

## Tax Brief

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### First High Court GST case – forfeited deposits taxable but little broader guidance

The first GST case has been decided by the High Court of Australia. By unanimous judgement delivered on 22 May 2008 in *Commissioner of Taxation v Reliance Carpet Co Pty Limited* [2008] HCA 22, the Court found for the Commissioner that GST was payable where a deposit held by a vendor for the sale of commercial property was forfeited.

#### Facts and Decision

The case was relatively straightforward. The taxpayer vendor entered into a contract for the sale of commercial property and the purchaser paid a deposit. The purchaser defaulted. The deposit was forfeited and retained by the vendor. The Commissioner later determined that the vendor was liable for GST of 1/11th of the forfeited deposit.

At first instance, the AAT<sup>1</sup> found in favour of the Commissioner, but this decision was overturned by the Full Federal Court<sup>2</sup> which found that no supply had occurred and subsequently no GST was payable.

The High Court found that the taxpayer vendor made a supply on entering into the contract of creating rights in the purchaser, broadly in respect of completing the sale. These rights are characterised as the supply of an interest in real property as defined for GST purposes (which includes any “contractual right exercisable over” land).

After examining five different purposes or effects of the deposit, it was held to be consideration for the creation of the rights upon entering the contract and GST was therefore payable on its forfeiture, with Division 99 simply providing timing rules.

The Court also confirmed that if the sale contract had completed, there would not have been two taxable supplies (entering into the contract and selling the land). Rather, on completion all payments (the deposit and balance) are consideration for the sale of the land. This ‘multiple supplies’ concern was dealt with early in the judgement where the Court stated:

*The composite expression “a taxable supply” is of critical importance for the creation of liability to GST. In the facts and circumstances of a given case there may be disclosed consecutive acts each of which answers the statutory description of “supply”,*

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<sup>1</sup> [2006] AATA 486

<sup>2</sup> [2007] FCAFC 99

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*but upon examination it may appear that there is no more than one “taxable supply”.*

## Impact of the Decision

While we had hoped that the Court would take the opportunity to analyse in detail the GST concepts of “supply” and “consideration” at length, it did not do so. Rather, the Court limited its analysis to the identification of supplies in the context of a property sale (ie addressed the facts only).

While this might mean that the case provides little guidance for other matters, a number of interesting issues do arise from the Court’s reasoning:

1. Noting *Sterling Guardian*<sup>3</sup>, the Court emphasised that legally GST is a tax on supplies, not on consumption in the manner of the European Union Value Added Tax system<sup>4</sup>.
2. Despite the interesting exchange regarding overseas precedent at the Special Leave hearing<sup>5</sup> European and other VAT/GST jurisdiction cases and approaches were noted but dismissed on the basis that the systems and provisions were readily distinguishable.

These points could be important for interpretation and the utility of foreign case law. While the mechanical similarities between Australian GST and EU VAT are obvious, VAT interpretation must necessarily occur in the context of it being described in the Sixth Directive as a tax on consumption, levied by way of a tax on transactions. In Australia, despite the GST Act’s Explanatory Memorandum and the comments of Justice Hill in *HP Mercantile*<sup>6</sup>, the High court implied that there is no such underlying “consumption” concept to colour interpretation.

3. While lower Courts have been at pains to examine the legislative intent of the GST Act and to treat it as a “practical business tax”, the High Court did not take this approach, at least expressly, and also made no reference to policy or ATO rulings. The provisions were simply addressed on their terms and in the context of the facts, including the legal context (eg the application of the Victorian legislation governing land transfers).
4. A direct connection is not required between supply and consideration.

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<sup>3</sup> *Sterling Guardian Pty Ltd v Commissioner of Taxation* [2006] FCAFC 12; (2006) 149 FCR 255 at 258

<sup>4</sup> Citing Article 2 of the European Community’s First Directive (67/227/EC)

<sup>5</sup> See particularly the discussion by Counsel for the taxpayer of *Société Thermale d’Eugénie-les-Bains v Ministère de l’économie, des Finances et de l’Industrie* [2007] 3 CMLR 1003 at 1019-1020 in the hearing transcripts at [2008] HCATrans 150 (15 April 2008)

<sup>6</sup> [2005] FCAFC 126

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5. While a transaction may be constituted by many supplies (as defined), not all will be taxable supplies, only those for which consideration can be identified.

Some issues were not addressed or arise from the decision:

1. Does Division 99 operate to deem a supply (on the Commissioner's argument before the Full Federal Court, but apparently not argued before the High Court)?
2. If the underlying supply would not have been taxable (eg was a supply of a going concern or of "non-new" residential property), would the rights granted by the vendor on entering into the contract have been taxable on forfeiture of the deposit? The application of section 9-30 (1)(b) and 2(b) should be triggered if the initial "making of the contract" supply amounts to the "supply of a right to receive" the relevant property.

In the long term, perhaps the biggest impact of the decision will be the manner in which the Court went about the business of identifying the supply and the consideration, two fundamental concepts for GST.

It did so simply and efficiently by examining the legal effect of what occurred between the parties and applying the terms of the GST Act to those facts. It did not get caught up in whether a legalistic or purposive approach should be adopted, it just applied the law.

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