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AUSTRALIAN TAX ALERT

GST: CHANGES FOR GOING CONCERN AND FARM LAND SALES

GST: GOVERNMENT ANNOUNCES "REVERSE CHARGE" RULES FOR THE SALE OF BUSINESSES AND FARM LAND

The GST Act presently provides an exemption for the sale of a "going concern" or for the sale of "farm land". Where the exemption requirements are met, such sales are treated as "GST-free" supplies that are not subject to GST. On 14 December 2013 the Assistant Treasurer, Arthur Sinodinos, announced that the Government would proceed with a previously announced measure to replace the current GST-free treatment for going concern and farm land sales with a "reverse charge". In this Tax Update we provide an overview on how the reverse charge arrangements may apply and highlight some of the potential implications of the changes.

CURRENT GST-FREE EXEMPTIONS FOR GOING CONCERN AND FARM LAND SALES

Presently the "going concern" exemption is available for the sale of an operating business (or part of an operating business, if that part is capable of being operated as a separate enterprise). The

going concern exemption is also commonly used for the sale of tenanted commercial premises.

There are a number of conditions that must be met in order for the going concern exemption to apply, including both the vendor and purchaser agreeing in writing that the sale is of a going concern (this requirement is usually addressed in the GST clause in the sale contract). Further, both parties must be GST registered.

There is a separate GST-free exemption for the sale of "farm land". Broadly speaking, that exemption is available where land that has been used to carry on a "farming business" (as defined in the GST Act) is sold to a purchaser which intends that a farming business will be carried on, on the land. Unlike for the going concern exemption, there is no requirement for the parties to agree in writing before the exemption applies. Further, there is no requirement for the purchaser to be GST registered.

WHAT IS THE BENEFIT OF THE CURRENT EXEMPTIONS?

Sales of operating businesses, tenanted commercial premises, and farm land are generally material transactions. The key benefit of the current GST-free concessions is that it allows such sales to occur, generally between GST registered businesses, on a GST exclusive basis.

Where the exemptions apply, the purchaser will benefit through:

- A. reduced cash flow costs, as it will not be necessary for the purchaser to pay an amount to the vendor on account of GST and then wait to receive the benefit of an offsetting credit; and
- B. reduced stamp duty costs, as stamp duty generally applies to the GST inclusive price that is paid for a dutiable asset.

It should be noted that it is the purchaser that obtains both of these benefits. However, it is the vendor that carries the GST risk if a sale has been misclassified as a GST-free supply.

WHY MOVE TO A "REVERSE CHARGE"?

The current GST-free exemptions, for both going concern and farm land sales, do not interact particularly well with some other provisions in the GST Act (particularly the post-sale adjustment provisions). To address this, and to provide greater certainty to the parties, the Board of Taxation recommended in a report published in December 2008 that the current GST-free exemptions be replaced with a voluntary reverse charge.

HOW WOULD A REVERSE CHARGE WORK?

In May 2009, Treasury released a Discussion Paper which broadly outlined how the reverse charge mechanism could operate. However, no draft legislation was released and the changes were not enacted.

Based on the 2009 Discussion Paper, a reverse charge could apply as follows:

- The sale of a "going concern" or the sale of "farm land" will be treated as a taxable supply, not a GST-free supply.
- If the parties agree in writing, the GST on such sales can be "reverse charged" so that it is payable by the purchaser and not the vendor.

- Both the vendor and purchaser must be GST registered (including for farm land sales, which did not previously require the purchaser to be GST registered).
- GST will apply at the rate of 10% to the taxable component of any reverse charged going concern or farm land sale.
- The parties may also be able to elect to apply the "margin scheme" if land is being sold as a part of a going concern sale.
- The vendor may not be required to issue a tax invoice or adjustment note for the sale.
- The current adjustment provisions (in Division 135 of the GST Act) that can apply following a going concern or farm land sale will be abolished and not apply.

DOES THE REVERSE CHARGE APPROACH RETAIN THE CASH FLOW BENEFITS?

As noted above, one of the key benefits of the current GST-free exemption provisions is the cash flow benefits available to the purchaser. That benefit should continue if a reverse charge mechanism is introduced, provided that the purchaser is entitled to full input tax credits for its acquisitions. This is because the purchaser's reverse charged GST liabilities and input tax credit entitlements should net out to "nil" in the same GST return. This is illustrated in the worked example below.

DOES THE REVERSE CHARGE APPROACH ALSO RETAIN THE SAME STAMP DUTY BENEFITS?

It is arguable that if a GST liability is reverse charged and imposed directly on the purchaser, the GST payable by the purchaser does not form a part of the "consideration" provided to the vendor for a dutiable asset, such that stamp duty should not be imposed on the reverse charged GST.

