

The new GST withholding regime for New Residential Premises and Potential Residential Land – some issues affecting the drafting of the contract of sale

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I. INTRODUCTION

With effect from 1 July 2018, a new withholding regime for GST will require purchasers to withhold an amount from the purchase price for 'new residential premises' and for 'potential residential land' where the supply of those types of land is a taxable supply made by the vendor. This is the first instance, outside the reverse-charge rules under the *A New Tax System (Goods and Services Tax) Act 1999* (the **GST Act**), where the recipient of a taxable supply has an obligation to remit the GST payable on a taxable supply to the Australian Taxation Office.

The new regime was legislated by Schedule 5 of *Treasury Laws Amendment (2018 Measures No. 1) Act 2018* (the **TLAA**). This amends Schedule 1 of the *Taxation Administration Act 1953* (Cth) by inserting new sections 14-250 and 14-255 and subject to the transitional rules as set out below.

This, in addition to the CGT withholding regime for non-residents, has introduced additional challenges for tax advisors and conveyances alike when advising and acting for purchasers and vendors in real property transactions covered by the regime.

The article below examines the key features of the new regime and how this will affect the drafting of the contract of sale.

2. WHY WAS IT INTRODUCED?

The rationale for the new withholding regime was to address non-compliance by some property developers and others of their GST obligations. The Explanatory Memorandum to the *Treasury Laws Amendment (2018 Measures No. 1) Bill 2018* elaborates on this rationale as follows:

5.3 Currently, supplies of new residential premises are generally subject to GST and the supplier remits the GST to the ATO in their next BAS. This can be up to three months after settlement.

5.4 One of the main forms of non-compliance with these obligations involves developers selling properties for a purchase price that reflects their GST obligations but dissolving their business before their next BAS lodgement to avoid remitting the GST (this is known as a form of 'phoenixing').

5.5 The ATO uses a range of strategies to tackle non-compliance with the GST law in the property development industry. The strategies are labour intensive, and costly to undertake and sustain.

5.6 Phoenixing to avoid paying GST has grown significantly over the last decade. As of November 2017 the ATO has identified 3,731 individuals that have actively engaged in this activity over the last 5 years. These individuals controlled over 12,000 insolvent entities responsible for \$1.8 billion in input tax credits between 2013 and 2017

3. HOW DOES THE GST WITHHOLDING REGIME APPLY?

Section 14-250(1) of Schedule 1 of the TAA provides:

14-250(1) You must pay to the Commissioner an amount if:

- (a) You are the recipient (within the meaning of the GST Act) of a taxable supply that is, or includes, a supply to which subsection (2) applies; and
- (b) In a case where the supply is a supply of potential residential land – either:
 - (i) you are not registered (within the meaning of that Act) or
 - (ii) you do not acquire the thing supplied for a creditable purpose.

A recipient of a taxable supply involving the land to which subsection 14-250(2) of Schedule 1 of the TAA applies would be the purchaser under a contract of sale for the requisite land. The withholding obligation is triggered only where the supply is a taxable supply except where the recipient of the supply acquires the requisite land as a creditable acquisition. That is, the withholding obligation does not apply in the case of business to business transactions.

This will also be the case where a registered purchaser acquires the requisite land under the margin scheme. When land is acquired under the margin scheme, section 75-20 of the GST Act provides that such acquisitions are not creditable acquisitions, the effect of which is to deny the purchaser the claim of an input tax credit. However, where a purchaser acquiring under the margin scheme does so for a creditable purpose, the Commissioner in LCR 2018/4 confirms that the purchaser will not have a GST withholding obligation in these circumstances.¹

Accordingly, and in all other cases where the recipient does not acquire the requisite land for a creditable acquisition (that is, as an end user), the supply may not be a taxable supply because it is:

- made by an unregistered vendor;
- a GST-free or an input taxed supply; or
- a supply for no consideration except if the supply is made to the associate of the supplier.²

In the case of these transactions there would not be a withholding obligation. Accordingly, the representations made by the vendor and reflected in the contract of sale need to be tested by the purchaser given the potential liability in the form of penalties for failing to withhold. These are discussed below.

