

GST on sale of residential property

By David Nicholson

On 29 March 2018, amendments were made to the Taxation Administration Act 1953 (TA Act) with related minor amendments to the A New Tax System (Goods and Services Tax) Act 1999 (GST Act) aimed at altering the mechanism and process for the collection of GST in the supply of new residential premises and subdivision of potential residential land. The amendments shift the burden for GST payment from the suppliers to the purchasers of such land transactions and will take effect as of 1 July 2018. The introduction of the new regime is the Federal Government's response to the growing problem of tax evasion by businesses in the property development industry referred to as 'phoenixing'. Whilst the Government's action to stop phoenixing has been commended, many in the industry have questioned whether the industry wide amendments are the best way to punish those particular suppliers engaging in phoenixing activity. There is also growing concern regarding the implementation of the new regime and what consequences will be felt not just by those engaging in phoenixing, but by innocent suppliers, purchasers and all those involved in the sale and purchase of real property.

The Problem - 'Phoenixing'

The proposed changes to the GST law were set out in the Treasury Laws Amendment (1018) Measures No. 1) Bill 2018 and tabled at Parliament on 7 February 2018. In the explanatory memorandum, the Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP explained that under the current GST law, the purchaser pays the GST as part of the purchase price to the supplier who is then responsible for remitting the GST to the ATO through their next Business Activity Statement (BAS). As there is often a time lag of up to three months between when the payment is received by the supplier and remitted to the ATO, some suppliers were exploiting the time lag by dissolving their company and transferring the assets to a new entity prior to the GST component of the purchase price being remitted to the ATO. As an unsecured creditor, the ATO is unable to recover the GST owed because the company carrying the GST liability has been stripped of all its assets. This type of tax evasion by suppliers is known as 'phoenixing'.

Phoenixing has grown significantly over the last decade with the ATO recording 3,731 individuals actively involving in phoenixing over the last five years as at November 2017. These individuals controlled over 12,000 insolvent entities responsible for over 1.8 billion in debt written off and 1.2 billion claimed in GST credits between 2013 and 2017. The ATO has tried implementing a number of strategies in an attempt to fight phoenixing, however these have been ineffective and often highly intrusive, costly and labour intensive.

New Regime

From 1 July 2018, where a supplier makes a taxable supply by way of sale or long term lease (being a lease of fifty years or more) of new residential premises or subdivision of potential residential land, the purchaser of such a supply will be required to withhold the GST portion of the purchase price and remit the GST directly to the ATO prior to or at the time consideration (other than the deposit) is first provided, which will often be at settlement. By placing the obligation on the purchaser to remit the GST component of the purchase price directly to the ATO, the time lag will be removed and the supplier will not receive the GST from the purchaser which is expected to eliminate the ability for suppliers to engage in phoenixing.

‘New residential premises’ for the purpose of the new regime will be residential premises which have not previously been sold as residential premises. It does not include commercial residential premises or premises that are “new” as a result of substantial renovations of a building nor residential premises that are both ‘new residential premises’ and ‘commercial residential premises’.

The term ‘potential residential land’ is defined in section 195-1 of the GST Act and means land that is permissible to use for residential purposes but does not contain any buildings that are residential premises. The definition includes land that has been zoned for residential use but does not currently contain any residential premises as well as house and land packages where there is a taxable supply of a vacant block of land which is the subject of a property subdivision plan.

Within the Local Government context, what is considered a ‘taxable supply’ can sometimes be hard to determine. For example, in the instance of an acquisition, the level of the supplier’s participation in the acquisition will determine whether the transaction is a taxable supply and therefore subject to the GST withholding or not. If the landowner takes a positive action, such as giving notice that the acquisition is necessary due for example to the local government’s continued use of the land, the landowner is considered to be making a supply and the transaction is subject to GST withholding which will be payable by the local government. However, if the landowner takes a passive role, the supply is generally not considered to be a taxable supply and the local government will not be required to remit any part of the compensation payable to the ATO for GST purposes. Local governments will therefore need to take extra care in determining whether each land acquisition is subject to the new regime or not in order to avoid potential penalisation by the ATO.

