Real Estate Transactions — GST Inclusive or Exclusive?

by Ashley Lee Si Han

The goods and services tax (“GST”) has been with us since 1 April 2015 and we have seen its impact on various parts of our lives. In theory, it is a relatively straightforward tax regime that can nevertheless prove difficult in practice, especially in relation to GST on real estate transactions.

Since the introduction of GST in Malaysia, the parties to any real estate transactions have inevitably dealt with the insertion of GST clauses in their contracts. Judging from the precedents of GST disputes under real estate transactions in various Commonwealth jurisdictions, it is important to exercise vigilance in relation to all transaction documents by ensuring that you have the right GST clauses which reflect your intention. If you are relying on a standard “one size fits all” GST clause for all real estate transactions, it might contain several loopholes, which can be a costly mistake in the event of a dispute, given the significant financial impact of GST.

Common disputes in real estate transactions

Disputes as to the treatment of GST under real estate transactions are generally between the parties to the contract. The disputes often do not involve the question of whether GST is payable because this is relatively straightforward in real estate transactions.

The more common dispute is who is liable to pay the GST under the contract and whether the price stated in the contract is “inclusive” or “exclusive” of GST. In this article, we will highlight the danger of relying on a standard “one size fits all” GST clause especially found in contracts pre-GST era or in the early days of GST era. Nevertheless, even after many years of having GST, various Commonwealth courts are still dealing with the dispute of whether a contract is inclusive or exclusive of GST.

Goods and Services Tax Act 2014

Section 9(3) states that “tax chargeable on any supply of goods or services is a liability of the person making the supply”. Therefore, in a real estate transaction, the GST chargeable on the taxable supply is the liability of the vendor or developer, being the person making the supply. The vendor or developer has no statutory right to pass on any part of its GST liability to the purchaser. GST is passed on by the vendor or developer to the purchaser pursuant to their contractual relationship. Therefore, the drafting of proper pricing provisions and GST clauses in the transaction documents is highly important to reflect the contractual relationship and intention of the parties.

GST cases from Commonwealth

Case 1: Price quoted is taken to be inclusive of GST if GST is not specified

Kuo Ching Yun & Anor v H & L Investments Holding Pte Ltd (1995) 2 MSTC 7295 (High Court, Singapore)

Facts

1 September 1994: The defendant was given an option to purchase a property by the then owners of the property.

3 October 1994: The defendant exercised this option.

26 October 1994: The defendant gave an option to purchase the same property to one Wang Chen Wing and/or nominee.

7 November 1994: The option given to Wang Chen Wing was exercised by Kuo Ching Yun, the first plaintiff.

12 December 1994: The first plaintiff transferred his rights and interests in the contract to W & N Management Pte Ltd, the second plaintiff.
1 January 1995: The defendant was registered as a GST-registered company.

3 January 1995: The sale of the property was completed by way of a tripartite transfer. The property was transferred to the second plaintiff and GST was paid by the solicitors for the plaintiffs under protest as the defendant disputed their liability to pay GST.

2 February 1995: The plaintiffs filed an application by way of an originating summons for the necessary directions for the return of this sum by the defendant.

The plaintiffs (i.e. purchasers) argued that the price quoted by the defendant (i.e. vendor) for the sale was inclusive of GST for the following reasons:

(a) Section 8(3) of the Goods & Services Tax Act 1993 provides that tax is a liability of the person making the supply, in this case the defendant.

(b) There was no provision in the option between the plaintiffs and the defendant for the plaintiffs to pay the defendant’s GST liability.

(c) Regulation 65(1) of the Goods & Services Tax (General) Regulations 1993 provides that where a vendor quotes a price, then that price is inclusive of GST.

Meanwhile, the defendant raised the following arguments to contend that the liability to pay the GST fell on the second plaintiff:

(a) Section 38(1) and (2) of the Goods & Services Tax Act 1993 impose the obligation to pay GST on the second plaintiff. Further, s 40 implied a term into the contract which imposed the obligation on the second plaintiff.

(b) Alternatively, Condition 12 of the Law Society Conditions of Sale 1994, which formed part of the terms and conditions of the purchase, imposed the obligation on the second plaintiff. The defendant’s argument was that on the date of the contract, the defendant was not registered with the Inland Revenue Authority of Singapore for the purpose of GST. Condition 12 reads:

“The purchaser shall on completion repay to the Vendor the amount of any expenses incurred by the Vendor in complying with any requirement made between the date of contract and completion by any Government Department…”

The defendant argued that the tax authority was a government department and as the defendant was compelled to pay GST to a government department between the date of the contract and the date of completion, Condition 12 made it incumbent on the second plaintiff to reimburse the defendant.

Issue

Whether liability to pay GST lies on the first plaintiff and/or second plaintiff (i.e. purchasers) or the defendant (i.e. vendor).

Decision

The High Court ruled that the plaintiffs were not liable to pay the GST to the defendant and, among others, ordered that the defendant refund or repay to the second plaintiff the sum of S$49,192.06 together with interest from 3 January 1995 to the date of the refund.

The High Court gave the following grounds in support of its decision:

(a) Section 38(1) of the Goods & Services Tax Act 1993 reads:

“Where any person makes any prescribed supply of goods or services to another person and that supply is a taxable supply but not a zero-rated supply, the
prescribed supply shall be treated for the purposes of the First Schedule — ..."

