

Retirement villages and GST

On 24 June 2009, the Australian Taxation Office (“the ATO”) issued a new GST ruling, GSTR 2009/4, which has potentially significant ramifications for developers of retirement villages.

The new ruling is likely to result in substantial GST credits and/or refund claims being submitted by retirement village developers who let the village to residents under loan / lease or loan / licence structures, whilst trying to sell the underlying freehold interest in the village.

Background

As many retirement village developers would be aware, it is quite common to construct a retirement village with the intention to ultimately sell it to an established operator. However, the ability to sell the retirement village, and the sale price which can be obtained for it, will be beneficially impacted if the village is filled with residents before being sold. This simply reflects the commercial reality that the attractiveness of the village to a potential purchaser will be enhanced by the ongoing income stream from the village, being the departure fees or deferred management fees (“DMFs”) payable by residents.

What the new ATO ruling recognises is that where a developer constructs a retirement village for the dual purpose of both letting the village to residents, and selling the underlying freehold interest in the village, they can take this duality of purpose into account in calculating the level of GST credits which they claim on their construction and other development costs.

Until very recently, the ATO did not recognise this duality of purpose, and effectively denied many retirement village developers the ability to claim these GST credits.

Is the new ATO ruling retrospective?

Yes. It represents the ATO’s view of the law both before and after the date of its issue. Practically, it means that developers and operators of retirement villages can potentially go back for up to 4 years and reclaim GST credits which may not previously have been claimed. There is an ability to obtain a refund of GST and several developers have already done so.

The new ruling not only applies to the costs of initially constructing a new retirement village, but it can also apply to improvements to a village, but only where there is a duality of purpose.

How do I demonstrate that I have a duality of purpose?

In essence, any developer who constructs a retirement village and fills it with residents as a means of maximising the sale price of the village should be able to demonstrate they have a duality of purpose. That is, a purpose of both letting and selling the village. Importantly, duality of purpose is not demonstrated by subjective factors, it is demonstrated by reference to objective criteria and evidence.

The types of documentation or evidence which may be used to support such a claim include:

- Business plans, budgets or minutes of meetings supporting the holding of the premises for sale;
- Accounting reports and financial statements supporting the holding of the premises for sale;
- Finance documents, including loan applications supporting the planned sale of the premises;
- Income tax treatment of the development (which is discussed further below);
- Nearer completion, marketing of the premises for sale, such as listing the premises with agents, putting together information memorandum to be circulated to potential purchasers, conducting inspections with prospective buyers, engaging in negotiations for the sale;
- Past activities of the entity in similar developments which have been held for sold.

Once a duality of purpose is established, what level of GST credits can be claimed?

Where a duality of purpose is established, the ATO requires developers to apportion their GST credits on a “fair and reasonable” basis. One method which is referred to in the new ATO ruling is the ‘output based indirect method’ which utilises the following formula:

$$\frac{\text{Consideration for the taxable supply of the premises}}{\text{Consideration for the taxable supply of the premises plus consideration for the input taxed supplies of residential rent}}$$

One of the difficulties with this formula is that it has not been adapted to the specific circumstances of retirement villages and can therefore be difficult to apply in practise. As such, it may be appropriate to include:

- In the numerator in the formula, the expected selling price of the village, based on a recent valuation;
- For that part of the denominator in the formula which refers to the “consideration for the input taxed supplies of residential premises by way of lease”, the sum of the rent (if any) payable by the residents, the recurrent charges payable by the residents, and the annualised DMF amount which accrues.

By way of example, where a developer is expecting that it may take up to 2 years from completion of construction before filling the village and selling the freehold interest, the level of GST credits which can be claimed typically amounts to approximately 95% of all GST credits on construction and other development costs.

It is strongly recommended that developers obtain professional advice on this aspect of the calculations, because it is necessary to establish that the methodology being adopted is objectively “fair and reasonable”, and not simply the most beneficial.

What are some of the traps in the new ATO ruling?

For the vast majority of retirement village developers, the new ATO ruling is likely to be beneficial, particularly from a cashflow perspective in being able to claim a significant proportion of GST credits as construction occurs. However, there are some potential traps to be wary of. They include:

- 1 If the developer purchases the land with the purpose of developing and then selling the village, this may result in any profits from the sale being assessed on income tax account rather than as a capital gain. In the new ATO ruling, the ATO alludes to the similarities between the GST position and the income tax / CGT treatment.
- 2 If the developer leases the retirement village accommodation for 5 years or more, the sale of that accommodation would ordinarily be input taxed for GST purposes. However, some controversially, the ATO takes the view in the new ruling that if the property has been held for the purposes of sale at any time during that 5 year period, it will not be input taxed on sale. As such, developers will need to consider the potential GST impact on the sale.
- 3 If the developer abandons the purpose of selling the village, then the developer may be required to repay some or all the GST credits which have previously been claimed.

While it is necessary to consider the potential impact of each of these issues on the specific circumstances of each development, generally the desire to improve cashflow by claiming GST credits up front proves to be the prevailing consideration.

What the new ATO ruling does not apply to?

The new ATO ruling will not impact on retirement villages where the accommodation is supplied GST-free, such as:

- Where the owner / operator is a charitable institution;
- Where the accommodation is serviced apartment accommodation which meets the requirements for GST-free treatment;
- Nursing home style aged care facilities.

For the above facilities, because the supply of accommodation is GST-free, GST credits can generally be claimed in relation to construction and other development costs, as well as ongoing improvements and maintenance costs.

The new ATO ruling will also not impact on retirement villages where the accommodation is sold to residents, such as in strata titled sales.

If I am impacted by the new ruling, what should I do?

If you are potentially eligible for a refund of GST, you can generally only revise your Business Activity Statements over the past 4 years. As such, you should consider acting quickly to preserve any refund entitlements.

We strongly recommend that you obtain professional advice before submitting any refund claim. In particular, it is necessary to ensure that the documentation you have supports a duality of purpose, and the methodology being used to claim GST credits is 'fair and reasonable'.

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