



## Tax Insights

### GST withholding obligation for residential property purchasers

#### Snapshot

On 7 February 2018 proposed amendments in relation to the payment of GST on sales of new residential property were introduced into Parliament.

In broad terms, the amendments will require purchasers of affected new residential premises or residential land in new subdivisions to withhold on account of GST and pay it to the ATO as part of the settlement process (i.e. usually 1/11<sup>th</sup> of the contract price, or 7% of the contract price if the margin scheme is used to calculate GST).

Requiring payment of the GST in this way will alter current arrangements under which vendors receive the full purchase price at settlement and are then required to later remit the GST component to the ATO when their next business activity statement (BAS) is due.

This will have short-term funding implications for vendors of affected new residential premises or residential land and will impact financiers and developers entering into development agreements with property owners (where the developer fee is calculated on the amount received by the vendor).

The measure was announced in the 2017-18 Budget. Subject to the passage of the amendments through Parliament in a timely way, the measure is intended to come into effect on 1 July 2018.

The amendments mainly alter the Taxation Administration Act 1953, with only minor amendments to the main GST law (i.e. A New Tax System (Goods and Services Tax) Act 1999).

### **Anti-phoenixing impetus but no exemption for low-risk property developers**

The Government announced the measure to address serious and ongoing non-compliance by 'phoenix operators' in the property development sector (i.e. persons establishing a new business to undertake a development, making sales for a price inclusive of their GST liability but then dissolving the business before their next BAS lodgement to avoid remitting the GST to the Australian Taxation Office).

Significantly, and despite submissions made by the property industry and advisors, the amendments provide no exemption from the measure for vendors that are low risk of undertaking phoenixing activity or otherwise failing to account for their GST liabilities – including for example, ASX-listed groups, government entities, or other taxpayers with a solid GST compliance history.

The loss of access to the GST component of property sales income between settlement and lodgement of the next BAS (potentially a period of several weeks, or in some cases several months) is expected to result in adverse cash-flow implications for many of these taxpayers.

There have been anecdotal suggestions these cash-flow changes could have flow-on impact for developers' financing arrangements (and may influence factors such as the amount financiers are willing to lend to fund developments).

### **Changes made to exposure draft legislation**

Treasury released exposure draft legislation in November 2017 (details are set out in our Tax@Hand article '[GST: New rules for residential properties](#)'). Following consultation with the property industry and other stakeholders, several changes have been made. Key changes evident in the amendments introduced on 7 February include the following:

#### **7% margin scheme withholding rate**

If the margin scheme is used to calculate the vendor's GST liability, a lower, 7% rate of withholding will ordinarily apply (although there is facility in the law for the Minister to make a determination to alter this rate to between 7% and 9%). With a reduced rate of withholding for margin scheme sales, the initial proposal to provide rapid refund arrangements for taxpayers making margin scheme sales is not proceeding.

## **Commercial residential premises and 'substantial renovation' properties excluded**

The proposed amendments clarify that the GST withholding rules will not apply to a supply of commercial residential premises (e.g. a hotel, hostel, school boarding accommodation, etc.) or new residential premises that have been created through 'substantial renovations' of a building (i.e. where all or substantially all of a building is removed or replaced, though not necessarily including removal or replacement of foundations, external walls, floors, roofing, staircases, etc.). This will welcomed by taxpayers developing properties of this kind, and avoid potential disputation about whether the extent of a renovation development is 'substantial' or not.

## **'Contract price' basis for calculating GST withholding**

To enhance the certainty for vendors and purchasers, the amendments clarify that the GST withholding amount is ordinarily to be calculated using the 'contract price' (i.e. without taking into account the normal adjustments that are commonly made for the purposes of settlement, e.g. adjustments for council rates, utilities, etc.). This will make the GST withholding calculation straightforward at settlement, but vendors will face the task of correcting their actual GST liability for transactions that involved such settlement adjustments when lodging their next BAS.

## **Notice requirements - vendors**

The requirement on vendors to notify a purchaser whether or not the supply of real property gives rise to a GST withholding obligation for the purchaser has been modified in respect of timing. The initial proposal that this notice must be provided at least 14 days before the supply (i.e. settlement) has been changed to a requirement to notify the purchaser at any time prior to settlement. However, there will likely be changes to the *pro forma* land sale contracts used in the various Australian States and Territories to place more prescriptive requirements around the timing of vendor notification. Further, exclusions to the requirement to notify purchasers have been added in relation to supplies of commercial residential premises and supplies of land in residential subdivisions that are made to a registered purchaser acquiring the land for a creditable purpose (e.g. to construct and sell new housing). Although not a change to the previous draft, it is important to be aware these notice requirements apply irrespective of whether the supply of the property is subject to GST, or whether the vendor is GST registered (or required to be registered). Penalties for failing to provide notice about whether GST withholding is required or not are potentially substantial: up to AU105,000 per failure for incorporated vendors; up to AU21,000 for other vendors.

