Ashurst Australia
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Special Indirect Tax Alert

Amazing lease supply: once seemed lost but now is found –

High Court decides MBI GST case

WHAT YOU NEED TO KNOW

- The High Court in *Commissioner of Taxation v MBI Properties Pty Ltd* [2014] HCA 49 has unanimously allowed the Commissioner's appeal from the Full Court of the Federal Court of Australia, and has held that, by operation of law, after MBI purchased premises, subject to an existing lease, MBI was making supplies which were neither taxable supplies nor GST-free supplies.
- The decision clarifies the GST treatment of the supply of leased premises made by the acquirer of land that is subject to an existing lease (ie, the new owner is considered to be making leasing supplies for GST purposes, whether taxable or input taxed, notwithstanding that the new owner did not grant the lease).

Background

The *MBI Case* is one of the cases related to the earlier decision of *South Steyne Hotel Pty Ltd v Commissioner of Taxation* [2009] FCAFC 155 (**South Steyne Case**). South Steyne Hotel Pty Ltd (**South Steyne**), the previous owner of the Sebel Manly Beach Hotel complex, strata-titled each of the 83 apartments in the hotel. South Steyne then leased each apartment to Mirvac Management Pty Ltd (**Mirvac Management**) (to be used in a serviced apartment business by that entity). MBI Properties Pty Ltd (**MBI**) acquired three apartments at the hotel from South Steyne, each of which was subject to existing leases from South Steyne to Mirvac Management.

The sale of each individual apartment was held to be a GST-free supply of a going concern, being an enterprise of leasing (see the majority decision of the Full Court in the *South Steyne Case*).

Notably, the Full Court in the *South Steyne Case* held that when MBI purchased the reversionary interest in the three apartments, there was no new supply by MBI to Mirvac Management of leased premises, but merely a continuation of the grant of the existing lease by South Steyne.

Under Division 135 of the GST Act, the recipient of a supply of a going concern has an increasing adjustment for GST, to take into account the proportion (if any) of the supplies that will be made through the going concern that will not be taxable or GST-free supplies.

The Commissioner issued a notice of assessment to MBI, determining that, under Division 135 of the GST Act, MBI had an increasing adjustment (representing 10% of the total purchase price for the three apartments). The Commissioner assessed MBI to GST on the basis of it having an increasing adjustment under section 135-5 of the GST Act. On disallowance of its objection to that decision, MBI appealed to the Federal Court.

Federal Court and Full Court decision

At first instance (covered in our November 2014 Special Indirect Tax Alert), MBI's appeal was dismissed, with Griffiths J accepting the Commissioner's argument that the continuation of the apartment leases resulted in a continuation of an input taxed supply of residential premises by way of lease from South Steyne to Mirvac Management and that was sufficient for Division 135 to apply.

On appeal to the Full Federal Court, the Court allowed the taxpayer's appeal, and held that the only relevant supply occurred, and was completed, on the grant of the leases by South Steyne to Mirvac Management. Therefore, the Court found, there was no input taxed supply which MBI could make. Accordingly, MBI did not have an increasing adjustment for GST under Division 135 of the GST Act.

High Court decision

The High Court unanimously allowed the Commissioner's appeal from the Full Court, finding that MBI was liable to an increasing adjustment for GST under Division 135.

The High Court held that each apartment lease, by operation of law, obliged MBI to give Mirvac Management use and occupation of the apartment throughout the term of the lease in consideration for the periodic payment of rent. MBI's observance of this continuing obligation was properly characterised as a supply of residential premises by way of lease by MBI to Mirvac Management, which was input taxed under section 40-35 of the GST Act.

The High Court also rejected MBI's argument that no increasing adjustment could be calculated in accordance with section 135-5 because the rent paid by Mirvac Management was exclusively the price for the grant of the lease by South Steyne to Mirvac Management and could not also be the price for the supply made by MBI to Mirvac Management. The High Court also held that MBI's intended supply of residential premises by way of lease to MML was for the rent to be paid to MBI by MML in observance of Mirvac Management's continuing obligation under the apartment lease. That is so whether or not that rent can be said also to have been payable in connection with South Steyne's grant of the apartment lease to Mirvac Management.

Implications

The decision provides certainty regarding the following issues:

- The choice of GST treatment of the supply of leased premises:
  - The premises can be supplied as a going concern as there is an enterprise, the operation of which can be continued; and
  - While the premises may be able to be supplied as a GST-free going concern, should it be treated as a GST-free going concern, where the underlying supply of leased premises is an input taxed supply, such that the purchaser of the land will be subject to an increasing adjustment for GST under Division 135?
- The liability for GST on the supply of leased premises that is a taxable supply (eg, a commercial lease), where the premises are sold subject to the lease:
  - The vendor should have comfort that the purchaser will be liable for GST on the supply of leased premises after the sale of the land;
  - Equally, the tenant, to the extent that it makes taxable or GST-free supplies, may be able to claim input tax credits on the GST amount charged by the new landlord on the rent; and
- The new landlord's ability to claim input tax credits in respect of the leasing enterprise it is carrying on.

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