



Tax
10 Shelley Street
Sydney NSW 2000

P O Box H67
Australia Square 1213
Australia

ABN: 51 194 660 183
Telephone: +61 2 9335 7000
Facsimile: +61 2 9299 7077
DX: 1056 Sydney
www.kpmg.com.au

Private and confidential
Committee Secretary
Senate Economics Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

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Contact Michael B Evans 02 9455 9315

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Dear Sir

**Submission to Senate Economics Legislation Committee
Reference to Committee of Taxation Laws Amendment (2006 Measures No. 3) Bill
2006 – Schedule 15: GST treatment of residential premises**

This is a submission to the Senate Economics Legislation Committee in relation to the terms of Schedule 15 of the Taxation Laws Amendment (2006 Measures No. 3) Bill 2006 (“the Bill”).

The Bill was referred to the Economics Legislation Committee for inquiry and report by Wednesday 21 June 2006. The Committee has not called for submissions, but the terms of reference of a related Bill state that written submissions will be accepted in written form prior to the date of report.

Because of the short period of time available to the Committee, this submission is limited in its scope and explanation.

Summary

- 1. The proposed amendments should be refused to the extent that the amendments apply to deny business an input tax credit for the cost of providing short-term accommodation (such as shearers quarters) to employees or contractors.**
- 2. The amendment proposed by Item 1 of Schedule 15 should be rejected because it denies input tax credits for costs incurred by employers in providing accommodation in hotels, motels etc. to their employees for the legitimate business purposes of the employer – with retrospective effect from 1 July 2000.**
- 3. In general, the amendments proposed by Schedule 15 of the Bill should be rejected because the principles adopted by the Full Federal Court, which the Bill seeks to overturn, are an accurate and proper construction to be used to determine the**

scope of the input taxed treatment of residential premises. The position enunciated in the Explanatory Memorandum is inconsistent with the Government’s original policy for the GST treatment of residential premises.

Submission

The amendments proposed in the Bill should not be agreed to and Schedule 15 should be deleted from the Bill.

The proposed amendments are not consistent with, nor do they achieve, the changes to the GST law that are described in the Explanatory Memorandum to the Bill. Further, if the amendments are effective in achieving the stated policy, there are significant impacts on business that would seem to be unintended consequences.

Illustration of the flaws in the Bill

The Explanatory Memorandum to Schedule 15 states that the proposed amendments “ensure that following the decision of the Full Federal Court of Australia in *Marana Holdings Pty Ltd v Commissioner of Taxation* [2004] FCAFC 307 (the *Marana* decision) supplies of certain types of real property are input taxed. This confirms the Government’s policy intent.”

In essence, the Bill treats the short-term letting of strata titled units such as serviced apartments or hotel rooms by owners as input taxed (unless the rooms or apartments are supplied by the hotel operator).

We submit that the principles adopted by the Full Federal Court are an accurate and proper construction to be used to determine the scope of the input taxed treatment of residential premises. The situations referred to hereunder illustrate that the position enunciated in the Explanatory Memorandum is inconsistent with the Government’s original policy for the GST treatment of residential premises and that the decision of the Full Federal Court should be left undisturbed.

The proposed amendments seek to give input taxed treatment and hence deny input tax credits in many circumstances where the costs incurred in providing short-term accommodation are incurred for the purpose and benefit of the employer’s business, and not for the private enjoyment of the employee.

The amendments seek to impose GST on business costs – a return to the inefficient and distortionary system of wholesale sales tax that the Government replaced with GST.

The flaws in the Bill may be illustrated by reference to two (2) simple examples:

Example 1

Deborah is an employee of KPMG. She is sent to North Queensland for one week to perform an audit of a KPMG client. Her employer, KPMG, contracts with a local hotel operator for her accommodation and pays the cost.

In this situation, there are 2 supplies being made for GST purposes:

- There is a supply of the hotel accommodation by the hotel to KPMG – that supply is of commercial residential premises and is subject to GST. This is confirmed by the amendment proposed in Item 1 of Schedule 15;
- There is a further supply of the hotel accommodation by KPMG to Deborah – that supply is a supply of residential premises - the accommodation in a single hotel room - but is not the supply of commercial premises because KPMG is not the hotel operator (refer to our comments further below). Moreover, the short-term duration of the supply does not prevent it from being residential premises.

The outcome under this example is that KPMG is denied input tax credits for the costs of providing the accommodation. However, the accommodation is for KPMG's business purposes and is not for Deborah's private consumption.

Example 2

Robert is a shearer. He is required to live in shearers' quarters on his employer's sheep station for the period of the wool clip.

The supply of the accommodation in the shearers' quarters is a supply of residential premises which is input taxed. Robert's employer is denied input tax credits for the costs of constructing, running, repairing and maintaining the shearers' quarters.

The reasoning process which supports the conclusions reached in these two examples is explained further below.

