

RISK MANAGEMENT INTENSIVE 2019

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Conveyancing tax issues

Contact information

Phil Nolan | Risk Manager | LPLC

Please contact me with any risk management issues.

T: 03 9672 3800 E: phillip.nolan@lplc.com.au

Website

lplc.com.au

Social media



@LPLC_AU



@LPLCAU



[Linkedin.com/company/lplc](https://www.linkedin.com/company/lplc)

Thought

How many tax issues do you raise with clients in a conveyancing matter?

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Conveyancing tax issues

Phil Nolan, Risk Manager, LPLC

CPD units: 1 Substantive law

Key points

- Develop, use and update a tax issues checklist.
- Invest in some good resources on taxes and consult them regularly.
- Take some time to read cases about taxes.

Introduction

Practitioners should consider which taxes to raise with conveyancing clients including duty and land tax because a client who has tax advice is in a better position to make informed choices and avoid potential pitfalls. Sometimes this means ensuring the client has obtained advice from other tax experts where necessary.

Acronyms explained

CGT – capital gains tax

GST – goods and services tax

Did you know?

Prior to the Duties Act 2000 (Vic) duty was referred to as stamp duty because of the practice of physically attaching a stamp to a document to denote that stamp duty had been paid. This had to occur to make the document legally effective.

Take the tax test

Tick the box if your answer is yes.

- ☐ Do I have a checklist of tax issues?
- ☐ Do I have enough tax knowledge to know which taxes may impact on a client's conveyance?

For example, by:

- o keeping up to date with changes to tax laws. For example, do you know that the Federal Government first home buyer deposit guarantee scheme is set to commence 1 January 2020?
- o monitoring websites with information about taxes. For example, the ATO electronic newsroom for small business. Go to www.ato.gov.au/newsroom/smallbusiness
- o attending seminars about tax issues
- o collecting resources about tax issues. For example, Foundations of Tax Law by Stephen Barkoczy published by Oxford.

- ☐ Do I discuss tax issues with conveyancing clients to enable clients to make informed choices?

Rule 7 of the *Legal Profession Uniform Law Australian Solicitors' Conduct Rules 2015* provides that a practitioner must ensure clients make informed choices.

- ☐ Do I refer clients to on-line calculators?

For example, the SRO land transfer calculator?

You can access the calculator here:

<https://www.sro.vic.gov.au/calculators/land-transfer-calculator>

- ☐ Do I document tax advice to clients in writing?
- ☐ Do I allocate responsibility for tax issues?

For example, telling the client to discuss CGT with their accountant before deciding.

Notes

CGT

Overview

Legislation: *Income Tax Assessment Act 1997* (Cwlth).

Commencement: 20 September 1985.

Aim: To collect tax on any net gain on disposal of a CGT asset.

Imposition: Payable as part of income tax.

Notable amending legislation: *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2015* (Cwlth).

Commencement: 1 July 2016.

Aim: To collect capital gains tax payable by foreign residents.

Imposition: 12.5 per cent withholding by an acquirer of certain taxable Australian property unless a clearance certificate is received for direct interests / variation obtained / declaration given for indirect interests.

Examples of assets caught

- \$750,000* or more value for acquisitions directly from the owner of:
 - freehold
 - leasehold
 - mining, quarrying or prospecting rights.
- \$750,000* or more value for acquisitions of company title interests.
- Any value for acquisitions indirectly - such as acquiring shares in a company, interest in a partnership or units in a unit trust and where the transferor owns 10 per cent or more of the entity and the entity is land rich.
- Options or rights to acquire any of the above.

* A market value of \$750,000 or more applies for acquisitions from 1 July 2017. Previously the threshold was \$2M or more.

Further information

The Australian Taxation Office website:

<https://www.ato.gov.au/General/Capital-gains-tax/>

LPLC Bulletins:

1 July amended CGT withholding payments for real property sales.

<https://lplc.com.au/bulletins/1-july-2017-amended-cgt-withholding-payments-for-real-property-sales/>

CGT withholding payments – practical examples.

<https://lplc.com.au/bulletins/cgt-withholding-payments-practical-examples/>

Amended CGT withholding payments for options, company title interests and indirect Australian real property transactions.