Where the parties are relying on GST-free treatment or input tax supply treatment, there will be more incentive for the purchaser to ensure that the land transaction is properly treated from a GST perspective. Before the contract is drafted, the parties will need to agree on the correct treatment of the transaction from a GST perspective at the outset as this affects some of the GST clauses that will need to be included.

From the above analysis, it becomes clear that the following issues need to be addressed in the contract between the parties:

- The nature of the land being conveyed – that is, is it land to which subsection 14-250(2) of Schedule 1 of the TAA applies?
- The nature of the supply for GST purposes; is the supply a taxable supply or something else (GST-free, input taxed or a supply outside the GST Act)?
- A representation by the vendor that it is registered for GST or at least will be registered for GST by the day of supply where a search of the ABR does not reveal that the vendor is registered for GST.
- A representation by the purchaser if it is registered for GST and is acquiring the requisite land as a creditable acquisition.

4. WHICH CONTRACTS DOES GST WITHHOLDING APPLY TO?

For standard contracts for the sale of land, the general rule is that GST withholding regime applies to contracts for the supply of new residential premises or potential residential land where any of the consideration (other than the deposit) was first provided on or after 1 July 2018.³

1. Refer to paragraph 20 of LCR 2018/4.

2. In this case, there will be deemed market value received by the supplier pursuant to Division 72 of the GST Act.

3. Refer to item 26 of Schedule 5 of the TAA 2018.

This is irrespective of whether the contract was entered into before or after 1 July 2018.

However, for existing contracts, the GST withholding regime will not apply where:

- the contract was entered into before 1 July 2018; and
- the consideration for the supply, other than the deposit, was first provided before 1 July 2020.⁴

We note that there is a special application of the transitional rules for property development agreements⁵ which is beyond the scope of this article to examine.

The rationale for the above transitional arrangements is given in the Explanatory Memorandum at paragraph 5.149:

5.149 This option includes a transitional arrangement, so as to minimise transitional costs on existing contracts for purchasers, service providers and property developers. Contracts signed before 1 July 2018 can continue under existing arrangements so long as they settle before 1 July 2020. This will allow most existing contracts to wash through (e.g. off the plan apartment purchasers that often take 1-2 years between contract and settlement), whilst preventing potential mischief from long dated contracts being signed and ensuring all new residential property contracts come under the withholding regime by 2020.

5. WHICH TYPES OF LAND DOES THE GST WITHHOLDING REGIME APPLY TO?

The types of land which the GST withholding regime applies to are set out in subsection 14-250(2) of Schedule 1 of the TAA provides:

14-250(2) This subsection applies to a supply, by way of sale or long term lease (within the meaning of the GST Act), of:

- (a) new residential premises that :
 - (i) have not been created through substantial renovations of a building; and
 - (ii) are not commercial residential premises;
 - (b) potential residential land that:
 - (iii) is included in a property subdivision plan;
 - (iv) does not contain any building that is in use for a commercial purpose,
- other than a supply that is of a kind determined by the Commissioner under subsection (3).

Subsection 14-250(3) of Schedule 1 of the GST Act enables the Commissioner, by way of legislative determination, to determine which supplies that the GST withholding regime will not apply.

The definition of new 'residential premises' differs from its definition under the GST Act in that excluded from the definition under the GST withholding regime are new residential premises '*created through substantial renovations of a building*'. The rationale given in the Explanatory Memorandum is as follows⁶:

The exclusion of substantial renovations ensures that a purchaser does not have to determine whether renovations are 'substantial renovations' of the property, which may be difficult to assess at the time of purchase. Similarly, commercial residential premises are excluded to make it clear that a withholding obligation does not apply in relation to the residential premises that are both 'new residential premises' and 'commercial residential premises'.

