



National Community Titles Institute

# Liability of Bodies Corporate to Income Tax and GST

9 August 2008



**NATIONAL  
CONGRESS**

7 - 9 AUG 2008 Darwin NT

# Outline



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- **What is a strata title bodies corporate?**
- **Common property and body corporate assets**
- **Commissioner's view of bodies corporate**
- **Calculation of taxable income**
- **Specific examples and issues**
- **Application of GST**
- **Tax compliance**

# What is a strata title bodies corporate?

- “Body corporate” - an entity created on the establishment of a strata titles scheme, the members of which are the owners of the lots included in the scheme
- Separate legal entity with specified powers, authorities, duties and functions as provided for under the relevant State strata title legislation
- Important to understand differences between the State Acts for purpose of applying income tax and GST laws
- In particular, in respect of ownership of **body corporate assets** and **common property**

# Common property defined

- Common property is that part of a strata plan that does not form any part of a proprietor's lot
  - includes fixtures and fittings comprised in the common property
  - examples include stairways, dining areas, recreational areas, office space, etc
- It is the body corporate's responsibility to administer, control and manage the common property
- Ownership of common property varies amongst the States and Territories

# Ownership of common property

- **In Queensland, Victoria and Western Australia:**
  - Ownership of the common property vests in the **proprietors** of the lots as tenants in common in shares proportionate to their lot entitlements
- **Qld**

Section 35 of the *Body Corporate and Community Management Act 1997*
- **Vic**

Section 28 of the *Subdivision Act 1998*
- **WA**

Section 17 of the *Strata Titles Act 1985*

# Ownership of common property

- **In New South Wales and ACT:**
  - The estate or interest of the body corporate in common property vested in it or acquired by it is held by the **body corporate as agent for proprietors** as tenants in common in proportions equal to their lot entitlements
- **NSW**
  - Section 20 of the *Strata Schemes (Freehold Development) Act 1973*
  - Strata Schemes Management Act 1996*
- **ACT**
  - Section 47 of the *Unit Titles Act 2001*

# Ownership of common property

- **In South Australia, Tasmania and Northern Territory:**
  - Common property is held by the **body corporate in trust for the proprietors** as tenants in common in shares proportional to their unit entitlements
- **SA**
  - Section 10 of the *Strata Titles Act 1988*
- **Tas**
  - Section 10 of the *Strata Titles Act 1998*
- **NT**
  - Section 24 of the *Unit Titles Act*

# Body Corporate Assets

- Body corporate assets are those assets not forming part of common property
- The body corporate has both legal and beneficial ownership of these assets
- Entitled to dispose of or acquire
- Includes depreciable assets not affixed to common property and money

# Funding of body corporate

- Under all State Acts the body corporate is able to charge a levy to proprietors to carry out its functions and duties
- Different State Acts require different types of funds to be established, however, all have a similar purpose
- **Administrative fund** – covers day to day expenses, general maintenance and repair of common property
- **Sinking fund** – longer term fund to cover larger repairs, improvements and replacement of common property
- **Special purpose fund** – may be established for a particular project (eg. large scale renovations), expected future liability

# Income Tax and Bodies Corporate

# The Commissioner's view

- Guidance on body corporate - ATO Ruling IT 2505
  - Requires updating for new State Acts but key principles remain relevant
- Body corporate is:
  - treated as a “public company”
  - not a “non-profit company” (TD 93/73) because able to distribute profits to its members
  - subject to corporate tax at 30%
  - able to frank dividends if “profits” distributed
- “Principle of mutuality” applies

# Principle of mutuality

- “Principle of Mutuality” - generally well-known common law principle providing that “one cannot make a profit out of oneself”
- Applies where participants associate together for a common purpose and make a contribution to a common fund
  - there must be identity as a class between contributors to the fund and participants in the surplus
- Important that the dealing is not one of trading intended to produce a profit

# Principle of mutuality

- Common examples of entities to which mutuality applies include social clubs and motoring organisations receiving membership subscriptions
- Principle of mutuality can apply to a body corporate
  - all proprietors of the strata scheme are members of the body corporate making contributions to a common fund for a common purpose (as specified in the State Acts)
  - only members of the body corporate are entitled to share in any surplus (even if only on winding up)

# Common mutual receipts

- Administrative and sinking fund levies
- Special purpose fund levies
- Rent collection fees payable by a lot owner relating to common property
- Interest derived in respect of late payment of levies

# Common non-mutual receipts

- Interest, dividends and other investment income
- Access fees (where not paid by an owner)
- Rental income from body corporate assets
- Profit on sale of body corporate assets
- Fees arising from transfer of management rights

# Principle of mutuality

- Receipts - analyse to determine whether mutual or non-mutual
  - Is the receipt a contribution by a member to enable the body corporate to carry out its purpose (ie mutual) or is the receipt from an external source or in the nature of a trading receipt (ie non-mutual)?
- Expenditure must be apportioned between mutual (non-deductible) and non-mutual (deductible)
- Income tax return includes:
  - Non-mutual income
  - /less* Wholly non-mutual expenses
  - /less* Deductible apportionable expenses
  - = Taxable Income / (Loss)