<https://lplc.com.au/bulletins/amended-cgt-withholding-payments-for-options-company-title-interests-and-indirect-australian-real-property-transactions/>

CGT exercise 1

Background

You act for two registered proprietors who instruct you to do two transfers of land as follows:

- Green acre (their principal place) from both to just one of them.
- Black acre from both to a self-managed super fund that they are in the process of establishing.

The clients tell you they are doing the transfers on advice from their financial advisor as part of a refinance of their Westpac business loans.

After this initial visit you write to the clients confirming their instructions and make it clear you are not providing any tax advice.

Some months after the transfers are registered the clients contact you saying their accountant recently informed them that CGT is payable. They also tell you, with some anger, that they would not have gone ahead with the transfers if you had explained to them the CGT consequences.

You deny any liability on the basis that you told them you were not providing any tax advice and given that the clients told you they had received advice from their own financial advisor before instructing you.

Questions

Does this 'carve out' protect the practitioner?

Is there anything more you might reasonably do in this situation about any tax issues?

Further information

LPLC Blog posted 3 February 2017, It's just a transfer of land.

<https://lplc.com.au/blog/just-transfer-land/>

CGT exercise 2

Background

You act for a husband and wife in the sale of 25 Doncaster Road, Balwyn North. The sale is subject to a lease of a granny flat at the rear of the property currently leased to a university student for \$100 a week. The lease expires in 6 months.

The husband is a foreign resident. The wife is an Australian citizen and resident tax payer. The clients tell you that for a few years they have run a business from home providing IT services to medical practitioners.

They tell you they are expecting about \$1,200,000 for the property.

You are about to send the draft contract and section 32 statement to them for approval.

Action

List three issues you would refer to in your letter enclosing the documents about CGT.

1. _____

2. _____

3. _____

GST

Overview

Main legislation: *A New Tax System (Goods and Services Tax) Act 1999* (Cwlth).

Commencement: 1 July 2000.

Imposition: 10 per cent value added tax payable on most goods and services. Registered businesses collect GST and those in the chain of supply are entitled to claim a credit for any GST paid. The end consumer is not entitled to claim a credit.

Examples of supplies:

- Taxable.
- Input taxed.
- Going concern / farm land.
- Margin scheme.

Causes of GST claims

- **Failure to manage the legal issues.** For example, did not check that the supply qualified as a going concern.
- **Simple oversight.** For example, margin scheme 'box' not completed in particulars of sale.
- **Poor engagement management.** For example, a practitioner acted for a client who purchased a property on the margin scheme. When the property was on-sold the practitioner did not discuss with the client whether the margin scheme was to apply to the sale.

Three recent GST FAQs

Q1: What should I do where I am acting for a purchaser buying a new townhouse and the vendor is not registered but I suspect they are required to be registered?

A1: If the supply is a taxable supply of new residential premises and you have a notice saying you do not have to withhold, then the Australian Taxation Office has told us you can rely on that notice providing nothing makes it unreasonable to believe the notice. The mere fact that the property is newly built without any further information is, according to the ATO, not enough to make it unreasonable to believe the notice.

Q2: My client is not registered for GST and he is selling a commercial property/factory for around \$400,000. Do I need to deal with GST in the contract?

A2: While your vendor client is not registered for GST the question you need to ask is whether he is required to be registered. The points to note are:

- an entity is required to be registered if its GST turnover from an enterprise is at or above the GST registration threshold (\$75,000 p.a.)
- GST turnover consists of current GST turnover and projected GST turnover and includes turnover from all sources other than salaries and input taxed turnover
- it is not a requirement that the enterprise be one relating to dealings in land
- whether an entity is required to be registered is not judged on a property by property basis.

In your case, the GST turnover is not restricted to the turnover from the business that your client operates. It will certainly include that turnover but will also include relevant turnover from other sources.

If the position is that your client is neither registered nor required to be registered for GST, section 188-25 of the GST Act excludes the proceeds of sale of a capital asset from projected GST turnover, so avoiding the situation where the sale itself triggers a requirement to be registered. This exclusion does not apply where land is trading stock, and land may become trading stock (for income tax and GST purposes) if acquired for the purpose of resale.

