

Is the margin scheme available where land is subdivided?

BRADY KING PTY LTD V COMMISSIONER OF TAXATION



INTRODUCTION

On 26 June 2008 the Full Federal Court handed down its decision in *Brady King Pty Ltd v Commissioner of Taxation*.¹ This decision had been eagerly awaited by both parties, being the answer to the controversial outcome of the case at the Federal Court level. The Full Federal Court upheld the Taxpayer's appeal that s 75-10(3) of *A New Tax System (Goods and Services Tax) Act 1999 (Cth)* (**GST Act**) was to be applied to determine the margin for payment of GST upon the sale of residential units. The Full Federal Court set aside the earlier Federal Court (Middleton J) decision and remitted the case to the trial judge for the determination of the actual margin on which GST was to be paid.

This case confirms that the margin scheme can be applied to the sale of stratum units which as at 1 July 2000 did not exist but were created on land purchased prior to 1 July 2000.

The decision of the Full Federal Court in *Brady King* followed a similar approach to that adopted by a differently constituted Full Federal Court in the case of *Sterling Guardian Pty Ltd v Commissioner of Taxation*² in construing the GST Act as a practical business tax. In so doing, the Full Federal Court has rejected in both cases, the long established principle for both real property and stamp duty law that states, in effect, there is no common identity between the subdivided portions of land and the original unsubdivided land.

BACKGROUND FACTS

In early 2000, 270 King Street, Melbourne was a tired 17 storey office block which had seen better days. On 22 May 2000,

Brady King Pty Ltd (the **Taxpayer**) entered into a contract to purchase 270 King Street for \$9.25 million. The contract of sale provided for the deposit of \$100,000 to be paid upon exchange of contracts, with a further \$400,000 to be paid within 90 days and the balance of \$8.75 million to be paid at settlement. Importantly, special condition 2(a) of the contract enabled the Taxpayer to enter onto the property to perform building works under an exclusive licence as soon as the deposit had been paid.

On 26 June 2000, a planning permit was granted to the Taxpayer which allowed 270 King Street to be subdivided and developed into residential units. Prior to 30 June 2000 the Taxpayer entered into 270 King Street and commenced works to convert the building to residential units.

The property appeared as a non-current asset on the taxpayer's balance sheet for the year ended 30 June 2000.

On 25 October 2000, the purchase was settled, and the Taxpayer became registered proprietor of that land on 4 November 2000.

In the fullness of time, 270 King Street was converted by the Taxpayer into 158 residential units. The units were registered as "stratum units". Most of these units were sold "off the plan" between April and November 2001.

On 25 January 2002, an estate agent valued each stratum unit as at 1 July 2000 for the purpose of assessment of GST under Div 75 of the GST Act which contains special rules about supplies and acquisitions, including rules to reduce the amount of the supply on which GST is payable upon the sale of a freehold interest,

long term leasehold interest or stratum interest in real property, being the margin scheme (the **margin scheme**).

The Taxpayer applied s 75-10(3) of the GST Act to determine the amount of GST on the supply of each of the Stratum Units on the basis of the real estate agent's valuation. The Taxpayer's self assessment, based on s 75-10(3) calculated the margin on the difference between the stratum unit value as at 1 July 2000 and the sale price of those of the 158 units which has been sold (only four were not sold).

The Taxpayer lodged its GST returns using the assessment of the value of 270 King Street on the basis of the valuations completed under s 75-10(3).

However on 17 June and 18 October 2004 the Commissioner of Taxation (**Commissioner**) issued amended assessments to the Taxpayer on the basis that the Taxpayer should have calculated and paid GST on the sale of each stratum unit in accordance with s 75-10(2) of the GST Act. Valuation of 270 King Street pursuant to s 75-10(2) required the margin to be calculated on the difference between what was actually paid for the purchase of 270 King Street, and the sale prices of the sold units.

