"SOME IMPACTS OF THE GST SYSTEM ON PROPERTY SALES"

by

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A paper presented to the PRRES Conference

University of South Australia
Adelaide

22-24 January, 2001

In the preparation of this paper, reference was made to several API and Australian Taxation Office publications. While acknowledging the help received from these sources, responsibility for the accuracy of the points in this paper remains with the author.

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a) Introduction

The purposes of this paper are:

b) to briefly canvass the key elements of the Government’s New Tax System, with emphasis on the Goods and Services Tax (GST); and

c) to identify and assess a range of impacts of the GST upon property sale transactions in Australia.

An Appendix summarises some procedural and other changes to the tax system and record-keeping consequent to introduction of the GST.

d) The New Tax System *

I shall focus on those changes which affect the property industry and property professionals.

d.1 Personal Income Tax Cuts

Personal income tax cuts totalling over $12 billion per annum were implemented from 1 July 2000. The cuts involve approximately 95 per cent of all taxpayers, and are substantial – as is evident from a study of Table 1.

* *A brief literature survey will be included*

TABLE 1

INCOME TAX RATES: AUSTRALIA 1999 and 2000			
Rates Prior to 1 July 2000		**Rates from 1 July 2000**	
Taxable Income $ to $	**Tax Rates %**	**Taxable Income $ to $**	**Tax Rates %**
0-5,400	NIL	0-6,000	NIL
5.401-20,700	20	6,001-20,000	17
20,701-38,000	34	20,001-50,000	30
38,001-50,000	43	50,001-60,000	42
50,000+	47	60,001+	47

Source: The New Tax System: Essentials, Issue One, March 2000

d.2 Other Income Tax Changes

Other changes to the Income Tax System have stemmed – or will stem - from the Ralph Report, and are tabulated so as to provide a full background against which to assess the GST changes.

The measures which follow are already operative or will be introduced over 2001. Those affecting the property industry include:

- changes to the Capital Gains Tax (CGT) system, such as the abolition of indexation of the cost base and averaging, along with the halving of the marginal tax rate applying to capital gains realised by individuals after more than a year from acquisition, with the rate for superannuation fund realised gains being reduced by one-third – capital gains realised by companies will be taxed at the full company rate;

- changes to the method of calculating depreciation deductions;

- reductions in the company tax rate from 36 per cent to 34 per cent from 1 July 2000 and to 30 per cent from 1 July 2001;
- cash refunds of excess imputation credits already paid in respect of dividends and other relevant income;
- changes to the entity system of taxation, in that certain trusts will be taxed similarly to companies, with beneficiaries able to claim imputation credits on trust income; and
- extension of more generous CGT rollover relief and retirement exemptions to most businesses.

d.3 Indirect Tax Reform

A GST at the rate of 10 per cent was introduced from 1 July 2000 on a wide range of goods and services. It is current Government policy that any request for a change to the GST rate must be made to the Commonwealth by all State Governments. It would need to be endorsed by the Commonwealth Government of the day, and relevant legislation passed by both Houses of Parliament. As modest taxes have a habit of expanding substantially over time, thus providing large increases to official revenues – witness the capital gains tax and taxes on superannuation – we can only wait and see whether the 10 per cent rate will remain fixed or not.

e) Impacts of the GST on Property Sales

The impacts are important. The broad situation follows.

e.1 General

- GST applies to most types of property transactions.
- The treatment of property sales for GST purposes depends on whether the subject property is private residential, commercial, residential, commercial or a farm.

- In some situations, the treatment of property sales for GST may also depend on whether the seller and/or the buyer are registered for GST purposes.

e.2 Sales of Land

- Land sold before 1 July 2000 was not subject to GST.

- Land acquired after 1 July 2000 from registered persons is subject to GST.

- Land acquired from non-registered persons, e.g. from individuals owning hobby farms, does not incur GST.

- GST is not charged for the first sale of any unimproved land held by the Commonwealth, a State or a Territory.

- Similarly, GST is not charged on unimproved land acquired by a public sector entity from a Commonwealth, State or Territory Government.

- In respect of the last two points, it should be noted that there are no guidelines in the legislation as to what constitutes improvements on the land.

e.3 Sales of Residential Property

- Sales of existing residential properties taking place after 1 July 2000 is not subject to a GST. In fact, existing residential properties are input taxed. This means that the sales are not subject to the GST and no input tax credits can be claimed for purchases acquired to make the supply, e.g. on solicitors' fees, selling agents' commissions and advertising costs.