If there is any likelihood at all that your client is required to be registered, the contract should be 'plus GST' and you should determine his GST status one way or another and, if the indication is in favor of registration, register him.

If the property is leased, you should consider if the going concern exemption will apply.

If the property is not leased, you should consider whether the margin scheme could be applied.

Q3: What are the notice and/or GST withholding requirements for retirement village units?

A3: Retirement villages will be subject to the withholding requirements but only if there is a supply of residential premises by way of sale or long-term lease. A long-term lease is defined as one of at least 50 years. A lease of less than 50 years, and a lease for at least 50 years but which is not reasonably expected to continue for at least 50 years, will not, according to the ATO, be long-term leases as defined in section 195-1 of the GST Act.

Your comments

GST exercise

Background

You receive a draft contract and section 32 statement from a client buying a factory in Officer. The vendor is an owner occupier.

The contract is dated 27 June 2019 with a sale price of \$1.2million. Settlement is in 90 days.

None of the GST boxes have been completed but the contract contains a special condition about GST.

Special condition

For the purposes of this special condition: 'GST' means GST within the meaning of the GST Act; 'GST Act' means A New Tax System (Goods and Services) Act 1999; Expressions used in this special condition which are defined in the GST Act have the same meaning as given to them in the GST Act.

The consideration payable for any taxable supply made under this contract represents the value of the taxable supply for which payment is to be made; Where a taxable supply is made under this contract for consideration which represents its value, then the party liable to pay for the taxable supply must also pay at the same time and in the same manner as the value is otherwise payable the amount of any GST payable in respect of the taxable supply.

Action

List three issues you would raise with your purchaser client about GST.

1. _____

2. _____

3. _____

Land tax

Overview

Main legislation: *Land Tax Act 2005* (Vic)

Commencement: *Land Tax Act 1877* (Vic)

Imposition: A tax on the value of land owned as at 31 December. There are various rates and a few exemptions.

Deduction: Generally, land tax can be claimed as an expense for a rental property for the period your property was rented or available for rent.

Comments

Practitioners are often pursued by clients who are found to owe unexpected land tax alleging that the practitioner failed to advise.

A common mistake that practitioners make involving land tax is they fail to pick up that the client purchasing land was a trustee, and so don't notify the State Revenue Office (SRO) that the land was acquired by the purchaser in a trustee capacity. The surcharge land tax rate for trustees operates where the total value of land owned by the trust is \$25,000, subject to several exceptions. This is a much higher rate than the general land tax rate which operates for land of \$250,000 or more.

One of the key things to do to avoid these oversights is to always make it your business to ask the client if they are buying the property in a trustee capacity. This question is in our Key risk checklist: Purchase of land – questions for the purchaser. Very often the contract of sale, nomination form or other documents will refer to a trust – so read the documents carefully. Give the SRO the appropriate trust acquisition notice or advise the client to do so.

More information on 'land tax and trusts' can be found on the SRO website here:

<https://www.sro.vic.gov.au/land-tax-and-trusts>

What's fairly new

The SRO announced in late March 2019 that you can now pay the land tax shown on the land tax clearance certificate by credit card or BPAY.

This means you will be able to pay the land tax shown amount on the clearance certificate through PEXA. When creating a destination line item, practitioners can select the 'other' category and enter the BPay details.

According to PEXA in the coming months, a specific category for land tax will be created, but practitioners will still be required to enter the BPay details.

Land tax - Examples of claims

Unaware of trust

In one claim a practitioner acted for a purchaser of a house for development.

The individual purchaser nominated a company as substitute purchaser. The matter settled in September 2014.

In early 2018 the SRO determined that the property was subject to the land tax surcharge for trusts and sought additional land tax of approximately \$20,000.

The client contacted the practitioner and sought an explanation as to why notice was not given to the SRO of the acquisition by a trust.

In this claim the practitioner did not ask whether the purchaser was a trustee and the client did not volunteer the information. In recognition that both the client and practitioner were to blame for failing to give notice, the claim settled with a small payment to the client.