Section 38(5) of the Goods & Services Tax Act 1993 defines “prescribed supply” as:

“For the purposes of this section, ‘prescribed supply’, in relation to goods or services, means such supply of:

(c) goods or services comprising in or related to land or any interest in or right over land,

as may be specified or described in regulations made by the Minister.”

No rules or regulations as to what constitutes “prescribed supply” within s 38(5)(c) appear to have been made yet. Section 38 was a contingent section and has yet to come into effect. In any event, a perusal of the whole of s 38 and particularly s 38(2) indicates that s 38 is an accounting provision.

(b) Section 40 of the Goods & Services Tax Act 1993 provides for adjustments in the terms of a contract on a change in the rate of GST charged. Since the Act came into force, there has been no change in the tax charged. Further, s 40 can only apply, if the contract for the sale of this property had been entered before 1 April 1994, with completion taking place thereafter or if there is a change in the tax rate. As there had been no change in the tax rate and as this contract was not entered before 1 April 1994, s 40 did not apply.

(c) Condition 12 of the Law Society Conditions of Sale 1994 does not support the defendant's submission as GST payment does not fall within the scope of this condition. The term “Government Departments or other local or statutory authorities” refers to government departments such as the Public Works Department. As the property was still in the owner's name between the date of completion and the option to purchase, notices issued by government departments and local or statutory authorities are addressed to the owner requiring the owner to carry out and to pay for these works.

Case 2: GST clause void for uncertainty and declared severable from the contract
Cityrose Trading Pty Ltd v Booth & Anor
[2013] VSC 504 (Victorian Supreme Court, Australia)

Facts

Booth (i.e. purchaser) purchased a piece of property from Cityrose Trading Pty Ltd (i.e. vendor). Kay & Burton Pty Ltd conducted the auction on behalf of Cityrose. The property was passed in at auction. Booth, who had attended the auction, later made an offer of A$2,250,000 for the purchase of the property and Cityrose accepted the offer.

The contract of sale was executed on that basis which included a table which set out the “Particulars of Sale” as follows:

“PURCHASE PRICE: A$2,250,000

DEPOSIT: A$225,000 on the signing hereof

RESIDUE: A$2,025,000”

The contract also included a “Special Condition” relating to GST, which provided as follows:

"7.1 For the purposes of this special condition:

(a) ‘GST’ means GST within the meaning of the GST Act;

(b) ‘GST Act’ means A New Tax System (Goods and Services Tax) Act 1999;

(c) Expressions used in this special condition which are defined in the GST Act have the same meaning as given to them in the GST Act."
7.2 The consideration payable for any taxable supply made under this contract represents the value of the taxable supply for which payment is to be made;

7.3 Where a taxable supply is made under this contract for consideration which represents its value, then the party liable to pay for the taxable supply must also pay at the same time and in the same manner as the value is otherwise payable the amount of any GST payable in respect of the taxable supply.”

The vendor was liable for the GST on the sale of the property. However, the purchaser was not informed until just before settlement that the vendor required payment of an extra A$225,000 in respect of GST under Special Condition 7. Under protest, the purchaser paid the amount on settlement, but it was to be held in trust by the vendor’s solicitors pending the outcome of an earlier tribunal decision (heard before the Victorian Civil and Administrative Tribunal).

Issue

Whether the GST clause required Booth (i.e. purchaser) to pay an extra amount of A$225,000 to Cityrose (i.e. vendor) in respect of GST.

Decision

The Supreme Court found in favour of the purchaser. The court held that the GST special condition was void for uncertainty and should therefore be severed from the contract, which meant that the GST clause did not apply so the purchaser did not have to pay the additional A$225,000 of GST to the vendor. As the law is clear that it is the supplier who should pay any GST payable on a taxable supply, the vendor had to fund the GST liability of A$225,000 out of the A$2.25 million purchase price, which effectively meant that the vendor lost 1/11th of its purchase price.

Justice Emerton in the Supreme Court of Victoria identified the following issues in the GST clause. First, the clause used terms that were defined in the GST legislation and purported to import those definitions into the contract. However, the way in which those terms were used in the GST clause was inconsistent with their statutory definitions. Second, parts of the clause seemed to serve no purpose and were unnecessary. Third, and most importantly, the GST clause did not assist with the question of whether the purchase price of A$2.25 million was inclusive or exclusive of GST.

In her judgment, Justice Emerton states:

“In my view, the language used is so obscure and so incapable of any definite or precise meaning that the Court is unable to attribute to the parties any particular contractual intention. Put another way, the competing constructions are equally ‘open’ (or not) and the Court is unable by legitimate means to divine what the parties should be taken to have intended as to whether Special Condition 7 rendered the purchase price GST-inclusive or GST-exclusive.”

Conclusion

The cases above highlight the danger of a poorly drafted GST clause in real estate transaction documents which increases the risk of a dispute and possibility of financial loss to one of the parties. Contracts should be clear and reflect the parties’ intention — whether the stated price is GST inclusive or exclusive.

About the author

Ashley Lee Si Han (als@lh-ag.com) is a Senior Associate with the Corporate Practice at Lee Hishammuddin Allen & Gledhill, who also works closely with colleagues from the Tax, GST and Customs Practice, led by senior partner Datuk D P Naban (dpn@lh-ag.com). She has wide experience in drafting agreements for purposes of tax compliance, including transfer pricing and cross-border transactions.