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Senate Standing Committee on Economics
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Inquiry into Tax Laws Amendment (2008 Measures No.5) Bill 2008

The Urban Development Institute of Australia (National), welcomes the opportunity to provide a submission to the Senate Standing Committee on Economics' Inquiry into the Tax Laws Amendment (2008 Measures No.5) Bill 2008.

The Urban Development Institute of Australia (UDIA) is the peak body representing the property development industry throughout Australia. Established at a state level in 1963, the Institute evolved to become a national body with a number of state-based divisions in 1970.

UDIA aims to secure the economic prosperity and future of the development industry in Australia, recognising that national prosperity is dependent on our success in housing our communities and building and rebuilding cities for future generations.

Our members cover a wide range of specialist and industry fields, including: Developers, Valuers, Planners, Engineers, Architects, Marketers, Researchers, Project Managers, Surveyors, Landscape Architects, Community Consultants, Environmental Consultants, Lawyers, Sales and Marketing Professionals, Financial Institutions, State and Local Government Authorities, and Product Suppliers.

Please find the attached submission schedule that in essence seeks to minimise the negative impact of the bill on development industry operations and consequent costs on development and housing affordability. We would welcome the opportunity to discuss our submission with the Committee in greater detail.

Yours sincerely

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PRESIDENT
UDIA (NATIONAL)

3 October 2008

Tax Laws Amendment (2008 Measures No.5) Bill 2008

UDIA's interest in regard to the legislation is Schedule 1, "GST and the sale of real property – integrity measure", which is a measure announced in the 2008-09 Budget designed to change the calculation of the GST on real property.

UDIA participated in the consultative process for the drafting of the legislation for this measure, and is thankful to The Treasury for this opportunity. We acknowledge that during the consultative process, The Treasury accepted UDIA's recommendation to change (defer) the implementation of the measure from the date of publication to the date of Royal Assent.

GST and the Sale of Real Property – Integrity Measure

UDIA does not believe that the introduction of this provision is warranted or necessary. It is our view that introduction of this measure will have undesirable impacts likely to exceed the intended purpose.

The development industry does not shirk from meeting its share of GST compliance and in general considers that the current process has been working well. UDIA is cognisant that the GST Act on its introduction provided for the margin scheme operation and apart from some abuses, which have been identified and dealt with by the Australian Taxation Office (ATO), we consider that it has overall achieved the objective set for it.

We are of the view that the legislative provisions that are now in place are adequate and that no further amendments are necessary or desirable. UDIA notes that in the past the ATO have indicated that they are prepared to challenge situations where they perceive there to be an abuse of the existing provisions and have made their views very clear in the form of Taxpayer alerts that have been finalised in the form of public rulings.

It is considered that the ATO have addressed the potential abuse of the existing provisions and are empowered to query and penalise inappropriate actions. We further believe that the action taken by the ATO has sent a clear message to those in the industry that might have considered taking an aggressive stance under the existing law, and that no further steps are required to address this area of concern.

Consequences of the legislation

The proposed legislative change will have a significant impact on the future costs of housing developments, which is at odds with the Federal Government's stated policy and programs to improve housing affordability in Australia.

It is, in effect, an increased tax on new housing developments, which will be passed onto homebuyers through increased prices.

As the exemptions have not been applied to all land transactions, it is difficult to estimate that percentage of development projects will be impacted by this change. However a major developer has calculated that the cost impact of the measure where it applies will be in the order of:

- $11,000 additional per lot on a 60 lot infill development; and
- $4,800 additional per lot on a 717 lot mixed townhouse & land development

UDIA notes that the explanatory memorandum for the legislation estimates that this measure will raise $523m in revenue over four years, however the measure was originally estimated to raise $620m in revenue over four years, however this figure was revised due to a change in the proposed commencement date, and an update in the base data used in the costing model.

Application of the Measure

Section 1.21 of the explanatory memorandum states that "This measure will apply prospectively so that arrangements already entered into will not be impacted."

It is critically important that there is no element of retrospectivity with this measure.

There can be a significant delay between the various transactions which will be impacted by the proposed changes to the margin scheme. Therefore any retrospectivity in the application of this measure will adversely impact on the feasibility of existing developments and also the viability of developments proceeding.

UDIA is concerned that there is some confusion in the explanatory memorandum over the commencement date of the measure.

Page seven of the explanatory memorandum states that the measure has effect from the date of Royal Assent, however in the text regarding financial impact it states that there has been a "…change in the commencement date of the measure from 1 July 2008 to 1 January 2009…"

UDIA believes that to ensure there is no possibility of retrospective application of the measure, that the date of effect be Royal Assent, and that any other references to a specific starting date be removed from the explanatory memorandum and legislation to avoid any possible confusion.

Anti-Avoidance Provisions

UDIA has serious concerns that the changes to the anti-avoidance provisions (Div 165) are intended to have overall application – not merely to 'GST and Real Property' in this amendment.