Transitional Period

As part of the new regime, the ATO have included a transitional period of two years for contracts entered into before 1 July 2018 where consideration is first provided before 1 July 2020. These pre-existing contracts will not be subject to the GST withholding obligation. However, parties to these contracts need to be cautious as if there is a circumstance which results in the first payment of consideration being delayed past 1 July 2020, the transitional exception will not apply and the purchaser will be required to withhold GST and remit the withholding to the ATO before or on the same date as the first consideration is paid.

Supplier's Obligations

Under the new regime, the supplier still remains liable for the GST payment, but the obligation to make the payment to the ATO falls on the purchaser. However, suppliers must not make a supply of residential premises or potential residential land to another entity before giving notice to the purchaser as to whether GST withholding will apply to the transaction.

If the supply is not subject to GST withholding, a simple notice from the supplier to the purchaser will suffice advising that GST withholding does not apply. If the GST withholding is applicable however, the notice requirements are more particular. Where GST withholding is required, the supplier's notice must include:

- (a) The name and ABN of the supplier;
- (b) The amount the purchaser will be required to withhold and pay to the ATO;
- (c) When the purchaser is required to pay that amount;
- (d) The GST inclusive market value of any non-monetary considerations; and
- (e) Any other matters specified in the Regulations.

A failure by the supplier to provide notice can result in penalties being imposed by the ATO. These penalties and the relevant defences are discussed later in the article.

Purchaser's Obligations

Once the purchaser receives the required notice from the supplier, the purchaser must notify the ATO of the transaction through the submission of a 'Form 1 - GST Property Settlement Withholding Notification'. The Form 1 is completed and lodged online to the ATO prior to settlement. The Form 1 advises the ATO of the transaction's particulars such as the parties involved and the expected settlement date. Once the Form 1 has been lodged, the ATO will supply the purchaser with a Payment Reference number (PRN) and Lodgement Reference Number (LRN). The purchaser must ensure that they make a record of the PRN and LRN as both are required when submitting the 'Form 2 - GST Property Settlement Date Confirmation'. The Form 2 is to be completed and submitted to the ATO by the purchaser on or before settlement. If the settlement does not proceed, there is no obligation on the purchaser to complete the Form 2 or pay the GST withholding.

If the purchaser does not receive notice from the supplier or receives notice that states GST withholding does not apply to the transaction, but has reason to believe the transaction is subject to the GST withholding obligation, the purchaser can make unilateral payment to the ATO.

The purchaser will not be penalised by the Commissioner if it makes a unilateral payment when GST withholding did not apply. However, purchasers considering unilateral payment must be wary as it could result in other forms of penalisation such as a contractual dispute between the parties. Whilst the supplier can apply to the ATO for a refund of the GST incorrectly paid by the purchaser, the provision of the refund by the ATO is not guaranteed and the supplier may experience

cash flow issues and delays as a result, which could lead to a contractual claim for damages against the purchaser.

Making Payment to the ATO

Generally, the amount of GST to be remitted to the ATO will be 1/11th of the contract price or price of supply. The payment can be made directly to the ATO on or before the day of settlement. As this may be difficult in practice, the new regime allows for the purchaser to present a bank cheque to the supplier at settlement made payable to the Commission of Taxation for the GST withholding amount. The purchaser will be protected from penalties associated with late payment in the instance the supplier does not provide the cheque to the ATO on the day of settlement as the cheque has been provided by the purchaser and the exchange recorded.

Despite the Hon Kelly O'Dwyer MP's representations that the Government had worked closely with property developers, lawyers, conveyancers and financiers to develop the new regime, there is no availability for payment to be made to the ATO through a trust cheque. At a recent seminar hosted by the Law Society, several lawyers and conveyancers criticised this omission and there are hopes there will be a further amendment passed to allow for the use of trust cheques.

The introduction of PEXA is predicted to simplify the payment process for the GST withholding and eliminate the requirement for purchasers to hand over a bank cheque at settlement and place their trust in the supplier to remit that cheque to the ATO. PEXA is an online conveyancing portal which will be compulsory for all eligible settlements in Western Australia from 1 December 2018. The purchaser would deposit the entire purchase price to PEXA and, through PEXA's portal's financial settlement facility, 1/11th of the purchase price would be remitted to the ATO with the remainder of the purchase price being remitted to the supplier. PEXA will therefore increase transparency as all parties can view the transaction and have complete visibility and assurance that the payment has been made.

Penalties and Defences

Where a supplier fails to give notice, makes misrepresentations or omits required information in its notice, the supplier has committed a strict liability offence, which means it is not necessary for fault to be established. The maximum penalty for such an offence under the new regime is 100 penalty units which currently equates to \$21,000.

