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A background image showing several stacks of gold coins, with some coins scattered around them, all set against a warm, orange-toned background.

GST: GOING CONCERN SALES - SERVICES & MANAGEMENT CONTRACTS TAX UPDATE

The Commissioner recently amended the ATO's public ruling on GST and going concern sales, GSTR 2002/5. As explained below, the amendments confirm that a vendor who is selling a tenanted commercial premises is not required to transfer management or services contracts in order for the GST-free going concern exemption to apply. This should simplify the application of the going concern exemption, as it is no longer necessary for vendors and purchasers to consider whether management and services contracts must be transferred to satisfy the exemption requirements.

1 Why is the amendment to the ruling important?

For GST purposes, the sale of a tenanted commercial premises may be viewed as the supply of a leasing "enterprise". In order for the going concern exemption to apply, such that the sale is GST-free, the vendor must supply to the purchaser "everything necessary for the continued operation" of the leasing enterprise.

Prior to the release of the Commissioner's recent guidance, there was often debate between vendors and purchasers (and their advisers) as to whether one of the "things" necessary for the continued operation of a leasing enterprise is management and services contracts. If such contracts are necessary for the operation of a leasing enterprise, it would mean the vendor must transfer those contracts to the purchaser (via assignment or novation) for the going concern exemption to apply.

However, as a practical matter, the transfer of management and services contracts can be problematic for a number of reasons including the following:

- A management or services contract may apply on a "portfolio wide" basis to a number of properties owned by the vendor (or vendor group). Such contracts may not be capable of assignment or novation in respect of one property only.

- A contract may not be capable of assignment or novation at all (this may be expressly prohibited in the document).
- A contract may require that the manager or service provider consent to any novation or assignment. Such consent could be withheld.
- A contract, and in particular a management contract, may automatically terminate in the event that the commercial premises are sold.

In addition to the above, the purchaser may already have its own preferred manager and / or service providers and hence may not want to take a novation or assignment of any contracts.

The Commissioner's recent amendments to the public ruling should simplify the application of the going concern exemption, as it is no longer necessary to consider whether management or services contracts must be transferred.

2 What are "services contracts"?

The expression "services contracts" is a commercial term used to describe the contracts that an owner of a commercial premises may enter into with various service providers. By way of example, such contracts may relate to:

- Supplies of electricity
- Supplies of telecommunication / internet services
- Advertising and promotional services
- Cleaning services
- Lift maintenance and monitoring
- Plant and equipment maintenance (such as for air-conditioning and escalators)
- Security / alarm monitoring services.

The above is not an exhaustive list and the types of services contracts involved may vary depending on the types of premises being sold. For example, the services contracts relevant to a shopping centre may be different to those required for a warehouse or office tower.

3 What is a "management contract"?

A property management contract is a services contract. However, management contracts are generally regarded as more important than other services contracts. The role of the manager may include, amongst other things:

- identifying and procuring tenants for the premises
- collection of rent and outgoings on behalf of the owner
- ensuring that tenants comply with lease terms (for example, ensuring that retail tenants comply with obligations to upgrade or renew their fit-out periodically)
- attending to queries or issues raised by tenants
- arranging for services to be provided by other contractors

Well known property managers may have their own established brands which can also help to attract tenants and / or customers to the commercial premises.

4 New ATO Example

As a part of the amendments to the public ruling, the Commissioner inserted the following illustrative example at paragraph 107B in GSTR 2002/5.

Example 16A: management and services contracts relating to an enterprise of leasing

107B. As part of a portfolio of real estate assets, SellCo owns a large combined retail shopping centre and office tower known as Black Tower. SellCo is selling Black Tower to AcquireCo subject to all existing tenancies.

107C. SellCo outsources the management of all of its properties to ProManagement under a portfolio wide management agreement. SellCo has also entered into other services contracts with third parties specific to Black Tower only. Among other things, those contracts cover services such as electricity, gas, telephone, internet, lift and escalator maintenance, air-conditioning maintenance, cleaning, security, advertising and centre promotions.

107D. The management agreement with ProManagement cannot be transferred to AcquireCo in respect of Black Tower as it applies to all of SellCo's properties on a portfolio wide basis. Some of the services contracts in relation to Black Tower are due to expire and will not be renewed before settlement. Other services contracts will be assigned or novated to AcquireCo on settlement. However, AcquireCo has its own preferred service contractors for some services so

requires SellCo to terminate those particular services contracts on settlement.

107E. Even though the management agreement and some of the services contracts are not being supplied by SellCo to AcquireCo, SellCo is supplying AcquireCo with all of the things that are necessary for the continued operation of the identified enterprise of leasing Black Tower. This is because the supply of Black Tower subject to the existing leases to the tenants is all that is required for this identified enterprise. Therefore, paragraph 38-325(2)(a) is satisfied and, provided the other requirements of section 38-325 are met, AcquireCo is making a 'supply of a going concern'.

107F. While none of the management or services contracts are necessary for the continued operation of the leasing enterprise, any services contracts that are assigned or novated to AcquireCo are transferred as part of the leasing enterprise, and can also be included as part of the 'supply of a going concern' by AcquireCo.

5 DLA Piper Comments

We agree with the Commissioner's views as set out in the above example. The amendments to GSTR 2002/5 will remove one issue for parties in considering whether the going concern exemption applies.

Nonetheless, the availability of the going concern exemption still requires careful consideration to ensure that all conditions have been satisfied. The issues can be complex and it should not be assumed that the exemption is available until all requirements have been reviewed and considered.

Contracts relating to sales of going concerns should be carefully reviewed to ensure that all GST issues are considered and risks are shared between the parties appropriately.

MORE INFORMATION

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