During the consultations with Treasury, UDIA was assured that the intention was that this provision was only to apply to Going Concern / margin scheme type situations, and that this would be made clear in the explanatory memorandum (the EM). Instead, Para 1.19 and 1.20 of the EM make it clear that these provisions have overall application.

UDIA understands that Treasury's rationale for this amendment is that it simply reflected what was already in Part IVA of the Income Tax Act and therefore was not a significant amendment. However UDIA strongly believes that this amendment is not necessary as Div 165 already had additional tests aimed at anti-avoidance when compared to Part IVA, in

that the latter merely looks to whether the 'scheme' has been entered into for the 'sole or dominant purpose' of deriving a benefit. In contrast the GST Act, Div 165 already has an additional test of whether the 'principal effect' of the scheme provides a GST benefit.

With the additional amendment proposed in this Bill, the anti-avoidance provisions of the GST Act are once again far more stringent than those applicable to Income Tax and potentially strike at the very heart of the taxpayer's entitlement to make certain elections that have been provided for under the GST Act, unless they have gone to the expense of obtaining a ruling from the ATO to the effect that they are not considered to have 'created a circumstance or state of affairs' for purposes of enabling it to make that election.

A practical example of this is the situation is where an entity wishes to sell a commercial building as a going concern. In order to do so, it enters into lease of the premises with a tenant (possibly with a related party) just prior to the date of settlement, thereby allowing it to sell the property as part of a 'leasing enterprise'. This situation has been widely accepted by the ATO, and indeed has been referred to and commented upon favourably in Public Rulings.

Under the proposed legislation, this could quite possibly constitute 'creating a circumstance or state of affairs' for purposes of enabling it to make that election to supply the property as a going concern.

The extension of the anti-avoidance provisions in the manner intended will create significant uncertainty for any taxpayer (not merely those that are involved in dealing with real property) where they are considering invoking one of the elections that is specifically provided for in the current GST law.

The impact of this is that it will act completely contrary to GST being a ‘practical business tax’ as has been claimed in a number of court cases on GST, as it is likely that parties to ‘normal’ business transactions will now wish to obtain a ruling from the Commissioner as protection against this provision being applied. This will have a significant delaying effect on the free flow of transactions as well as having an impact on the cost of doing business in that advisors will need to be engaged where previously this had not been the case.

The alternative is that small to medium businesses that are less able to appreciate the impact of the subtle changes in the law (or may be entirely unaware of them) will be trapped at a later point in time in a situation where they risk being demonized as a result of what is ostensibly normal business practice, that has always been acceptable in the past.

Properties that move in and out of the GST Regime

Despite UDIA having raised this issue with Treasury at an earlier stage, the provisions, as currently drafted, still do not take account of the fact that a property might have moved in and out of the GST regime during the period between 1 July 2000 and the current date (which is a period of time that is constantly increasing).

An example of a common situation that UDIA is aware of, is one where a couple farmed a piece of land (more as a hobby farm than anything else) at, or around 1 July 2000. Due to confusion around at that time the couple thought that they needed to register for GST and did

so. They operated as a GST registered entity for some time (possibly a year or two) until it became clear that they were neither required to be registered, nor did they derive any significant benefit from being registered.

The couple then de-registered and made an appropriate adjustment in their final BAS for that fact. Five or six years later, they wish to retire completely, and sell their hobby farm. A developer wishing to save stamp duty enters into an agreement with them whereby the developer will do the subdivision, marketing etc, and will be paid out a development fee based on the sale price (under the margin scheme assuming that the cost base will be determined on the value as at the date that the landowners 're-' register for GST) less an agreed 'value' of the land.

Under the current draft of the legislation, they would be required to use the value of the land as at 1 July 2000 for the purposes of the margin scheme calculation - essentially as a penalty for having tried to do the right thing by registering for GST at the outset, even though they were not required to do so.

The UDIA believes that, in the same manner as taxpayers should not seek to obtain unintended benefit out of the application of the GST law, this should also be the case with respect to the Government. In its current version, the amendment would result in the double taxation of transactions involving real property in these situations.

As a result, the UDIA believes that, in line with the policy underlying the margin scheme provisions as they have stood since first being introduced into the original legislation, GST should only be imposed on the value that has been added to real property by a taxpayer during the period that the taxpayer has either been registered or required to be registered.

What this would involve is an amendment to the current draft provisions that would ensure that the valuation that should be applied to land in these circumstances should be as at the time when the landowner became registered or required to be registered just prior to the sale at issue.

Date of Acquisition

UDIA believes that the legislation should also clarify that the ‘date of acquisition’ is the date of settlement.

In the Brady King decision, doubt was cast as to whether it is the date of the contract (ie when a right to real property is created - which is under the definition of 'real property' deemed to be real property), or the date of settlement - which is the commonly accepted point in time.

The difference can amount to a number of years between the former and the latter, particularly where development lease situations occur.

ENDS