

# Taxing times in conveyancing

ALL CONVEYANCING PRACTITIONERS NEED TO HAVE A BASIC UNDERSTANDING OF TAX ISSUES TO AT LEAST ALERT CLIENTS THERE MAY BE A PROBLEM AND SEND THEM OFF FOR MORE EXPERT ADVICE. **BY HEATHER HIBBERD AND PHILLIP NOLAN**

All practitioners practising in conveyancing need to understand the tax implications of buying and selling property. Excluding tax advice from your retainer may not be sufficient to avoid all liability as a court may find that the practitioner should have drawn any relevant tax issues to the client's attention.<sup>1</sup> Some understanding of the tax issues is needed if only to refer clients to other tax experts.

LPLC's tax checklist<sup>2</sup> identifies many issues that need to be considered in conveyancing transactions to help practitioners and clients to agree on who will deal with those issues.

## Land tax

The most frequent land tax issues practitioners need to remember and build into their checklists and systems are set out below.

### Is the client buying as trustee of a trust?

Land owned by a trustee on behalf of a trust, subject to certain exclusions,<sup>3</sup> is subject to land tax, once the aggregate Victorian land holding reaches \$25,000 instead of the general threshold of \$250,000. The tax payable is at a higher surcharge land tax rate than the general land tax rate.<sup>4</sup>

### Claims

Claims have arisen where practitioners didn't realise that the client was buying the property as trustee on behalf of a trust. The practitioners did not submit the land tax trust form 8, resulting in the wrong land tax being paid. The mistakes were usually discovered during a State Revenue Office audit and penalties and interest were incurred.

### Risk management

Ask the client at the start of the transaction if they are buying on

behalf of a trust and tell them that higher land tax will be incurred unless an exclusion applies.<sup>5</sup> Confirm the client's instructions in writing.

Are there land tax implications if buying more than one property from the same vendor?

Land tax is usually adjusted at settlement based on the value of the property, that is, on a single holding basis, as though the land described in the particulars of sale is the only land owned by the vendor. It may be advantageous for some purchasers to buy multiple properties from one vendor under separate contracts rather than in one contract.

Similarly, it may be advantageous for a vendor with multiple land holdings to do adjustments on a proportionate basis.

While practitioners are not necessarily required to do the various calculations, they should understand the issue and raise it with clients in appropriate circumstances.

You should:

- Add land tax certificates to the checklist of certificates you obtain for purchasers.
- Know what land is exempt from land tax. The most common exemptions are principal place of residence property, primary production land, land owned or used by charities and rooming houses. A range of other land tax exemptions is set out on the SRO website.<sup>6</sup>
- Have a basic understanding of these exemptions.

### Why is it important to obtain a land tax certificate?

Practitioners acting for purchasers should always obtain a land tax certificate, first, to check the amounts payable and second, because the purchaser can rely on the amounts in the certificate if liabilities

arise in the future from tax default by the vendor, or errors in the SRO records. This protection is set out in s 96 of the *Land Tax Act 2005* (Vic) and

#### SNAPSHOT

- There are often tax consequences when buying or selling real estate and conveyancing practitioners need to understand what those tax issues may be.
- Land tax, duty and GST consequences of a conveyancing transaction can affect the way the client decides to structure their purchase or sale.
- Practitioners need to make appropriate inquiries and give timely advice about potential tax issues to help clients make the right decisions.

TAX TIME

only applies if the bona fide purchaser for value obtains the certificate. The protection does not apply if the purchaser relies on a certificate provided by the vendor.

## Duty

Claims involving duty have increased significantly in the past few years. The most common mistakes involve not understanding when nominations will result in a sub-sale and incur a second amount of duty. The other major issue is failing to advise foreign residents about increased duty they have to pay.

When do nominations incur double duty?

Section 32J of the *Duties Act 2000* (Vic) sets out the basis on which duty will be payable on transfers. While somewhat difficult to follow, it essentially says that double duty will be payable when a vendor agrees to transfer land to an original purchaser and then to a subsequent purchaser, often through nomination, in two circumstances:

- The original purchaser “undertook or participated in land development” before the new purchaser was nominated.
  - The subsequent purchaser pays or is liable to pay more consideration than the original purchaser.
- “Land development” is defined broadly and includes:
- preparing a plan of subdivision or taking steps to have it registered
  - applying for or obtaining a planning permit
  - applying for or obtaining a building permit or approval
  - doing anything on the land for which a building permit or approval would be required
  - requesting an amendment to a planning scheme that would affect the land
  - developing or changing the land in any way which would increase its value.

