RESIDENTIAL DEVELOPMENTS: PURCHASERS TO PAY GST TO ATO AFTER 1 JULY 2018

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Australia Tax Alert

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Treasury has released consultation draft legislation on GST for sales of "new residential premises" and "potential residential land" (subdivided residential lots).

As explained in detail further below, if enacted, the proposed laws will require purchasers of new residential premises and potential residential land to withhold 1/11th of the purchase price as GST (including for margin scheme sales). That withheld amount must be paid to the ATO on settlement.

The consultation period is only two weeks, with any comments required to be provided to Treasury by Monday, 20 November 2017.

WHAT IS DRIVING THIS CHANGE?

The Government wants to prevent the loss of GST revenue to "phoenix" operators.

At its most simple, a phoenix arrangement involves a new company that is established to undertake a specific residential development project. During the development phase the company will claim GST refunds for land purchase and development costs. On completion, the company will sell the new residential premises or residential lots, which is a taxable supply and subject to GST. However, in a phoenix arrangement the company will not remit the GST to the ATO and instead distributes all proceeds to another company or related parties.

By the time the ATO issues assessments for the unpaid GST, it is often too late. The company has no assets and it may be in the process of being wound up.

In the absence of the proposed reforms, the Budget Papers estimate lost GST from phoenix activities will be AUD660 million over the next three years.

The new measures are intended to beat phoenix operators by requiring purchasers to withhold GST from the purchase price and to pay this amount directly to the ATO.

WHEN WILL THE NEW MEASURES START?

The proposed start date is 1 July 2018.

For contracts signed prior to that date, the new measures will not apply if the purchase price is paid before 1 July 2020. This effectively provides a two year transition window for current off-the-plan sales.

It should be noted that all contracts which complete after 1 July 2020 will be caught, even if the contract is entered before 1 July 2018. This will be relevant for off-the-plan sales that are not expected to complete for another 2.5 years or more.

IS THERE ARE ANY EXEMPTION FOR DEVELOPERS WITH A GOOD GST COMPLIANCE HISTORY?

No. The current draft legislation applies to all developers selling new residential premises or potential residential land.

It is arguable that developers with a good compliance history should be exempt from the withholding measures. One way to achieve this could be through the ATO issuing a GST "clearance certificate" to exempt developers. The clearance certificate could be provided to the purchaser ahead of settlement to make it clear that GST withholding does not apply.

VENDORS MUST ISSUE A NOTICE TO PURCHASERS

The draft legislation requires vendors to issue a notice to purchasers at least 14 days prior to settlement advising whether the purchaser must withhold. If withholding is required, the notice must include details about the vendor (name and ABN), the amount to be withheld and the date the amount must be paid to the ATO.

It is presently unclear whether a vendor must issue a notice in relation to any residential sale, or whether a notice is only required for a taxable supply of new residential premises. The explanatory memorandum suggests that all vendors of residential premises must issue a notice, but this is not reflected in the wording of the relevant provisions in the draft legislation. It is expected that this will be clarified when the final form of the legislation is released.

Failure to issue the notice is a strict liability offence. The applicable penalty is 100 units (at AUD210 per unit = AUD21,000). This applies per notice (i.e. per contract).

It is a defence if the vendor honestly and reasonably believed the property being sold was not a "new residential premises".

It is expected that most developers will look to include the required notice in the contract for sale.

PURCHASERS MUST ISSUE A NOTICE TO THE ATO TWICE

The draft legislation states that if a purchaser is required to withhold GST, the ATO must be notified of this at least five days prior to the withholding payment (i.e. at least five days prior to settlement).

The ATO must also be notified a second time on the settlement date when the withheld amount is paid.

Ultimately it will be a purchaser's responsibility to determine if withholding applies, and if so, the amount to be withheld. However, if the purchaser does not receive any notice advising that withholding applies, or relies on a notice stating that withholding is not required, this will be a factor that is take into account in determining whether any penalties should apply for failure to make the required notifications and any failure to withhold.

HOW DOES THE WITHHOLDING WORK FOR MARGIN SCHEME SALES?

A developer may have a reduced GST liability if the "margin scheme" applies to the sale of a new residential premises or residential lot.

Regardless, the purchaser will be required to withhold and remit 1/11th of the purchase price to the ATO. This avoids the need for the developer to disclose its margin to the purchaser.

Of course, this also means that GST will be overpaid on margin scheme sales. This will have a cash flow impact on developers.

