The Mischel & Co. Group
Accountants & Advisors

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GST Withholding changes to Property Development transactions

New laws have been passed affecting the GST obligations of property developers. These laws take effect from 1 July 2018, but may affect contracts entered into prior to this date.

The major feature of the changes brought in by the *Treasury Laws Amendment (2018 Measures No. 1) Act 2018* is that purchasers of new residential premises or subdivided land (with certain exclusions) need to withhold the GST component of the purchase price and remit this amount to the ATO. This is a departure from current practice, whereby the purchaser provides the full purchase payment to the vendor, with the vendor carrying the responsibility to remit the GST to the ATO.

Sale of land contracts will need to be varied to reflect the new payment obligations. The Law Institute of Victoria has indicated that they will be incorporating a new Special Condition 5A and General Condition 15B in its Sale of Land Contract to reflect the new legislative requirements.

While this primary feature focuses on the purchaser and carries some steep penalties for non-remission (an administrative penalty of 100% of the GST that was not remitted), the practical implications of the new laws fall most heavily on the vendor.

Obligations for vendors

Vendors will be required to provide a notice to the purchaser by the time of settlement that identifies the purchaser's obligation to withhold and remit GST, sets out the amount of GST that the purchaser needs to remit to the ATO and when this must take place as well as certain other details. This measure is designed to make matters simpler for the purchaser, but will have the effect of imposing further obligations on the vendor.

Failure to provide this notice comes with steep penalties, currently set at $21,000 for individuals and $105,000 for companies. Further, non-compliance is a strict liability offence, so innocent omissions are still likely to be penalised.

It should be noted that the vendor will need to continue its present practice of calculating the GST on the supplies made and report this amount in its Business Activity Statement (**BAS**). The preparation of the notice for the purchaser is an additional compliance obligation. Vendors are still prima facie liable for the GST component on the supply, but receive a credit for the amount withheld and remitted (see further below).

The amount of GST that the purchaser needs to withhold is 1/11th of the contract price for the property *without allowing for adjustments* (or 7% if the margin scheme has been applied). As the amount that the vendor needs to report is based on the contract price after adjustments, these two amounts are unlikely to be the same.

A further complication for vendors is that they receive a credit for the amount withheld only if the purchaser actually remits the amount withheld. This places a practical requirement on the vendor to ensure that remission takes place. One means by which the new law expressly provides for to meet this requirement is to require the purchaser to provide a bank cheque made out for the precise amount of the GST payable to the Commissioner of Taxation. With the introduction of the PEXA system, it is anticipated that such remissions will be more secure with the move to electronic conveyancing.

Special transitional measures are in place for parties to a property development agreement, in which the agreement deals with how sales proceeds are to be divided amongst the parties including how GST liabilities are to be funded (sometimes referred to as waterfall payments). The new rules may result in unintended adverse consequences for some parties under these arrangements. Consequently, to ensure that no parties are unfairly disadvantaged or receive an unwarranted windfall gain, the transitional measures provide relief for such agreements entered into prior to 1 July 2018 if certain conditions are met.

The new rules apply to relevant supplies of real property where any part of the purchase payment (other than a deposit) is provided on or after 1 July 2018 (ie, not the date that the contract was entered into).

However, if the contract was entered into prior to 1 July 2018 and consideration first provided before 1 July 2020, then the new rules do not apply as a transitional measure.

Developers with projects that may extend beyond this timeframe should, therefore, consider making arrangements to come within the transitional measure if they want to remain outside the new rules. Otherwise, systems should be put in place to ensure compliance.

Beyond the need to ensure compliance with the new legal obligations, developers should be mindful of the likely adverse cash flow implications arising from these new rules. No longer will developers have access to the GST funds prior to lodging their BAS. Further, the calculation of developer's fees may need to be reviewed (which are often calculated on the basis of amounts received by the vendor) and access to finance may be affected. Property developers should consider these implications when preparing for operating under the new rules.

Action to take

With just under three months until the new withholding regime comes into effect, there is time to review present arrangements.

Contracts that are entered into prior to 1 July 2018 should be reviewed to see if they are affected by the new rules and, if they are, whether they come within the transitional relief. This will be determined by when any payment is to be received (other than a deposit) for the supply. In particular, long term projects in which payment is not expected until after 1 July 2020, regardless of when contracts are signed, should be reviewed.

It may be possible to take appropriate action with current developments. If the commercial implications are particularly adverse, then measures should be investigated to review whether it is possible to come within the transitional relief.

At a minimum, contracts should be reviewed to ensure that developers are not unduly exposed and systems are in place to ensure compliance.

Any other agreements, such as property development agreements with waterfall payment arrangements, should be reviewed to ensure that parties are not unduly disadvantaged.