## Claims 2

Claims commonly arise when the law firm knows its purchaser client is about to, or has, lodged a planning application before a related company or entity is nominated as purchaser, but fails to warn the client of the double duty exposure.

## Risk management 2

Include advice in your precedent letter to purchaser clients about the risks of

double duty when nominating if any land development, including lodging planning applications, has occurred.

When do foreign purchasers pay additional duty?

There is additional duty payable for foreign natural persons, foreign corporations and trustees of a foreign trust. Foreign entities are defined on the SRO website.<sup>7</sup> The definitions practitioners sometimes don't know are: a foreign corporation is any corporation incorporated outside Australia or if incorporated in Australia the controlling interest is held by a foreign natural person, foreign corporation or foreign trust. A foreign trust is a trust where a substantial interest is held by foreign natural person, foreign corporation or another foreign trust.

There are various exemptions that may apply but in general the extra duty payable by a foreign purchaser of residential property is 7 per cent. Giving residential property to a foreign party also incurs the extra duty.

While not strictly duty, foreign buyers may also be caught by the vacant residential land tax.<sup>8</sup>

## Claims 3

Clients often allege after the transaction that they were not advised there would be extra duty, and had they been advised they would have restructured the purchase so that it was not made by a foreign party. This can happen where the purchasers are a husband and wife, but only one is a foreign person or the purchaser is a family trust and one of the beneficiaries is a foreign person, which creates a foreign trust.

Often the firm is unaware the party is a foreign purchaser, so the advice is not given.

## Risk management 3

Become familiar with the definition of foreign purchaser. Ask clients at the start of the matter, particularly if you are giving precontractual advice, if they are foreign purchasers and advise them of the extra duty.

When are transfers of property between beneficiaries and trusts not exempt?

There are exemptions from duty for transfers to and from a trustee. These exemptions are set out in Chapter 2 Part 5 of the *Duties Act*.<sup>9</sup> They relate to specific types of trusts and beneficiaries and all criteria in the sections must be complied

with for the exemption to apply. This is not an area where a general understanding of principle is enough. If you are going to advise on these transactions, you need to read the legislation and any reliable commentary, including the SRO website,<sup>10</sup> as well as the terms of any trust deeds carefully.

## Claims 4

The common claim scenario involves trust property that is subdivided and developed and then one or more titles transferred to various beneficiaries. The beneficiaries are often also trustees of the trusts. The exemptions do not apply for various reasons, including the way the trust deeds are written; the amount transferred does not match the unit holders' interest; the transfer is made in satisfaction of a debt owed to the beneficiary; or the beneficiary pays out or takes over the existing mortgage. The clients allege, had they been properly advised, they would have restructured their arrangements. The practitioner usually makes the mistake of generalising about the arrangements instead of looking closely at the detail of the transaction.

## Risk management 4

The law in this area is complex and if you do not have a detailed knowledge of the legislation and its application you should refer clients to a suitably qualified tax barrister, solicitor or accountant. You should make it clear in your retainer that you are not advising on this aspect and the importance of obtaining advice.

## GST

The application of GST legislation and rules is not always simple. LPLC's GST checklist<sup>11</sup> is a useful tool for everyone practising in conveyancing. It is designed to take practitioners through the main issues to consider and provide them with links to the relevant reference material. We cannot deal with all GST issues in this article, but below are some that appear regularly in the claims or via the LPLC GST Hotline.

## Who fills in the 'plus GST' box?

Filling in the “plus GST” box might seem like a simple administrative task, but it underpins whether practitioners are dealing with GST with their vendor clients. In some

claims the practitioner or clerk does not even turn their mind to whether GST is payable, often because they don't realise the property is commercial or new residential property. In other cases, the client hasn't decided whether to make the contract plus GST and it is left blank and not revisited.

GST needs to be on the checklist and be considered each and every time.

### What are residential premises?

Residential premises in most cases will be obvious, but there will always be those properties that occupy the fringe of the definition. The definition can be found in s195-1 of the GST Act<sup>12</sup> as land or a building that is occupied, or capable of being occupied, as a residence. For land to meet the definition it must have a building on it that has the physical characteristics of a residence.<sup>13</sup>

If the building is no longer habitable because, for example, the bathrooms are damaged or not working or the kitchen is non-existent, then it will not meet the requirements of being a residence, even if it is in a residential zone. The property needs to be treated as vacant residential land.

Similarly, if the building had previously been a residence but has been turned into an office so that it no longer has the characteristics associated with residential accommodation and is leased for use as an office, it cannot be treated as residential property.

### What are new residential premises?

The sale of new residential premises is a taxable sale if the vendor is registered or required to be registered for GST, and the supply is made in the course or furtherance of an enterprise that the vendor carries out.