However, there may be a risk that some State or Territory revenue authorities will take the view that the purchaser's agreement to reverse charge the GST means that the purchaser has voluntarily assumed a liability of the vendor. Assumed liabilities can form part of the consideration for the transfer of dutiable property. Consequently, there may be a risk that some State or Territory revenue authorities will seek to impose duty on the reverse charged GST.

WORKED EXAMPLE ILLUSTRATING A REVERSE CHARGE SALE

Property Co owns a small commercial office tower in the Sydney CBD which is fully tenanted. It has decided to sell the building, and assign all tenant leases, for \$100 million (excluding GST). Stamp duty is payable on the sale at a rate of 5.5%.

The table below illustrates the different GST treatments that could apply to the sale.

1. Taxable sale - GST payable by Vendor

Price (ex GST)	\$100 million
GST payable to Vendor @ 10%	\$10 million
Total payable to Vendor	\$110 million
Amount subject to stamp duty	\$110 million. Duty payable on the \$10 million referable to GST, increasing duty cost by \$550,000.
Cash flow cost?	Yes - Purchaser to fund \$10 million GST from completion date until an input tax credit is received.

2. GST-free sale - current going concern exemption applies

Price (ex GST)	\$100 million
GST payable to Vendor @ 10%	\$0
Total payable to Vendor	\$100 million
Amount subject to stamp duty	\$100 million. Save \$550,000 in duty compared to taxable sale.
Cash flow cost?	No - Purchaser does not have to pay any GST or wait to receive any credit.

3. Reverse charge sale

Price (ex GST)	\$100 million
GST payable to Vendor @ 10%	\$0
Total payable to Vendor	\$100 million
Amount subject to stamp duty	Arguably \$100 million, but see discussion on stamp duty benefits above.
GST payable by Purchaser @ 10%	\$10 million
Credit to Purchaser @ 10%	\$10 million
Cash flow cost?	No - the Purchaser's GST liability and credit entitlement should net out to "nil" in the same GST return.

EXTENDING THE "GOING CONCERN" CONCEPT

As a part of the change to the reverse charge mechanism for going concern sales, it had previously been proposed that the "going concern" concept be expanded to potentially cover more sales.

Presently, a vendor that is supplying a going concern must supply "**all of the things**" that are necessary for the continued operation of the enterprise being supplied. It had been proposed that this be expanded so that the vendor only needs to supply "**substantially everything**" necessary for the continued operation of the enterprise.

This change could be relevant in circumstances whether the purchaser doesn't want to acquire all of the vendor's assets, as the purchaser already has some assets of its own that it can use to carry on the acquired business. For example, this could potentially be relevant where the purchaser already has its own business premises and does not want to take over the vendor's premises.

WHEN WILL THE CHANGES BECOME EFFECTIVE?

The previous Labor Government announced as a part of the 2009-10 Budget that it would adopt the Board of Taxation recommendation and introduce a reverse charge for going concern and farm land sales. However, the required amendments were not legislated.

The Abbott Government has decided to retain this particular GST measure. The Assistant Treasurer's

media statement does not provide any guidance on when the legislation may be introduced, other than that it will likely be "during 2014". The media statement also indicates that the changes will apply prospectively from the date the enacting legislation receives Royal Assent.

OTHER IMPLICATIONS TO CONSIDER

Apart of the issues outlined above, other implications of the changes may need to be considered. These issues may include the following:

- The GST treatment of "call options". Generally speaking, the GST treatment of a call option is the same as the GST treatment of the supply that will be made on the exercise of the option. Therefore, if the call option allows the option holder to acquire land or a business on a GST-free basis, the call option will itself be GST-free. Going forward, call options over going concern and farm land assets may instead be taxable supplies.
- Will Vendors continue to want GST indemnities (including for interest and penalties) in respect of going concern and farm land sales if the GST has been reverse charged? Is the Vendor still at risk of having a GST liability if the parties have misclassified a sale as the supply of a "going concern" or "farm land" (such that the reverse charge option wasn't available)?
- Will there be circumstances in which it is beneficial for the parties to treat a sale as a taxable supply with GST payable by the vendor, rather than seeking to reverse charge the GST?
- What transitional arrangements will apply where contracts or options have been entered (but not completed) prior to the date that the reverse charge provisions commence?
- Will parties need to amend their transaction documents to replace old "going concern" and "farm land" provisions with new clauses relating to the reverse charge arrangements?
- Will the going concern concept be extended, so that the reverse charge provisions can be applied in a wider variety of circumstances?

HOW WE CAN ASSIST

Our Tax Team can provide the following assistance in relation to the proposed changes:

- Preparation of submissions as a part of any formal consultation processes which the Government or Treasury may undertake before enacting the changes.
- Assistance with understanding and modelling the impact of the proposed changes.
- Drafting of appropriate clauses for inclusion in transaction documents.

FOR FURTHER INFORMATION, PLEASE CONTACT:



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