

# Reinforcing the divide: commercial residential premises and South Steyne

**SOUTH STEYNE HOTEL PTY LTD V COMMISSIONER OF TAXATION.<sup>1</sup>**



## INTRODUCTION

On 20 November 2009, the Full Federal Court heard an appeal by South Steyne Hotel Pty Ltd (**Taxpayer**) in relation to the characterisation of certain supplies based on their classification as either being residential premises or commercial residential premises. This matter was first heard by Justice Stone of the Federal Court on 30 January 2009,<sup>2</sup> being one of the first interpretations of the amended provisions in *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (**GST Act**) relating to residential premises that were included after the decision in *Marana Holdings Pty Ltd & Another v Commissioner of Taxation*.<sup>3</sup> Before Justice Stone, heavy emphasis was placed on the ordinary meanings of “reside” and “residential premises”, as well as how the ordinary meanings of these terms were interpreted for GST purposes. The Federal Court dismissed the Taxpayer’s appeal, finding for the Commissioner in each case under a strict interpretation of the amended provisions in the GST Act.

On appeal by the Taxpayer, the Full Federal Court upheld three of the Federal Court’s findings by majority, only conceding that the sale of each apartment to MBI Properties Pty Limited was GST-free under s 38-325 of the GST Act. The point in relation to the supply of a going concern is restricted to the particular facts arising in this case.

The recent decision of the Full Federal Court is important as it reinforces the distinction made between residential premises and commercial residential premises under the amended provisions of the GST Act. Such reinforcement is

particularly important given the silence of parliament to date as to the wider consequences of the amendments made to the GST Act. In any event, developers, property owners and business operators (including management right scheme operators) are likely to be affected where they are involved with apartments forming part of a larger scheme which may still be characterised as residential premises rather than commercial residential premises for the purposes of GST.

## BACKGROUND FACTS<sup>4</sup>

In December 2000, the Taxpayer purchased the Sebel Complex (**Hotel**) located in Manly, New South Wales. The Hotel contained 83 rooms (**Apartments**), 24-hour reception area, restaurant, bar, swimming pool and conference room. The Hotel was given a 4.5 star rating, offering guests the use of services such as valet parking, safety storage box, cleaning and laundry services, and room service.

Decorated in a similar style, each Apartment contained one or two bedrooms, and contained similar fittings, furnishings and chattels. Importantly each Apartment contained basic facilities to make tea and coffee, a bar fridge and television, linen, ironing board and bathroom supplies. The two bedroom Apartments also contained laundry facilities in the bathroom.

In August 2006, the Apartments were strata titled. New planning restrictions were imposed which precluded the Apartments from being used either as permanent accommodation or as a residential flat building.

An arrangement was put in place to enable the Apartments to be used as part of a serviced apartment business. Under this arrangement, the Taxpayer sold the reception area, offices and car parking spaces to Mirvac Hotels Pty Ltd (**MHL**). The Taxpayer entered into separate lease agreements for each Apartment with Mirvac Management Pty Ltd (**MML**), under the terms of which MML was obliged to operate the Apartments as a part of the serviced apartment business. A management agreement was put in place between MHL and MML under which MML gave MHL exclusive rights to operate the serviced apartment business.

Between September 2006 and October 2007, the Taxpayer sold 15 Apartments to various investors, including MBI Properties Pty Ltd (**MBI Properties**). Each contract of sale permitted the purchasers to participate in the management rights scheme that was in place, and each purchaser elected to participate in that scheme. One purchaser in particular, MBI Properties, made an Apartment available for use by its employees from time to time.

## RELEVANT LEGISLATION

The GST Act sets out a distinction in s 9-5 between taxable supplies and other supplies for the purpose of GST. In accordance with s 9-30 of the GST Act, supplies that are GST-free or input taxed are dealt with in Div 38 and Div 40 of the GST Act respectively.

The specific requirements contained in s 38-325 of the GST were particularly important before the Full Federal Court, being that:

- (1) The supply of a going concern is **GST-free** if:
- (a) the supply is for consideration; and
  - (b) the recipient is registered or required to be registered; and
  - (c) the supplier and the recipient have agreed in writing that the supply is of a going concern.
- (2) A **supply of a going concern** is a supply under an arrangement under which:
- (a) the supplier supplies to the recipient all of the things that are necessary for the continued operation of an\* enterprise; and
  - (b) the supplier carries on, or will carry on, the enterprise until the day of the supply (whether or not as a part of a larger enterprise carried on by the supplier).