## **Notice requirements – purchasers**

The proposed amendments do not include the earlier proposal that purchasers be required to provide the ATO with at least five days' notice ahead of a GST withholding payment being made.

## **Purchasers failing to withhold GST**

Under the proposed amendments, purchasers who fail to meet a GST withholding payment requirement will potentially only face an administrative penalty (i.e. criminal penalty will not apply). Purchasers will be protected from penalty for non-payment in circumstances where they relied on a 'no GST withholding requirement' notice from the vendor that

was incorrect and nothing made it unreasonable for the vendor to rely on that notice.

### **Timely GST withholding payment to ATO satisfied by bank cheque at settlement**

In practice, it is likely to be difficult for some purchasers and their conveyancers to make an actual GST withholding payment to the ATO on or before the day of settlement. The proposed amendments recognise this by relieving purchasers from penalty for late payment in circumstances where a purchaser provides to the vendor, at or before settlement, a bank cheque payable to the Commissioner of Taxation for an amount equal to the purchaser's GST withholding obligation.

### **Transitional arrangements**

The exposure draft legislation released by Treasury in November 2017 included transitional measures in relation to existing contracts of sale and existing property development arrangements (i.e. in both cases, those entered into before 1 July 2018).

The proposed amendments introduced into Parliament also include transitional measures for existing contracts of sale and existing property development arrangements, although in somewhat changed terms.

Existing contracts of sale will be subject to a two-year transition period. Contracts entered into before 1 July 2018 will not be affected by the new rules if "consideration for the supply" (other than the deposit) is first provided before 1 July 2020. The proposed amendments make no reference to the timing of settlement however, arguably raising the prospect in relation to supplies for which some but not all of the consideration (other than the deposit) is provided before 1 July 2020 but settlement (and presumably payment of the balance of the consideration) occurs on or after that date.

In relation to existing property development arrangements, the proposed amendments seek to modify the contractual arrangements agreed to by the parties to the extent that the agreed distribution or 'waterfall' payment arrangement would be altered as a result of GST withholding obligations arising for purchasers. The intent is to ensure that the parties to existing property development arrangements are neither advantaged nor disadvantaged due to purchaser withholding obligations in circumstances where each of the following four requirements are met:

1. The arrangement was entered into before 1 July 2018 between an entity making a taxable supply of real property affected by the proposed amendments and one or more entities at least one of which supplies development services in relation to the real property, and the arrangement deals with the distribution between the parties of the consideration for the real property supplied.
2. The arrangement requires either that an amount must be distributed to the entity making the supply of the real property for the payment of that entity's GST liability in respect of the supply (taking into account any relevant entitlement to input tax credits), or that distributions of the consideration, between the parties, must be adjusted to take account of the supplier's GST liability.
3. Distributions under the arrangement made when a purchaser has withheld a GST amount, would result in the parties being in a

different position than would be the case if there had been no withholding obligation.

4. A withholding payment has been made to the ATO by the purchaser in relation to the taxable supply.

### **Deloitte observations**

The proposed amendments, following the exposure draft legislation, are likely to be most welcomed by purchasers and by businesses providing property conveyancing services. The changes made should assist the ease and practicality of requiring purchasers, most of whom will be private home buyers, to be responsible for paying the vendor's GST liability to the ATO.

That said, property developers will continue to face the complex task of dealing with the cash flow and administrative impacts of both existing property development agreements and new agreements in the future. The new regime does not impact the usual GST reporting process and adds additional administrative complexity of identifying 'credits' processed by the ATO (i.e. withholding payments made to the ATO by purchasers) when lodging each BAS, to ensure that tax liabilities are met.

Entities financing property development activity will also need to consider the potential ramifications of the proposed amendments. As things presently stand, when a property developer goes into liquidation, the Commissioner is an unsecured creditor in relation to any unpaid GST liabilities, and will commonly be unsuccessful in recovering those liabilities in full. An issue to be resolved is the impact of the withholding requirement where there are lenders and other secured creditors involved with property development projects.

Finally, it is interesting to note an observation in the Regulation Impact Statement accompanying the proposed amendments, suggesting that the Government may explore extending the GST withholding measure to business to business commercial premises transactions in the future.

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