

ANGST UPDATE

GST & PROPERTY CONTRACTS ADVISORS BEWARE!!!

INTRODUCTION

In this edition, we have decided to revisit GST and real property to highlight some recent law changes and cases which emphasise some of the GST issues to consider when reviewing contracts involving real property and enterprises. Unfortunately our simplified "New Tax System" has become a legal nightmare in relation to major transactions. Already the Courts have seen numerous cases where parties to the contract have suffered losses for a variety of reasons including:-

- Badly drafted contracts.
- Not fully understanding what they were signing.
- Not getting advice before they signed the contract.
- Convoluted GST clauses designed to trap the unwary.

Unfortunately there are still some lawyers that do not have a full appreciation of the GST provisions that apply to margin method and going concern supplies. It is not necessarily entirely their fault as they are property law specialists not tax specialists. When significant dollars are involved we strongly recommend that the contract is reviewed by a GST specialist. This edition identifies some of the problems that have arisen. Unfortunately these are just the "tip of the iceberg" and many more problems are certain to arise.

As specialist GST advisors we strongly recommend against the use of the going concern concession unless both parties to the contract are absolutely certain that a going concern is being supplied. Significant care is also required when using the margin method in contracts. The following examples demonstrate why we have come to this conclusion.

1. VENDOR & PURCHASER MUST NOW AGREE TO USE THE MARGIN METHOD.

From 29th June 2005, where the vendor under a contract of sale for real property wishes to apply the margin scheme, he is required to obtain the



EDITOR – TONY EVANS

**September 2005
Volume 4 Issue 3**

CONTENTS

- 1. Agreement required for margin method to apply!**
- 2. The Purchaser is not the taxpayer!**
- 3. Tricky contracts**

DISCLAIMER

The contents of this paper are for general information only. They are not intended as professional advice and cannot be relied upon in any way whatsoever. Readers of this publication should consult a qualified accountant or other suitably qualified professional before acting upon any information included in this publication. Whilst all care and diligence has been exercised in the preparation of this newsletter, GuSTAX Consulting Pty Ltd expressly disclaims all liability for any loss or damage arising from reliance upon any information in this paper.

GuSTAX Consulting Pty Ltd

ABN 16 097 171 509

(Just Tax Consulting)

PO Box 5200

Studfield Post Office

Wantirna Vic. 3152

Email: tony@justtax.com.au

Website – www.justtax.com.au

"Angst Update" is a registered business name in the State of Victoria.

written consent of the purchaser. If written consent is not obtained, the supply will be a full taxable supply where GST applies.

This change only applies to contracts signed on or after that date. Whilst it is not a requirement that this written agreement between the vendor and the purchaser is actually included in the contract of sale, we strongly recommend that it is, otherwise the purchaser may withhold the consent and use it as a bargaining point prior to the settlement of the transaction. If it is written into the contract, the purchaser has no choice but to agree to this condition before signing. The vendor should always double check to ensure this clause has not been deleted before placing their signature on the contract.

Whilst this legislative change did receive significant publicity, it is possible that some lawyers are not aware of this change. It is imperative that you put them on notice of this requirement if they are drafting the contracts.

In some cases, the margin method may be included in the contract as a back up method of calculating the GST. Care will be required in drafting contracts in these situations to ensure the consent between the two parties is still in writing and effective where the margin method is applied as a contingency under the contract.

2. REMEMBER, THE PURCHASER IS NOT THE TAXPAYER UNDER GST

The taxpayer is the vendor or supplier under a contract of sale when GST is applied and remitted. Where the contract uses the margin method, the purchaser cannot recover the GST and it forms part of the purchase consideration for the property. Technically the purchaser does not pay GST, they remit an additional amount of consideration for the acquisition. Where a supply is made GST-free, as in the instance of going concerns, and the supply is later deemed to be taxable, the vendor has the obligation to remit the GST. Any indemnity they have obtained from the purchaser is an indemnity to pay more money for the acquisition. Whether this additional amount can be recovered as an input tax credit will depend on whether a tax invoice is obtained and the purchaser has creditable purpose in relation to the acquisition.

The fact that the vendor is the taxpayer puts the purchase at a severe disadvantage when it comes to disputes that may arise out of the contract. The following examples demonstrate this.

What if the valuation used in applying the margin method is inadequate in the eyes of the purchaser?

In recent litigation, a purchaser believed the property valuation, obtained by the vendor for the purposes of applying the margin scheme, was approximately \$350,000 below the actual market value. The purchaser was

ABOUT THE EDITOR – TONY EVANS

Tony is a Chartered Accountant with over 25 years experience in tax consulting and business services in small, medium and large accounting firms.