The supply by a natural person of their own home is not a taxable supply since it would not be made in the course or furtherance of an enterprise.

The definition of new residential premises appears in s40-75 of the GST Act. The premises will be new if:

- a new residence has been built in place of an old residence or
- a residence has been substantially renovated
- the property had not been sold as residential property before, such as when a previously commercial property has been converted to a residence.

New residential premises cease to be new

if they have been previously sold or rented out for a continuous period of five years.

### When will an isolated transaction for the sale of a property trigger the need for GST registration?

Where a vendor of commercial property or new residential premises is not registered for GST it may appear that GST is not payable. However, there is a further question that needs to be asked. Was the supply done in the course or furtherance of an enterprise? GST ruling GSTR 2001/7<sup>14</sup> at paragraphs 46-47 sets out that where an entity buys a property, such as a suburban shop, and refurbishes it with a view to then selling it for a profit, it is an isolated transaction that constitutes an enterprise. The sale of the property is treated as trading stock rather than the disposal of a capital asset. The sale price is part of the enterprise turnover for the purposes of assessing projected GST turnover and usually will be more than \$75,000, so the vendor will be required to be registered.

The key issue here is what was the vendor's purpose in buying the property in the first place when assessing whether this was an isolated transaction that triggers the requirement to be registered for GST.

### When can the margin scheme be used?

The margin scheme can be applied if the parties agree in writing before settlement to apply it. Where a nomination occurs, the new purchaser should confirm in writing to the vendor the use of the margin scheme. Agreements after settlement must be done with the Commissioner of Taxation's approval (s75-5(1A)).

The margin scheme can be applied to property that was previously bought on the margin scheme. It can also be applied where the previous purchase was input taxed, non-taxable or GST-free, for example, existing residential property. There are some less common restrictions on the use of the margin scheme that can be found at s75-5 of the GST Act. If GST was paid on the full sale price when buying the property, the margin scheme cannot be applied on the sale.

Developers who buy existing residential premises and then develop them into new residential premises will usually want to sell on the margin scheme and can do so if the sale contract specifies the margin scheme

be used. Developers who buy residential vacant land will want to buy on the margin scheme so they can sell the developed property on the margin scheme. This should be discussed if giving pre-contract advice for the purchase, and the subsequent sale.

### Practical examples

LPLC's GST FAQs<sup>15</sup> has a lot of practical examples on GST issues and further information about GST withholding can be found in LPLC's bulletin, *GST practical examples*.<sup>16</sup> All LPLC checklists can be found at [lplc.com.au](http://lplc.com.au).

### Conclusion

Tax issues in conveyancing transactions are often not simple. Practitioners doing conveyancing need to have a general grasp of the issues, so they can at least warn clients of the potential pitfalls and when they need to get further tax and/or financial advice. It is not enough to just say you don't advise on tax. You need to be at least consciously incompetent in this area. That is, know what you don't know. ■

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The authors acknowledge the assistance of Derry Davine in the preparation of this article.

1. *Snopkowski v Jones (Legal Practice)* [2008] VCAT 1943.
2. <https://lplc.com.au/checklists/key-risk-checklist-tax-issues/>
3. See s46A of the Land Tax Act for a list of exclusions such as a superannuation trust.
4. State Revenue Office website <https://www.sro.vic.gov.au/node/1506>
5. See s46A of the *Land Tax Act 2005* (Vic)
6. <https://www.sro.vic.gov.au/node/1460>
7. <https://www.sro.vic.gov.au/node/1658>
8. The vacant residential land tax applied from 1 January 2018 to homes that were vacant for more than six months in the preceding calendar year in inner and middle Melbourne. Land owners of vacant residential property are required to notify the State Revenue Office by 15 January every year. Failing to notify is a notification default and penalties may apply.
9. [http://www.austlii.edu.au/cgi-bin/viewdb/au/legis/vic/consol\\_act/da200093/](http://www.austlii.edu.au/cgi-bin/viewdb/au/legis/vic/consol_act/da200093/)
10. <https://www.sro.vic.gov.au/node/1478>
11. <https://lplc.com.au/wp-content/uploads/2018/04/Key-Risk-Checklist-GST.pdf>
12. *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act).
13. GSTR 2003/3 para 26, <https://www.ato.gov.au/law/view/document?DocID=GST/GSTR20033/NAT/ATO/00001&PiT=99991231235958>
14. <https://www.ato.gov.au/law/view.htm?DocID=GST/GSTR20017/NAT/ATO/00001>
15. <https://lplc.com.au/risk-management/taxgst/gst-qa-2/>
16. <https://lplc.com.au/bulletins/gst-withholding-practical-examples/>