Other relevant provisions of the GST Act include:

### Section 195-1 – Definitions

“**commercial residential premises**” means:

- (a) a hotel, motel, inn, hostel or boarding house; or ...
- (f) anything similar to residential premises described in paragraphss (a) to (e).

“**residential premises**” means 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;

### Section 40-35 – Residential rent

- (1) A supply of premises that is by way of lease, hire or licence (including a renewal or extension of a lease, hire or licence) is input taxed if:
- (a) the supply is of residential premises (other than a **supply of commercial residential premises or a supply of accommodation in commercial residential premises provided to an individual by the entity that owns or controls the commercial residential premises**); or
  - (b) the supply is of commercial accommodation and Division 87 (which is about long-term accommodation in commercial premises) would apply to the supply but for a choice made by the supplier under section 87-25...
- (2) However:
- (a) the supply is input taxed only to the extent that the premises are to be used predominantly for residential

accommodation (**regardless of the term of occupation**); and

- (b) the supply is not input taxed under this section if the lease, hire or licence, or the renewal or extension of a lease, hire or licence, is a long-term lease.

### Section 40-65 – Sales of residential premises

- (1) A sale of real property is **input taxed**, but only to the extent that the property is residential premises to be used predominantly for residential accommodation (**regardless of the term of occupation**).
- (2) However, the sale is *not* input taxed to the extent that the residential premises are:
- (a) commercial residential premises; or
  - (b) new residential premises other than those used for residential accommodation (**regardless of the term of occupation**) before 2 December 1998.

### DECISION OF THE FEDERAL COURT

The Federal Court found for the Commissioner, and dismissed the Taxpayer’s appeal in full so that the supplies were categorised as follows:

1. the lease of each Apartment from the Taxpayer to MML was an input taxed supply of residential premises;
2. the sale of an Apartment to an investor was a taxable supply. Stone J considered that the wording of cl 47.6.6 of the contract of sale had the effect of negating the agreement between the parties as to whether the supply was a going concern;
3. the continuation of leases in Apartments sold to investors were input taxed supplies of residential premises; and
4. the supply of accommodation by the apartment owner to an employee of the registered proprietor was a taxable supply.

In general, the Federal Court gave great consideration to the interpretation of the amended provisions in the GST Act and to the seeming distinction between the meanings of “residence” and “residential” for the purpose of GST.

### ISSUES BEFORE THE FULL FEDERAL COURT

The Full Federal Court was asked to reconsider the characterisation of each of the four separate supplies and therefore

to determine which category of supply they fell:

1. the lease of each Apartment from the Taxpayer to MML;
2. the sale of Apartments to investors who each participated in a Management Rights Scheme;
3. the continuation of leases in those Apartments sold to investors (so that an investor took title to the Apartment subject to the lease); and
4. the supply of accommodation by the apartment owner to an employee.

### DECISION

By majority, Full Federal Court found in favour of the Commissioner and dismissed the Taxpayer’s appeal in relation to three of the four findings made at first instance (being supplies 1, 3 and 4 above). In relation to the second supply, the Full Federal Court determined that the wording of cl 47.6.6 created an internal inconsistency in the contract of sale, but that the provision was not sufficient to override the agreement of the parties that the sale was the supply of a going concern. Accordingly, the Full Federal Court overruled the decision of Justice Stone.

#### Supply 1

There was consensus between all three judges that the lease of each apartment comprised the lease of “residential premises” for the primary use of residential accommodation and were, therefore, not separately “commercial residential premises.” Accordingly, this was an input taxed under s 40-35 of the GST Act.

