Avoiding GST traps on off-the-plan purchases

A growing concern for investors who buy off the plan can arise through a Division in the GST law, which vendors and developers can exploit to pass GST costs onto buyers. As *Michael Quinn* explains, uninformed investors can be hit with GST bills they never expected, and which can run into tens of thousands of dollars

These days it's becoming increasingly common for 'Mum and Dad investors' to try their hand at the investment property market. The purchase of a property appears to be a safe and solid decision and a great starting point, particularly for first-time investors looking to get a foothold in investing. This is so especially when compared to some other alternatives that are much more volatile and potentially carry a higher risk.

Generally speaking, purchasing property is a great investment option and can be extremely fruitful but, like all business ventures, there are a number of little-known facts that you should be aware of when looking to enter into a property purchase agreement.

In particular, one such problem – which has been reported as a growing concern that 'Mum and Dad investors' need to be aware of – arises from a Division in the GST law relating to the GST-free supply of a going concern and increasing adjustments for purchasers.

It seems that the details of this Division are quite well known to and continually exploited by a number of property vendors.

However, very little is known about it by prospective purchasers. And this is where the problems begin.

The most frequently experienced situation in which investors are involved is usually similar to the following example.

A developer constructs a high-rise apartment complex in a popular coastal destination. The individual units are then rented out to members of the public under a lease arrangement.

After a time, the developer of the complex sells off the individual units to 'Mum and Dad investors'. The developer sells the units, telling the buyers that they are in the business of carrying on lease agreements.

This allows for the transaction to be made as a GST-free supply, under the 'supply of a going concern' provision of the GST Act (the full name is *A New Tax System (Goods And Services Tax) Act 1999* (No 55 of 1999).

So, what does this information mean in practical terms? Let's look at the explanation of the terms 'supply of a going concern' and 'GST-free supply' to get a better understanding. According to the Australian Taxation Office (ATO), 'supply of a going concern' occurs when:

- A business is sold, and that sale includes all of the things that are necessary for the business to continue operating, and
- The business is carried on up until the day of sale

The supply of a going concern is GST free if it meets certain requirements, including:

- The sale is for a payment or consideration
- The purchaser is registered, or required to be registered, for GST, and
- The seller and the purchaser have agreed, in writing, that the supply is of a going concern

Other terms and phrases that are frequently used in regards to the 'supply of a going concern' transaction are 'input tax' and 'input tax credits'. 'Input tax credits' are able to be claimed on any GST that is included in the cost of acquiring or importing supplies for use in an enterprise. 'Input taxed' means that GST isn't charged on that particular supply. However, you're then not allowed to claim input tax credits for anything that is acquired or imported in order to produce the supply.

There is certainly no problem with buying an already operational business and all the required extras to continue running that business. Unsuspecting investors are being caught out when the vendor encourages the purchaser to register for GST, explaining that by doing so they won't have to pay any GST on the initial purchase transaction.

However, if the buyer's acquisition is for the purpose of making input tax supplies, that is, ongoing residential rental, then the buyer has no entitlement to claim input tax credits in connection with expenses incurred in the course of the purchase. Under Division 135 of the GST Act (titled 'Supplies of going concerns'), the buyer is required to pay the increasing adjustment of 10% of the purchase price as GST in the business activity statement (BAS) lodged for the tax period in which the purchase occurs.

The situation is further compounded by the two parties agreeing in writing that the supply is of a going concern. If this isn't agreed, then the transaction becomes a simple 'buy and sell', and the vendor is then liable to pay GST on the sale.

Under the Act, the vendor hasn't done anything legally wrong by advising the purchaser to register for GST, agreeing that the transaction is a 'supply of a going concern'. In such a situation, the ATO has no choice but to pursue the unsuspecting purchaser for the unpaid GST.

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Below is an example of the purchase of an existing residential property and the cost difference in the various scenarios (see box).

One scenario is where the 'supply of a going concern' is made and the transaction is therefore GST free but the increasing adjustment must be paid by the buyer. In the other situation, the buyer doesn't agree to the 'supply of going concern' and is therefore not liable for GST or the increasing adjustment payment.

It's of great importance to note that buyers of leased residential properties should never agree that the supply is of a going concern.

It's also important that, if you're looking to purchase an investment property, you must obtain independent legal advice before signing any property agreements. Do not opt into such an agreement before getting independent legal advice.

This will help you avoid getting caught by such GST traps as outlined above. The likelihood is that the property vendor is more concerned about their own monetary situation rather than your financial wellbeing.

Although most vendors are upstanding and legitimate business people, that their concern is with their own financial priorities shouldn't be overlooked.

There can be costly consequences from acting without first seeking independent professional advice.

Buying residential property: with and without liability

In this example, the agreed sale price of a property is $500,000, which doesn't include any GST that the vendor may be liable for. If the property is sold for that amount as a 'supply of a going concern', it's GST free and the vendor can claim input tax credits for expenses related to the transaction such as real estate agent and solicitor's fees.

As the purchase is for the purpose of ongoing residential rental (which is an input tax supply), the purchaser can't claim input tax credits and must pay the increasing adjustment of 10% of the purchase price in the business activity statement that is lodged for that period ($50,000). This brings the total purchase price to $550,000.

Had the buyer not agreed that the transaction was the 'supply of a going concern', the supply would have been 'input taxed' and no GST would be payable, making the total cost of the purchase the original figure of $500,000.

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