A 'property subdivision plan' is defined in section 195-1 of the GST Act to mean:

- ... a plan:
 - (a) for the division of real property; and
 - (b) that is registered (however described) under an Australian law.

'Potential residential land' is also defined in section 195-1 of the GST to mean:

... land that is permissible to use for residential purposes, but that does not contain any buildings that are residential premises.

4. Refer to item 27 of Schedule 5 of the TAA 2018.

5. Refer to item 28 of Schedule 5 of the TAA 2018.

6. Refer to paragraph 5.11 of the Explanatory Memorandum.

Where the planning laws provide that land is zoned for a variety of uses including residential use, the Commissioner takes the view that the land will nonetheless qualify as 'potential residential land'⁷. Land will not be potential residential land where under the planning laws, residential use of the land is prohibited.

6. WHEN MUST THE AMOUNT BE PAID?

This is provided for in subsection 14-250(4) of the GST Act as follows:

14-250(4) You must pay the amount on or before:

- (a) the day on which:
 - (i) any of the consideration for the supply (other than consideration provided as a deposit) is first provided; or
 - (ii) if the supplier is your associate, and the supply with our consideration – the supply is made; or
- (b) if a determination under subsection (5) applies – the day provided under the determination.

Under a standard land contract⁸, the purchaser will need to withhold the amount from the payment of the balance of the purchase price which is due at settlement.

This will not be the case under a terms contract, which is a contract under which the purchaser, in addition to paying a deposit, pays one or more instalments of the purchase price.

This approach as to when the withholding obligation arises is consistent with the current treatment of the payment of deposits under land contracts. Under Division 99 of the GST Act, a deposit is not treated as consideration for a supply unless the deposit is either forfeited or applied as part of the consideration for the supply⁹.

The Commissioner cautions that the above analysis relies on the deposit paid under a contract being a *genuine deposit*¹⁰. His views on what constitutes a genuine deposit are contained in GSTR 2006/2.

If a payment under a contract for the sale of land, albeit described as a deposit, is not a genuine deposit the Commissioner will treat it as part of the consideration for the supply¹¹:

This means the purchaser may be required to pay a GST withholding amount on, or before, paying the deposit to the vendor.

7. WHAT IS THE AMOUNT OF THE WITHHOLDING?

There are four (4) scenarios in which the GST withholding regime provides for how the amount of the withholding is to be determined. They are:

1. where the supply is made under the margin scheme;
2. where the supply is not made under the margin scheme;
3. where the supply is made by supplier associated with a recipient and for which no consideration, or less than market value consideration, has been paid;
4. where the supply is a mixed supply and has taxable and non-taxable components and where it is practicable to ascertain, at the time any of the consideration for the supply (other than consideration supplied as a deposit) is first provided, the amount [to be paid to the commissioner]¹².

7. Refer to paragraph 24 of LCG 2018/4.

8. Refer to GSTR 2000/28 where at paragraph 13, a standard land contract is defined to mean 13. For purposes of this Ruling, a standard land contract is a written contract for the sale of land that provides for:

- the payment of a deposit that is either to be forfeited if the purchaser defaults or applied as consideration on settlement; and
- the payment of the balance of the purchase price upon settlement.

9. Refer to section 99-5 of the GST Act.

10. Refer to paragraph 39 of LCG 2018/4.

11. Refer to paragraph 41 of LCG 2018/4.

12. Refer to subsection 14-250(10) of Schedule 1 of the TAA.

7.1 Where the margin scheme applies

Subsection 14-250(6)(a) of Schedule I of the TAA provides that:

14-250(6) The amount to be paid to the Commissioner is an amount equal to:

- (a) if the margin scheme applies to the supply:
 - (i) the percentage, of the amount provided under subsection (7), determined by the Minister under subsection (8); or
 - (ii) if there is no such determination – 7% of the amount provided under subsection (7); or

For the purposes of subsection 14-250(6)(a)(i) of Schedule I of the TAA, the relevant percentage is specified in subsection 14-250(8) of Schedule I of the TAA as a percentage exceeding 7% but not exceeding 9%.

