GST FREE? TREATMENT OF GOING CONCERNS & FARMLAND

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In December 2013, the Government announced its intention to replace the GST free treatment for the supply of both going concerns and farming businesses with a ‘reverse charge’ mechanism. The scheme was initially proposed by the Rudd Government in 2009 but was not implemented. Corporate and Commercial lawyer, Sam Bassingthwaighte, provides an overview on how the reverse charge arrangements may apply and highlights some of the potential implications of the proposed changes.

CURRENT SITUATION

Currently, a supply of a going concern may be treated as GST free. Without the GST exemption, the seller would be required to charge GST (treating the sale as a taxable supply), in respect of which the purchaser would be able to claim an input tax credit, if they are registered for GST.

Under the existing legislation, there are a number of conditions that must be met in order for the going concern exemption to apply. These include, but are not limited to, both the seller and purchaser agreeing in writing that the sale is of a going concern (usually addressed in the GST clause in the contract for sale), everything necessary for the continued operation of the business being supplied to the buyer and both parties being registered for GST.

There is a separate GST exemption for the sale of land which has been used to carry on a farming business (as defined in the GST Act), where the purchaser intends to continue farming the land. Unlike the going concern exemption, there is no requirement for the parties to agree in writing before the exemption applies or for the purchaser to be registered for GST.

The current treatment of the supply of going concerns and farmland as GST free provides two main benefits to the purchaser:

- the purchaser does not have to fund the GST component and then wait to receive the benefit of the offsetting credit; and
- as stamp duty is generally calculated on the GST inclusive price the cost to the purchaser is reduced.

The seller carries the GST risk if a sale has been wrongly classified as a GST free supply.

‘REVERSE CHARGE’ MECHANISM

The Government has indicated that the reverse charge mechanism will commence when the amendments to the GST Act are passed and become law, which is likely to be the first half of 2015. Transitional provisions will be included to preserve the current position for contracts already on foot.

The proposal renders both supplies of going concerns and farmland taxable and introduces a system allowing parties to agree to reverse the GST burden, making the purchaser liable to pay the GST not the seller. Essentially, this achieves the same result that occurs with an ordinary taxable supply, where a contract contains either a GST inclusive price or requires the purchaser to reimburse the seller the GST payable in addition to the principal amount. However, the mechanism differs from an ordinary taxable supply as follows:

- provided all the parties are registered for GST , once the parties agree to reverse charge the GST, the agreement has legislative backing in addition to contractual enforceability;
- the purchaser is directly liable to the Commissioner of Taxation to pay the GST, it is not reimbursed to the seller (as such, a tax invoice is not required); and
- provided the purchaser is entitled to full input tax credits, the GST liability should be completely offset resulting in the same cash flow benefit that arises under the current scheme.

POTENTIAL DISADVANTAGES

Until the draft legislation is released, uncertainty will remain as to how the reverse charge mechanism will operate. Depending on the drafting of the legislation and the consent of the States and Territories, the stamp duty and GST exemptions under the previous mechanism may no longer be available.

The potential pitfalls of the proposed mechanism are as follows:

- GST: the current cash flow benefit will not be available to a purchaser who is not entitled to a full input tax credit in respect of the acquisition.
- Stamp Duty: the reverse charged GST may be included in the dutiable value of the transaction resulting in the purchasers having to pay more duty.
- On Sales: for purchasers wishing to develop and on-sell real property forming part of a going concern or farming business, it may be necessary to carve out that real property in order to preserve the application of the margin scheme for the future.

LOOKING FORWARD

Purchasers should ensure that any future contracts they enter into provide for the potential application of the reverse charge mechanism, even before the legislation is passed.

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