# Apportionment of expenses

- Divide expenses between **Mutual**, **Non-Mutual** and **Apportionable**
- **Mutual expenditure** relates wholly to derivation of mutual receipts
  - maintenance fees
- **Non-mutual expenditure** relates solely to assessable income
  - depreciation of body corporate assets (?)
  - include statutory deductions:
    - income tax return and BAS preparation (to extent income tax related) (s25-5 ITAA97)
    - rates and land taxes (s25-75 ITAA97)
    - superannuation (s290-60 ITAA97)
- **Apportionable expenditure** is all remaining expenses
  - body corporate manager's fees, audit fees, bank fees, GST related BAS preparation costs

# Apportionment of expenditure

- Deductible Apportionable Expenses are determined by applying the following formula (para 16 of IT 2505):

Non-mutual income

Total Income                      x      Apportionable Expenditure

- Taxable income = Non-mutual income  
    /less wholly non-mutual expenses  
    /less deductible apportionable expenses

# Taxation of income from common property and body corporate assets per IT 2505

IT 2505	✓ Assessable		✗ Non - assessable		✓ Deductible	✗ Non-deductible
	Income from Body Corporate Assets	Rental income from Common Property	Sale of Body Corporate Assets	Sale of Common Property	Depreciation of Common Property	Depreciation of Body Corporate Assets
Owners as tenants in common (Qld, Vic, WA)	✗	✓	✗	✓	✓	✗
Body Corporate as agent for owners (NSW, ACT)	✗	✓	✗	✓	✓	✗
Owners as beneficiaries (Tas, SA & NT)	✗	✓	✗	✓	✓	✗
Body Corporate as public company	✓	✗	✓	?	✗	✓

# Issues regarding common property

- Commissioner's view regarding treatment of income from common property is covered by IT 2505
  - However, ruling is silent on treatment of gains from disposal of common property
- Issues arise due to:
  - Differing ownership under State Acts
  - Interaction with mutuality principle
  - CGT provisions
- Large number of conflicting private binding rulings
- Case-by-case basis

# Examples

# Example 1: Income from common property

- Body corporate receives annual licence fees for television antennas installed on common property
- Strata scheme is registered in NSW
- Body corporate's interest is held as agent for owners as tenants in common in proportions equal to their lot entitlements
- Licence fees are paid directly into sinking fund

# Example 1: Income from common property

- According to ATO, income of owner
  - In PBR 31324, ATO considered the operation of the *Management Development Act* and *Freehold Development Act* and concluded that the owner was entitled to payments arising from the licence
  - Owner can also “direct” payment to body corporate
    - Section 6-5(4) ITAA97 includes the amount in the owner’s assessable income where income is applied or dealt with on owner’s behalf or as directed
- Not assessable to body corporate, funds held for benefit of proprietors

## Example 2: Sale of common property

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- Unit owners Mr and Mrs X wish to expand and purchase a stairwell leading to the top floor units which they own
- Four units in block of units located in Surfers Paradise
- Stairway is common property

## Example 2: Sale of common property

- Mr and Mrs X are effectively acquiring the remaining 50% interest in the common property (already own 50%)
- Unit holders entitled to proceeds from sale
  - Qld - common property vests in the proprietors of the lots as tenants in common in shares proportionate to their lot entitlements
- Capital gain or loss will arise for ground floor unit holders
- No CGT consequences for body corporate as ownership vested in unit holders

## Example 3: Sale of common property

- Assume same facts as example 2, but the proceeds from disposal are contributed by agreement to the sinking fund and used to improve the building
- Body corporate is a party to the transaction
- Ground floor unit holders subject to CGT?

## Example 3: Sale of common property

- Ground floor unit holders will still be subject to CGT
- Taxation of body corporate?
  - Need to consider nature of contribution and dealing with unit holders
- Principle of mutuality should apply to body corporate as source of funds is not external and identity between contributors and participants remains
- Need to ensure the amount of any contribution relates to the estimated future expenditure / liabilities of the body corporate (*Sydney Water Board Employees' Credit Union Ltd v FCT* (1973) 129 CLR 446)

## Example 4: Sale of common property

- A unit contained in a residential building for use as common property is sold to a third party
- Strata scheme is registered in NSW
- Ownership of common property is vested in the body corporate as agent for proprietors
- Units were constructed after 20 September 1985
- Body corporate listed as vendor on sale of unit

# Example 4: Sale of common property

- Does a capital gain or loss arise? If so, to whom?
  - CGT provisions should apply to individual unit holders
- If funds retained by body corporate, does mutuality apply?
  - possible argument that funds redirected to body corporate by unit holder and hence, mutual if contributed to sinking fund (still taxable to unit holders)
  - Need to closely consider intentions of relevant parties and any agreements entered into
  - Whether purpose of the disposal is to meet future liabilities
- Consider whether contribution deductible to unit holder

# Example 5: Transfer of management rights

- Body corporate receives a “transfer fee” for granting existing manager approval to assign management rights to a new manager
- Manager is also a lot owner
- Does “principle of mutuality” apply?