- Newly constructed properties sold after 1 July 2000 attract a GST. This applies whether a property is bought by an owner-occupier or an investor. However, subsequent sale of that property by private individuals is free of the GST.

- The price of existing residential homes has arguably increased as new residential homes are always subject to GST. This is a point which may assist owners having to pay the GST on legal fees and agents' commission.

- The construction industry has estimated that – due to the GST - the price of a new residential home has increased by approximately 5 per cent, not the full 10 per cent rate of GST. Eligible first home buyers are entitled to a non-income tested compensatory payment of $7,000, available for new and existing homes.

e.4 Sales of Commercial Property

- GST applies to the sale or on after 1 July 2000 of all commercial property by a registered business.

- Certain transitional rules are applying, which are beyond the scope of this paper.

- The seller must pay GST on the full amount of the sale value of the property, unless the seller is eligible for and uses the margin scheme.

- A seller who is registered is entitled to claim input GST credits on expenses associated with the sale e.g. legal expenses, agents' commission, registration fees and valuation fees.

- If the buyer is registered for GST, the buyer is able to obtain an input tax credit for the GST included in the selling price of the property.

- If the buyer is not registered for GST, he may ask that the seller calculate GST using the margin scheme.

- As with residential sales, the GST is payable on sale when the purchaser gains access to the property, that is on settlement. The payment of a security contract or the exchange of contracts do not in themselves trigger GST at that point.

- If the sale is by auction, special rules operate (see later). In broad summary,

- if the auction is run as GST-inclusive, and the seller is registered, then the GST is one-eleventh of the sale price; but
- if the auction is run as GST-exclusive, then the 10 per cent GST is added to the sale price.

e.5 Commercial Residential Accommodation

Since 1 July 2000,

- sales from an unregistered vendor entity, irrespective of the registration status of the purchaser, have not been subject to GST; and
- sales from GST registered vendor, irrespective of the registration status of the purchaser, have been subject to GST.

e.6 Auctions

- Before the auction of any property begins, the auctioneer needs to know and inform the bidders
  - whether the seller is registered for GST;
  - whether the property being sold is subject to GST; and
  - how the GST will be calculated.
- An auction of an existing residential property is always GST-exclusive, as even if the seller is registered, he is not entitled to charge GST.
- Auction sales of commercial property on behalf of registered vendors are normally subject to GST.
- Auction sales on behalf of unregistered sellers are not subject to GST.

e.7 Off-the-Plan Sales

- These are not considered to be construction contracts.

- Settlement of contracts relating to off-the-plan sales are usually made on completion. Since 1 July 2000, GST is payable on these sales on settlement. The margin scheme may be used.

e.8 Sales of Farmland

In general, the sale of farmland is subject to GST where the seller is registered. Where the purchaser is registered, he/she is entitled to an input credit for the GST paid on purchase.

The sale of farmland is classified as GST-free in two circumstances and where certain conditions are met.

- Firstly, where farmland is sub-divided into a block to be used for a residential premises, if:
  - the current owner has carried out a farming business on the land for at least five years; and
  - the current owner sells to an associate (e.g. family) for nil or consideration less than market value.
- Secondly, where:
  - the current owner has carried out a farming business on the land for at least five years; and
  - the purchaser must be acquiring the land with the **intention** of continuing to use the land as a farming business.

Where the purchaser does not continue to use the land as farmland at some point in time after the purchase, then the purchaser can be liable for an amount of GST that would have been paid on purchase.

For example, a farmer buys a farm and operates it for two years. He/she then discontinues to operate – he/she is required to pay a partial GST amount to reflect what would have been paid had the transaction not been GST-free in the first place.

If the farmer sells livestock and plant and equipment all separately, they are subject to GST if the seller is registered.

e.9 Liability for GST

- A standard contract for the sale of land or other property usually provides for the payment of a deposit, with the balance payable on completion or settlement, in exchange for a duly executed transfer. Under this standard contract, the liability for GST arises when settlement takes place - this is deemed to be the date of supply. GST is paid by the purchaser to the vendor at the time of settlement. As stated earlier, the GST is included in the sale price.