7.2 Where the margin scheme does not apply

Subsection 14-250(b) of Schedule I of the TAA provides:

14-250(7) For the purposes of paragraph 6(a) and (b), the amount is:

- (b) otherwise – 1/11 of the amount provided under subsection (7).
 - (i) What is the “amount” referred to in each of the above scenarios?

The amount referred to in subsection 14-250(6)(a) and (b) is specified in subsection 14-250(7) of Schedule I of the TAA as follows:

14-250(7) For the purposes of paragraph 6(a) and (b), the amount is:

- (a) If the contract for the supply specifies an amount (the contract price) that is the price of the supply, subject to normal adjustments that apply on completion of the transaction of that kind – that contract price; or
- (b) otherwise – the price for the supply.
 - (ii) What about non-monetary consideration?

If the consideration for the supply of the requisite land solely consists of non-monetary consideration, the recipient must still nonetheless make a payment in accordance with the GST withholding regime.

This might require the parties to negotiate terms which include that part of the consideration be in monetary form which can then be applied towards making the requisite withholding payment to the Commissioner.

7.3 Supplies between associated parties

Where a supply is between associated parties and for no consideration or is for consideration that is less than the GST inclusive market value, then subsection 14-250(9) provides that the amount to be paid to the Commissioner is an amount equal to 10% of the GST exclusive market value.

7.4 Mixed supplies

A mixed supply in this scenario arises where:

- the supply is only partly of new residential premises or potential residential land (together, the **taxable component**) to which section 14-250 of Schedule I of the TAA applies;
- it is practicable to ascertain the portion of the consideration which relates to the taxable component when the consideration is first provided.

This is provided for under subsection 14-250(10) of Schedule I of the TAA.

The Commissioner states in LCG 2018/4 that the parties should use a reasonable methodology to apportion between the taxable component and the non-taxable component much in the same way as the allocation would proceed for a mixed supply under the GST¹³. Reference is made to the Commissioner's ruling in GSTR 2001/8 for this purpose.

When the apportionment of the consideration is determined, the sale contract or contracts (where there is more than one) should then separately identify the consideration for each supply being made.

13. Refer to paragraph 54 of LCG 2018/4.

8. HOW DOES THE WITHHOLDING APPLY WHERE THERE ARE MULTIPLE PURCHASERS?

Subsection 14-250(11) of Schedule 1 of the TAA provides:

14-250(11) If there is more than one recipient (within the meaning of the GST Act) of the supply (the original supply):

- (a) treat each recipient as being the recipient of a separate supply; and
- (b) treat the amount under subsection (6), (9) or (10) (as the case requires) for such separate supply as being the same proportion of that amount of the original supply, as the proportion of the original supply that is constituted by that separate supply.

Treat recipients who are joint tenants as a single recipient for the purposes of this subsection.

Where two (2) or more recipients of a supply are tenants in common, whether in equal shares or some other proportion, they will each be treated as being the recipient of a separate supply, the consideration received for that separate supply will be the recipient's proportion of the total consideration under the contract.

Each recipient will be under an obligation to make a payment to the Commissioner.

Example 5.1 of the Explanatory Memorandum is about two (2) entities purchasing land as tenants in common. It is contemplated that the amount each needs to be withheld can be paid to the ATO at the same time.

9. IS THERE WITHHOLDING REQUIRED FROM AN OPTION FEE?

The Commissioner states that there is no GST withholding in respect of the option fee. This is based on his view in GST Determination **GSTD 2014/2** that an option fee paid for an option does not form part of the consideration for the acquisition of the underlying property.