Knowledge of trust

In a similar claim which resulted in a bigger payment to the client, the practitioner prepared the nomination form which referred to the nominee company in its capacity as trustee of a trust. The practitioner failed to either give notice to the SRO about the trust acquisition or tell the client to do this.

Lucky it was an SMSF

In another matter notified to LPLC, the clients accountant questioned why the client's SMSF was paying land tax at the higher trust rate.

The client contacted their lawyer who promptly sought a refund from the SRO of the overpaid land tax.

See s. 46E of the *Land Tax Act 2005* (Vic).

Further information

For more information refer to the LPLC publications:

'Land can be taxing' - LJ 1 March 2014, found here: <https://lplc.com.au/lj-articles/land-can-taxing/>

'More land tax woes' - blog posted 12 December 2014, found here: <https://lplc.com.au/blog/land-tax-woes/>

What's new from the budget?

- Absentee foreign owner surcharge increased from 1.5% to 2% commencing 2020 for land holding at 31 December 2019.
- Change to method of valuing heritage land from hypothetical development to cost approach.

Relevant legislation

State Taxation Acts Amendment Act 2019 (Vic)

Land tax exercise

Background

A client of many years passed away in July 2017.

The deceased's daughter is named as sole executor and instructs you to act in the probate.

It is a very complicated estate with numerous property holdings, trusts and companies that need to be dealt with.

The daughter also seeks advice from you about her entitlement as a beneficiary including whether any duty will be payable on a transfer of one of the properties from the estate to the daughter's SMSF.

Action

List three land tax issues you would raise with the daughter.

1. _____

2. _____

3. _____

Duty

Overview

Main legislation: *Duty Act 2000* (Vic)

Commencement: *Stamp Duties Act 1879* (Vic)

Imposition:

**An Act for granting certain Stamp Duties and to
provide for the management and collection
thereof. [17th December 1879.]**

MOST GRACIOUS SOVEREIGN—

WE Your Majesty's most dutiful and loyal subjects the Legislative Assembly of Victoria in Parliament assembled towards raising the necessary supplies to defray your Majesty's public expenses and making an addition to the public revenue have freely and voluntarily resolved to give and grant unto your Majesty the several duties hereinafter mentioned, and do therefore most humbly beseech your Majesty that it may be enacted: And be it enacted by the Queen's Most Excellent Majesty by and with the advice and consent of the Legislative Council and the Legislative Assembly of Victoria in this present Parliament assembled and by the authority of the same as follows (that is to say) :—

Preamble.

Exemptions: Many, including principal place, no change in beneficial ownership.

Other relevant legislation: Taxation Administration Act 1997 (Vic) which contains provisions for the administration and enforcement of taxation laws.

Comments

The most common mistake involving duty, is failing to advise purchasers that double duty will be incurred when a nomination occurs after a planning application has been made. Often the practitioner is aware the purchaser is proposing to do building works on the property and is going to lodge a planning permit but fails to give them a warning not to before they nominate a new, often corporate, purchaser.

Clear advice about the impact of doing any building works, which includes lodging a planning permit, is needed to avoid these mistakes. See sections 32I and 32J of Duties Act.

Further information

LPLC blogs

'Nomination woes – GST, foreign investment and stamp duty', blog posted 4 September 2015, found here: <https://lplc.com.au/blog/nomination-woes-gst-foreign-investment-and-stamp-duty/>

'Take a step back', blog posted 1 June 2018, found here: <https://lplc.com.au/lii-articles/take-a-step-back/>

What's new from the budget?

Relevant legislation: *State Taxation Acts Amendment Act 2019* (Vic)

Foreign buyers: Increase from 7% to 8% additional duty for foreign buyers. Applies to contracts entered into from 1 July 2019.

Economic entitlements – ‘a fresh head of duty’.

Introduction:

Recent changes to the *Duties Act 2000* (Vic) have created a ‘fresh head of duty’.

Background

Since 2012, s.81 of the Duties Act imposed duty where a party acquires an ‘economic entitlement’.

S.81 was amended in 2013 and the words ‘in a private landholder’ in section 81(5) were inserted by the *State Tax Laws Amendment (Budget and Other Measures) Act 2013*.

