the four categories of supply that arise in a GST context.

Type of Supply	GST Applies to the Supply?	Input Tax Credits Available on Related Costs?
Taxable	Yes	Yes
GST-free	No	Yes
Input-taxed	No	No
Out-of-scope	No	No

As can be seen from the table above, only taxable supplies are subject to GST. However, the character of the supply is relevant to the availability of input tax credits.

Build-to-Rent vs Build-to-Sell

The comments that follow apply to “for profit” entities. The special rules that apply to endorsed charities are set out further below.

The sale of a “new residential premises,” such as a newly constructed apartment, is a taxable supply and subject to GST. In some circumstances, the developer may be able to calculate the GST on the sale on a concessional basis under the “margin scheme."

The entity that developed the premises is entitled to full input tax credits for GST incurred on all land acquisitions and development costs. This is on the basis the land and development costs will be used to make taxable supplies.

In contrast, the lease of a new apartment to a residential tenant is an input taxed supply. GST does not apply to the rents received. However, the entity that developed the premises is not entitled to any input tax credits for GST incurred on costs associated with acquiring the land or the development costs. This is on the basis those acquisitions relate to making input taxed residential leasing supplies.

There may be some instances where an entity has a “dual intention” and intends to lease a new apartment whilst also continuing to actively market the apartment for sale. This can give rise to complex apportionment issues when determining the extent to which input tax credits are available on the land and development costs.

Worked Example

The following example illustrates the different input tax credit entitlements.

Assume:

- Land has been purchased at a cost of AU$22 million, including AU$2 million of GST;
- Development costs are AU$88 million, including AU$8 million of GST; and
- Total costs are AU$110 million, including GST of AU$10 million.

An entity acquiring the land and development costs solely to develop and sell new residential premises will be entitled to full input tax credits of AU$10 million, leaving a net cost of AU$100 million.

In contrast, an entity acquiring the land and development costs solely to develop and lease new residential premises will not be entitled to full input tax credits. The AU$10 million of GST is irrecoverable and the net cost is AU$110 million.

In a build-to-rent scenario, input tax credits are also not available for repair and maintenance costs or sales and marketing costs.

The irrecoverable GST cost can adversely impact the internal rate of return for a build-to-rent project, potentially making it unviable.

Commercial Residential Premises

The GST Act defines certain types of commercially operated premises as “commercial residential premises.” Broadly speaking, this includes premises such as hotels, inns, motels, boarding houses, caravan parks, and camping grounds.

The definition also includes premises which are “similar” to those types of premises which are specifically listed.

Special rules apply to supplies of long-term accommodation in commercial residential premises. GST is calculated at a concessional rate of 5.5% while full input tax credits are available on all land and development costs.

Accordingly, if premises do qualify as commercial residential premises, this may alleviate the GST leakage that would otherwise be incurred upfront at the land acquisition and development phase. However, it also means that GST will be applicable in respect of the accommodation supplied (albeit at a concessional rate for long-term supplies).

The Australian Taxation Office has issued a public ruling, GSTR 2012/6, setting out when it considers premises qualify as commercial residential premises. One of the key requirements is that a person who is occupying the premises must have the status of a guest. That won’t be the case where a person has a residential lease that provides exclusive possession.

The Australian Taxation Office does not accept that all types of commercially operated accommodation are “commercial residential premises.” For example, retirement villages are considered to be residential premises, not commercial residential premises.

Endorsed Charities

Special rules apply to supplies made by endorsed charities for nominal consideration. **Those rules provide that supplies of accommodation made by an endorsed charity will be GST-free if:**

- The supply is made for consideration that is less than 75% of market value; or
- The supply is made for consideration that is less than 75% of the cost of the supply.

The benefit of the accommodation supplies being GST-free is that GST does not apply to the rents or accommodation fee income, but full input tax credits are available on all land acquisition and development costs.

This is relevant in the context of build-to-rent projects that will include an element of social or affordable housing. The premises must be owned (or leased) by the endorsed charity that will supply the accommodation.

TRANSFER DUTY

Duty Generally

In Australia, all eight states and territories impose transfer duty (previously known as “stamp duty”) on the transfer of dutiable property, including land.

As transfer duty applies at a state and territory level, there are differences between the way the tax is administered and the rates that apply across each of the jurisdictions.

In all jurisdictions, the tax is calculated (at the applicable rate) based on the higher of the consideration to be paid for the land and the unencumbered market value of the land.

South Australia has abolished transfer duty on most classes of real estate, but the tax still applies to the transfer of residential or primary production land (other than some commercial categories of residential property, such as hotels and motels).