# Example 5: Transfer of management rights

- Arguably, receipt arose under a commercial transaction with an owner / manager and therefore in the nature of trade
- Manager not acting in capacity as lot owner when making contribution. Therefore, lack of identity between contributors and participators in the fund.
- Result is that the transfer fee assessable to body corporate (ie not mutual)
- Assessable as income or capital gain? Likely to depend on nature of arrangement and whether characteristics such as regularity and recurrence are present

# Specific Issues

- Structures are becoming increasingly complex
- Minimal case law regarding taxation of bodies corporate
- Potential for challenge by ATO
- Focus on dealings with third parties
- Confirm actual ownership of common property prior to any sale
  - For example, whether there has been the transfer of beneficial ownership of common property to the body corporate on registration of new plan converting common property to a lot (*Houghton & Anor v Immer (No.155) Pty Ltd Matter No CA 40764/96 (1997) 44 NSWLR 46*)

# Specific Issues

- Main residence CGT exemption
  - Does not apply where unit holders are taken to dispose of common property as main dwelling is not also being sold (s118-165)
- CGT discount
  - CGT discount available to individuals, trustees and superannuation funds where asset held for at least 12 months
  - Only available in respect of certain CGT events (eg. disposal case CGT event A1)
- **Pre-CGT assets**
  - If body corporate acting as agent, consider whether any gain made by lot owners on sale of common property may be disregarded as pre-CGT gain
  - If lot owners acquired their interest post-CGT
  - ATO may have different view (eg PBR 34526)

# Specific Issues

- Reporting issues
  - Need to have reporting channels in place to inform owners of their income tax obligations
  - Responsibility of body corporate manager?
  - For example, in case of sale of common property owners will require market value information to calculate cost base and share of capital proceeds
  - Similar issues arise in case of income derived from common property. Income may be significant eg. income from mobile phone towers.

# Goods and Services Tax

# GST

- A body corporate is an “entity” for GST purposes
- Taken to carry on an “enterprise” by providing services to members and discharging its responsibilities (MT 2006/1)
- Must register for GST if turnover is \$75,000 or more
  - Consistent with income tax, a body corporate is not a non-profit body and as such does not qualify for the increased threshold of \$150,000
- Levies form part of turnover for determining whether obliged to register. Consideration for supply of common property does not (PBR 76450)

# GST

- If registered, body corporate is liable for GST on levies & contributions
  - Claim ITCs for GST included in maintenance costs, cleaning, etc.
- Disposal of common property by body corporate where held as agent is treated as a joint supply by the individual lot holders, not the body corporate (ATO ID 2004/694; para 15 GSTR 2000/37)
  - Difficult to implement in practice as need to know individual lot holders' status
  - Separately need to confirm whether “taxable” supply
- “Transfer fees” received in respect of management rights are also likely to be a taxable supply on basis that body corporate is releasing manager from a contractual obligation

# GST – recent examples

- Edited PBR authorisation no. 76450
  - Body corporate not registered for GST
  - Common property compulsorily acquired by authority
  - Authority to also pay for disturbance and property adjustments
  - Payment for disturbance and property adjustments is not consideration for a supply (= payment of compensation)
  - Owners of the units are making supply of common property

# GST – recent examples

- Edited PBR authorisation no. 76777
  - Owner of a number of units registered for GST
  - Body corporate entered into contract of sale of part of common property for GST inclusive price
  - Body corporate granted purchaser naming rights of the property for a certain period, price included GST
  - Owner of the units liable for GST for their share of the common area and naming rights
  - GST payable by owner attributable to the tax period(s) in which they became aware that consideration for the supply has been received by the body corporate

# GST – recent examples

- Edited PBR authorisation no. 79863
  - Rulees = individual owners of a number of units
  - Common property vested in body corporate as agent (NSW)
  - Owners agree for common property to be subdivided to create new residential lot, with the result that the legal & beneficial in the lot will vest in body corporate.
  - Body corporate to incur expense of development of residential unit, construction of replacement car park on common property, etc
  - Body corporate to sell the residential unit
  - Creation and transfer of new residential lot not a taxable supply
  - Sale of new unit is a taxable supply by the body corporate
  - Body corporate entitled to apply the margin scheme when calculating the GST payable in relation to the sale (subject to conditions being satisfied)

# Tax compliance

# Tax compliance

- Body corporate required to lodge an income tax return for any year in which it has derived assessable income (TD 93/7)
- Required to lodge a Strata Title Body Corporate tax return except where:
  - net capital gains have been made
  - utilised carry forward tax losses
  - overseas transactions or interests, or
  - needs to make an interposed entity election
- In these “other” cases, company tax return is required

# Tax compliance

- IT 2505 states that any income generated by common property where property held on trust should be included in a Trust tax return (SA, NT, Tas)
- Interesting to note that Body Corporate tax return instructions state that where the body corporate has made a capital gain or loss in respect of common property, the gain or loss must be included in the owner's tax return
- Body corporates are subject to the PAYG system as usual (eg must lodge Activity statements (ie BAS/IAS) and pay instalments)

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