Founder and Managing Director of GuSTAX Consulting Pty Ltd, he was previously a tax consulting partner with a boutique tax division in one of mid-tier Melbourne accounting practices. Tony's diverse tax specialisations include: -

- Corporate & Trust Taxes
- CGT
- GST
- FBT
- PAYG
- Other Federal Taxes

He is renowned as being an excellent communicator and trainer, able to

- explain complex taxation issues in a practical manner
- tailor sessions to participants' skill set
- relate the topic to the client's demographics

Over the last five years, Tony has conducted numerous technical sessions for members of the profession and their clients. He is an active participant in three tax discussion groups and regularly attends and presents at other discussion groups. As our Tax Training Director and Senior Taxation Consultant, Tony is in constant contact with the latest issues effecting today's accounting practices, and incorporates these into the training to produce both a practical, and logical approach.

provided a copy of the valuation only three days before settlement. They decided to accept it based on the fact they did not have adequate time to obtain an alternative, and would sue the valuer at some later point. As a result of the original low valuation, the purchaser was required to remit a further \$35,000 to cover the additional GST arising.

The purchaser then took the matter to the Tribunal, proving the valuation was underestimated by approximately \$350,000. However, the purchaser failed in their attempt to recover the loss as the Tribunal held the valuation was prepared for the vendor only, and the vendor was not out of pocket. The purchaser could not establish that they had relied on the valuation or had a right to rely on it. They merely used it to determine the final consideration payable.

This problem could have been avoided if the contract gave the power for the purchaser to obtain the valuation for and on behalf of the vendor or to approve the vendor's valuation before it could be used. However it didn't and as a result they were out of pocket. In fairness to the lawyers, this was an unforeseen consequence and one that you would not expect to draft a contract to protect against. However lawyers drafting contracts

IN-HOUSE TAX TRAINING

In today's tax environment it is essential for accountants in practice to be up to date. With the constant barrage of new laws, rulings and announcements it is essential to be aware of these changes so that clients can be properly advised. Therefore regular tax training is becoming a necessity, rather than a luxury. The key is to ensure the training is practical, and can be easily understood by you and your staff. You need to know the important points, and not be swamped by all the literature being produced by the ATO etc. We pride ourselves in our reputation for presenting our tax sessions in a practical, and easily understood manner. Tony Evans, our Tax Training Director, not only trains, but consults to accounting practices on a daily basis. Therefore, he is alert to the issues you and your staff face, and incorporates these into the sessions, giving you practical solutions.

NO "LOCKED IN" CONTRACTS

We do not lock you into a contract. Bookings are locked in to ensure the training occurs when you want it. However, you can cancel the training at any time. We are confident of your satisfaction in providing this guarantee.

WHAT'S IN OUR MONTHLY UPDATES

The majority of our clients split their 2 hour training session evenly between the monthly tax update, and a special topic, **but how we do it is up to you**. We electronically provide a comprehensive set of supporting notes for both the tax update, and the special topic prior to the session. This enables you to review the notes and get more out of the training. We tailor the session to your needs. We encourage our sessions to be interactive, allowing time for questions and general discussion to expand on issues and improve your level of understanding. Our monthly tax update notes are comprehensive, fully indexed, and easily understood. They cover:-

- Tax Legislation changes and its status
- Announcements by the Government and Australian Taxation Office
- GST and Income Tax Case Decisions
- Superannuation & Other Tax Cases
- Draft & Final GST & Income Tax Rulings & Determinations
- Superannuation and Other Tax Rulings and Determinations
- Tax Office Publications
- Lists of Interpretative Decisions, Product Rulings and Class Rulings
- General announcements and issues of interest not covered above

With over 40 **special topics** to choose from (refer our website for a complete list - www.justtax.com.au), you get to select the topic and the month you wish it presented. We use case studies, examples and other techniques to reinforce the training. Our notes are always comprehensive, easily understood, and extremely useful for reference purposes. We continually update our existing topics, as well as develop new ones. We will consider specific topic requests provided there is enough demand for them.

WE COME TO YOU

Training is at your premises. This minimises your downtime and increases productivity.

COST

For a two hour session (GST inclusive)

| | 2006 Calendar Year |
|-----------------------------|--------------------|
| 1 – 5 sessions per year | 907.50 |
| 6 or more sessions per year | 825.00 |

NO CONTRACTS – NO FUSS

should now prepare for this possible outcome.

Who can obtain a private ruling on the GST status of the transaction?