In a build-to-rent context, transfer duty issues to consider may include the following:

- Can the land be purchased while it has the lowest market value (for example, prior to development approval being obtained)?;
- Can the land be acquired as a GST-free supply of a going concern? Duty is calculated on the GST-inclusive price, so acquiring as a GST-free going concern reduces the duty cost by 1/11th;
- Are there any duty risks from securing a site via a call option (or a put and call option)? The duty rules relating to options are complex and vary by jurisdiction;
- What are the duty risks if the land needs to be transferred to another entity (such as a new subsidiary or fund) on completion of the purchase? There are double duty and “sub-sale” risks that may arise if a third party is nominated as the transferee on completion; and
- Will transfer duty apply to a “heads of agreement?" If the heads of agreement constitutes an agreement for the transfer of land, duty will apply. This is why most heads of agreement are nonbinding until formal documentation has been entered.

Foreign Investor Surcharges

In addition to duty at general rates, all six Australian states impose surcharge rates of duty on the purchase of residential-related land by a foreign entity (which may include Australian companies and trusts that are foreign controlled or owned).

Neither of the two Australian territories imposes surcharge transfer duty rates.

In all six states, the applicable surcharge duty rate is either 7% or 8%. This applies in addition to duty at general rates.

Five jurisdictions, being New South Wales, Victoria, South Australia, Queensland, and Western Australia, each offer some form of exemption or ex gratia relief for qualifying build-to-rent projects. The concession requirements vary across the jurisdictions as discussed further below.

Charities

Charities may be exempt from transfer duty. Generally it will not be sufficient for the land to be acquired by a charity—it will be necessary to show that the land will also be used in connection with the entities’ charitable purposes.

Again, this can be relevant for build-to-rent projects that will involve an element of affordable or social housing that will be transferred to a charity to own and manage.

LAND TAX

Land Tax Generally

With the exception of the Northern Territory, all Australian states and territories impose land tax.

Land tax is an annual tax applied to taxable land within a jurisdiction. It is levied on the owner of the land, although some jurisdictions do extend the tax to also apply to lessees that lease land from the Crown, a state government agency or a local council (in which case the lessee is the deemed owner).

The rates that apply vary across all jurisdictions. There may be different rates that apply based on the nature of the owner of the land (companies versus trusts and individuals). It is calculated based on the unimproved value of the land (i.e. disregarding any buildings or other capital improvements).

All jurisdictions offer exemptions, such as for a principal place of residence or primary production land. Exemptions may also apply for retirement villages or land lease projects. The requirements for such exemptions do vary widely.

Where an entity owns multiple parcels of land within a jurisdiction, those will generally be aggregated (and treated as a single parcel) when determining the land tax that applies.

Land Tax Surcharges

Some jurisdictions, including New South Wales, Victoria, Queensland, Tasmania, and the Australian Capital Territory, impose surcharges on foreign owners of land in those jurisdictions.

In Queensland and Victoria, the surcharges are not confined to residential-related land and may apply to any taxable land (that is not otherwise exempt). Both states provide exemptions or ex gratia relief for qualifying build-to-rent projects.

Generally, the surcharge rate is 2%, although New South Wales has increased its surcharge rate (confined to residential-related land only) to 4%. The surcharge applies in addition to land tax at general rates.

BUILD-TO-RENT CONCESSIONS

As noted above, five jurisdictions, being New South Wales, Victoria, South Australia, Queensland, and Western Australia, each offer some form of exemption or ex gratia relief for qualifying build-to-rent projects.

In New South Wales, qualifying projects must:

- Include a minimum of 50 separate dwelling units;
- Satisfy certain workforce requirements (to help upskill new workers);
- Meet certain planning law requirements;
- Meet any affordable housing policies;
- Ensure that dwellings cannot be strata subdivided for 15 years and must be managed by a single entity with onsite management; and
- Ensure that tenants must be offered a residential lease with a minimum term of at least three years (although the lease taken out may be for a term of less than three years).

Qualifying projects in New South Wales receive the following benefits:

- Exemption from surcharge purchaser duty;
- Exemption from surcharge land tax; and
- A 50% reduction in the value of the land for land tax purposes for up to 20 years.

The requirements and exemptions available do vary widely. In some jurisdictions, such as Victoria, the concessions may require a combination of both ex gratia relief (for surcharge purchaser duty and land tax) and statutory concessions (for land tax reductions).

REQUIRED REFORMS AND HARMONISATION

The one thing that all investors want when it comes to making investment decisions is certainty. While it is helpful that most states and territories do now offer some form of build-to-rent concession for qualifying projects, the lack of harmonisation across jurisdictions means there are different rules to navigate, particularly for large asset portfolios that span multiple jurisdictions.

Further, some jurisdictions require applicants to seek discretionary ex gratia relief. This does not provide the same level of certainty as a legislated exemption or concession.

With respect to GST, the upfront GST leakage is a material impost for new build-to-rent projects. One potential solution would be to permit a developer to claim back full input tax credits when land acquisition and development costs are incurred. Those credits can then be paid back over, say, 10 years (or when the property is sold, if earlier). Whilst the developer would still incur GST leakage, the cost would be spread over a timeframe during which cash flows are received to ameliorate some of the financial impact.

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National Law Review, Volumess XIII, Number 221

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