- If the contract is not a standard contract, the vendor needs to examine the terms of the contract to determine when liability for GST arises.

- If a sale "falls through", GST is only payable if the deposit is forfeited, that is, normally after exchange of contracts but before settlement.

e.10 Calculation of GST

- There are two primary methods for calculating the GST where the sale is subject to GST:

  – Normal Methods; and

  – Margin Scheme.

- Separate and distinct parcels of land can be sold using either the Normal Method or the Margin Scheme. Nomination of the method should be made prior to putting the property on the market.

- Once a property has been sold after 1 July 2000 using the Normal Method, subsequent sales of that land, or portions thereof, cannot be sold using the Margin Scheme.

- Under the Normal Method of determination, the amount of GST is achieved:

  – for a sale by dividing the value of the sale by 10, while

  – for a purchase or acquisition, the price is divided by 11.

- Under either Method, the seller remits the GST to the ATO.

- The acquiring entity may claim the GST component of the price as a tax credit at the end of the tax period.

- For the purposes of providing a base for calculating the GST, market values rather than development or construction costs are the relevant benchmark.

e.11 Other Sale and Similar Arrangements

- Options:

  – When an entity enters into an option to purchase land, GST is charged on the consideration paid for that option.

  – The later exercise of that option is only taxable if and when a further payment is made.

- Staged settlement

  – Where an entity disposes of property via a staged settlement arrangement, with periodic payments being made, GST is paid in line with these periodic payments.

e.12 Sale as a Going Concern

- The sale of a going concern is GST-free in the following circumstances:
  - the purchaser must be registered or required to be registered for GST;
  - the supplier must carry the business until it is sold;
  - all of the things required for the continuing operation of the business must be supplied; and
  - both parties must agree in writing that the supply is of a going concern.

e.13 Selling Commission

- GST also applies to selling commissions and other selling costs, such as fees charged by solicitors and surveyors and advertising costs, irrespective of whether the property has been recently constructed or is an existing property.

e.14 Repairs and Renovations

- GST applies to repairs and renovations to an existing property, including a farm.

e.15 Utilities and Government Services

- Charges for water supplies, sewerage services and drainage are GST-free.

e.16 Insurance

- Supply of most types of general insurance of property is a taxable supply and is subject to GST.

f) Summary

To summarise:

- The reform of the Australian Taxation System from 1 July 2000 has been substantial, with significant implications for the entire property sector, as well as for other parts of the economy.

- The impact of the income tax cuts and the GST are being felt by many, although rising interest rates over the last twelve months have reduced the value of the tax cuts for those with mortgages.

- Record keeping and compliance activity has increased significantly, while the ACCC is closely monitoring prices in relevant areas.

- The GST, where applicable, is adding to the prices of properties sold. This has been recognised by the Government in the case of residential sales, as it is granting enhanced assistance to First Home Owners.

- The seller may be able to claim input credits where GST is payable, but not where the sale is GST-free.

- On a wider plane, the new income tax cuts along with higher property prices are making negative gearing a little less attractive to middle income investors, but high income earners are still able to benefit from tax deductions at the 48.5 per cent rate. In the case of newer residential constructions, landlords are continuing to benefit from the building allowance and from plant depreciation, albeit at slightly lower rates. Overall, the impact of The New Tax System on negative gearing is not great. If there are significant further increases, the impact of rising interest rates will be greater.

- Whereas the GST is adding an upwards bias to property prices and is enlarging the administrative compliance work of many property professionals, it is not in itself likely to result in any significant property market upheavals. As in past periods of booms and busts, the mix of supply and demand factors, along with any sharp changes in economic fundamentals, such as movements in inflation, interest rates, economic growth, employment and confidence levels, along with global trends, will have a greater impact.

If these indicators remain favourable in the medium term, the industry has already adjusted in part and will continue to adjust fairly rapidly to the GST, with overall property activity remaining buoyant. If however:

- a selection of these indicators turns sour and/or a large over-supply of property stock emerges, then property activity will become more volatile, vacancy rates will rise and values could decline; while
- any significant lift in demand, including a return of overseas buying interest, could lead to another surge in sales and values.

These factors, rather than the GST, will continue to influence property market activity and values in the years ahead.