Some contracts allow the parties to obtain a private ruling on the GST status of the transaction prior to settlement. This is a common practice with the supply of going concerns to alleviate uncertainty about the GST status of the transaction. In most cases, the purchaser will prepare and pay for the private ruling request as they are the party with the most to gain from a positive ruling. This leads to interesting problems in preparing and dealing with the ruling request:-

- As the taxpayer is the vendor, only the vendor can submit and obtain the ruling.
- Normally the vendor will not care if a positive ruling is obtained as back up clauses in the contract will usually ensure that the contract proceeds as a full taxable supply or a margin method supply if a negative result is obtained.
- Where the purchaser is trying to get a going concern concession, they need to show that the vendor is supplying everything necessary for the continued operation of the enterprise. Without an intimate knowledge of the vendor's operations, it is extremely difficult to prepare an accurate ruling.
- The vendor will need to approve any ruling submitted by the purchaser and sign it as taxpayer.
- The vendor will always take a conservative approach as they are the party attesting to the truth and accuracy of the ruling and the party at risk if the ruling is inaccurate in any way. They will be less willing to argue in favour of the concession as it is not in their best interests.
- If a negative result is obtained, the purchaser usually has no right of appeal as only the taxpayer (vendor) can object and it is not in their best interests to do so.

All hell can break loose if the ATO subsequently challenges or withdraws the ruling on the basis that the transaction did not proceed as the ruling specified. The vendor will need to defend a ruling but may not really care if there is an effective indemnity in place from the purchaser. With an effective indemnity, they could incur excessive costs in defending the ruling! There are many issues outside the control of the purchaser!

3. TRICKY CONTRACTS

Another recent case dealt with a contract that had two conflicting clauses. One clause allowed the purchase price to be grossed up to take account of GST. Another clause in the contract stated:-

"Normally, if a party must pay the price or any other amount to the other party under this contract, GST is not to be added to the price or amount"

The purchaser relied on this clause and argued that the ability to gross up the contract was outlawed by this clause. You would expect that this conclusion was reasonable. Surely with conflicting clauses in a contract, the purchaser would be protected. However the Court ruled that the use of the word "normally" at the start of the clause basically really meant that unless another clause in the contract said something different, this clause applies.

Unfortunately another clause did say something different and the Court ruled that the contract had to be grossed up for GST.

It is unreasonable to expect an accountant reviewing a contract to identify this fine point of law and in our view the blame should rest with the lawyers drafting and reviewing the contract. However, where conflicting clauses are identified, the conflicting clause should be removed before signing the contract.

CONCLUSION

It should be clear that GST in relation to going concerns and the margin method can be a real minefield. Contracts can be extremely complex and full of traps for the unwary. Unfortunate consequences can arise out of these complex contracts. Our litigious society and overly clever lawyers only add to this problem. Taxpayers and their accounting advisors are being squeezed in the middle.

There are several basic rules to obey to minimise these risks. These are:-

- Taxpayers should get good advice before entering into contracts. There is little anyone can do once the contract is signed!
- Select your lawyer carefully. Make sure they have a good knowledge of GST or consult with some one who does.
- Keep it simple. The more complex the clauses in the contract, the more things can go wrong.
- If you cannot understand it do not sign it! Contracts can be drafted in plain easy to understand English! Lawyers have a responsibility to make the contract understandable for the parties to the contract.
- Remember a contract is an agreement between two parties. Don't let the lawyers turn it into a duel between the two legal firms! Many disputes can be avoided provided the two parties have a clear understanding of what they mutually negotiated and this is expressed clearly in writing.
- If it is a complex contract, explore all the possible outcomes to ensure all bases are covered.

Some lawyers are hiding behind accountants when it comes to GST by asking the accountant to sign off on the GST tax consequences of the contract by reviewing the GST clauses. This is unacceptable practice. Accountants are not lawyers and will not fully understand the legal interpretation and implications of the clauses. Only lawyers can draft contracts and they must ensure the GST clauses work. If they don't they should be the party responsible. They must have a clear understanding of the tax consequences of the transaction so they can draft the contract correctly. If they are uncertain, they should seek instruction from the client or their accountant on what the desired outcomes are and then ensure the contract achieves these outcomes.

Preferably, accountants and other advisors should specifically instruct the lawyer drafting the contract of the specific tax outcomes required so the lawyer is in no doubt what the contract is meant to achieve.

The tax laws are tough enough without complicating things with convoluted unintelligible contracts. These must be avoided.

Copyright strictly reserved. No part of these Notes may be reproduced or copied in any form or by any means (graphic, electronic or mechanical, including photocopying, recording, taping, or information retrieval systems) without the written permission of GuSTAX Consulting Pty Ltd.