Developers will need to recover the overpayment directly from the ATO. For developers that account for GST on a monthly basis, this will be done via the developer's next monthly GST return (BAS).

For developers that have quarterly tax periods, the developer will have the option to apply to the ATO for a refund prior to lodging their next quarterly GST return. This proposed refund mechanism is new and an attempt to reduce the cash flow impact of the proposed measures.

WILL THE VENDOR STILL HAVE TO REPORT A GST LIABILITY ON THE SALE?

Yes, under the proposed arrangements the developer will still be required to report a GST liability in its GST return (BAS) for the relevant sale. However, the developer will be entitled to a credit for the GST that has been withheld and remitted to the ATO on the developer's behalf.

Excluding any minor discrepancies (for example, in relation to settlement adjustments), the GST liability and credit should generally net out to nil in the same GST return.

HOW DOES THE WITHHOLDING WORK FOR INSTALMENT CONTRACTS?

Where withholding applies, the purchaser's withholding obligation is triggered on payment of the first part of the purchase price, excluding the deposit. Where the purchase price is payable in instalments, this means the GST on the total purchase price must be withheld from the first instalment.

For example, assume a property is sold for AUD11 million, including GST of AUD1 million. The purchaser will pay a deposit of AUD1 million on exchange, with the balance of the purchase price being paid in two instalments of AUD5 million six months apart.

The payment of the deposit will not trigger any GST withholding. However, the payment of the first instalment of AUD5 million will trigger GST withholding on the total purchase price. That is, the purchaser will be required to withhold AUD1 million from the AUD5 million instalment payment. No further GST would need to be withheld

when the deposit is released and the final instalment paid.

DOES THE WITHHOLDING APPLY TO THE CONTRACT PRICE OR THE ADJUSTED PURCHASE PRICE?

It is common for the contract price to be adjusted on settlement to take into account amounts such as land tax, water rates and council rates.

Under the draft legislation, the withholding will be applied to the adjusted purchase price. This may raise practical difficulties if the total of all settlement adjustments is not known when the vendor is required to issue a notice to the purchaser (at least 14 days prior to settlement).

This is an issue that will be raised in consultation and the requirements in the final legislation may be different.

WHAT IS THE IMPACT ON BANKS AND OTHER PROPERTY FINANCIERS?

Secured lenders who finance residential developments take security over the property and rank ahead of unsecured creditors, including the ATO.

If a development project is underperforming, secured creditors may be entitled to all of the proceeds received by the developer, including the GST component of the purchase price. If the proposed measures are enacted, the ATO will instead receive GST payments ahead of secured creditors.

To illustrate, assume a developer sells a new apartment for AUD550,000, including GST of AUD50,000. Presently a bank may be entitled to 100% of those proceeds, being the full AUD550,000. If the developer has no other funds, the ATO may miss out on the GST.

Under the proposed measures the AUD50,000 of GST will be paid by the purchaser directly to the ATO. The developer will only receive the net proceeds of AUD500,000. Those net proceeds may be all that the bank can recover from the developer. Accordingly it would be the bank, not the ATO, who misses out on the AUD50,000 of GST in this example.

PROPERTY DEVELOPMENT AGREEMENTS (PDAS)

The draft legislation includes provisions which are intended to provide some transitional relief in the context of PDAs.

PDAs are arrangements whereby a landowner pays a developer for undertaking a residential development on the landowner's property. The developer is paid from the proceeds that the landowner receives on the sale of the new premises / lots (as the case may be).

Typically PDAs involve complex payment distribution arrangements (often referred to as a "payment waterfall").

Ideally PDAs entered into prior to 1 July 2018 (or some earlier date) would not be subject to the proposed measures, so that any existing payment waterfall arrangements are not disturbed. The proposed transition measures for PDAs do not currently go this far.

ELECTRONIC SETTLEMENTS

Vendors will want certainty that any withheld GST has in fact been remitted to the ATO by the purchaser. Conversely, purchasers will want the new arrangements to occur painlessly with the funds simply flowing to the required party (developer and ATO) on settlement.

These are additional reasons why electronic settlement solutions such as PEXA will be increasingly important going forward.

CONSULTATION ONGOING

As noted above, submissions can be made to Treasury on the reform proposal through to Monday, 20 November 2017.

Interested parties, including the Property Council of Australia, are expected to make submissions on a number of key issues, including continuing to push for exemptions for developers with an excellent GST compliance history.

Once the legislation is finalised, developers will need to have updated contracts and systems in place to ensure compliance from 1 July 2018.

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