Under GSTD 2014/2, the Commissioner states at paragraphs 16 and 17:

16. Where an entity has exercised a call option to compel the transfer of real property, for GST purposes, the call option fee does not form part of the consideration for the property.

17. This is the case even if the agreement between the parties specifies that the call option fee forms part of the price for the supply of the real property. The operation of section 9-17 varies what may be the outcome under contract law.

10. SUPPLIER NOTIFICATION

Section 14-255 of Schedule 1 of the TAA provides that where a supplier makes a taxable supply of new residential premises or potential residential land, the supplier must give the recipient a notice before making the supply which contains the following information:

- (a) whether the other entity will be required to make a payment under section 14-250 in relation to the supply; and
- (b) if the other entity will be required to make such a payment in relation to the supply:
 - (i) your name and ABN; and
 - (ii) the amount that the other entity will be required to pay to the Commissioner under section 14-250;
 - (iii) when the other entity will be required to pay that amount; and
 - (iv) if some or all of the consideration for the supply will not be expressed as an amount of money – the GST inclusive market value of so much of the consideration as will not be expressed as an amount of money;
 - (v) such other matters as are specified in the regulations.

A supplier is not required to give the above notification where the supply being made is a supply of¹⁴:

- commercial residential premises; or
- potential residential land where the recipient is registered and acquires the land for a creditable purpose.

¹⁴ Refer to subsection 14-255(2) of Schedule 1 of the TAA.

The vendor will therefore need to undertake some due diligence of the recipient to ascertain whether the recipient is registered for GST and is making the acquisition for a creditable purpose. It would be expected that in addition to the vendor searching the ABR website for the GST registration status of the recipient, it can seek various representations from the recipient which can be included as part of the contractual representations and warranties supported by the purchaser giving an indemnity in the event that they are incorrect and the vendor suffers loss as a result.

Where a vendor does not provide the supplier with a notice the recipient purchaser must still withhold an amount and pay that amount to the Commissioner¹⁵.

It is an offence if the supplier does not provide the notice under subsection 14-2585(1) of Schedule 1 of the TAA for which the penalty is currently 100 penalty units¹⁶.

The Commissioner states that, in this case, the purchaser should withhold on the basis of information that is known. At paragraph 68 of LCG 2018/4:

... If the purchaser believes that the supply is a taxable supply to which section 14-250 applies, and there is no agreement between the parties to apply the margin scheme, then generally the purchase should withhold 1/11th of the contract price or price. If there is agreement between the parties to apply the margin scheme, then the purchaser should withhold 7% of the contract price or price.

II. WHAT IF THERE IS ANOTHER PARTY NOMINATED AS THE TRANSFEROR UNDER THE CONTRACT?

The Commissioner accepts that the party to be named on the transfer form giving effect to the conveyance of the land is the party to whom the vendor is required to provide the requisite information¹⁷.

12. PURCHASER NOTIFICATION

Subsection 16-15(2) of Schedule 1 of the TAA provides that:

16-250(2) An entity must pay an amount (even if it is a nil amount) to the Commissioner under Subdivision 14-E (about payment in respect of taxable supplies of certain real property) must notify the Commissioner of the amount:

- (a) on or before the day provided in a determination under subsection (3); or
- (b) if there is no such determination – on or before the day on which the amount is due to be paid (regardless of whether it is paid).

The notification must be in the approved form and lodged with the Commissioner.

Purchasers are required to use approved forms to notify the Commissioner of the above information, such forms are available from the ATO's website.

