

PHOENIXING DEVELOPERS COULD BE THING OF THE PAST

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In the five years to November 2017, AUD1.8 billion of GST revenue was written-off due to phoenixing – where companies are stripped of assets and liquidated, then restarted under a different name leaving creditors out of pocket.

Phoenixing typically occurs where a special-purpose company is established for a residential project and that company does not remit GST on completed sales. At the end of the project the company is stripped of assets and left insolvent. A new company is then established for the next project and the process starts again. Aside from the revenue impact, this creates an uneven playing field between compliant and noncompliant developers.

In response, the federal government has introduced a bill which, if enacted, will require purchasers of new residential premises or residential land to withhold 1/11th of the contract price on settlement for GST applicable sales. The withholding rules commence from July 1, 2018.

The purchaser has two options regarding the withheld GST.

It can be remitted to the ATO on or before settlement. Alternatively, the purchaser may provide the vendor with a bank cheque for that amount at settlement (made out to the commissioner). If the purchaser retains evidence of providing the bank cheque, the purchaser will not be penalised for failing to remit the withheld GST. It is in the vendor's interests to pass the bank cheque to the ATO promptly.

The ATO has identified 3731 individuals who it considers to be actively involved in phoenixing. They controlled more than 12,000 insolvent entities which, over the same five years, claimed AUD1.2 billion in GST credits.

The government announced the measures in the May 2017 budget and Treasury released consultation draft legislation in November 2017. The Property Council submitted that developers with an excellent GST compliance history (both large and small) should be exempt. This could have been achieved by the ATO issuing GST clearance certificates. This has not been adopted and the measures will apply to all developers. All vendors of residential premises, including investors and private home owners, will need to issue a notice to the purchaser advising whether GST withholding applies. Failure to do so is a strict liability offence attracting a maximum penalty of AUD21,000 for individuals and AUD105,000 for companies. Updated sales contracts will likely include an option the vendor can select to indicate whether GST withholding applies and satisfy the new notice requirements. Some developers have expressed concerns about the impact of the measures on the settlement experience for purchasers. This is because they are not prepared to hand over title at settlement if it is unclear whether the withheld GST has first been received by the ATO in cleared funds.

As a practical matter, this should not be an issue if payment can be made to the ATO via PEXA on settlement. Where PEXA is not available, the likely fall back will be for the vendor to require the purchaser to provide a bank cheque on settlement. Other solutions may develop as real time banking becomes more common under the New Payment Platform. The withholding measures will have an adverse impact on future cash flows for developers.

Developers will no longer have the use of the GST component of the purchase price between settlement and their next BAS lodgement. Financiers are also impacted. The withholding effectively provides the ATO with a priority ahead of secured creditors for the GST.

Developers that engage in property development agreements with landowners (involving developing land for a fee based on the sale price of new residential premises or lots) will need to consider the impact on their payment waterfall arrangements. The bill includes complex and extensive transition provisions for existing PDAs, but these may not apply in all circumstances. Reasonable minds will differ as to whether GST withholding is the best solution to address phoenixing. Critics argue that if the ATO knows the individuals who are the controlling minds, those individuals should be pursued directly. Such debates aside, the bill is significantly better for the consultations that occurred late last year. It includes reasonably practical options for most of the issues that arose, which is a credit to all involved.

There will of course be some complex issues on the fringes. However, after an initial period of adjustment, GST withholding should quickly form a part of normal residential conveyancing practice in most cases.

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