In reaching this conclusion, Edmonds and Emmett JJ illustrated that the characterisation of the supply depended on the definitions of “residential premises” and “commercial residential premises,” which in turn, raised the question about whether an apartment in the Hotel was akin to “a hotel, motel, inn, hostel or boarding house.” Emmett J highlighted that “there is nothing in the GST Act or the policy underlining the GST Act that suggests that the characterisation of an individual supply can be approached by treating it as if it were the aggregate of that supply and other supplies.”<sup>5</sup> Further, “the individual apartments supplied by the Taxpayer to [MML] are very different from a hotel

or motel”<sup>6</sup> and “[i]t is not an ordinary use of English to describe a single or individual apartment as being similar to a hotel or motel.”<sup>7</sup>

### Supply 2

The Full Court (with Edmonds J dissenting) ruled that the primary judge erred when she decided that the sales of the apartments were taxable supplies. Instead, the Full Court considered that the sale of the apartments was a GST-free supply

provided to an individual “by the entity that owns or controls the commercial residential premises,”<sup>8</sup> and, therefore, not an input taxed supply. It was submitted by the Commissioner and subsequently accepted by the majority that MHL provided the accommodation to the guest in its own right as principal (not as MML’s agent) and therefore, the MHL exercised such practical “control” of the commercial residential premises constituted by the hotel.

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the individual apartments supplied by the Taxpayer to [MML] are very different from a hotel or motel.

”

of a going concern in accordance with s 38-325 of the GST Act. The “garbled language” of clause 47.6.6 of contract of sale was construed as being generally consistent with the parties having agreed in writing that the sale was a GST-free supply of a going concern. The exact wording of clause 47.6.6 could not override the agreement of the parties in this regard.

### Supply 3

The Full Court unanimously upheld the primary judges’ decision that there was no separate or further supply by MBI Properties to MML but merely a continuation of each of the input taxed leases granted by the Taxpayer. In considering this supply, the Full Court referred to Div 156 of the GST Act and concluded that the lease was *attributable* to the supply made by the original landlord, that is, the Taxpayer.

### Supply 4

By majority (Finn and Emmett JJ), the Full Court agreed with the primary judges’ decision that the supply of overnight accommodation to an employee of MBI Properties was a taxable supply in accordance with s 40-35(1) of the GST Act, being a supply of accommodation in commercial residential premises

Emmett J concluded that the accommodation was provided by MHL and not in its capacity as agent for MML by reference to the tax invoice supplied. However, Edmonds J states that it is incorrect to rely on the fact that the invoice was provided by MHL because an invoice can be given by either the principal or the agent in an agency relationship.

### CONCLUSION AND COMMENT

The decision of the Full Federal Court in *South Steyne* provides useful reinforcement of the interpretation of the GST Act in relation to the residential premises and commercial residential premises. Notwithstanding the unique circumstances involved in this case relating to the supply of a going concern, the appeal confirmed the decision made by Stone J in every respect.

Notwithstanding this, like Justice Stone, the Full Court found the amendments to the GST Act to be “curious”<sup>9</sup> in relation to the disregard for the length of actual or intended occupation, even if the intention that the premises be used as a residence or for residential accommodation is still required. Unfortunately however the Full Court did not take this curiosity further as to comment on the appropriateness of either the amended provisions of the

GST Act, or the application of these provisions to compartmentalise residential premises that, when aggregated, is used in a commercial setting.<sup>10</sup>

On 4 December 2009, the Commissioner issued a decision impact statement in relation to the decision of the Full Federal Court. The statement comments primarily upon the Court’s finding that where an Apartment sold to a purchaser was subject to a lease, that there was no separate supply in relation to the lease. The Commissioner confirmed that a document issued by the current owner of leased premises as a tax invoice will be treated as a tax invoice (if it otherwise qualifies as such) even if the lease was granted by a previous owner. Alternatively, where the supply of real estate is an input taxed supply, the new owner will not be entitled to input taxed credits under the lease. The Commissioner is considering the impact of the *South Steyne* decision on GSTR 2008/1 and GSTR 2004/4.

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#### Reference notes

- 1 [2009] FCAFC 155.
- 2 [2009] FCA 13.
- 3 (2004) 141 FCR 299.
- 4 Note that the facts of *South Steyne* and the decision of the Federal Court have been the subject of a previous case note in the April 2009 issue of the Australian Taxation Institute’s *Blue Journal*.
- 5 Above n 1, at [24].
- 6 Above n 1, at [28].
- 7 Above n 1, at [29].
- 8 Above n 1, at [35].
- 9 Above n 1, at [21].
- 10 Above n 1, at [39].