More recently s.81 was amended pursuant to the *State Taxation Acts Amendment Act 2019* (Vic).

According to the second reading speech the purpose of the changes to the economic entitlement regime is to address technical issues and gaps consistent with the findings of the Supreme Court's decision in *BPG Caulfield Village Pty Ltd v Commissioner of State Revenue* [2016] VSC 172.

In the BPG case Justice Croft commented that:

The Commissioner sought to argue against this interpretation and operation of sub-ss 81(3), (4) and (5) on the basis that the word “interest” should be taken to bear the same meaning throughout these provisions. Superficially, this argument may seem attractive.....In my view, there is here, clear reason to do otherwise.....because this approach, as advocated by the Commissioner, would have the effect of raising a fresh head, or heads, of liability to duty. [45]

SRO example of how the amendments operate

ABC owns a parcel of land in Melbourne valued at \$30 million. ABC has obtained planning approval to develop the land into an apartment tower. However, ABC has neither the means nor the expertise to undertake the development. In order to proceed with the development, ABC has entered into an arrangement with a developer, XYZ, under which XYZ has agreed to fund and oversee the development.

Under the arrangement XYZ is entitled to have the build cost reimbursed plus 50% of the profit, while ABC is entitled to \$30 million (i.e. the initial value of the land) plus 50% of the profit. The build cost is \$80 million. The projected gross sale revenue upon sale of the developed apartments is \$150 million.

As the arrangement includes a payment other than a specified economic entitlement in percentage form, the integrity provision will apply to deem the taxpayer to have acquired 100%. However, this is subject to the Commissioner exercising his discretion to determine a lesser amount if it is appropriate to do so. The intent of the integrity provision is to encourage taxpayers to be more transparent on the economic entitlements obtained under the arrangement to enable the appropriate duty to be applied. It is not the intent to take a higher duty than the total benefits received.

Accordingly, the taxpayer will need to substantiate that the build cost is \$80 million and not a profit-sharing fee. Assuming that the taxpayer does this, the Commissioner will exercise his discretion to determine the economic entitlement is 50%.

In the event that the taxpayer does not substantiate that the build cost is \$80 million (i.e. does not substantiate that the build cost is not a profit sharing fee) or alternatively stays silent, on the facts of this matter, the Commissioner will still exercise his discretion and reduce the economic entitlement to 66.67%, being the maximum percentage of benefits that the taxpayer could be said to be entitled to under the arrangement when it was entered into.

Notably, duty is calculated by reference to the unencumbered value of the land at the time the economic entitlement was acquired, not by reference to the end value of the development. In this scenario, duty will be calculated by reference to the vacant land value (\$30 million), not the end value of the development (\$150 million). That is, duty will be payable on the percentage interest deemed to have been acquired in the vacant land.

Further information

Link to information on the SRO website about the new economic entitlement provisions in Part 4B of Chapter 2 (i.e. economic entitlement in relation to land):

<https://www.sro.vic.gov.au/economic-entitlements>

Link to information on the economic entitlement provisions that have been retained in the Landholder Duty regime in Part 2 of Chapter 3 (i.e. relevant acquisition of an economic entitlement in a private landholder):

<https://www.sro.vic.gov.au/node/1425>

Did you know?

From applications for a refund can only be made to the SRO online using the all-in-one duties refund smart form.

Are you concerned about SRO red tape?

Practitioners who are concerned about Government red tape affecting their business may wish to notify the Red Tape Commissioner.

Contact: Jason Knight, Manager Red Tape Unit, Phone: 03 9092 5803

Email: jason.knight@betterreg.vic.gov.au

Duty exercise

Background

The trustee of a family trust instructs you to transfer a property to a son who is a specified beneficiary.

This is the third such transfer by the trustee. The previous two transfers were to the other two children of the trustee.

The client provides you with the usual information about the transfer including details of a loan account between the trust and the son.

Action

What duty issues you would raise with the trustee?

Appendices index

LPLC Key risk checklist – Tax issues

LPLC Key risk checklist – GST

‘Tax issues in conveyancing’, LIJ Article May 2019