- At the present time, notwithstanding recent rises in interest rates and inflation, along with the outworkings of the Budget forecasts of a slightly easing economy over 2000-2001, and the recent GST-induced spike in inflation, the property outlook remains generally positive. Following a decade of ongoing recovery and growth since the recession of 1990-91, this scenario is a satisfactory background against which the GST and other elements of The New Tax System were introduced.

APPENDIX

Registration

- A key aspect of The New Tax System was the need for many entities to register, both for an Australian Business Number (ABN) and for GST.

- All companies registered under the Corporations Law and all other businesses were required to register for the ABN. Without an ABN, other businesses may withhold tax (currently 48.5 per cent) from payments to your business. The ABN is a single identifier for business dealings with the Australian Taxation Office and with other government departments and agencies.

- The ABN is also the GST registration number. A business could register for the ABN even if it did not register for GST.

- Specifically, a business needed to register for GST to claim back the GST paid on its business inputs. In fact, in a business-to-business transaction, the purchaser is obliged to withhold tax if the supplier does not provide his or her ABN – unless the payment is $50 or less.

- Of course, any tax withheld by a payer can be applied as a credit to any tax paid by a business at the end of the financial year – but that may be up to a year or so away.

f.1 Record Keeping, Reporting and Pricing Policy

- It is essential to account for the GST included in all sales and input tax credits.

- Businesses need to supply and keep tax invoices and sufficient records for all transactions. In particular, accounting should be adequate for Pay As You Go (PAYG – see below) reporting. In essence, a business manager will need to know its trading and investment income each quarter.

- There is a single reporting form to the Australian Tax Office (ATO). This is the Business Activity Statement (BAS). (Businesses not in the GST system and some individuals with investment income use a similar Instalment Activity Statement). The statement includes:

  – the GST included in sales;

  – the GST included in purchases;

  – PAYG instalments;

  – amounts withheld from payments to others;

- details of Fringe Benefits Tax (FBT) instalments; and
- the amount the business owes to – or is owed by – the ATO.

- These statements are lodged quarterly (although some Investment Activity Statements may be lodged annually) by mail, electronically or through a tax agent. Businesses with an annual turnover of $20 million must lodge electronically monthly.

- A new PAYG system is operating. This is a new system for reporting and paying withheld amounts (GST amounts deducted from payments to others) and tax on one's own business, professional and investment income. It replaces 11 taxes, including company and superannuation fund instalments, provisional taxes and Pay As You Earn (PAYE).

- Businesses which currently deduct taxes under the Prescribed Payments System (PPS) have also faced new arrangements from 1 July 2000.

- It must be emphasised that business stationery, tax invoices and certain other business records must include the business name and ABN.

- Staff need to be adequately trained in all GST procedures.

- A business's pricing policies must be settled in line with the Australian Competition & Consumer Commission (ACCC) guidelines.

GST-Free Activities etc.

GST-free activities include:

- most food;
- exports of goods and services, but not tourism related services;
- most medical, hospital, health, education and childcare services;
- private health insurance premiums;
- non-commercial activities of charitable institutions and religious services;

and, from a property perspective,

- local government rates and water and sewerage rates and charges;
- sale of a business as a going concern; and
- farmland supplied for farming.

Abolition of Existing Indirect Taxes

The GST has replaced the following indirect taxes:

- the wholesale sales tax;
- and in consultation with the States, the following types of taxes:
  - financial institutions duty;
  - debits tax;
  - a wide range of stamp duties; and
  - bed taxes.

f.2 Changes to Commonwealth-State Financial Relations

- These are far reaching. Since 1 July 2000, the Commonwealth is providing the States with all revenue from the GST, conditional upon the States abolishing "inefficient" taxes, such as the financial institutions duty, the debits tax and various stamp duties, and not re-introducing them.
- Financial Assistance Grants have been abolished.
- The States have taken over (from the Commonwealth) the payment of general purpose assistance grants to local government.

Other Measures

- Increases have been made to a wide range of social security and veterans (age and service) pensions, while a range of other measures to offset the GST effect on prices paid by pensioners have been introduced.
- A First Home Owners Scheme was introduced to offset the net impact of the GST on the price of new homes (construction costs only and excluding land). It is providing those eligible with a lump sum payment of $7,000 from 1 July 2000.
- Excises on petrol and diesel will be reduced at the time of GST's introduction so that pump prices need not rise.