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March 2005 Newsletter

This newsletter deals with GST on long-term contracts, changes to the NSW land tax regime and the ability of builders, engineers and architects to receive payments under the Payments Act.

GST

GST ON LONG-TERM CONTRACTS INCLUDING LEASES

When GST was introduced on 1 July 2000, the transitional provisions allowed supplies made under some pre-8 July 1999 contracts to be GST free until 30 June 2005 (or an earlier “review opportunity”).

This treatment meant that suppliers under long-term contracts which did not allow for recovery of GST or for a general renegotiation (which takes into account GST) would have to bear the GST from 1 July 2005 without being able to recover that liability from their customers.

A good example of this is a long-term lease without GST recovery or market rent review clauses (there are a number of these leases in existence).

Even though after 1 July 2005 the supplier would bear the GST liability, and the customer (e.g. the tenant) would not have to pay it, the customer still stood to obtain a input tax credit equal to 1/11th of the cost of the supply.

Recently proclaimed legislation provides a mechanism for suppliers to pass on the GST obligation to customers (e.g. tenants), but suppliers need to act promptly and follow the correct procedure to avoid

being stuck with non-recoverable GST from 1 July 2005. The new legislation provides for a procedure under which:

- the supplier makes an offer for an increase in the price (or the rent on a lease) based on GST;
- if not accepted, the supplier obtains a determination of the appropriate increase from a recognised arbitrator. The increase will not necessarily be 10% because the arbitrator is meant to look at not only increases in the cost for the supplier because of the imposition of GST, but also at the savings arising from the abolition of sales tax and some other taxes as part of the original GST package of laws;
- if the customer does not accept the arbitrated figure within the required period, or elects to pay the GST itself, the customer will become directly liable for the GST (and will be entitled to associated input tax credits as if it has received a tax invoice) in place of the supplier. In that case the supplier will be able to avoid GST on the supply.

Due to the notice that has to be given and the potential delays in the arbitration process, it is important that suppliers (eg. landlords) with long-term contracts start the procedure ASAP.

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LAND TAX

CHANGES TO THE NSW LAND TAX REGIME

Changes to the land tax system will see many property owners in NSW liable for land tax this year for the first time. The changes are in effect for the 2005 land tax year.

Summary of key land tax changes

The keys changes to the land tax legislation are:

- abolition of land tax threshold;
- introduction of progressive land tax rates; and
- abolition of Premium Property Tax.

Effective from the 2005 land tax year, the tax-free threshold of \$317,000 that applied in the 2004 land tax year and previous years in respect of land subject to land tax has been removed. Therefore, if you owned a holiday home, an investment unit or any property other than your primary place of residence as at midnight on 31 December 2004, you may be liable to pay land tax.

The changes have also introduced a progressive scale of rates:

Taxable value of land	Rates of land tax payable
Not more than \$400,000	0.4 cents for each \$1
More than \$400,000 but not more than \$500,000	\$1,600 plus 0.6 cents for each \$1 by which the taxable value exceeds \$400,000
More than \$500,000	\$2,200 plus 1.4 cents for each \$1 by which the taxable value exceeds \$500,000

Exemptions and concessions

There are numerous exemptions and concessions that apply to land that would be subject to land tax but for the exemptions and concessions. One common exemption is the “principal place of residence” exemption.

Numerous concessions apply to the principal place of residence exemption. For example, there is a concession for absence from the former residence. The concession is available provided the person has used the former residence as a principal place of residence for a continuous period of 6 months and returns to use and occupy the former residence within 6 years.

If the former residence is rented out, it cannot be leased for more than 6 months and the income derived cannot be more than is reasonably required to cover the cost of council and water rates and the cost of maintaining the property.

Abolition of Premium Property Tax Act

Previously, land that exceeded the premium tax threshold was subject to land tax even if the land might otherwise be exempt from land tax. The repeal of the *Premium Property Tax Act* allows the principal place of residence exemption to be claimed in respect of such land.

What needs to be considered?

Prior to the changes to the land tax system, land tax was not a significant issue unless the taxable value of the property exceeded the tax-free threshold. However, with the recent changes, land tax has now become an issue that must be carefully considered by all property owners and investors.

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BUILDING LAW

BIG WIN FOR BUILDERS, ENGINEERS AND ARCHITECTS

In the period since its introduction in 1999, the *Building & Construction Industry Security of Payments Act (Payments Act)* has become a favourite tool for building, architectural and engineering contractors trying to ensure continuity of cash flow, despite project disputes.

The Payments Act establishes a procedure and requirements which, if followed, require the party to a relevant contract liable to make payment to notify the contractor within 14 days whether or not it disputes a payment and the grounds of dispute. Any dispute is then referred to adjudication.

In a number of cases, the adjudications did not meet the natural justice requirements that generally apply. As a result, many dissatisfied parties in a Payments Act adjudication applied to the Courts to have the adjudications set aside.

In the recent decisions of *Transgrid v Siemens Ltd & another*, and *Brodyn Pty Limited v Davenport & another*, the NSW Court of Appeal narrowed the scope for appeal on the grounds of denial of natural justice. This is particularly the case where an appeal was not lodged until the result was known.

The Court suggested that parties should try and have natural justice issues dealt with during the course of the adjudication hearing.

The basis for the Court's decision was that ordering payments to be made to a contractor did not necessarily affect the payer's final position, since if there was an error the payer was able to claim the payment back in court proceedings.

The commercial reality is that recovering the money from a solvent contractor can be difficult, and if the builder is insolvent (e.g. the recent liquidation of Walter Constructions), then the payer's final rights have been jeopardised in a practical sense.

In summary, the Court's decision reinforces the ability of engineers, architects, building contractors and subcontractors to receive payments in relation to disputed claims. On the other hand, the payer has to carefully consider what action it takes in any adjudication proceedings.

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