A purchaser who fails to make a payment will be liable to pay the ATO for a penalty in the amount of GST withholding owed plus the general interest charged on the unpaid GST withholding. As previously mentioned, the purchaser may also be liable to other contractual penalties.

There is a defence available to the purchaser in instances where the purchaser was given notice by the supplier advising GST withholding did not apply to the transaction and at the time the first consideration was paid on the contract, there was nothing that made it unreasonable for the purchaser to rely on the representation made by the supplier. The purchaser is

not required to make any additional inquiries about the premises and can rely on the notice provided by the supplier unless information available contradicts or calls into question the validity of the representations. However, at this point it is unclear what the standard of reasonableness will be. If the test is applied to the purchaser's agent it may be harder for this defence to be relied upon as the agent will have a more sophisticated knowledge and expertise in settlements and therefore be held to a higher standard in regard to whether it was reasonable for the agent to rely on the supplier's representation or not.

Consequences of the new regime: What does the future hold?

After the amendments' second reading in parliament, several senators were critical of the way in which the regime tackles the issue of phoenixing. Senator David Leyonhjelm opined that the bill had been rushed and will lead to unintended consequences that will place a greater burden on consumers and developers. He further emphasised that the bill was an extraordinary overreaction to the rare event that is phoenixing and was the equivalent of using a sledgehammer to crack a nut. Many senators were also disapproving of the fact that the bill was taking the responsibility for GST payment away from the suppliers and burdening the purchasers when the burden should remain with the suppliers.

The question has been raised, and validly so, as to why all suppliers were being targeted by the new regime instead of the 3,731 individuals known to the ATO to be engaging in phoenixing activity. Both Senator Doug Cameron and Murray Watt questioned why the introduction of director identification numbers was not being considered by the Government. Each director would be registered with an identification number which would go a long way in assisting regulatory authorities keep tabs on directors doing the wrong thing rather than all suppliers being targeted.

The ATO has suggested that the new regime will reduce complexity and regulatory burden for industry and substantially reduce the administrative costs in ensuring compliance with the law. However, the reduction in administrative costs and complexity may not filter down to suppliers and purchasers. Suppliers will likely experience additional administrative complexity in regard to their BAS and GST credits and all suppliers will suffer the cash flow issue of no longer being able to hold onto the GST component until remittance to the ATO. Purchasers will also suffer administrative burden due to them being responsible for the lodgement of the Form 1 and Form 2 and the payment of the GST withholding.

Whilst the consequences of the new regime are not yet known, what is clear is that amendments will need to be made to the standard Contract of Sale used in each State or Territory to address the changes to the settlement process, timing and obligations of each party.

Purchasers will likely require contracts to include warranties from the vendors as to whether the transaction is subject to GST withholding and the inclusion of the right for the purchaser to subtract the GST component from the purchase price. Purchasers may also experience increased conveyancing costs due to the additional requirements and burden on the

purchaser. Consequently, lawyers and conveyancers will need to educate themselves on the new regime and amend their procedures and documentation accordingly.

Unfortunately, the new regime offers no exemption measure for those suppliers who are at low risk of engaging in phoenixing activity or other forms of GST avoidance. One such body that would be an obvious choice are government entities such as local governments. The new regime only offers limited scope for such an exemption to be made in the form of the Commissioner's discretion to determine, by legislative instrument, that the obligation to pay the GST withholding or give notice does not apply in circumstances that are not intended. For instance, in cases where the State is the supplier of the new residential premises, it is appropriate that there be some flexibility in the new regime so that the withholding is not applied inappropriately if the laws and rules regarding the supply of the State's land are amended.

Whilst the new regime will no doubt substantially decrease the amount of phoenixing activity in the industry, it effectively punishes those who have never engaged in, nor intended to engage in, phoenixing. It burdens and adds administrative complexity to the purchasers, conveyancers, lawyers and suppliers and has therefore been criticised for simplifying the GST collection mechanism for the ATO but complicating it for everyone else. With the introduction of PEXA, the new regime may become more easily integrated into the settlement process and the effect of many of the abovementioned issues will hopefully be lessened. However, the real consequences of the new regime are yet to be determined and all we can do is hope the ATO's sledgehammer does not crack more than the intended nut.

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