As the value of the 158 stratum units as at 1 July 2000 was higher than the value of 270 King Street as a 17 storey office block the amount of GST payable under s 75-10(3) was lower than the amount payable under s 75-10(2). The Taxpayer appealed against the amended assessments issued by the Commissioner to the Federal Court.

THE LEGISLATION

Section 75-10 of the GST Act in part provides as follows:

The amount of GST on taxable supplies

- (1) If a taxable supply of real property is under the margin scheme, the amount of GST on the supply is 1/11 of the margin for the supply.
- (2) Subject to subs (3) and s 75-11, the **margin** for the supply is the amount by which the consideration for the supply exceeds the consideration for your acquisition of the interest, unit or lease in question.
- (3) Subject to s 75-11, if
 - (a) the circumstances specified in an item in the second column of the table in this subsection apply to the supply; and
 - (b) an approved valuation of the freehold interest, stratum unit or long-term lease, as at the day specified in the corresponding item in the third column of the table, has been made;

the **margin** for the supply is the amount by which the consideration for the supply exceeds that valuation of the interest, unit or lease.

Use of valuations to work out margins

Item	When valuations may be used	Days when valuations are to be made
1	The supplier acquired the interest, unit or lease before 1 July 2000, and items 2, 3 and 4 do not apply.	1 July 2000
3	The supplier is registered or required to be registered and has held the interest, unit or lease since before 1 July 2000, and there were improvements on the land or premises in question as at 1 July 2000.	1 July 2000

- (4) This section has effect despite s 9-70 (which is about the amount of GST on taxable supplies).

Note Section 9-90 (rounding of amounts of GST) can apply to amounts of GST worked out using this section.

DECISION OF THE FEDERAL COURT

At first instance Middleton J considered two questions:

- (a) whether the Taxpayer was entitled to apply s 75-10(3) based on the difference

between the sale price of each unit and the value of each unit as at 1 July 2000; and

- (b) if so, whether the valuation the Taxpayer relied upon complied with the requirements of s 75-10(3).

Middleton J found that for the purposes of s 75-10(3) there had to be strict identity in juridical terms between that which the Taxpayer acquired and that which the Taxpayer supplied. Further, the interest had to be a legal interest.

At 270 King Street, the Taxpayer acquired title to a piece of land with an office building on it. The Taxpayer sold 154 stratum units. Middleton J found that s 75-10(3) could not apply because the Taxpayer had no interest in any of the relevant stratum units on 1 July 2000 because the stratum units were not in existence on that date (under real property law stratum units come into existence when the plan of subdivision is registered).

Middleton J did not consider the valuation point.

Both the Commissioner and the Taxpayer were dissatisfied with the outcome. The Taxpayer appealed against the decision of Middleton J to the Full Federal Court.

DECISION OF THE FULL FEDERAL COURT

The Full Federal Court found that it was not essential that the property acquired should be identical to the stratum unit supplied. Furthermore, the interest acquired by the Taxpayer under the contract of sale on 22 May 2000 was a sufficient interest in land required for the application of the margin scheme.

REASONING OF THE FULL FEDERAL COURT

On appeal to the Full Federal Court, the parties sought clarification of the decision of Middleton J regarding:

1. the non-existence of the stratum unit before 1 July 2000; and
2. whether the Taxpayer held or acquired the necessary interest before 1 July 2000.

Non-existence of the stratum unit before 1 July 2000

Both the Commissioner and the Taxpayer argued that there did not need to be strict identity in juridical terms between what the Taxpayer acquired and what it supplied.³

The Full Court agreed with both parties stating that the purpose of the Margin Scheme would be frustrated "if such a common place transaction as the present one were held to be outside s75-10(3)".⁴ Furthermore the Full Court agreed with the Commissioner's submission that GST "is a practical business tax and it therefore proceeds on the basis that a supply of real property is a supply of a tangible asset, not the disposal of an intangible interest or bundle of rights".⁵ The Full Court held that this practical approach considered in light of the terms of s 75-15 of the GST Act (which provides for allocating the consideration for an acquisition if a supply relates to only part of a freehold interest, stratum unit or lease) meant that it was not essential that the property acquired should be identical to the stratum unit supplied.

