

Article Information

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Government Targets “Phoenix Operators” with Direct GST Payment

To close the gap on “phoenix operators” and property developers that do not remit GST to the ATO following the completion and sale of their property development, the Federal Government has announced that it will implement a measure which will require purchasers to pay GST directly to the ATO. Senior Associate, Adam Rinaldi looks at the issues associated with the implementation of this measure and summarises the potential impact that other measures announced in the Budget will likely have on property related transactions and the property industry.

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Background

As part of the Government’s commitment to ensure the integrity of Australia’s tax system, the Government announced in the 2017 Budget that from 1 July 2018 purchasers of newly constructed residential properties or land in new subdivisions will be required to pay the goods and services tax under *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST) (presently set at 10%) directly to the ATO as part of the settlement. The policy has been announced to strengthen GST law, maintain the integrity of the Australian taxation system and to ensure property developers comply with their GST obligations and remit GST on their residential sales.

The measure will be primarily implemented to address ATO concerns in relation to “phoenix operators” that do not remit GST to the ATO following the sale of their residential property. The term “phoenix operator” refers to companies that deliberately liquidate to avoid paying creditors. The ATO’s concerns are mostly aimed at targeting developers that:

- incorporate a special purpose company to undertake a residential development;
- claim and receive the benefit of input tax credits for GST incurred on their construction costs; and
- receive payment and cash refunds in relation to the input tax credits but fail to remit GST on the sale of the residential property after the residential development has been completed (noting that under the current law the developer/vendor is liable to remit GST to the ATO).

The measure is aimed at securing payment of GST to the ATO in full without the ATO having to initiate recovery action in cases of non-payment.

In addition to the above, the other policy driver for the implementation of the measure is cash and liquidity. The Government estimates the measure will increase GST revenue by \$660 million and increase GST payments to the states by \$1.6 billion over the forward estimates period. The Property Council of Australia has questioned these revenue estimates and raised concern about their impact:

“This seems an extraordinary figure and we will be seeking additional information from the ATO about how these changes

will work. This will impact the cash flow of thousands of builders and we want to see more details from the ATO.”¹

The Government has enunciated that as most purchasers use conveyancing services to complete their purchase, they should experience minimal impact from these changes. However, the measure was unanticipated and gives rise to the following practical issues:

- There is no commentary or guidance in relation to the transitional arrangements to be implemented by the Government – it is not clear how the measure will be applied to off-the-plan contracts where settlement will occur after 1 July 2018 and contracts exchanged prior to 1 July 2018 with settlement to occur after 1 July 2018.
- The responsibility to remit GST is imposed onto the purchaser who is unlikely to be “*carrying on an enterprise*” or registered for GST.
- Although it is clear that the purchaser will pay the GST, it is yet to be determined whether the GST will be paid on the vendor’s behalf (i.e. GST may be imposed on the purchaser under a withholding regime) or whether the purchaser will be liable to pay the GST.
- The consequences for non-payment of GST by the purchaser are not clear. Specifically, will the vendor remain liable if the purchaser fails to pay GST or is the purchaser liable to pay GST? This issue will affect contracts being drafted and may result in the vendor requiring an indemnity from the purchaser in relation to the payment of GST or security from the purchaser to secure the performance of the payment obligation.
- It is difficult for the purchaser to verify whether the vendor has a GST liability.
- How is the purchaser expected to verify the quantum of the GST liability as the vendor may have calculated the GST liability using the margin scheme?
- Who will be liable if the quantum of the GST remitted to the ATO is incorrect?
- If there are multiple taxable supplies to a transaction involving the supply of new residential premises or subdivided residential land, will the purchaser be responsible for the payment of GST in respect of the other taxable supplies?
- Rental guarantees are a common sales incentive and may result in a reduction to the purchase price and require an adjustment in relation to GST. Will the vendor receive the benefit of the GST decreasing adjustment if the GST liability is imposed on the purchaser?
- Will the vendor be required to issue a tax invoice in relation to the taxable supply?
- The precedent contracts for the sale and purchase of land prepared and issued by the Law Society in each State and Territory (and other standard form contracts) will need to be amended to reflect the new measure and the potential shift in liability for the payment of GST from the vendor to the purchaser.
- The measure has implications for lenders as the full proceeds of sale usually required by lenders at settlement will be reduced by the GST deduction – the measure may result in amendments to loan covenants and affect the commercial terms of any loan facility.

The measure is scheduled to commence on 1 July 2018 and the impact of the measure will depend on the final form of legislation. Contracts which are to settle after 1 July 2018 should be reviewed prior to exchange to address some of the issues contemplated above and to address the risks associated with any potential shift in liability for the payment of GST to the purchaser.

Other Measures Announced

The Government will also impose a 50 per cent cap on foreign ownership in new property developments. This measure is being implemented to ensure that new housing supply is available for the use of Australians and to increase the housing stock for Australian purchasers. This will not be welcomed by developers that specialise in overseas marketing to foreign investors and could adversely affect the level of activity in relation to apartment developments.

To bolster the integrity of the capital gains tax rules, the Government will:

- deny foreign and temporary residents access to the main residence exemption when they sell property in Australia; and
- expand the foreign resident capital gains tax withholding regime by increasing the withholding rate from 10 per cent to 12.5 per cent and reduce the threshold from \$2million to \$750,000.

Contracts which are to settle after 1 July 2018 should be reviewed prior to exchange to address the change in capital gains tax withholding threshold and withholding rate.

For further information on how these issues might affect you or any proposed development or transaction, please contact one of our specialist property lawyers.

1. K Morrison (Chief executive, Property Council of Australia) Budget—Chief Executive’s Response to individual initiatives, 9 May 2017.