Penalties apply where purchasers do not make the required notification

13. WHAT IF THE PURCHASER DOES NOT WITHHOLD AND REMIT?

Where a purchaser does not withhold the required amount or it does remit it to the Commissioner, that purchaser may have an administrative penalty imposed which is equal to the amount of the withholding.¹⁸

There are two (2) instances, provided under subsection 16-30(2) of Schedule 1 of the TAA, when a penalty will not be imposed. They are:

- Where the purchaser is given a notice stating that the withholding is not required. This is provided in subsection 16-30(2) of Schedule 1 of the TAA as follows:

16-30(2) Subsection (1) does not apply in relation to a failure to pay an amount to the Commissioner as required by Subdivision 14-E if:

15. Refer to subsection 14-255(3) of Schedule 1 of the TAA.

16. Refer to subsection 14-255(4) of Schedule 1 of the TAA.

17. Refer to paragraph 66 of LCG 2018/4.

18. Refer to subsection 16-30(1) of Schedule 1 of the TAA.

- (a) the amount relates to a taxable supply of new residential premises (other than commercial residential premises); and
 - (b) the entity was given a notice under section 14-255:
 - (i) stating that the premises are not new residential premises; or
 - (ii) indicating that the entity will not be required to pay an amount to the Commissioner under section 14-250 in relation to the supply; and
 - (c) at the time consideration for the supply (other than consideration provided as a deposit) is first provided, there was nothing in:
 - (i) the contract for the supply; or
 - (ii) any other circumstance relating to the supply;
 - that made it unreasonable for the entity to believe that the statement or indication was correct.
- Where the purchaser provides a bank cheque at settlement to the vendor made out in the name of the Commissioner for the amount of the withholding. This is provided in subsection 16-30(3) of Schedule 1 of the TAA:
 - 16-30(3)** Subsection (1) does not apply in relation to a failure to pay an amount to the Commissioner in relation to a taxable supply as required by Subdivision 14-E if:
 - (a) the entity required to pay the amount in relation to the supply gives the supplier a bank cheque on or before the day consideration for the supply (other than consideration provided as a deposit) is first provided; and
 - (b) the bank cheque is for the amount the entity is required to pay to the Commissioner; and is payable to the Commissioner.

If the vendor does not pass the bank cheque onto the Commissioner, the purchaser will not be liable for the administrative penalty. In LCG 2018/4, the Commissioner states that the purchaser must retain suitable documentary evidence of having given the relevant bank cheque to the vendor. At paragraph 76 of LCG 2018/4:

Suitable evidence includes a photocopy of the cheque and other evidence from the purchaser's bank that the cheque has been drawn, the purchaser's direction to pay the bank cheque to the ATO, a settlement statement, directions from the vendor and correspondence from the vendor showing receipt of the bank cheque. Evidence that merely shows what was intended by the parties before settlement, and does not show that the purchaser actually gave the bank cheque to the vendor, would not be sufficient.

It is acknowledged by the Commissioner that the parties can agree as a matter of contract as to how the withheld amount is to be paid to the Commissioner, whether directly by the purchaser or by the vendor under a direction given by the purchaser.¹⁹

14. DOES THE GST WITHHOLDING OBLIGATION APPLY WHEN SUPPLIES ARE MADE BETWEEN MEMBERS OF A GST GROUP OR BETWEEN A JOINT VENTURE OPERATOR AND A JOINT VENTURER?

The answer is no. The reason is because such supplies would not be taxable supplies and therefore the threshold requirements in subsection 14-250(1) of the GST Act would not apply.

15. CONCLUSION

The Standard NSW Sale of Land Contract contains clauses which cover the GST withholding regime. There may be a requirement to draft additional clauses in the sale of land contract where representations might be needed from the purchaser as to whether or not, for example, it will be acquiring the new residential premises or residential land as a creditable acquisition. As previously stated, the GST withholding regime does not apply to such land transactions.

The ATO has also indicated in various seminars it has held for taxpayers that it has identified errors in its IT system handling the notification process. The ATO has said that it is seeking to address these issues through a series of enhancements to be announced in October 2019. These errors include purchasers failing to lodge forms and the supplier failing or incorrectly reporting the sale on their own BAS.

If you have any queries about the new GST withholding regime, please contact Andy Milidoni on (02) 8274 9579 or 0400 523 937.

¹⁹ Refer to paragraph 76 of LCG 2018/4.