Did the Taxpayer hold or acquire the necessary interest before 1 July 2000?

The Taxpayer and the Commissioner each took a different approach to the question of whether the Taxpayer held or acquired the necessary interest in the stratum units before 1 July 2000.

The Commissioner argued that the stratum units which the Taxpayer sold were not "derived" from the equitable estate it held as purchaser, rather they were derived from the fee simple estate it obtained on completion of the purchase and registration. As a result, the Taxpayer was only able to complete the purchase and obtain registration because of the enforceable rights it gained by entering into the contract. The source of the Taxpayer's interest in the stratum units prior to 1 July 2000 was the contract of sale.

The Taxpayer's original submission was based on the case of *Federal Commissioner of Taxation v Suttons Motors (Chullora) Wholesale Pty Ltd*⁶ in relation to the property being trading stock. However, in light of the High Court decision of *Reliance Carpet Co Pty Ltd v Commissioner of Taxation*⁷ the Taxpayer made a further submission to the Full Court. This further submission emphasised

the breadth of the statutory definition of "real property" to support the conclusion that when the Taxpayer entered into the contract on 22 May 2000 it acquired or held something that was an inextricable part of the interest which it sold after 1 July 2000.⁸

The Full Court found that once the "precise juridical identity approach" is rejected and a practical construction adopted, it is not possible to "ring fence" the interest the Taxpayer acquired under contract from the stratum unit later supplied.

On the date of introduction of GST, the Taxpayer held an equitable interest only in 270 King Street. It did not settle the purchase until 25 October 2000 and did not become legal owner of the fee simple until 9 November 2000 when the transfer was registered. However, the Taxpayer did have a sufficient interest in the land for the purposes of the margin scheme. As a result, s 75-10(3) applied so that the margin scheme was available where land is subdivided.

The Commissioner has not sought Special Leave to appeal to the High Court.

COMMENT AND CONCLUSION

The Full Federal Court has upheld the Taxpayer's appeal and overturned the controversial decision of Middleton J in the case of *Brady King* on the question of whether the margin scheme was available to the taxpayer on the sale of stratum

units. The Full Federal Court clarified and confirmed its earlier approach to the effect that a practical approach needed to be taken in interpreting the GST Act and it was not essential that the property acquired should be identical to the stratum unit supplied after redevelopment.

Furthermore, the Full Federal Court found that the meaning of "held" or "acquired" in the GST Act was sufficiently broad so that the Taxpayer held or acquired its interest in 270 King Street upon its entry into the contract for purchase entitling it to enforceable rights in relation to that property prior to 1 July 2000.

This case confirms that the margin scheme can be applied to the sale of stratum units that were under construction, or yet to be developed on land purchased prior to 1 July 2000. In reaching its conclusion, the Full Federal Court has rejected in both cases (*Brady King* and *Sterling Guardian*), the long established principle for both real property and stamp duty⁹ law that states, in effect, there is no identity between the subdivided portions of land and the original unsubdivided land.

In the writer's view, the decision of *Brady King* is restricted to GST and should be considered separately from the approaches in real property and stamp duty law.

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Reference notes:

- 1 [2008] FCAFC 118 (26 June 2008)
- 2 [2005] FCA 1166
- 3 Above n 1, at [22].
- 4 Above n 1, at [23].
- 5 Referring to the decision of the Federal Court in *Sterling Guardian Pty Ltd v Commissioner of Taxation* [2005] FCA 1166 at [25]
- 6 (1985) 157 CLR 277.
- 7 [2008] HCA 22.
- 8 Above n 1 at [38].
- 9 See for example: *Growing Wealth Pty Ltd v Commissioner of Stamp Duties (Qld)* 2001 2 Qd R 603. *Commissioner of State Revenue (Vic) v Pattison* [2001] 3VR 520. *Sportscorp Australia Pty Ltd v Chief Commissioner of State Revenue (NSW)* (2004) 205 ALR 1.

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