Input tax relief for short-term employee accommodation

As indicated above, this Bill has the effect that an employer is denied input tax credits for costs of providing short-term accommodation for its employees. Short-term employee accommodation is stated to be input taxed, even if no price is charged for that accommodation and the employees are “on site” for the employers purposes. An example of the circumstances where this might apply is the provision of shearers’ quarters. The Explanatory Memorandum gives the following illustration:

“Example 15.2: Employee accommodation

Coalmer Enterprises Ltd provides accommodation for its employees in residential barracks. The employees’ occupation of the barracks is not subject to conditions relating to their terms of employment, such as limitations on personal possessions or a requirement to vacate at the end of a period of duty or a set quota of work. Nevertheless, the barracks are occupied on a short-term basis. These amendments ensure that the supply of the accommodation to the employees remains input taxed.”

This example is most likely to detrimentally impact on companies and partnerships that operate in industries where employees must live on the property to carry out their duties – that is, the companies would be denied input tax credits for the costs of constructing and then maintaining barrack style accommodation. Again, that would be a bizarre outcome given that the purpose or object of providing accommodation in these circumstances is a business input of the business, not private consumption of the employees.

We consider that denial of input tax credits for costs associated with employee accommodation in these circumstances is based on an incorrect interpretation of the GST law and is inconsistent with the principle that business is entitled to input tax relief for its business inputs. However, it seems clear that the proposed amendments are based on the presumption that input tax credits will be denied for costs associated with short-term employee accommodation.

Employee’s hotel accommodation – Item 1 of schedule 15

The proposed amendment, if enacted, will deny GST registered taxpayers (including businesses, governments, charities and religious organisations) input tax credit relief for costs incurred in providing their employees or contactors accommodation in hotels, motels etc. The denial of credits will take effect from 1 July 2000.

Item 1, of Schedule 15 of the Bill proposes an amendment to be made to paragraph 40-35(1)(a) of the *A New Tax System (Goods and Services Tax) Act 1999*.

Paragraph 40-35(1)(a) states that a lease, hire or licence of “residential premises” is input taxed but not if the premises are “commercial residential premises”, such as a hotel.

The main amendments, as discussed above, are intended to secure, *inter alia*, input taxed treatment of the lease of single units of accommodation in the nature of hotel rooms and strata title units, unless supplied as “commercial residential premises”.

If it is accepted that the licence of a single hotel room is a supply of “residential premises” and is not the supply of “commercial residential premises”, the proposed amendment contained in Item 1 inserts a further exception to the input taxed treatment so that full GST will continue to apply to the supply of an individual room by the entity that owns the hotel. The Explanatory Memorandum explains the clause in the following terms:

“15.10 However, supplies of accommodation provided to individuals in commercial residential premises by an entity that owns or controls the premises remain subject to GST in accordance with the existing rules. This means that supplies by an entity that, for example, owns a hotel and supplies accommodation in the hotel to guests, are not input taxed (unless the existing option to input tax long-term commercial accommodation is exercised). An entity that owns or controls commercial residential premises may provide accommodation to an individual such as an employee of company even though the supply of accommodation is made by the entity to the employer company.

15.11 The reference to an entity that ‘controls’ commercial residential premises include an entity that leases the premises from the owner or owners and supplies the accommodation to guests in its own right.”

The effect of the amendments in Schedule 15 is, therefore, intended to give input taxed status to the provision of a hotel room unless it is supplied by the owner or controller of the hotel. The example in the Explanatory Memorandum points out that, without the amendments proposed by Item 1, a hotel operator who, in making a supply of hotel accommodation to a company, provides accommodation in its hotel to an employee of the company, would treat the price paid by the employer as input taxed. The proposed amendment allows full GST to continue to apply. The employer would wish, quite properly, to claim an input tax credit for the supply made to it, being a genuine input to its business operations.

However, as the Explanatory Memorandum states, the purpose of these amendments is to secure input taxed status to supplies of single units of accommodation such as hotel rooms. Accordingly, by providing the accommodation in the hotel to its employee, the company has made an input taxed supply and would not be entitled to an input tax credit for the GST paid to the hotel operator because the costs are incurred in “making an input taxed supply”.

The denial of input tax relief for costs of obtaining and providing employee accommodation seems to be an outcome intended under these amendments.

Conclusion

Our submission is that the proposed amendments should be rejected because the proposed amendments, if enacted in their present form, deny business an input tax credit for the cost of providing:

- short-term accommodation (such as shearers' quarters) to employees or contractors; and
- employees' accommodation in hotels, motels while travelling on work,

even where the purpose or object of the provision of accommodation to the employee is solely for the benefit of the employer.

Both of these will apply with retrospective effect from 1 July 2000.

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We thank you for the opportunity to raise these issues with you. We would be pleased to discuss the issues in further detail or to attend a hearing by your Committee if necessary.

Yours sincerely



Michael B Evans
Partner